S. Hrg. 99-528

REVIEW OF SOCIAL SECURITY TRUST FUND POLICY

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

NOVEMBER 7, 1985

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SOCIAL SECURITY TRUST FUND INVESTMENT POLICY

THURSDAY, NOVEMBER 7, 1985

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY AND
INCOME MAINTENANCE PROGRAMS,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 2:15 p.m. in room SD-215, Dirksen Senate Office Building, the Honorable William L. Armstrong (chairman) presiding.

Present: Senators Armstrong, Moynihan, Boren, Bradley, and Mitchell.

[The press release announcing the hearing, the prepared written statements of Senators Moynihan, Mitchell, and Boren and a background paper on the effect of the current debt limit on Social Security follow:]

PRESS RELEASE No. 85-086

FINANCE PANEL TO REVIEW SOCIAL SECURITY TRUST FUND POLICY

The Senate Committee on Finance has scheduled a November 7 hearing to review the management of the Social Security Trust Fund assets, Chairman Bob Packwood (R-Oregon) announced today.

Senator Packwood said the Committee's Subcommittee on Social Security and Income Maintenance Programs will conduct the hearing.

The hearing is scheduled to begin at 2:00 p.m., Thursday, November 7, 1985, in Room SD-215 of the Senate Dirksen Office Building in Washington.

Senator Packwood said Senator Bill Armstrong (R-Colorado), Chairman of the Subcommittee on Social Security and Income Maintenance Programs, would preside at the hearing.

The hearing will review the policy and procedures followed by the Secretary of the Treasury in investing and redeeming Social Security Trust Fund assets.

Testimony will be received from Mr. John J. Niehenke, Deputy Assistant Secretary of the Treasury for Domestic Finance.

Others who desire to present their views on this subject to the Committee are urged to prepare a written statement for submission and inclusion in the printed record of the hearing, Senator Packwood said. These statements should be typed, double-spaced, on only one side of each page of letter-sized paper and must not exceed 25 pages. They should be mailed with five (5) copies to Betty Scott-Boom, Committee on Finance, Washington, D.C., 20510, no later than two weeks after the hearing date.

STATEMENT BY SENATOR DANIEL PATRICK MOYNIHAN ON THE DISINVESTMENT OF THE SOCIAL SECURITY TRUST FUNDS

Within the last 24 hours, I have received information from the Congressional Budget Office which makes it all too apparent that since September—not November 1, as we had been told previously—the Secretary of the Treasury has been cashing-in substantial amounts of long-term bonds from the Social Security Trust Funds. This can be confirmed by the Treasury's own figures.

This pattern of disinvestment has been pursued with no prior notice to Congress, and without the prior knowledge of the two public trustees of the Social Security Trust Funds.

Based on the Treasury figures, we now know that in September the Department cashed-in $6.9 billion in long-term interest-bearing securities from the Social Security Trust funds, another $4.8 billion in long-term securities in October, and at least $12.8 billion more this month. When the debt limit impasse is resolved, these monies will be reinvested, first in short-term certificates of indebtedness and then, next June 30, in new long-term bonds. According to the most recent interest-rate forecast by the Office of Management and Budget, long-term interest rates will be nearly one percentage point lower next June than the rate paid on the cashed-in securities. Today, the Social Security Administration released its estimate of the costs to the Trust Funds from these transactions: some $875 million in lost interest income over fifteen years.

Disinvestment on this scale is unprecedented, and as a result, the total invested assets of the Trust Funds have fallen from $37 billion at the end of August to $10 billion on November 4—a $27 billion reduction in three months. The Treasury claims to have credited the OASDI Trust Funds with substantial amounts of "uninvested" assets; but under debt limit pressures these are essentially IOUs which can not be used to pay benefits.

We also now know that in October of last year, when the Congress—and the Treasury—faced a similar debt limit impasse, the Treasury cashed $5.5 billion in long-term bonds from the Trust Funds, at a loss in interest income over the 1985-91 period of some $440 million. This estimate comes from the Social Security Administration; but the loss has never been acknowledged by Treasury, nor have the OASDI trust funds been reimbursed for it.

Social Security is a well-financed program. According to the most recent actuarial estimates, OASDHI held a surplus of $46.8 billion at the end of 1984, and expects to have a surplus of $58.5 billion at the end of this year. By 1990, the OASDHI surplus will exceed $286 billion.

It is wholly inappropriate, however, to cash-in—for three months in a row—the assets of a program that is well-financed and self-financed, to float the rest of government—which is in deep deficit.

It is wholly improper—three months in a row—to use up Social Security's invested assets to finance benefits, while making no attempt to use daily payroll tax receipts (the program's current cash income) for this purpose. During this period, Social Security payroll tax receipts were apparently used to finance other, non-Social Security activities—while OASDI's assets were drawn down to pay benefits.

These practices are improper and the Treasury must make up all such losses. I have asked Mr. Niehenke of the Treasury Department to bring with him today legislation to make the Trust Funds whole.

MEMORANDUM November 7, 1985

FROM: Harry C. Ballantyne SN
Chief Actuary, SSA

SUBJECT: Long-Term Effects of Debt-Limit Problems in 1984 on the Interest Earnings of the Social Security Trust Funds—INFORMATION

In October of 1984, the total amount of advance tax transfers could not be invested at the beginning of the month because the total U.S. public debt was too close to the debt ceiling then. As a result, long-term bonds amounting to $5.1 billion were redeemed early in October for the payment of OASDI benefits at the beginning of the month. Of the total $5.5 billion redeemed in the month, $3.0 billion was in 10.75-percent bonds and $2.5 billion was in 13.75-percent bonds. The maturity dates of these bonds ranged from June 30, 1987, through June 30, 1991.

Later in October, the debt ceiling was increased, and the amount obtained from the disinvestment of long-term bonds was reinvested according to longstanding practices, initially in short-term certificates of indebtedness that, for October 1984, paid interest at a 12.625-percent rate. On June 30, 1985, these certificates were "rolled over" into long-term bonds bearing a 10.375-percent interest rate.

Because the interest rate payable on the new investments made in October 1984 and rolled over in June 1985 differed from the average rate payable on the long-term bonds that were disinvested earlier, the long-term interest earnings of the trust funds are affected. The table below shows the effect on interest earnings, year by year. The table shows direct effects only and not the indirect effects resulting from interest lost or gained because of the direct change in interest earnings, i.e., "interest on interest."

Year ending June 30—	Effect on the interest earnings of the OASI and DI Trust Funds (in millions)
1985	-$7
1986	-100
1987	-100
1988	-99
1989	-85
1990	-35
1991	-14
Total	-440

Obviously, the amount that would need to be transferred to the trust funds today in order to offset the effects of the debt-ceiling problems in 1984 would be less than $440 million, because that amount would have been earned over a period of several years.

Harry C. Ballantyne

Harry C. Ballantyne

MEMORANDUM November 7, 1985

FROM: Harry C. Ballantyne SN
Chief Actuary, SSA

SUBJECT: Long-Term Effects of Debt-Limit Problems on Interest Earnings of the Social Security Trust Funds—INFORMATION

In September and October of this year, the total amount of advance tax transfers in each month could not be invested at the beginning of the month because the total U.S. public debt was too close to the debt ceiling. As a result, long-term bonds amounting to \$6.9 billion and \$4.8 billion were redeemed in September and October, respectively, for the payment of OASDI benefits at the beginning of each month. Of the total \$11.7 billion in bonds redeemed in the two months, \$11.5 billion was in 10.375-percent bonds and \$0.2 billion was in 10.75-percent bonds. The maturity dates of these bonds ranged from June 30, 1987, through June 30, 1991.

On November 1 and November 4, long-term bonds were again redeemed so that benefits could be paid at the beginning of November. The bond redemptions amounted to \$9.3 billion on November 1 and \$3.5 billion on November 4, for a total of \$12.8 billion. These bonds had interest rates ranging from 8.75 percent through 10.75 percent and maturity dates ranging from June 30, 1991, through June 30, 2000.

Eventually the debt ceiling will be increased, at which time the amounts obtained from the disinvestment of long-term bonds in September, October, and early November will be reinvested. Under present investment practices, the amounts will be invested initially in short-term certificates of indebtedness. On June 30, 1986, however, these certificates will be "rolled over" into long-term bonds bearing a coupon rate to be determined by a formula in the Social Security Act. The yields on those bonds cannot be known at this time, but the rate assumed for purposes of estimating the future operations of the trust funds was 9.875 percent for the Mid-Session Review (MSR) of the President's 1986 Budget, and 10.75 percent for alternative II-B in the 1985 Trustees Report.

Because the interest rate payable on the new long-term investments made in June 1986 will almost certainly differ from the average rate payable on the long-term bonds that were disinvested earlier, the long-term interest earnings of the trust funds will be affected. This long-term effect will depend on the June 1986 interest rate. The attached table shows the estimated effect on interest earnings, year by year, on the basis of the two sets of assumptions—MSR and alternative II-B. The table shows direct effects only and not the indirect effects resulting from interest lost or gained because of the direct change in interest earnings, i.e., "interest on interest."

Harry C. Ballantyne

Harry C. Ballantyne

Effects of Redemptions of Long-Term Bonds on the Interest Earnings of the OASI and DI Trust Funds
(in millions)

Year ending June 30—	Redemptions of— September and October	Redemptions of— November 1 and 4	Total
		Mid-Session Review	
1987	-$62	-$75	-$137
1988	-49	-75	-124
1989	-36	-75	-111
1990	-24	-75	-98
1991	-10	-75	-85
1992	—	-74	-74
1993	—	-62	-62
1994	—	-50	-50
1995	—	-42	-42
1996	—	-30	-30
1997	—	-20	-20
1998	—	-17	-17
1999	—	-14	-14
2000	—	-11	-11
Total	-181	-694	-875
		Alternative II-B	
1987	45	43	88
1988	36	43	78
1989	26	43	69
1990	16	43	59
1991	7	43	50
1992	—	42	42
1993	—	40	40
1994	—	35	35
1995	—	24	24
1996	—	17	17
1997	—	15	15
1998	—	13	13
1999	—	10	10
2000	—	8	8
Total	130	418	548

Social Security Administration
Office of the Actuary
November 7, 1985

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Rudolph G. Penner
Director

November 6, 1985

MEMORANDUM

TO: Laurie Fiori

FROM: Paul Cullinan

SUBJECT: Securities Held by the Social Security Trust Funds

As you requested, I am providing this memorandum that presents an analysis of the actual investments of the OASDI funds since June 30, 1985. It is not possible to describe the daily investment position of the funds, however, as this information is not readily available. Instead this memorandum describes the changes in trust fund assets concentrating on the end of month balances. Trust fund investments are also presented for November 4, the latest date for which the data are available.

Redemptions for July through October. On June 30, 1985, the OASDI trust funds purchased $21.6 billion in 10.375 percent special issue bonds and held a total of $36.9 billion in invested assets. (See Table 1.) By the end of October, approximately $7.7 billion of the securities purchased on June 30 remained in the trust funds' portfolio, and the total investments of the trust funds amounted to $23.1 billion. An additional $15.9 billion of OASDI assets were uninvested on October 31.

The difference in the investments held at the end of June and at the end of October is primarily the result of the $6.9 billion redemption of the 10.375 bonds that took place in September, and the additional $4.6 billion in these bonds that were redeemed in October. These redemptions are much larger than those which might normally be expected to occur, and would seem to be the result of the inability to credit the trust fund for the full amount of the advanced tax transfers. On the other hand, the remaining difference of $2.4 billion resulted from transactions in July and August, and these appear to be the result of normal practices when trust fund outgo exceeds income.

Table 1. Assets of the OASDI Trust Funds, Excluding Marketable Securities (in billions of dollars)

	June 30	July 31	Aug. 31	Sept. 30	Oct. 31	Nov. 4
13.75%	5.2	5.2	5.2	5.2	5.2	5.2
10.75%	8.9	8.9	8.9	8.9	8.7	3.8
10.375%	21.6	21.0	19.2	12.3	7.7	1.0
9.75%	0.8	0.8	0.8	0.8	0.8	0.0
8.75%	0.4	0.4	0.4	0.4	0.4	0.0
Subtotal	36.9	36.2	34.5	27.6	22.8	10.0
CD's	0.0	1.6	2.8	8.9	0.3	0.0
Total Invested	36.9	37.8	37.2	36.4	23.1	10.0
Uninvested	0.3	0.5	0.2	3.1	15.9	N.A.
Total Assets	37.2	38.3	37.4	39.5	39.0	N.A.

N.A. -- not available

Source. Monthly Statement of the Public Debt Outstanding, various issues, SSA's Office of the Actuary, and discussions with Treasury staff.

In addition to the redemptions of the 10.375 bonds, about $0.2 billion in 10.75 percent bonds were redeemed in October. These would not have been redeemed under normal investment practices, because even if the trust fund outgo exceeded income, the 10.375 percent securities would have been redeemed first after the normalized tax transfers and certificates of indebtedness (CD's) were cashed in.

Redemptions in November. Redemptions of long-term bonds were again required in November as a result of the inability to credit the normalized tax transfers, and amounted to about $9.3 billion on November 1 and $3.5 billion on November 4. Consequently, OASDI investments--excluding $261 million in marketable securities--at the end of November 4 consisted solely of $10.0 billion in long-term investments. Although I could not obtain estimates of the total uninvested assets, these are probably in the $28 billion to $30 billion range.

Two major differences distinguish the November redemptions from those that took place in the two preceding months. First, the redemptions on November 1 exceeded those that would have been necessary to cover the benefit payments that were directly deposited on that date, by between $2 and $3 billion. Second, the November 4 redemptions of $3.5 billion occurred 3-4 days earlier than they normally would have.

If you have any further questions, please call me at 226-2820.

cc: Sydney Olson
Joe Humphreys

ROBERT J MYERS
9610 WIRE AVENUE
SILVER SPRING MARYLAND 20901

October 23, 1985

MEMORANDUM

Subject: Investment and Dis-investment of the Social Security Trust Funds

According to an article in the Washington Post today, Treasury Secretary Baker has suggested that, in order to solve the problem created by the debt limit not being raised, the investments of the Social Security Trust Funds be liquidated in part and held as cash balances (non-interest-bearing). It is quite true that if this procedure were followed, the outstanding National Debt would be reduced by the amount of the trust-fund investments which were dis-invested, and that then this amount of public-debt obligations could be sold to the general public.

In the past, the Trust Funds have always carried some relatively small cash balances (at times, even negative). However, the result of following the procedure of dis-investment mentioned above could result in extremely large uninvested cash balances, and thus significant losses of interest to the Trust Funds.

Even though this procedure would work out in the manner indicated, I would raise the question of whether it would be in violation of the law as it is contained in the Social Security Act. Section 201(d) of such Act provides that: "It shall be the duty of the Managing Trustee to invest such portion of the Trust Funds as is not, in his judgment, required to meet current withdrawals". Clearly, the creation and maintenance for a period of a large uninvested non-interest-bearing cash balance could not possibly be judged as being "required to meet current withdrawals". Further, the investment procedure under present law is well described in the Report of the Committee on Ways and Means on the Social Security Act Amendments of 1983 (Report 98-25, Part 1) in the following words: "Under current law payroll tax revenues which are in excess of the amount necessary to pay current benefits are to be invested" (page 69). In this connection, it may be noted that both the House and Senate versions of the 1983 Amendments provided for a change in the investment procedures by eliminating the establishment of varying long-range maturity dates and interest rates for the trust-fund investments, and instead providing the simplified procedure of the investments being on a "current-account" basis, with the interest rate varying each month according to the market-rate experience; strangely enough, this provision, which would have made it even clearer that the assets of the Trust Funds should be currently and fully invested, was dropped in conference.

In summary, I believe that the proposed procedure of dis-investing the interest-bearing investments of the Social Security Trust Funds is both undesirable insofar as the Social Security program is concerned (because it would produce a significant decrease in its financial resources) and also against the letter and spirit of the law (that the assets of the Trust Funds should be prudently invested so as to produce an investment return which is fair and equitable to both the Trust Funds and the General Fund of the Treasury).

Robert J Myers

Robert J. Myers

ROBERT J MYERS
9610 WIRE AVENUE
SILVER SPRING MARYLAND 20901

November 2, 1985

MEMORANDUM

Subject: Investment and Dis-investment of the Social Security Trust Funds (cont'd)

This supplements my memorandum of October 23 on the above subject by proposing a method under which the Trust Funds would be promptly equitably reinvested for any interest loss due to the dis-investment which has occurred.

First, it should be recognized that no loss (either short-run or long-range) will occur for the Trust Funds as a result of the advance tax transfers (i.e., the so-called normalized tax transfers) not having been made in the last few months. With one exception, this procedure is not really necessary for any trust fund when it has a balance well in excess of the next month's outgo (as has been the case recently); the reason for this is that any advance tax transfers must be repaid by the end of the month with appropriate interest adjustment. The only exception is for the transfers on July 1, at which time the Certificates of Deposit purchased in the previous 12 months come due and are reinvested on a long-range scheduled basis, which in turn would be disrupted 2 days later (in the absence of the advance tax transfers) to obtain the funds necessary for the benefit checks for the previous month.

However, sizable interest losses may be incurred by disinvestment of governmental obligations if this is done for issues bearing relatively high interest rates. Conversely, the Trust Funds have held some issues with low interest rates compared with current market rates, and a gain could actually occur upon disinvestment and then reinvestment within a short time. Also, interest losses could occur if the usual prompt investment of tax income in excess of outgo is not made.

I believe that the best solution to the situation (which would treat equitably both the Trust Funds and the General Fund of the Treasury) would be to take two legislative steps. First, all special issues with maturity dates after June 30, 1986 which were dis-invested should be reinvested in their original form and with no account being taken of the period between dis-investment and reinvestment in determining the interest payable on December 31, 1985 (and thereafter). Second, at the end of the month following the raising of the debt ceiling, computations should be made jointly by the Treasury Department and the actuaries of the Social Security Administration to determine how much should be transferred from the General Fund to the Trust Funds so that they are in the same position as they would have been if dis-investment had not occurred (and such transfer of funds should be authorized).

As a subsidiary matter, I should like to point out that the troublesome situation which has occurred in the recent past would have been much less so if the recommendations of the National Commission on Social Security Reform as to the method of investment of the Trust Funds had been contained in the final legislation. Strangely enough, this recommendation was included in both the House and Senate versions of the 1983 Amendments, but was dropped in conference. In brief, this recommendation was to eliminate the illusion of long-term investments with fixed durations and interest rates (but redeemable at par at any time) and instead substitute a pooled Money Market type of investment procedure, with an interest rate which would vary each month according to the average market yield on government obligations having 4 or more years to go to maturity. I believe that such a change is desirable for many reasons and should be made.

Robert J. Myers

ROBERT J. MYERS

STATEMENT OF SENATOR GEORGE J. MITCHELL

Mr. Chairman, I would like to commend you for scheduling this hearing today. It is important that the Congress promptly review recent events involving the investment and redemption policies used by the Secretary of the Treasury with regard to social security trust funds.

Beginning in September of this year, the Treasury faced a problem with the issuance of social security benefit checks because of the statutory debt limit. Congress's failure to raise the debt limit apparently led to the disinvestment of securities held in the Social Security trust funds in the amount of $7 billion in long-term bonds from the trust funds in September and another $4 billion in October.

A provision contained in the Social Security Amendments of 1983 requires the Treasury to credit the Social Security Trust Funds at the beginning of each month with the amount of funds expected from FICA taxes over the course of the month. It appears that this procedure, called normalized tax transfers, was not carried out by the Treasury during the months of September and October, because to do so might have jeopardized other Government obligations.

The normalized tax transfers are usually invested in short term securities which are redeemed over the next several days to finance the benefit checks sent out on the third day of the month. The failure to invest the normalized tax transfers has adversely affected the trust funds.

To what extent the trust funds have been affected, however, will not be known until next June 30, when all the Social Security's short term assets are rolled over into long-term bonds. Harry Ballantyne, Chief Actuary of the Social Security Administration, has analyzed the possible ramifications of the Treasury's actions, and has stated that the losses could amount to as much as $800 million over the next 15 years.

Mr. Chairman, it is very important for the Congress to have all the facts surrounding the recent actions by the Secretary of the Treasury in this matter.

Social Security is vital to the well being of millions of senior citizens in our country. Those older Americans who have invested in the Social Security System throughout their working years expect the government to keep its promise to them, to meet their end of the contract.

In recent weeks, millions of people, both current and future Social Security recipients, have expressed concern about the actions of the Treasury. These people are worried about the solvency of the system and are angry about what they see to be a violation of the sacred trust between the senior citizens of our country and the Federal Government.

I have received many letters from senior citizens in my home state of Maine expressing their deep concern about these recent events. One constituent wrote, "How can you and the Finance Committee agree to use Social Security Trust Funds, which is a solvent fund, to help bail out the Administration's poor management and indebtedness"?

Another constituent wrote, "The President, in doing this will have reneged on his campaign pledge never to touch Social Security."

Mr. Chairman, we do indeed have an obligation to protect the Social Security Trust Funds from being used for any other purpose except to finance social security benefits for beneficiaries. We must carefully review the circumstances surrounding the Treasury's actions and determine whether the decisions made where within the law and represent the best course of action that could have been taken under the circumstances.

I look forward to the testimony of Mr. Niehenke, Deputy Assistant Secretary of the Treasury for Domestic Finance. I hope that his testimony will help to answer the questions surrounding these recent events to the Committee's satisfaction

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STATEMENT OF SENATOR DAVID L BOREN

Mr. Chairman, I want to compliment you for calling this oversight hearing regarding the investment policies of the Secretary of the Treasury with respect to the Social Security Trust Funds.

I am very concerned over reports that changes in these policies as a way of providing additional debt authority for the Treasury may lead to significant loss of interest for the Social Security Trust Funds. Although estimates of the interest loss vary, it is clear that manipulation of Trust Fund investment policy has occurred and that a tangible loss of funds to Social Security will result.

Regardless of the legal issues involved in the decision to use Social Security in this way, and I believe there are many, I want to register my serious reservations about the propriety of this action. The Social Security program represents a solemn agreement between the federal government and the people of this nation. As such, we must be ever-watchful that the foundation and integrity of this important program are maintained.

In recent years, Congress has been forced to make many difficult decisions to keep the Social Security system financially sound. In every instance, however, Congress has openly debated the issues and made a deliberate decision concerning the course of action that should be taken.

The recent changes in investment policies that have occurred with respect to Social Security did not come as a result of Congressional action. Instead, the Treasury Department has made this decision unilaterally. I believe the actions taken were wrong. I have serious doubts that the use of the Social Security Trust fund to solve the Treasury's debt limit dilemma is appropriate.

The debt limit problem is one which Congress and the Administration must resolve as a separate issue. To manipulate the Social Security Trust Fund as a pawn in the debt limit debate constitutes a breach of faith with those who depend on Social Security. I hope this hearing today will help send a strong message to the Treasury Department that such actions will not be tolerated.

85-1042 EPW

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THE EFFECT OF THE CURRENT DEBT LIMIT ON SOCIAL SECURITY

David Koitz
Specialist in Social Legislation
Education and Public Welfare Division
November 6, 1985

ABSTRACT

The Treasury Department recently had to alter its investment and redemption procedures for a number of Federal trust funds, including social security, because of constraints imposed by a statutory limit on Federal debt. This paper provides a preliminary account of the actions taken. It will be updated to provide additional information.

56-331 O—86——2

THE EFFECT OF THE CURRENT DEBT LIMIT ON SOCIAL SECURITY

Social security income is invested in Federal bonds and securities that are held by the social security trust funds. When the Treasury makes disbursements for social security benefits and administrative costs, the balance of securities held by the trust funds is reduced accordingly. These securities and those of other Federal trust funds are counted, along with most other debts of the Government, as Federal liabilities that together cannot exceed a statutory limit (the so-called debt ceiling). The limit is now $1,823.8 billion. The Treasury Department recently informed Congress that because aggregate Federal liabilities had reached the statutory limit in September 1985, the Department was not able to issue, or had to delay issuing, certain new Federal securities to the social security and other Federal trust funds required by their respective laws.

The social security trust funds were first affected on September 3, 1985, when the Treasury Department was supposed to issue short-term securities to the trust funds equal to the $15.1 billion in expected social security tax receipts for that month (a Treasury estimate). The requisite securities were not issued that day, but according to Treasury briefing materials, all but $3.1 billion due to the trust funds had been invested on September 30th. Again on October 1 and November 1, the Treasury did not issue the required securities. At the end of October, cumulatively some $15.9 billion due to the trust funds had not been invested. (It is not clear when new securities required in November will be issued). Ordinarily, these new securities would be redeemed within a few days of issuance to reflect the Treasury's payment of social security benefits early in the month. However, because they had not been issued, other longer-term holdings of the trust funds were liquidated instead.

Social security benefit payments were not jeopardized in September, October, and November because Treasury was able to secure sufficient cash on the requisite payment dates to cover them. The Department appears to have been able to meet its cash requirements over the past few months in a variety of ways. Part was met through the normal flow of tax and other receipts into the Government. An additional amount was obtained through various internal transactions, involving the Federal Financing Bank, which permitted the Treasury to borrow more funds from the public without exceeding the statutory debt limit. Yet still other cash was obtained, according to Departmental representatives, by reducing longer-term Federal debt holdings of the social security and other trust funds--to reflect Treasury disbursements that had been made or would be made on their behalf--and then using the room this created under the debt ceiling to obtain additional borrowed funds from the public.

Because of a technical feature in the Social Security Act, Treasury asserts that the initial delay and later failure to issue new securities to the social security trust funds did not result in a loss of interest for the months of September and October (although, whether an interest loss arose due to the liquidation of pre-existing securities is not totally clear). However, because the Treasury's cash balance was extremely low at the end of October, on November 1, it liquidated long-term holdings of the trust funds--a few days earlier than normal--so that they could borrow additional funds from the public while staying within the debt ceiling. This was done to assure that ample cash was on hand to assure payment of the November benefits (which were received by social security recipients on Friday, November 1). Treasury estimated this early redemption could result in a one-time interest loss of $10 million. It also is possible that when new securities are subsequently issued to the trust funds (presumably after the debt ceiling is raised) to replace those that were redeemed in November and earlier, the interest rates they carry will be lower than those carried by the longer-term securities that were prematurely redeemed. This is not an inevitable outcome, since it will be determined largely by interest rates and debt durations that are not currently determinable. Nonetheless, both chambers of Congress are considering legislation to assure that the social security trust funds do not lose any interest as a consequence of the constraints imposed by the debt ceiling.

Senator ARMSTRONG. The committee will come to order. And we apologize to those who were here promptly at 2 o'clock, but as I explained earlier, Senator Moynihan and I were summoned to the floor to vote. And we have now taken care of that and hope we will have perhaps an uninterrupted period that we can come to grips with this issue.

During the last couple of weeks, the Treasury operations in connection with the debt limit have come under increasing concern, both in the Senate and throughout the country. And, specifically, the question of the handling of Social Security has become an important issue. It always does, although it has arisen this time in a slightly different form than in the past when the crisis seemed to be would the Social Security checks go out.

During this most recent period in which we have been voting on and negotiating the debt limit increase question and the associated Gramm-Rudman proposal and the other issues, the policy question has taken a somewhat different turn; particularly, this idea of disinvestment or as it came to be called advanced redemption. I thought had sort of a Calvinist sound about it. Hopefully, like Calvinism, one can enjoy it without necessarily understanding it. I'm not sure about that.

But in any case, there are two or three issues I hope we can address this afternoon. And I should acknowledge at the outset that this hearing is really at the suggestion of Senator Moynihan, who framed several of these issues very neatly and raised concerns which the subcommittee and which, indeed, the full committee are concerned about. It's important that we understand what has happened about the advanced redemption or the disinvestment; whether or not the trust funds have been jeopardized to any extent; whether or not the rights of those who are entitled to receive benefits under Social Security have been compromised; the legal authority under which the Department has acted; the extent to which, if any, legislation may be needed to deal with similar circumstances in the future.

So my hope is that we can have a full understanding and respond to any concerns that have arisen. And if legislation is needed, that we will be well briefed on that at the end of this hearing and be able to go forward.

Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman. And thank you for holding these hearings. I know your schedule isn't any better than any others are. And I appreciate the fact that you are able to do this.

May I say that the more I learn of what has been going on, the more it seems to me that my understanding of Calvinism—the more you understand it, the less you enjoy it. It is unfortuante that in this year marking the 50th anniversary of the Social Security Act, and for the first time ever, the question has arisen of whether there has been a misuse of Social Security funds.

Mr. Niehenke will speak to that. I certainly won't prejudge it. But I will make a simple statement which is that the Social Security trust funds are in surplus; more comes in every year than goes out. And the condition is expected to continue for another 25 years at a minimum. The fund is in good shape.

But last August, we had $37 billion in Treasury bonds in that trust fund, and today we have $10 billion. And my question is: What has happened to the $27 billion, which is in some respect missing. And the next question and perhaps the prior question is: Why was the committee not told about this?

This committee was never told until just this month about this process of advanced redemption, the cashing in of bonds for purposes that were represented in the press as for the purpose of financing general obligations of the Government. The question is: Were Social Security funds, in effect, used to pay general obligations? It would have been an extraordinary violation of trust. And the first such ever mentioned in a half century.

Now we learned that last year, this same procedure was followed. We didn't know that. We found it out. Mr. Chairman, the Congressional Research Service and CBO would tell us these things. We never learned them from Treasury.

And what is more, the two public trustees of the trust funds were never told. There really is an issue of good faith here. And I have been quiet on this and hopeful that we could all understand each other, as I think any Member of this body would want, but I really have to say to you, Mr. Chairman, that a lot of us have been shaken by what it is that we weren't told by people who knew and had the information. And that's why I think it's time for the Treasury to come forth with complete information.

I have a statement I would like to put in the record.

Senator ARMSTRONG. Of course, we will be happy to put a statement in the record.

And we are eager to hear the testimony and responses of Mr. John J. Niehenke, Deputy Assistant Secretary for Domestic Finance.

Mr. Secretary, thank you for coming over. Please proceed in any way you would like to. We are going to be reasonably informal this afternoon. We would be glad to put your full statement in the record, or have you read it to us or just go forward as you think best.

STATEMENT OF JOHN J. NIEHENKE, DEPUTY ASSISTANT SECRETARY OF THE TREASURY, WASHINGTON, DC

Secretary NIEHENKE. I would prefer to read the statement, if it's all right, Mr. Chairman.

Senator ARMSTRONG. Please proceed.

Secretary NIEHENKE. Mr. Chairman and members of the subcommittee, I welcome this opportunity to appear before you to explain what actions Treasury has taken during the current debt limit impasse that have affected the Social Security trust funds. In this testimony, I will cover four points. First, explain how the Social Security trust funds operate with respect to the payment of benefits, transfer of credits and redemption of obligations by these trust funds when there are no debt limit restraints on investment by the trust funds. Second, explain what actions Treasury has taken with respect to these funds during this current debt limit impasse. Third, outline three types of potential costs to the trust funds arising from the actions Treasury has taken. And, finally, outline the costs to the non-Social Security funds due to the failure of Congress to increase the debt limit.

I know this committee recognizes the importance of managing the finances of the United States on a routine and responsible basis and assuring that those due payments from the United States receive those payments on an orderly basis. Failure to increase the debt limit has strained our ability to meet these responsibilities. This strain results in uncertainty on the part of those due payments from the United States about when and whether they will receive those payments.

The Secretary of the Treasury must reconcile his responsibility not to issue debt in excess of the debt limit with his concurrent responsibility to manage responsibly the finances of the United States, including timely payment of benefit payments for a number of programs for which he serves as fund manager. In balancing these responsibilities, the Secretary has made decisions based on four guidelines: One, avoid an unprecedented default on obligations of the United States; two, ensure that recipients of Social Security and other retirement programs receive their payments when expected; third, minimize, to the extent possible, the costs to the various funds administered by Treasury of actions taken; and, four, stay within the debt limit.

I can report to you today that in spite of numerous and complex problems, Treasury has, to date, managed to avoid default, ensured that recipients of Social Security payments have been paid on time, minimized the cost to the trust funds of actions necessary to make payments on time, and stayed within the debt limit. I must caution, however, that we are running out of time. Continued delay in passing a debt limit bill is unacceptable. I trust today's testimony will clarify what we have done and reassure you that our actions have not jeopardized any payments from the Social Security or other trust funds. But I must point out that the only long-term solution to relieve the anxiety that recipients of payments from the funds are experiencing is prompt passage of a debt limit bill.

I will now turn to the normal operation of the two Social Security trust funds—Federal Old Age and Survivors Insurance Trust Fund and Federal Disability Insurance Trust Fund.

The trust funds receive transfers in the form of credits from the Treasury in amounts equal to taxes collected—primarily FICA withholding taxes—under applicable provisions of the Internal Revenue Code. Since May 1, 1983, the transfer has been made at the beginning of each month in an amount equal to the Secretary's estimate of tax receipts to be received by the trust funds that month. This procedure is referred to as the normalized tax transfer. These transfers are invested in interest-bearing obligations maturing on the next June 30. These obligations are subject to the debt limit.

At the end of each month, Treasury mails checks and forwards electronic funds transfer tapes for benefits payable on the third day of the following month. When these transfers are made and checks are presented to the Treasury, payment is made from the Treasury cash account and trust fund investments are then redeemed to reimburse the Treasury. Thus, monthly redemption of obligations held by the trust funds is and has been an integral part of the Secretary's administration of the trust funds.

To properly account for benefits paid by electronic funds transfer, obligations with a face value of approximately 50 percent of the total benefit payments would be redeemed on the day electronic funds transfers and checks are payable. In accordance with requirements of section 153 of the Social Security Amendments of 1983, obligations in a face amount equal to approximately 30 percent of the benefit payments would be redeemed on the fourth business day following the check issue date, and the remaining 20 percent would be redeemed on the fifth business day following the issue day.

The normal redemption procedure is that the first obligations redeemed are those that mature on June 30, taking the lowest interest rates first. The redemption process includes the most recently invested NTT. If these obligations are insufficient to cover benefit payments, obligations maturing the next June 30 are redeemed, again lowest interest rate first, and so on. Therefore, in months when the NTT is less than benefits paid, which can happen even when there is an annual surplus, longer term obligations may be redeemed. This happens several times each year, most recently in August 1985. These redemptions are totally unrelated to the debt limit and take place due to normal fluctuations in monthly trust fund receipts.

Long-term investments are made each June 30. The proceeds of all maturing obligations are reinvested in obligations with maturities based on projected benefit payments. All obligations mature on June 30, but they mature in different years. The interest rate on each of these obligations, no matter what the maturity, is a statutory formula rate for the June during which they are issued. This rate may be higher or lower than the rates on the maturing obligations.

Now let me explain the actions Treasury has taken during the current debt limit impasse. On September 3, 1985, Treasury transferred the full September NTT to the trust funds as required by law. However, also on that date, the principal amount of outstanding obligations subject to the debt limit reached the statutory limit of $1,823.8 billion. Therefore, the Treasury was unable to fully invest the NTT on September 3. However, as trust fund obligations were redeemed to reimburse Treasury for payment of trust fund benefits during December according to Treasury's normal operating practice, the uninvested balance in the trust funds was invested to the maximum extent possible.

On October 1st, Treasury again transferred the full October NTT to the trust funds. However, because obligations outstanding subject to the statutory debt limit again equaled the limit, the NTT was not and thereafter has not been invested.

I want to assure you in spite of the inability to invest the NTT, trust fund total balances have remained essentially stable since July 31. The trust fund balances and investments for the period July 31 to October 31, 1985 are shown in the table which appears in the testimony.

Under normal circumstances, obligations with face amounts totaling almost $15 billion would have been redeemed by the trust funds on November 1, 7 and 8. $6.899 billion of the obligations would have been redeemed on November 1; $4.816 billion would have been redeemed on November 7; and $3.21 billion would have been redeemed on November 8. That amount equals the amount of benefits that will be paid in November. No more than this $15 billion of obligations will be redeemed from the trust funds. However, instead of being redeemed on November 1, 7 and 8, they are being redeemed on November 1, 4 and 8. On November 1 obligations in an amount equal to $9.613 billion were redeemed. On November 4, obligations in an amount of $4.181 billion were redeemed. And on November 8, obligations in an amount of $1.131 billion will be redeemed.

Let me stress that while the timing of redemptions has been accelerated, since the same amount of obligations would have been redeemed in any event, trust fund obligations were only used for trust fund November payments.

This early redemption, also referred to as disinvestment, was necessary because unlike September and October, when Treasury's cash balances were sufficient to permit payment of benefits followed by redemption of obligations held by the trust funds, in November, Treasury's cash balance was virtually depleted. As of the close of business on October 31, the Treasury's cash balance was only $1.8 billion compared to a normal cash balance on that date of between $10 and $20 billion, and a desirable minimum cash balance from a cash management point of view of $5 billion. Treasury estimated that checks and electronic funds transfers that would be presented to the Treasury for payment the next day would be in excess of $10 billion, including approximately $6.9 billion of trust fund benefit payments. November 1 revenues were estimated to be less than $3 billion. A similar situation was projected for November 4. Thus, unless Treasury took action, the United States would have defaulted. If the United States defaulted, recipients of Social Security payments would not have been paid.

In order to avoid the default on November 1, on Tuesday and Wednesday, October 29 and 30, Treasury auctioned $13 billion in new Treasury obligations, which were issued on November 1. The auction raised cash to enable Treasury to make benefit payments. An additional $4¾ billion of Treasury's securities was auctioned on Thursday, October 31 for issuance on November 4; also to provide cash for benefit payments.

In order to minimize costs to the trust funds, Treasury altered its normal method of redeeming securities and, in November, redeemed securities on the basis of lowest interest rate first—regardless of maturity. This Treasury action avoided the redemption of high coupon obligations held by the trust funds.

The failure to pass a debt limit and the actions taken by Treasury to ensure November benefit payments could result in three potential losses to the trust funds: First, losses directly due to noninvestment of the normalized tax transfer; second, losses resulting from acceleration of the November redemptions; and, three, losses resulting from premature redemption of obligations maturing after June 30, 1986. Let me discuss each potential loss.

The NTT mechanism was part of the 1983 amendments to the Social Security Act. As explained above, under the NTT, anticipated receipts are invested on the first business day of each month. By law, excess interest earned by the trust funds, however, must be repaid to the Treasury. This adjustment is accomplished at the trust fund interest payment dates by reducing the interest otherwise due the trust funds on the Treasury obligations by the amount of excess interest earned by the trust funds because of the NTT. Due to this semiannual interest netting mechanism, Treasury, at this time, can and will make the trust funds whole for loss of interest due to the inability to invest fully the trust funds.

A second loss is that which results from the accelerated redemption of trust fund obligations. Last week in testimony I testified this loss would be approximately $10 million. I can now report that we have been able to determine the loss is $9 million.

The third potential loss arises from premature redemption of trust fund obligations with maturities after June 30, 1986. The economic effect on the trust funds of premature redemption of longer maturity obligations is uncertain and, moreover, different for each of the funds. For example, although the OASI obligations redeemed had interest rates slightly higher than the current statutory investment rate, obligations redeemed by the DI in November carried interest rates lower than the current rate. Thus, if interest rates remain steady until June 1986, although the OASI would experience a loss from redemptions, DI would have a gain. While we cannot quantify what will happen as a result of these redemptions, we do know that in October 1984 there was a loss when we had to redeem long-term obligations. Furthermore, we know that as the GAO reported to Congress in 1979, the trust funds experienced losses in 1978 due to a debt limit impasse that year.

Finally, let me briefly comment on losses experienced by other funds. Unlike the Social Security trust funds, other funds do not operate under the advanced investment normalized tax transfer system. Therefore, as I stated in September and as Secretary Baker reiterated in an October 1 letter, when those funds are uninvested, they lose interest. Because of this interest loss, as debt limit capacity became available during October through redemptions to pay benefits, those funds were partially invested. We estimate that the interest lost to those funds because of delayed investments and noninvestment was approximately $70 million through October 31.

Yesterday I testified that early redemption of securities held by the civil service retirement fund resulted in a one-time interest loss of approximately $404,000, similarly, the railroad retirement account lost approximately $265,000.

These other funds may also suffer losses due to the redemption of obligations with interest rates above what they could have invested at today and maturities beyond June 30, 1986. As with the trust funds, it is not possible to calculate the effect of redemption on these obligations because it requires prediction of interest rates after June 30, 1986.

Section 273 of House Joint Resolution 372, as passed by the House on November 1, provides for issuance of securities and transfers of funds to relieve all funds of losses resulting from the debt limit impasse this year. As I testified yesterday, Treasury will, of course, comply with that provision or similarly effective legislation, if enacted into law. This legislation, however, would not cure the losses from previous years, a fact you may wish to take into consideration when you consider this legislation.

The debt limit impasse has put us all in a position of facing choices we would rather not face. The Secretary has recently been faced with choosing between defaulting on U.S. obligations, including beneficiary payments, or advancing the redemption of trust fund obligations to meet those benefits. He chose the latter course to ensure that millions of Americans would continue to receive their benefits in a timely fashion.

Mr. Chairman, that concludes my prepared remarks.

[The prepared written statement of Secretary Niehenke follows:]

FOR RELEASE ON DELIVERY
EXPECTED AT 2:00 P.M.
NOVEMBER 7, 1985

STATEMENT OF JOHN J. NIEHENKE
DEPUTY ASSISTANT SECRETARY OF THE TREASURY (FEDERAL FINANCE)
BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS
OF THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Subcommittee:

I welcome this opportunity to appear before you to explain what actions Treasury has taken during the current debt limit impasse that have affected the Social Security Trust Funds. In this testimony I will cover four points. First, explain how the Social Security Trust Funds operate with respect to the payment of benefits, transfer of credits and redemption of obligations by these Trust Funds when there are no debt limit restraints on investment by the Trust Funds. Second, explain what actions Treasury has taken with respect to these funds during this current debt limit impasse. Third, outline three types of potential costs to the Trust Funds arising from the actions Treasury has taken. Finally, outline the costs to the non-Social Security funds due to the failure of Congress to increase the debt limit.

I know this Committee recognizes the importance of managing the finances of the United States on a routine and responsible basis and assuring that those due payments from the United States receive those payments on an orderly basis.

Failure to increase the debt limit has strained our ability to meet these responsibilities. This strain results in uncertainty on the part of those due payments from the United States about when and whether they will receive those payments.

The Secretary of the Treasury must reconcile his responsibility not to issue debt in excess of the debt limit with his concurrent responsibility to manage responsibly the finances of the United States including timely payment of benefit payments for a number of programs for which he serves as fund manager. In balancing these responsibilities, the Secretary has made decisions based on four guidelines: (1) avoid an unprecedented default on obligations of the United States; (2) ensure that recipients of Social Security and other retirement programs receive their payments when expected; (3) minimize, to the extent possible, the costs to the various funds administered by Treasury of actions taken, and (4) stay within the debt limit.

I can report to you today that in spite of numerous and complex problems, Treasury has, to date, managed to avoid default, ensured that recipients of Social Security payments have been paid on time, minimized the cost to the Trust Funds of actions necessary to make payments on time, and stayed within the debt limit. I must caution, however, that we are running out of time. Continued delay in passing a debt limit bill is unacceptable. I trust today's testimony will clarify what we have done and reassure you that our actions have not jeopardized any payments from the Social Security or other Trust Funds. But I must point out that the only long-term solution to relieve the anxiety that recipients of payments from the funds are experiencing is prompt passage of a debt limit bill.

I will now turn to the normal operation of the two Social Security Trust Funds -- Federal Old Age and Survivors Insurance Trust Fund (OASI) and Federal Disability Insurance Trust Fund (DI) (the Trust Funds). The Trust Funds receive transfers in the form of credits from the Treasury in amounts equal to taxes collected (primarily FICA withholding taxes) under applicable provisions of the Internal Revenue Code. Since May 1, 1983, the transfer has been made at the beginning of each month in an amount equal to the Secretary's estimate of tax receipts to be received by the Trust Funds that month. This procedure is referred to as the Normalized Tax Transfer ("NTT"). These transfers are invested in interest-bearing obligations maturing on the next June 30. These obligations are subject to the debt limit.

At the end of each month, Treasury mails checks and forwards electronic funds transfer tapes for benefits payable on the third day of the following month. When these transfers are made and checks are presented to the Treasury, payment is made from the Treasury cash account and Trust Fund investments are then redeemed to reimburse the Treasury. Thus monthly redemption of obligations held by the Trust Funds is and has been an integral part of the Secretary's administration of the Trust Funds.

In 1983, in accordance with the requirements of section 153 of the Social Security Amendments of 1983 (P.L. 98-21), Treasury and the Social Security Administration agreed that to properly account for the time when checks are actually presented to Treasury for payment obligations with a face value of approximately 50 percent of total benefit payments would be redeemed on the day electronic funds transfers and checks are payable. Obligations in a face amount equal to approximately 30 percent of the benefit payments would be redeemed on the fourth business day following the check issue date; the remaining 20 percent would be redeemed on the fifth business day following the issue date.

The normal redemption procedure is that the first obligations redeemed are those that mature the following June 30, lowest interest rate first. The redemption process includes the most recently invested NTT. If these obligations are insufficient to cover benefit payments, obligations maturing the next June 30 are redeemed, again lowest interest rate first, and so on. Therefore, in months when the NTT is less than benefits paid (which can happen even when there is an annual surplus), longer term obligations may be redeemed. This happens several times each year, most recently in August, 1985. These redemptions are totally unrelated to the debt limit and take place due to normal fluctuations in monthly Trust Fund receipts.

Long-term investments are made each June 30. The proceeds of all maturing obligations are reinvested in obligations with maturities based on projected benefit payments. (All obligations mature on June 30, but they mature in different years.) The interest rate on each of these obligations, no matter what the maturity, is the statutory formula rate for the June during which they are issued. This rate may be higher or lower than the rates on the maturing obligations.

Now let me explain the actions Treasury has taken during the current debt limit impasse. On September 3, 1985 (the first working day of September), Treasury transferred the full September NTT to the Trust Funds as required by law. However, also on that date, the principal amount of outstanding obligations subject to the debt limit reached the statutory limit of $1823.8 billion. Therefore, Treasury was unable to fully invest the NTT on September 3. However, as Trust Fund obligations were redeemed to reimburse Treasury for payment of Trust Fund benefits during September according to Treasury's normal operating practice, the uninvested balance in the Trust Funds was invested to the maximum extent possible.

On October 1, Treasury again transferred the full October NTT to the Trust Funds. However, because obligations outstanding subject to the statutory debt limit again equaled the limit, the NTT was not, and thereafter has not been invested.

I want to assure you that, in spite of inability to invest the NTT, Trust Fund total balances have remained essentially stable since July 31. The Trust Fund balances and investments for the period July 31 - October 31, 1985 are shown in the following table (in millions of dollars).

	July 31	August 31	September 30	October 31
Invested:				
Long-term	36244	34436	27535	22642
Short-term	1563	2760	8875	321
Total invested	37807	37196	36410	22963
Uninvested	453	160	3077	15877 est.
Grand Total	38260	37356	39487	38840 est.

Under normal circumstances, obligations with face amounts totaling almost $15 billion would have been redeemed by the Trust Funds on November 1, 7 and 8. $6.899 billion of obligations would have been redeemed on November 1, $4.816 billion would have been redeemed on November 7 and $3.21 billion would have been redeemed on November 8. That amount equals the amount of benefits that will be paid in November. No more than this $15 billion of obligations will be redeemed from the Trust Funds; however instead of being redeemed on November 1, 7 and 8, they are being redeemed on November 1, 4 and 8. On November 1 obligations in an amount of $9.613 billion were redeemed. On November 4 obligations in an amount of $4.181 billion were redeemed. On November 8 obligations in an amount of $1.131 billion will be redeemed. Let me stress that, while the timing of redemptions has been accelerated, since the same amount of obligations would have been redeemed in any event, Trust Fund obligations were only used for Trust Fund November payments.

This early redemption, also referred to as disinvestment, was necessary because unlike September and October, when Treasury's cash balances were sufficient to permit payment of benefits <u>followed by</u> redemption of obligations held by the Trust Funds, in November Treasury's cash balance was virtually depleted. As of the close of business on October 31, the Treasury's cash balance was only $1.8 billion (compared to a normal cash balance on that date of between $10 and $20 billion and a desirable minimum level of $5 billion). Treasury estimated that checks and electronic funds transfers that would be presented to the Treasury for payment the next day would be in excess of $10 billion, including approximately $6.9 billion of Trust Fund benefit payments. November 1 revenues were estimated to be less than $3 billion. A similar situation was projected for November 4. Thus, unless Treasury took action, the United States would have defaulted. If the United States defaulted, recipients of Social Security payments would not have been paid.

In order to avoid default on November 1, on Tuesday and Wednesday, October 29 and 30, Treasury auctioned $13 billion in new Treasury obligations, which were issued on November 1. The auction raised cash to enable Treasury to make benefit payments. An additional $4.75 billion of Treasury securities was auctioned Thursday, October 31, for issuance on November 4, also to provide cash for benefit payments.

In order to minimize costs to the Trust Funds, Treasury altered its normal method of redeeming securities and, in November, redeemed securities on the basis of lowest interest rate first -- regardless of maturity. This Treasury action avoided the redemption of high coupon obligations held by the Trust Funds.

The failure to pass a debt limit and the actions taken by Treasury to ensure November benefit payments could result in three potential losses to the Trust Funds, (1) losses directly due to non-investment of the Normalized Tax Transfer; (2) losses resulting from acceleration of the November redemption, and (3) losses resulting from premature redemption of obligations maturing after June 30, 1986. Let me discuss each potential loss.

The NTT mechanism was part of the 1983 amendments to the Social Security Act. As explained above, under the NTT, anticipated receipts are invested on the first business day of each month. By law, excess interest earned by the Trust Funds, however, must be repaid to the Treasury. This adjustment is accomplished at Trust Fund interest payment dates by reducing the interest otherwise due the Trust Funds on the Treasury obligations by the amount of excess interest earned by the Trust Funds because of the NTT. Due to this semi-annual interest netting mechanism, Treasury, at this time, can and will make the Trust Funds whole for loss of interest due to the inability to invest fully the Trust Funds.

A second loss is the loss that results from the accelerated redemption of Trust Fund obligations. Last week in testimony I testified this loss would be approximately $10 million. I can now report that we have been able to determine that the loss is approximately $9 million.

The third potential loss arises from the premature redemption of Trust Fund obligations with maturities after June 30, 1986. The economic effect on the Trust Funds of premature redemption of longer maturity obligations is uncertain and, moreover, different for each of the funds. For example, although the OASI obligations redeemed had interest rates slightly higher than the current statutory investment rate, obligations redeemed by DI in November carried interest rates lower than the current rate. Thus, if interest rates remain steady until June, 1986, although OASI would experience a loss from the redemptions, DI would have a gain. While we cannot quantify what will happen as a result of these redemptions, we now know that in October, 1984 there was a loss when we also had to redeem long-term obligations. Furthermore, we know that, as the GAO reported to Congress in 1979, the Trust Funds experienced losses in 1978 due to a debt limit impasse that year.

Finally, let me briefly comment on losses experienced by other funds. Unlike the Social Security Trust Funds, other funds do not operate under an advance investment "normalized tax transfer" system. Therefore, as I stated in September and as Secretary Baker reiterated in an October 1 letter, when those funds are uninvested, they lose interest. Because of this interest loss, as debt limit capacity became available during October (through redemptions to pay benefits), those funds were partially invested. We estimate that the interest loss to those funds because of delayed investments and non-investment was approximately $ 70 million through October 31.

Yesterday I testified that early redemption of securities held by the Civil Service Retirement Fund resulted in a one-time interest loss of approximately $404,000. Similarly the Railroad Retirement Account lost approximately $265,000.

These other funds may also suffer losses due to the redemption of obligations with interest rates above what they could be invested at today and maturities beyond June 30, 1986.

As with the Trust Funds it is not possible to calculate the effect of redemption of these obligations because it requires predictions of interest rates after June 30, 1986.

Section 273 of H.J. 372 as passed by the House on November 1, provides for issuance of securities and transfers of funds to relieve all funds of losses resulting from the debt limit impasse this year. As I testified yesterday, Treasury will of course comply with that provision, or similarly effective legislation, if enacted into law. This legislation, however, would not cure losses from previous years, a fact you may wish to take into consideration when you consider this legislation.

The debt limit impasse has put us all in the position of facing choices we would rather not face. The Secretary has recently been faced with choosing betweeen defaulting on all United States obligations, including beneficiary payments, or advancing the redemption of trust fund obligations to pay those benefits. He chose the latter course to ensure that millions of Americans would continue to receive their benefits in a timely fashion.

Mr. Chairman, that concludes my prepared remarks.

Senator ARMSTRONG. Thank you, Mr. Secretary. The fable of the dog and the manger?

Secretary NIEHENKE. I think so.

Senator ARMSTRONG. I couldn't help thinking of that as you testified about the debt limit. I don't happen to share your enthusiasm for raising the limit on the public debt, but I must say that I do recognize the frustration you have when Congress both is unwilling to trim expenditures to meet revenues or raise revenues to meet expenditures or to increase the ability of Treasury to borrow. It does put you in kind of a catch-22 situation. And in due course, I trust we will get that resolved.

Secretary NIEHENKE. I certainly hope so.

Senator ARMSTRONG. Hopefully, along responsible lines, that remains to be seen.

I have several questions I want to ask, and I think what I will do is I will propound a couple of questions arising out of your testimony and then ask each of my colleagues to do so and then we will just go back and forth with as many questions as there are.

I want to start, however, by asking about the lost interest. You had testified that several of the funds lost interest. And you are referring in each case to specific trust funds that have lost interest. I want to be absolutely sure that to the extent they have lost interest, there has been an offsetting savings in the general fund. So we are talking about an interfund transfer, are we not? In other words, in each case the investment is in obligations of the U.S. Government. So the Government as a whole has not lost or gained anything in the process.

Secretary NIEHENKE. It all occurs within the budget itself, so that's true.

Senator ARMSTRONG. Exactly.

Second, I want to be sure that I understand correctly that if, therefore, it is the desire of Congress to make the trust funds whole—and I sense that is the course of action that we would wish to follow, and it's certainly the indication of sentiment from the Senate that we would wish to follow such a policy—really we are not out anything in an overall sense whether that occurs today or tomorrow or a week from now or whenever it occurs. It's a question of figuring out what the loss to the trust fund has been and what the offsetting gain to the general fund has been. And simply putting through legislation to implement our policy desire, if, in fact, that is our decision.

Secretary NIEHENKE. That's true with regard to the funds that have been uninvested during this period. Yes. And legislation would be required to correct that. Yes.

Senator ARMSTRONG. Some of the other funds, you have testified, can be done automatically without legislation in this semiannual cleanup mode.

Secretary NIEHENKE. That's the NTT. Yes. That can be done automatically within the legislation.

Senator ARMSTRONG. I want to ask one other question before I yield to my colleagues for their first round of questions.

To what extent could you identify in the steps you have gone through in your testimony, those decisions which were discretionary and those which were mandated? Do you feel that you have exercised discretion? That the Treasury has exercised discretion? Or have you been, by and large, simply following the dictates of the law, over which you had little or no discretion? Could you identify those areas of discretion that you have exercised?

Secretary NIEHENKE. The primary area of conflict, if I can call it that, has to do with the responsibilities of the Secretary of the Treasury, in one regard, as the managing trustee to fully invest the trust funds. The other conflict in law is that as managing trustee the Secretary is required to make available funds to make benefit payments. I alluded to that in my testimony. If there is a discretionary area, I would point to that area. And upon analysis, the Secretary concluded that he would prefer to, in the latter case, make the funds available to make beneficiary payments.

Senator ARMSTRONG. Whether invested or not, the funds that were expected to be invested—that were expected to be held in trust, have been held in trust.

Secretary NIEHENKE. All the fund transfers have been made. However, those funds have not been able to be invested because of the debt limit problem.

Senator ARMSTRONG. I understand that. But I want to sharpen that question because a few days ago a reporter for one of the largest news-gathering organizations in the country approached me in a state of some alarm and raised this question: Senator, I was told that Treasury is being sued for failing to deposit into the trust funds the tax collections received from the withholding tax.

Your testimony is that that did not occur?

Secretary NIEHENKE. That is not true.

Senator ARMSTRONG. That all of the money that was scheduled to flow into the trust fund, did, in fact, flow into the trust fund?

Secretary NIEHENKE. All the transfers that should have been made by law were made.

Senator ARMSTRONG. I thank you. I have some other questions, but let me now yield to Senator Moynihan.

Senator MOYNIHAN. On page 6 of your testimony, you give us a table with the amounts of long-term investment held by the trust funds—July 31, August 31, September 30, October 31. You show it dropping from $36 billion in July to $22 billion on October 31. What is it today?

Secretary NIEHENKE. I don't think we have that number with us.

Senator MOYNIHAN. You don't?

Secretary NIEHENKE. No.

Senator MOYNIHAN. You've come to this committee without that number, sir? That number is $10 billion.

Now this has been a pattern. You have performed before this committee and the House Committee, repeatedly withholding information which is our right and our need to have, and the consequence is you are not being trusted. I don't know if that comes through to you.

Secretary NIEHENKE. Let me try to estimate those for you.

Senator MOYNIHAN. You don't know what the current trust fund level is—would you mind going out and calling Treasury and asking?

Secretary NIEHENKE. Let me make you an estimate, which I think I can do.

Senator MOYNIHAN. Well, that's a lot better than saying you don't know. And it's a lot better than coming to this committee on a day like this without that information.

This has been going on for 1½ years.

Secretary NIEHENKE. Taking the long-term investment amount on October 31—and I think by reducing it by the two numbers which I cited as being redeemed on November 1 and November 4—that would give us a pretty good idea of what that balance would be.

Senator MOYNIHAN. Well, we have all afternoon. I'm telling you it's about $10 billion.

Secretary NIEHENKE. That could be right.

Senator MOYNIHAN. Mr. Chairman, should we recess?

Senator ARMSTRONG. I think without objection the figure would be $10 billion.

Secretary NIEHENKE. I'll accept the number $10 billion as an estimate.

Senator MOYNIHAN. All right, sir. You accept the number is $10 billion.

Secretary NIEHENKE. I don't——

Senator MOYNIHAN. Then why do you come here to this committee and give us a number that is $22 billion when the relevant number is what is the condition today?

Secretary NIEHENKE. We'll use $10 billion for purposes of this.

Senator MOYNIHAN. Now we will do so because I have shouted at you to make you do so, which is not the formal way this Committee elicits information. The Treasury doesn't come before this committee and have to have information dragged out of it. This is the Finance Committee. We've been here as long as the Treasury. We have a relation of trust and candor. That table is misleading.

Just as was said, there was $36 billion in long-term investments of trust funds in August and there is $10 billion today and $26 billion is yet to be accounted for.

Secretary NIEHENKE. Excuse me, Senator. This has happened on numerous occasions before.

Senator MOYNIHAN. Not under these circumstances—on numerous occasions in order to deal with a problem of a debt ceiling you have sold long-term investments?

Secretary NIEHENKE. We have come into the circumstance before—

Senator MOYNIHAN. How many times before, sir?

Secretary NIEHENKE. Clearly in 1984, again in—

Senator MOYNIHAN. That's one.

Secretary NIEHENKE. I cited in my testimony 1979.

Senator MOYNIHAN. Was that a debt ceiling?

Secretary NIEHENKE. That was a debt ceiling problem, yes.

Senator MOYNIHAN. And how much did you sell?

Secretary NIEHENKE. Several billion dollars, I think, is the number.

Senator MOYNIHAN. And so we have two. In 50 years, 3 times.

Secretary NIEHENKE. Three examples of that, yes, sir.

Senator MOYNIHAN. Never anything of this magnitude of the last 3 months.

Secretary NIEHENKE. I don't think so.

Senator MOYNIHAN. You don't think so.

Secretary NIEHENKE. The fact that this debt limit impasse has been so prolonged has aggregated the problem.

Senator MOYNIHAN. Well, that's a fair point, and I'm not going to argue that. But we want to know what you are doing.

Is it not the case that in 1984 you did this, as you just said?

Secretary NIEHENKE. Yes, sir.

Senator MOYNIHAN. And the Social Security Administration itself estimates that the loss in interest from the 1984 disinvestment is $440 million. Are you aware of that?

Secretary NIEHENKE. I'm aware that we disinvested the long-term securities in 1984. At that time, we could not tell, based upon the reinvestment, whether or not there would have been a gain or loss. I now understand that based upon the June 30, 1985, reinvestment, it is now estimated that the loss was in the approximate range of $400 million. Yes.

Senator MOYNIHAN. It was what I just said?

Secretary NIEHENKE. That's right, sir.

Senator MOYNIHAN. But you left it out of your testimony. You talked about $9 million but you never mentioned 400-plus million. That is a question of candor.

All right. Second—this happened in 1984. Were the public trustees informed?

Secretary NIEHENKE. I don't know specifically whether——

Senator MOYNIHAN. Well, I will tell you the answer to that too. They were not. And when you started this process in August, were they informed? You don't know. I'll tell you the answer. They were not. They learned about it a week ago in the context of the kinds of questions that the chairman was asked by the journalist.

You are trifling with the trust that the Treasury has rightly acquired over a very long time, sir. I don't think you understand the feeling at least of one member of this committee that there has been an absence of candor which in different circumstances could mean an absence of good faith. You come in here representing yourself as showing what the books look like and leaving $10 billion off. You talk about a $9 million loss in interest, and avoid a 400-plus million loss in interest.

I asked you about the trustees. You didn't give me an answer on the telephone, and you didn't give me an answer today. And, lastly, I asked you in a gesture of good will to come to this hearing—and I've been trying to get this hearing for 2 weeks—and bring up legislation that makes the trust funds whole for the interest lost. Saying, the Treasury and the President wants to do this.

But no, we have to pry information out of you. In effect, you are saying, figure it out yourself, fellows.

Secretary NIEHENKE. I think we've cooperated with several committees on——

Senator MOYNIHAN. We are quite capable of figuring it out ourselves, but it would be more reassuring if we had a sense that you would like to work with us in doing it.

I'm sorry, Mr. Chairman. I don't think in 9 years on this committee I have so spoken, but this is a solemn trust and you are trifling with that trust. You had a difficult situation. Secretary Baker has had a difficult situation. We know it. But, we also expect candor and openness in explaining how you made your way through those difficulties.

Thank you.

Senator ARMSTRONG. Thank you, Senator Moynihan.

Senator Mitchell, do you have an opening statement or questions for the Secretary?

Senator MITCHELL. I have an opening statement, Mr. Chairman, but in the interest of time, I ask that it be inserted in the record.

Senator ARMSTRONG. Of course.

Senator MITCHELL. I will proceed directly to questions.

Thank you very much. Is it Mr. Niehenke?

Secretary NIEHENKE. Niehenke, yes, sir.

Senator MITCHELL. I'm sorry I wasn't here during your entire statement.

I understand that you have described the process by which a transfer of funds is made at the beginning of each month by Treasury in an amount equal to the Secretary's estimate of the tax receipts to be received by the trust funds in that coming month.

Secretary NIEHENKE. Yes, sir.

Senator MITCHELL. Referred to as the normalized tax transfer.

Secretary NIEHENKE. That's right.

Senator MITCHELL. And in your testimony you indicated that contrary to the reports—the chairman referred to a question he had been asked by a reporter—that, in fact, those transfer of payments were made as scheduled on the first of each of the months in question. Is that correct?

Secretary NIEHENKE. That's correct, Senator.

Senator MITCHELL. I wonder if you would tell me whether it is Treasury's position that the Treasury is required by law to make such normalized tax transfers and that you don't have authority not to make them, absent some change in the law. What is the Treasury's position with respect to whether or not there is a legal requirement? I understand you have done it in the past, but assuming this occurred in the future, what's the Treasury's position on the legality of that?

Secretary NIEHENKE. I understand we are required by the 1983 amendments to the Social Security Act to do that.

Senator MITCHELL. So that Treasury could not fail to make the normalized tax transfer of payment absent some change in the law?

Secretary NIEHENKE. That's right.

Senator MITCHELL. Now do you—I think the answer to this is self-evident, but I will ask it anyway. Do you feel that Treasury has any legal obligation to notify either the public trustees or the Congress, and specifically the relevant committees of Congress, when it engages in the practice that was pursued here? That is, what has been referred to as "disinvestment" or the early redemption of certificates.

Secretary NIEHENKE. In a letter of October 22 to the joint conferees, Secretary Baker did indicate this course of action, the possible disinvestment in the trust funds in order to make cash available to pay beneficiaries during the month of November.

Senator MITCHELL. Do I understand that then to be an answer in the affirmative? That Treasury does——

Secretary NIEHENKE. In that case, Treasury communicated this particular circumstance to the Congress.

Senator MITCHELL. I'm trying to distinguish between what occurred and what legal obligation you feel exists. Do you believe that the Treasury Department has a legal obligation to make such notification or was that done on a voluntary basis of the Treasury Department?

Secretary NIEHENKE. I'm not sure of that question. Could I consult?

Senator MITCHELL. Well, you could ask also—you indicated in your testimony that there were previous situations in which a similar practice had occurred. And so the—you could include in the answer whether or not Congress was notified at that time.

[Pause.]

Secretary NIEHENKE. I guess we are not sure as to the narrow question of the legal responsibility. I think that in the case of October 1985—and, I believe, as I reread our communications in 1984 in a similar circumstance, we did raise the prospect with the Congress at that time that due to the debt limit problems we were not going to be able to fully invest balances of different funds. So I think that communication was made.

Senator MITCHELL. Would it be fair to say, then, that you are taking no position on the question of whether or not you have a legal responsibility to inform Congress, but you are saying in any event——

Secretary NIEHENKE. I think we have informed Congress. And I would answer separately your question about the legal responsibility perspectively, if that's OK.

Senator MITCHELL. That's right. But your answer is that you are taking no position on whether or not you have a legal responsibility to inform Congress, but you are saying we have notified them in any event, whether there is a legal responsibility.

Secretary NIEHENKE. That's right. And I'll follow up with your question about the legal——

Senator ARMSTRONG. Senator Mitchell, if you would yield for a moment. And I think we should have a definitive response from Treasury.

Senator MITCHELL. Fine.

Senator ARMSTRONG. But staff advises me that there is no such requirement. That the managing trustee is not required by law to notify the other trustees. And that there is a requirement for one meeting a year among the trustees. So at least on a preliminary basis, it appears that the answer to your question is no.

Senator MITCHELL. I think that's the case, Mr. Chairman. And what I wanted to get at, Mr. Chairman, in the absence of a legal responsibility, whether or not Treasury has a policy, a specific policy, in which there will be formal notification to Congress in the event such occurrences take place, either in the past or in the future.

Secretary NIEHENKE. I think we had communicated those circumstances where not having the debt limit capacity we were unable to invest certain fund balances. I think we have a fairly long record of that.

Senator MITCHELL. And may I take it, then, that that could be characterized as the policy, and that we could be confident that should any such occurrence be likely to take place in the future notification will occur then?

Secretary NIEHENKE. I'm confident we will continue to behave in the same manner, which is when we are confronted with this, we will certainly alert the Congress as to the dilemma.

Senator MITCHELL. Just because you notified Congress in the past, there is no reason why you would do so in the future. And if there is no legal requirement, as seems to be the case, and there is no policy regarding notification, then we can have no confidence, of course, that that notification will occur. And what I'm trying to get at is to determine whether or not there should be any legislative action to require such notification and whether or not there is a policy by Treasury as a significant element in determining what appropriate congressional action should be.

Secretary NIEHENKE. I can't say that we have written in a handbook somewhere that this is the policy as to ~~how~~ the Secretary is going to act as the managing trustee, but I will rely heavily on the fact that we have articulated this with the Congress over a great many years when we were confronted with this problem.

Senator MITCHELL. And speaking for the Treasury now, you are saying that it is your intention to do so should this occur at any time in the future.

Secretary NIEHENKE. I think we have to relay to the Congress our problem in this area.

Senator MITCHELL. I don't know about the time, Mr. Chairman. Do I have time left?

Senator ARMSTRONG. Senator Mitchell, we are proceeding kind of on an informal 5 minute rule, so if you have got more, go ahead, or if you want to take a second round, we are going to do that as well.

Senator MITCHELL. I'll defer to my colleagues, Mr. Chairman, and I will come back on the second round. I do have additional questions.

Senator ARMSTRONG. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman.

Mr. Niehenke, are you familiar with the section of the debt limit bill entitled "Interest Repayments to Social Security Trust Funds and other Retirement Funds?"

Secretary NIEHENKE. No, I have not read that, Senator.

Senator BRADLEY. You had better talk to your man.

Secretary NIEHENKE. That's section 273 that I referred to in my testimony.

Senator BRADLEY. And you haven't read it?

Secretary NIEHENKE. I haven't read it. I've been briefed as to what it does.

Senator BRADLEY. OK.

Is it the Treasury's position that they would like to see the trust funds fully repaid for any loss sustained over the last several weeks?

Secretary NIEHENKE. Yes, it is. I think we have cooperated in some of the language with staff members to be sure that the legislation is effective to accomplish that end.

Senator BRADLEY. And could you explain for the record how the loss has occurred; from what action?

Secretary NIEHENKE. Losses occur from several actions. In one regard, they occur from the fact that due to the fact there was no debt capacity after September 30, certain funds were uninvested for a period of time and still partially invested till now. A second with regard to the action that the Secretary took with regard to the Social Security trust funds and the accelerated redemption that is occurring right now, in early November. That will also result in some loss.

And assuming that whatever Congress action is going to be with regard to the debt limit, until such time as we do get an increased debt limit, that loss will continue to accrue.

Senator BRADLEY. So that the loss derives from, first, acceleration of redemption of bonds?

Secretary NIEHENKE. In the case of the Social Security trust funds in November, yes.

Senator BRADLEY. And then, second, it occurs because you have not invested available funds. Is that correct?

Secretary NIEHENKE. That's right.

Senator BRADLEY. If you do invest available funds, and the interest rate has dropped from where it was when you stopped or hesitated to invest, would you consider that to be part of the loss as well?

Secretary NIEHENKE. It would normally be part of the loss. I recall the legislation is designed to cure that, however. To put the funds in the position they would have been in had the debt limit legislation passed and those funds could have been invested at that time.

Senator BRADLEY. You are certain that the provision in the debt limit bill will cover both contingencies?

Secretary NIEHENKE. Yes. I——

Senator BRADLEY. And that the fund will be made whole?

Secretary NIEHENKE. Based on the current experiences.

Senator BRADLEY. And that includes the lost interest from the interim period? Is that correct?

Secretary NIEHENKE. The interim period being like——

Senator BRADLEY. So that the fund will be repaid with interest.

Secretary NIEHENKE. Interim period being the current period?

Senator BRADLEY. The period from whenever with the debt limit is——

Secretary NIEHENKE. September 30 to now, yes.

Senator BRADLEY. Thank you.

Senator ARMSTRONG. Thank you, Senator Bradley. Senator Boren.

Senator BOREN. Thank you, Mr. Chairman.

I would ask consent that an opening statement I have appear in the record. And I want to compliment you for having these hearings. We are all very concerned that the integrity of the Social Security fund be protected.

I would ask this question: As Senator Bradley just mentioned, some of the loss to the fund occurred because of early redemption of securities.

Secretary NIEHENKE. That's right, Senator.

Senator BOREN. Now I assume that the securities have been invested at various rates of interest. In other words, some of the bills or bonds bear one rate of interest and others bear a different rate of interest. Is the Secretary of the Treasury constrained in any way to decide which ones he redeems first?

Secretary NIEHENKE. Well, in the case of the Social Security trust funds, we made a divergence from our normal policy, as described in my testimony, and we decided to use a policy of using the lowest interest rate first in order to create the least harm in the funds.

Senator BOREN. Has that been done without exception?

Secretary NIEHENKE. In this circumstance, yes.

Senator BOREN. When you say "in this circumstance," was it also done in 1984 the same way?

Secretary NIEHENKE. No. In 1984, we followed the policy as described in my testimony that said that we went to the first June 30 and then the lowest interest rate and then repeated that process on out.

Senator BOREN. See, I'm concerned about that because in a way the Secretary of the Treasury in some sense is in a potential conflict of interest because he is here wearing two hats. He's going to benefit in one way in terms of being the recipient of the bonds—in other words, if you cash in those with a higher rate of interest first, it's going to save the Treasury money, but it's going to cost the trust fund money. Since the Treasury is the one paying the rate of interest, since these are Government obligations, there is an incentive to the Secretary to cash in those with higher rates of interest first.

But there is no requirement in the law that would require him in these sorts of situations to only deal with those of the lowest rates of interest first.

Secretary NIEHENKE. Yes. No provision in the law. May I explain that for just a minute because there are two elements at work there.

I think when you redeem a security there are two factors you have to take into consideration. First of all, of course, the interest rate on the security itself, which may vary considerably. The other factor is the maturity on that security because you can turn that around and manipulate it in many different ways.

The policy that we have out into place generally says we should always deal with the current maturities first and then work our way out. And then in the context of that, take the lowest interest coupon first and then work up to the highest.

So we have both factors of maturity and interest working for us.

Senator BOREN. Understand in this last instance you followed the policies you said that would have cost the Social Security fund the least amount in terms of lost earnings. But that is not necessarily the policy that was followed in 1984.

Secretary NIEHENKE. No. We followed—I think the effect was the same, though. I think the effect was the same.

Senator BOREN. In light of that, since there is a potential that there could be a conflict of interest, there is the potential in law apparently that would allow the Secretary discretion to do otherwise, have you ever asked this committee, has the administration ever asked that we tighten this loophole to make sure that if there is a disinvestment in the future that it be conducted in a manner that would result in the least possible loss to the Social Security trust fund?

Secretary NIEHENKE. I don't think we have asked the committee for that. But I think we have acted in a way that has been fairly responsible with regard to the trust fund.

Senator BOREN. I understand that you are supporting the proposal to make this fund whole now for the actions that occurred in 1985. After there was disinvestment in 1984, did the Treasury come to Congress with a proposal to make the trust fund whole after the loss of income during that period of time?

Secretary NIEHENKE. No. I think the trust fund loss that occurred during that period of time was a result of the action of not being able to invest the fund fully. We could not project at that time, or anybody could project at that time, whether or not there was going to be a loss or a gain. There can be a corresponding gain.

Senator BOREN. Now you understand that there is a loss.

Secretary NIEHENKE. Now we understand there is a loss.

Senator ARMSTRONG. Senator Boren, could we just pin that point down? For the record, in such a circumstance sometimes a gain will result and sometimes a loss will result.

Secretary NIEHENKE. That's right.

Senator ARMSTRONG. Would you just all in one place explain why that occurs? In other words, why would a loss occur and why would a gain occur?

Secretary NIEHENKE. Sure.

Senator ARMSTRONG. If you will forgive me for taking your time.

Senator BOREN. I'm very interested in what the chairman has asked.

Secretary NIEHENKE. The way the fund operates, if you will, in just looking at the table, you realize that there are both short- and long-term investments that occur. The short-term investments occur on a monthly basis during the course of a year. And they accumulate. They mature on June 30. It is at that point, on June 30 when the longer term investments are made.

So in order to project whether there is going to be a gain or a loss, you have to make some prediction or some assumption about what interest rates are going to be on June 30, 1986, in this case. So based upon the current circumstance, it's not clear to us what that is going to be. I understand there are estimates floating around of both a gain and a loss in the current circumstance.

But with regard to 1984, you couldn't know when the debt limit finally passed in October 1984 whether or not there was going to be a gain or a loss.

Senator BOREN. I understand that now. But now you do know that there was a loss. And what was the amount of that loss?

Secretary NIEHENKE. I hear a number of about $400 million. We vary a little bit, but it's approximately the same.

Senator BOREN. I heard the figure earlier $440 million. I think that was a figure cited by Senator Moynihan, which was not contradicted.

At what point in time did you learn that there was a loss, there would be a loss, that you could reasonably project to be of that magnitude?

Secretary NIEHENKE. At what point in time could it have been done?

Senator BOREN. When did you learn, when did you reach the determination that we had had a loss as a result of disinvestment in the range of $400 million plus?

Secretary NIEHENKE. Frankly, we just focused on this in the last 24 hours.

Senator BOREN. In other words, the Treasury did not feel any obligation after having followed a policy of disinvestment to monitor itself to determine how much loss there was to the trust fund and then to report that loss back to the Congress and request the Congress, if necessary, to take action to make the Social Security trust fund whole again.

Secretary NIEHENKE. In the case of——

Senator BOREN. My question is: Why in the world—and Senator Moynihan has mentioned how important it is that we have a relationship of trust. It disturbs me greatly that the question should have to be asked by this committee or by others why would the Treasury have not felt an intense obligation itself to have determined the amount of loss? Why was the Treasury then not, once it made the determination of the amount of loss, ask us, initiate the request itself, for action to make the Social Security trust fund whole? Why was that not done?

Secretary NIEHENKE. Let me just state that we did not disinvest in 1984. What happened in 1984 was that we followed the normal redemption procedures which had been in effect, which resulted in the redemption of some longer term securities because there was no debt capacity available to make those investments at the time.

It was not the administration that chose to take that tact. We did not have debt capacity in order to make the ordinary investments in the course of operating the trust funds. Therefore, the funds were redeemed and then reinvested when we got that capacity. Whether or not there was going to be a loss, we could not predict at the time. If there is a loss prospectively or a gain prospectively, that's all considered in the course of the operation and the management of the trust fund and will be addressed over time.

Senator BOREN. Well, I think the question is when will it be addressed over time. I would think that there is an obligation on the part of the Treasury, if its own policies result in a loss of income to the fund, whether it comes from disinvestment, whether it comes in a failure to make investments, for whatever reason, that you would feel some obligation to determine the amount of that loss without any prodding from anyone. After all, there is a fiduciary responsibility here. And that then it would be your initiative, the initiative of the Treasury Department, to make the amount of the loss known to the Congress and to ask the Congress, then, if additional legal authorities are necessary and for action to make the fund whole.

Why was that not done? Why has it taken outside prodding or questioning? Why have you not been the first to come forward with the information and to inform the Congress and request action?

Secretary NIEHENKE. I would respond that we take a longer term view of the fund's activities. And I think we are all certain and aware and very desirous of having these funds in good shape and operating efficiently over time. And, therefore, we take a fairly long view on this.

But let me just say one more thing. If you isolate what happened in 1984 and look at the redemption process and the investment process that went on, in the early part of that transaction, there was actually a gain to the fund. Correspondingly, the Treasury did not come back and try to take the money away either.

We just take a long view on this.

Senator BOREN. How long a view is a reasonable view? Are we talking about looking at it over 10 years, 50 years?

Secretary NIEHENKE. I think the long-term health of the fund.

Senator BOREN. What is the long term? How do you define long term? Should you be making a report to this committee on an annual basis, a decade basis, once every century? What is your view of the long term?

Secretary NIEHENKE. I think there is a trustee report annually.

Senator BOREN. An annual report?

Secretary NIEHENKE. And that implicitly tells you the condition of the fund and what has occurred in the immediate period.

Senator BOREN. Implicitly. Why do you not feel an obligation to explicitly inform us and to suggest action that should be taken? I think that's what is troubling us. It's a matter of attitude. It's a matter of casualness. Oh, well, some day we were going to get around to determining what in the long run was the loss to the fund. And, oh, well, if some day if someone in Congress uncovered it, we might admit to it. And, oh, well, some day we might sit down and talk to you about something we should do about it. Why in the world would you not feel a keener sense of responsibility to protect the integrity of the moneys that have been paid in by the employees and employers of the country?

Secretary NIEHENKE. I think there is another side to that coin, Senator. And the reason we found ourselves in the condition we were in was because we were in yet another debt limit impasse. We were constrained in what we could do, and, therefore, this is the action that resulted from that.

Senator BOREN. This is the last question, Mr. Chairman.

Would you suggest that in light of the fact that there appears to be no legal restrictions or constraint on the Secretary to make sure that he disinvests or handles these problems in a way that would minimize loss to the trust funds that we just spell out statutorily the order of actions that would be taken in terms of disinvesting in the lowest rate of interest first or some other formula? Or at least a directive in statute that the Secretary should conduct himself in a manner that would minimize, or the trustee, that would minimize the potential loss to the fund?

Secretary NIEHENKE. I think the Secretary has acted responsibly in this regard. And you are, of course, free to take whatever initiative you might like to consider in that regard.

Senator ARMSTRONG. Senator Boren, partly in response to your question, staff has furnished me with a memo that I'm going to ask to be Xeroxed and passed around and also entered into the record about the $440 million estimated loss in the trust fund as a result of the 1984 action. The most important finding of it—and I will just ask the staff to run some copies so that all the members of the committee can have it—is that the actual loss to date is $7 million. The balance of it occurs over a very long period of time.

And I sort of see where you are going with your line of questions, and I may end up agreeing with you, but I want to be cautious because it has not been, to date at least, the policy of the Finance Committee or of the Congress, so far as I know, that the trustees were expected to maximize returns to the trust fund. There is, in fact, in the law an averaging procedure where the investments are based upon the average yields of Treasury securities. And so there has been a sense of fairness, but not a sense of seeking maximum advantage for one Government fund at the expense of another Government fund. I'm not prejudging, and you haven't exactly said what you propose, although I sort of sense that you are leading in the direction of assuring a maximization or at least a consideration of that point of view.

Senator BOREN. I'm very concerned, Mr. Chairman, that we leave it solely to the discretion of the Secretary of the Treasury because he does have a potential conflict of interest. After all, on the one hand he is the keeper of the general revenue funds. Therefore, he would like to pay the lowest rate of interest possible to anyone that is buying Government securities. Therefore, he has an incentive to redeem earlier.

Now I'm not saying that this Secretary of the Treasury has conducted himself in any manner at all improperly, but I am saying that as a matter of long-term policy for the next 10 people that hold the office of the Secretary of the Treasury, should there be a decision made by Congress as a matter of policy as to what should take place in these kinds of situations so that we do not have a unilateral action being taken with wide discretion on the part of the Secretary of the Treasury. And I think we should consider that.

Senator ARMSTRONG. That seems to me a reasonable line of inquiry. Let me just pin down some specifics that stem from that.

Mr. Secretary, you testified that Treasury redeemed trust fund securities earlier than usual by a few days in order to have the money on hand to pay benefits. Did Treasury redeem the funds earlier than was absolutely necessary to meet those obligations?

Secretary NIEHENKE. No.

Senator ARMSTRONG. Did the Treasury redeem more than it needed to at the time of the first redemption? That is, as I understand it, the first redemption occurred on November 1 and then a second one on November 4. Could, in your professional opinion, could they have redeemed a little less on November 1 and earned a little extra interest over that weekend till November 4 or did they only redeem the amount absolutely necessary in order to meet their obligations?

Secretary NIEHENKE. Well, to perfectly answer the question, the redemption process had to match essentially a market borrowing program that we—put in place in order to generate cash in order to meet these beneficiary payments. So the acceleration was designed to give us the market borrowing authority we needed to raise the cash in order to meet those benefit payments.

With regard to the amount of investment that was redeemed, we projected the amount of beneficiary payments and accelerated redemption of no more than that amount.

Senator ARMSTRONG. So the answer is you only redeemed the amount you had to pay benefits?

Secretary NIEHENKE. To pay benefits. And the timing was tied in with market borrowing, which we did in order to raise cash to accomplish that end.

Senator ARMSTRONG. The question has been raised to some extent this afternoon and also in other forums of whether or not there is a conflict of interest. Where in some way the Treasury Secretary has discretion in the handling of these funds.

Let me ask this. Let me go back to a question I asked earlier. Could you outline the legal authority that the Treasury Secretary operates within? In other words, did he have the discretion not to redeem these funds or to redeem them on a different timetable. Could he have opted for some other policy, then, to redeem these funds?

Secretary NIEHENKE. When the Secretary reconciled his responsibilities and concluded he had to take actions in order to meet beneficiary payments during the month of November, he used his broad authority to redeem securities in the trust funds for the benefit of beneficiaries. It's not articulated anymore specifically than that, other than he has the ability to redeem.

Senator ARMSTRONG. Had he not done so, what would have happened to the checks?

Secretary NIEHENKE. We would have defaulted and we would not have met these beneficiary payments in November.

Senator ARMSTRONG. Thank you.

Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, just a few things here.

First of all, with respect to the obligation of the Secretary to maximize earnings for the funds, I think is probably right that there is no obligation one way or another. But it is a fact, if memory serves, that the special bonds purchased for the the Social Security trust fund are always redeemable at par. They never fall below par. Is that not right, sir?

Secretary NIEHENKE. That's right, Senator.

Senator MOYNIHAN. So right then and there that is a provision of the law that says maximize. So the law begins there.

Mr. Niehenke, I see we have a vote on. I'm sorry that this happened, and I think we have lots of ways to work it through. I mean you knew about the last year's events which would lead to a $440 million loss and you didn't mention it to us. Incidentally, it's $7 million for 1985. It's $100 million for 1986 and $100 million for 1987—you know, it adds up pretty fast.

You didn't come forward to say we want to do this right. It's a trust. It's not your money. It's a trust and you ought to be sort of forthcoming in making people feel good about it and not have us find out things that you did. You never told us about this action. You indicated something might be done, but you never told us.

In 1983 we put two public trustees on the Social Security Board of Trustees—I was on that Presidential commission that led to the 1983 legislation. And I negotiated at the Blair House for 10 days and 10 nights to get that legislation that the President signed with great pride in 1983. We put two public trustees on the board to make people feel that somebody would be thinking about the public's interest, no matter what administration would be in office, no matter which one comes and goes. You didn't tell them. You didn't tell us.

I think, Mr. Chairman, the General Accounting Office should be asked to give us its view of what has happened. And I think we have to draw legislation and make sure that a certain level of information is provided, so that we never go through a situation like this again.

I don't make any personal charges, but I do have to say that this has been disappointing, and it has been difficult. We've had to struggle to get information. It ought to have been volunteered to us. And I don't understand how this happened.

Senator ARMSTRONG. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

Mr. Niehenke, did I understand you to say in response to Senator Boren's question that you were unaware of the loss resulting from the 1984 action until the last 24 hours when you focused on it?

Secretary NIEHENKE. That's right, Senator.

Senator MITCHELL. And so is it a fair conclusion to draw from that that had not the current crisis occurred and public attention been focused on it that this loss may have gone permanently undiscovered or uncalculated and therefore not corrected?

Secretary NIEHENKE. I'm not sure. I think that probably it would have come up in the context of an analysis of the trust funds either by the actuary or the trustee or whatever process is used to review the actions and conditions of the fund.

Senator MITCHELL. Since you indicated that the relevant date for determining a loss was June 30 of the year following the action in which it occurred, is it fair to say that this information was available and could have been calculated shortly after June 30 of this year?

Secretary NIEHENKE. It probably could have been calculated; yes.

Senator MITCHELL. And it has clearly been calculated now in response to the increases that are being made in connection with the current crisis.

Secretary NIEHENKE. That's right.

Senator MITCHELL. You state in your statement at page 11, you refer to the House legislation and then say that that would not cure losses from previous years; a fact you may wish to take into consideration when you consider this legislation. May I take that to be the Treasury's recommendation or support for action by this committee that would, in fact, cure not only the losses from the most immediately past occurrence, but the ones that have occurred previously, both this year and in 1984?

Secretary NIEHENKE. I think the answer to that generally is yes, but the happenstance of reinvestment in the funds is something I can't emphasize enough. Interest rates change. The June 30 anniversary date is critical to the reinvestment process that goes on in the funds. And if it's the desire of this committee to pursue that, we would be happy to help and work with you and support you in that.

Senator MITCHELL. Well, certainly, according to your own testimony, each year as of June 30 or immediately thereafter it would be possible for the Treasury to calculate the amount of loss that resulted from any disinvestment or early redemption of certificates that occurred in the 12 months prior to that. Isn't that correct?

Secretary NIEHENKE. If there is a repeat of past problems with debt limit crises, yes, we would have to take a look at that at that time to see if there was any behavior that resulted in any change in the complexion of the portfolio.

Senator MITCHELL. And in retrospect would you not agree—obviously, it's easy for all of us with the benefit of hindsight—it happens in every walk of life. We get hindsight a lot too. But with the benefit of hindsight in retrospect, would you not agree that it would be a sound policy for Treasury in the event this has occurred in the past and in the future to make such calculations immediately following the time in which the information is available; that is, June 30 of each year, to notify the Congress and to submit to Congress that the action be taken to correct that?

Secretary NIEHENKE. I think based upon the experience we have gone through here, I'm certain we are going to engage that kind of an analysis.

Senator MITCHELL. One of the things that occurs, does it not, Mr. Niehenke, is that since this is all an internal accounting matter within the Government that to the extent losses to the Social Security trust funds have occurred, gains to the Government from a revenue and expenditure standpoint offset that so that to the extent——

Secretary NIEHENKE. It's all within the context of the budget.

Senator MITCHELL. So really if you were more concerned about the appearance of the Federal budget deficit than the status of the Social Security trust funds, in effect, if this $440 million figure, for example, were correct what it means is that the Social Security trust funds would be reduced by that amount; correspondingly, the Federal budget deficit over the same period would also be reduced by that amount because the Government would not have had to pay that amount independent of that. Is that a correct——

Secretary NIEHENKE. It doesn't have a deficit effect.

Senator MITCHELL. It doesn't?

Secretary NIEHENKE. No. It's all within the context of the budget. It's all consolidated.

May I point out also that——

Senator MITCHELL. That would be true if Social Security were taken outside the unified Federal budget.

Secretary NIEHENKE. Yes.

Senator MITCHELL. In other words, prior to 1969 or subsequent to 1993 or if we do move it up.

Secretary NIEHENKE. That's right.

Senator ARMSTRONG. Senator Moynihan, you get the next to the last word.

Senator MOYNIHAN. Thank you, sir.

I think, Senator Mitchell, that's a very fair question. And why don't we include that into a general set of questions to the General Accounting Office. These are accounting issues in the first instance.

May I, for the interest of the committee and our guest today—the question arises about this $440 million interest loss. And how did we discover it? We discovered it because my associate, Laurie Fiori, asked Harry Ballantyne, who is the chief actuary of the Social Security Administration. She asked him. He knew. He told her right away. But it seems to me some way to regularize this so it doesn't just happen that one crisis leads to discovery of what took place previously.

Senator ARMSTRONG. Well, we are grateful to Ms. Fiori for raising that to our attention. We are grateful to the Senators for their interest. We are grateful to you, Mr. Niehenke, for coming over.

I want to just be sure we don't adjourn if you have anything left unsaid you would like to say. We are going to go vote and won't come back unless you think there is something more you want to get on the record.

Maybe I should ask this. I mean I know what your answer is going to be, but let me ask it. You weren't trying to keep that $400 million a secret, were you?

Secretary NIEHENKE. Oh, no. There was no offensive act in that regard.

Senator ARMSTRONG. Well, to the extent—I think we have accomplished a useful purpose here, but I guess we have, among other things, indicated that we would like to be kept closely informed and so keep in touch and if you see anything like that coming down the pike, don't wait for us to ask.

Secretary NIEHENKE. If I may just take you up on your suggestion for a comment. I would just say that I would be happy not to go through like you any more debt limit problems. And I think if we can find a way to get over this problem and possibly put the debt limit process within the greater budget process, we could hopefully not meet like this and enjoy these kind of exchanges. I would find that, personally, very beneficial.

Senator ARMSTRONG. On that cheerful note, we are adjourned. Thank you.

[Whereupon, at 3:26 p.m., the hearing was concluded.]

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