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SOCIAL SECURITY TAX CUT

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

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SOCIAL SECURITY TAX CUT

MONDAY, FEBRUARY 5, 1990

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 2:05 p.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Riegle, Packwood, Dole, Danforth, Chafee, Heinz, Durenberger, and Symms.

[The press release announcing the hearing follows:]

[Press Release No. H-3, January 23,1990]

SENATOR BENTSEN ANNOUNCES HEARINGS ON SOCIAL SECURITY TAX CUT; PROTECTING SOCIAL SECURITY SHOULD BE TOP PRIORITY, FINANCE CHAIRMAN SAYS

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, announced Tuesday the Committee will hold hearings on a proposal to reduce Social Security taxes.

Bentsen (D., Texas) said the Committee hearings on the proposal of Senator Daniel Patrick Moynihan (D., New York) will be at *2 p.m. on Monday, February 5, 1990, and at 10 a.m. on Thursday, February 8, 1990* in Room SD-215 of the Dirksen Senate Office Building.

The proposal would involve a roll-back of the 1990 increase in Federal Insurance Contributions Act (FICA), or Social Security, taxes. A larger reduction would take effect on January 1, 1991, reducing the rate from its present law level of 6.2 percent (plus 1.45 percent for Medicare) to 5.1 percent.

"In considering this proposal, my first priority is making certain that we never have to cut Social Security benefits for future generations of Americans. That means answering a lot of questions, and that's why I am calling a hearing of the Finance Committee," Bentsen said.

"Senator Moynihan has proposed a kind of fiscal surgery here. I don't know whether it can keep Social Security and the budget healthy, but I propose to find out," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. The hearing will come to order. Last month Senator Moynihan certainly captured the national interest when he proposed to cut substantially the current Social Security tax rates and to return to pay-as-you-go status. He deserves a lot of credit. He has put on the table an issue that can no longer be ignored. We are running substantial deficits in the budget and they are being masked by a growing Social Security surplus.

The Social Security financing system that is now in place arose out of some amendments that were adopted in 1977 and 1983. In considering those amendments, the Congress and the Administration never really debated the issue of pay-as-you-go versus building up large reserves to pay the future retirement benefits of the baby boomers.

Neither the experts nor the Congress nor the Administration anticipated that Social Security reserves would build up at such a rapid rate as has actually taken place. After the enactment of the 1983 Financing Reform Amendments, the Social Security actuaries tried to project when the trust fund contingency ratio would reach 100 percent or a full year of benefits. They said 1994. Now they are saying 1991.

So clearly, the trust funds are in better shape than the actuaries anticipated that they would be. They are projected to grow very rapidly for the next quarter of a century.

Today the Social Security system is sound. That is my number one priority. The number one priority of this committee—and I am sure the number one priority of Senator Moynihan—is to keep it sound. I hope that today's hearings will provide the members of this committee and the American public with a thoughtful and a thorough discussion of what kind of policy is best for Social Security.

What policy will best assure that future beneficiaries will receive the full benefits to which they are entitled? How do we ensure a fair and equitable tax structure to finance that system?

I defer now to the ranking minority member for such comments as he might want to make, Senator Packwood.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Mr. Chairman, thank you.

I would wager that everyone at this table—Republican and Democrat, conservative and liberal—comes to the same conclusion. That is, we want to make sure that there will be sufficient money available to pay the benefits that we are promising to Social Security recipients.

If we guarantee that we will cut taxes now and in the future, run the system on a pay-as-you-go basis, then, as more and more recipients become eligible, it presumes that we will raise the taxes in the future. I feel a little more comfortable about having a reserve now in the form of Treasury Notes to pay benefits in the future, than in having a hope that we will raise the taxes in the future to pay for benefits.

As far as surpluses being invested in Treasury bonds, I perfectly understand that this money is not in a sock. It is in Treasury bonds and the money is being used for the general purposes of Government. But I would rather have had them, Mr. Chairman—with all deference—in Treasury bonds over the past 8 years than in Texas real estate. I fear——

The CHAIRMAN. We seem to have a lot of company on that nowadays. [Laughter.]

Senator PACKWOOD. I fear that had Social Security been able to invest their funds in something other than Treasury bonds, they would have done what many, many other managers of funds did, including savings and loans. And we would have found ourselves in a situation where we had to bail Social Security out. We will not have to do that to Social Security.

So, as long as the money is in Treasury notes and as long as the U.S. Government does not renege on its Treasury notes, that money is as safe as anything—and I emphasize again, anything—it could be in. And if we ever do renege, it will not be on just the Treasury Notes that Social Security holds. It will be on the Series E bonds and the money that Prudential has invested and everyone else has invested. The country will have gone bankrupt. I hope that day never comes.

But at the moment, Social Security has a safer investment than anything else it could be investing the surplus in.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Moynihan?

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Mr. Chairman, briefly I would like to speak principally to thank you, sir, for holding these hearings which I would think of in a form of oversight hearings. There are other committees that have oversight over Federal insurance programs and savings and loan and institutions, for example, or Federal installations that manufacture nuclear weapons, for example.

We have oversight over the Social Security trust funds. And we have taken this as a steep responsibility. As you recall, sir, and as others here will do, in 1985 we found that the Treasury had disinvested—or prematurely cashed in $27 billion in Social Security trust fund bonds and they had not told us. They had not told the public trustees that were created by the 1983 Social Security amendments. But we learned about it and we held hearings. It was arranged that the trust funds would be made whole. We did not just let it go by and figure it would work out for itself.

That was the first time, in 1985, when we began to see the accumulation of trust funds coming up now very fast. At this point, as you know, they are rising at $1 billion a week and heading for $3 billion.

So in the summer of 1988 your subcommittee requested the General Accounting Office and our distinguished Comptroller General—Mr. Bowsher is here today—if they would look at this question of what was happening to these surpluses and what should be done with them. And we got a really great report.

As, Mr. Chairman, you will recall, January of last year the GAO reported to us and they said, save the money in the only way it can be saved—by buying down privately held Treasury debt—or if you are not going to do that, return Social Security to pay-as-you-go financing when you have an adequate reserve.

In May and June of 1988 your subcommittee held hearings on this subject. We heard, for example, from Robert J. Myers for 23 years the Chief Actuary of Social Security. He said at that time, it is not going to be saved; go back to pay-as-you-go.

And here we are. I would hope it would not come as any surprise that we are holding these hearings. This issue has risen because we have been systematically raising it for 3 years.

And lastly, if I can say, we begin to get some acknowledgment out in the President's budget—acknowledgment that the money is now being used as general revenue—it is not being saved. But that there should be established a Social Security integrity and debt reduction fund. But the problem with this fund is that we get integrity after the next Presidential election.

Senator DOLE. Phased in.

Senator MOYNIHAN. Phased in.

Senator DOLE. Phased in integrity.

Senator MOYNIHAN. Phase in integrity. Yes, sir.

The Republican Leader has said it better than I. My friend, Senator Heinz, when confronted with an editorial description of this, that what is going on is thievery—he said it is not thievery; it is embezzlement.

And the very distinguished Senator Dole has just said we are going to have phased in integrity. I ask, can we have integrity now?

I thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Dole.

OPENING STATEMENT OF HON. BOB DOLE, A U.S. SENATOR FROM KANSAS

Senator DOLE. Well, first, I would like to thank you, Mr. Chairman, for having this hearing. Senator Moynihan has started what I think is a good opportunity to debate the issue of the Social Security Trust Funds.

Some of us here today—myself, Senator Heinz, Senator Moynihan—as well as some of the people who will be testifying here today were on the 1983 Commission. Our task was to rescue the system. It now appears we may have over-rescued the system. But in any event, we did the best we could.

I keep reading all about these taxes that were raised in 1983. Well, I want to make one point clear—we did not raise taxes in 1983. Although we accelerated the 1977 rate a bit, there was not any increase in payroll taxes.

One question the Commission discussed then was how big the reserve should be. Some said 100 percent. I thought it ought to be bigger myself. But in any event, I think we succeeded in coming to an agreement because of the work of the 1983 Social Security Commission. At one point, the Commission almost collapsed. I recall meeting Senator Moynihan on the Senate floor 1 day and we both agreed we ought to go back and try one more time. And after some period of time we finally came together. The President and Speaker O'Neill came together as well, and I think that was very important.

What has the 1983 Social Security Commission Agreement done? It has restored confidence in the system to about 38 million Social Security recipients, and that is the one thing we do not want to shake. Social Security is all some people have. That is their only income.

While I certainly commend Senator Moynihan for starting a debate, I do not know how many votes he has. It is pretty much like my foreign aid proposal. I am ahead in the cloak room, but I cannot get any votes on the floor. He may be in the same fix, but he has started the debate.

Let me first state that I do not want to add to the deficit. I do not want to raise taxes and I do not want to cut benefits. I think Senator Packwood may have stated that pretty well. If we ever reach the point where we renege on the promise to always have Social Security there for our seniors, we are in deep, deep trouble as a nation. But this is an opportunity to possibly make some adjustments and I certainly commend the Chairman and Senator Moynihan for starting this debate.

The Administration, I believe, does have a proposal. I think members on both sides of the aisle have already talked with Mr. Darman and others about some modification, so we do not wait until after the next election to start setting aside the Social Security trust funds.

I think the bottom line is, whatever happens, the reserves are going to depend more on the behavior of the economy than on anything we might do in Congress. The outstanding performance of the Reagan economy is why I think we have had a pretty good surplus build up so far. I think most people are pretty happy about the current state of Social Security, and I just hope we can find some way to underscore the confidence we have in the system. I, in fact, think confidence in the system is growing. I do not find a lot of support in my State for reducing payroll taxes. I think the President made it pretty clear in the State of the Union message that he disagrees—not with Senator Moynihan personally, but only with his proposal.

So we will start the debate and see what happens.

The CHAIRMAN. Thank you.

Senator Heinz?

OPENING STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Mr. Chairman, Pat Moynihan and I have sung a duet on this subject for quite some time. What he has quite appropriately called thievery I call embezzlement. I thank you for a captive audience for us to be able to continue our brief performance.

The CHAIRMAN. I understand that the difference was a class difference between thievery and embezzlement.

Senator HEINZ. Yes, I read that.

But the reason I choose the term "embezzlement" is because what Congress has done is to embezzle the future security of America's retirees. I say Congress because occasionally the implication that this is something an Administration did gets brought into the debate. The fact is that this is a practice that Congress legislated and relegislated and has condoned ever since 1983.

It is clear to me that it is Congress' fault for not having owned up and admitted to this problem. We all had a little debate in November on the Senate floor where the Senate leadership was so embarrassed with the prospect of telling the American public the truth, that they did not want to face up to an amendment that I and others wanted to offer which would have protected the Social Security system and ended the deficit deception which has been practiced.

Mr. Chairman, I am grateful that Pat Moynihan has performed a service here in getting this issue on the right track. But I must tell you that I am extremely concerned that the Moynihan proposal—S. 2016—will wreck the entire train by derailing years of efforts to ensure that the Social Security system remains sound.

I have three brief comments that I would like to make and illustrate, if I may, with some pictures. My first point has to do with the deficit. The deficit we are reporting, of course, supposedly is going down. The surpluses in Social Security are going up. But if you look at the real deficit without counting Social Security surpluses, it goes up and keeps rising.

The Moynihan proposal will almost certainly bankrupt the Social Security system in short order. Now this, Mr. Chairman, is not my own conclusion; it is from the charts and tables provided by the Finance Committee Staff that you have distributed to us all. Based on an entirely plausible set of economic assumptions, table 32, which we all have, shows that the Moynihan proposal would create an annual and rapidly growing shortfall in the entire Old Age and Survivors Program beginning in 1992 and will literally completely bankrupt the system so it cannot make any benefit payments at all in 1998.

In short, those who support the Moynihan plan are proposing a clear and present danger to the safety and soundness of Social Security and its present and future retirees.

The CHAIRMAN. Senator, would you limit your statement because we have a long hearing.

Senator HEINZ. Mr. Chairman, I have been trying to bring this subject up in the Finance Committee and with your deference I would very much appreciate——

The CHAIRMAN. Senator, I would be delighted to allocate time for you as a witness if you would like it. But if you will, please——

Senator HEINZ. If the Senator would yield me 3 additional minutes I will be able to wrap up.

The CHAIRMAN. All right.

Senator HEINZ. Some will say that the more optimistic set of assumptions are the right ones. Let's look at these assumptions before we accept them. They are based on inflation of exactly 4 percent every year for 10 years, in spite of the fact we know energy prices will be going up; the purchasing power of the dollar down; an entire decade without a recession or even an economic slow down; unemployment that never rises above 5.5 percent; and wages that are increasing 30 percent faster than prices. In the face of more and tougher foreign competition from EC and Eastern Europe, I wonder who we are kidding.

Mr. Chairman, that is a world we would all like to live in. It is a world we dream about living in, but it is not the real world as we know it.

Therefore, my first point of concern about the Moynihan plan is that it is nothing less than a sugar-coated poison pill for Social Security—the equivalent of the Medieval practice of purging the patient with a disease by bleeding him to death. And it is the committee's own numbers that prove it.

My second point is that this plan, which is very attractive initially to individuals, splits the payroll tax cut 50-50 between individuals and employers. But it is not at all certain that this same split will apply to new taxes needed to make up this $55 billion deficit.

If we take Senator Hollings proposal of a 5-percent sales tax, something like 90 percent of the money will come out of the pocket of consumers. Something like 80 percent, if you go the increased gas tax route, will come out of the pocket of consumers and workers. So what appears good going into your pocket is not going to feel too good when the money comes out.

To put it in the context of somebody who is a typical wage earner earning $24,000 a year, going into the pocket is $240 per year, but coming out of that person's or family's pocket would be $360 in the form of Senator Hollings VAT tax—or $401 in the form of a motor fuels tax.

Mr. Chairman, I appreciate your forbearance of my making these points. The fact that raising additional revenues to balance this tax cut burdens workers and families and consumers so heavily is that, of course, half of the $55 billion in cuts goes to business. Indeed, if enacted it would be the largest business tax cut in history.

That really brings me to my last brief point. I have said that this would be the largest business tax cut in history—a minimum of $150 billion over 5 years for every type of business from McDonalds to General Motors. But if we did it, it would mark the first time where the Congress would knowingly shift a massive amount of tax burden off of business and onto the shoulders of wage earners and consumers.

The Moynihan plan is tax reform thrown into reverse. Mr. Chairman, we should reject the Moynihan plan because its sugar coating hides a twin toxic menace—poison that will bankrupt the Social Security system and burden the many to benefit the few.

Many of us think the right way is to remove Social Security from the budget and many of us will try and do that.

The CHAIRMAN. The Senator's time has expired.

Senator HEINZ. Mr. Chairman, my time has expired.

The CHAIRMAN. It certainly has. [Laughter.]

Senator HEINZ. I thank the Chairman for his forbearance.

The CHAIRMAN. If the Senator would like another hour at the end of this testimony, I would delighted to accommodate him.

Senator HEINZ. I would move to revise and extend my remarks.

The CHAIRMAN. I had anticipated that.

Senator Durenberger?

OPENING STATEMENT OF HON. DAVE DURENBERGER, A U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER. Thank you, Mr. Chairman. I assure you I have no charts. I have a thought or two and one suggestion.

First, I want to say that I think we all owe a debt of gratitude to the voters in New York who have sent Pat Moynihan to the United States Senate. He has never been reluctant to speak his mind and the more controversial the issue, the more controversial he makes it. But he has also been willing to share with us some very positive suggestions.

Seven years ago, as we all know, when the Social Security system was in crisis and when things were so bad the Government was forced to borrow from the Medicare hospital insurance trust fund, it was Pat and Bob Dole and John Heinz and others who have spoken here who helped make a difference. What Bob Dole said here today about the security of our elders is important. Because not only if they are confident in Social Security but they are confident in the other things, except Catastrophic, that we may try to do in this committee.

The problem that, if I may say so, the problem we have with Pat Moynihan is not of his making, it is of ours. We often do not hear what he is saying because—not necessarily the folks here, but a lot of people have come to understand that he is talking in terms that many of us are not yet willing to come to grips with. The best known example is welfare reform where he described for us decades ago something we finally go to. His problem was, he described it when we were at the height of the great society and he could not get it passed until we reached the depths of that same approach.

Pat Moynihan is a reformer who always comes too soon. Just like a fireman who gets to the fire 2 hours before anybody sees any smoke.

So I for one welcome Pat's proposal and I welcome these hearings in particular. Because I think they give us an opportunity to debate in front of the American public how to make the income security and the social insurance system of this country work for the generations of current and future workers.

What is at issue here is simply the fact that today we are eating our children's seed corn. We priced them out of higher education, out of housing, and out of health care so that all the rest of us could have without paying for it. Now we have the gall to raise the tax on their work—ostensibly to secure their retirement, but actually to spend it on ourselves—prolonging the depth of our current debt—as John showed on one of his charts—and buying it with their retirement taxes.

Mr. Chairman, I would suggest that our colleague is not talking about cutting Social Security or cutting taxes or cutting the deficit. He is trying to get his generation, our generation, to stop lying to its kids about how much we are willing to pay so they can be almost as well off as we. Ours is the first of 13 American generations which is about to leave its children less well off than we were left by our parents.

Pat Moynihan knows that and it is time that the rest of us paid him and our kids some respect.

The CHAIRMAN. Thank you, Senator.

Senator Symms?

OPENING STATEMENT OF HON. STEVE SYMMS, A U.S. SENATOR FROM IDAHO

Senator SYMMS. Thank you very much, Mr. Chairman. I join with my colleagues in my appreciation to Senators Moynihan and Heinz and others who have lead this debate on proper accounting for the Social Security trust fund. And, Mr. Chairman, I thank you for having these hearings.

I would point out to my colleagues that the General Accounting Office report, which Senator Moynihan showed, on page 6 it says, "In our view, the preferable course of action would be to make the accumulation of Social Security trust fund reserves an economically meaningful process, one that represents net additional national savings."

Now, Mr. Chairman, I have introduced a bill that I think should be an important part of this debate. I would hope that my colleagues would look at this proposal very seriously. It would provide an economically meaningful process to actually put the increase, where it would increase the national private savings rate for every American family. My bill provides for establishing for every American worker a new account within the framework of Social Security—a defined contribution account using the accumulated Social Security surplus. Show the surplus fund chart, please.

These accounts would be substantially the same as President Bush's family savings accounts. But I would start the process by putting the accumulated Social Security surplus—this portion here—into each worker's account. By putting the money in the family savings account it would protect it from spending by the Congress, which is what Senator Durenberger, and Senator Heinz and Senator Moynihan are talking about.

We are spending the savings on other projects, putting Treasury bills or Treasury bonds in an account that someday will have to be redeemed. I am suggesting you put it in each American's account so that it will not be able to be used or be able to be used to cover up the Federal deficit.

The Social Security system is a so-called "defined benefit program." I would not change that in any way.

I also want to say to the President and others who have made this very clear that I am not messing around with Social Security. My proposal is to create an additional benefit within the framework of Social Security to establish a defined contribution account similar to what we, and others, and the Federal employees already enjoy with the Federal Employees Thrift Savings Plan.

Now, Mr. Chairman, every American—they write this Congress, they write all of us—they are in anger about their Social Security taxes being used for other purposes other than savings toward their own retirement.

I would just like to point out a simple example. Let me give one simple illustration. Let's see if there is any points there I do not want to leave out. But I want to get this through within my allotted time.

Take the average worker who earns an average wage today of $20,400. That is the average wage of someone subject to the Social Security tax. Let's assume this person works their entire life—49 years until retirement—at this average, assume the average wage grows at the real, adjusted for inflation rate of 0.5 percent per year. That is a rather slow rate for wages to grow. They have often grown faster in the past.

Under current law the real Social Security benefit of this worker will increase from $7,100 per year now to $13,272 in the year of the retirement of the worker. That is a substantial increase from his current defined benefit under Social Security as it exists today.

Now assume further that we take the Social Security surplus, the point that I showed in the other chart, approximately 2 percent, and save it in a tax sheltered account as I have proposed. Here is the benefit. At 2 percent it would be $37,000; at 5 percent it would be $91,000; at 7 percent it would be $176,000. That is why I have called this bill the Social Security Benefits Enhancement Act.

These additional amounts of savings available to the average worker cannot be provided under the current defined benefit Social Security law. The accumulated surplus is simply taken by the Government, as Senator Moynihan has stated so clearly, and used elsewhere.

Mr. Chairman, this is manifestly unfair. Social Security actuaries have assumed in all of their calculations of the Social Security surplus that the trust funds accumulate interest on their Government bond funds at the very low rate of 2 percent. The average yield on the stock market since the mid-1920's has been closer to 9 percent. The current yield on corporate triple A bonds is between 5 and 6 percent. This is not only doable, it is feasible. It would be honest to the American people. It could be done.

The question will be, of course: What do you do about the deficit? You do the same thing about the deficit you would do with the Moynihan proposal and that is, you slip the target date for the balanced budget from 1993 where it comes here if you take the Bush line—and that is the Darman fund there—or if you take the Moynihan line here, you have the budget balanced by 1995 and you have taken all of this accumulated savings and you start putting it into private accounts.

Thank you very much. I hope the committee will seriously consider this proposition.

The CHAIRMAN. Thank you, Senator.

Senator Danforth?

OPENING STATEMENT OF HON. JOHN C. DANFORTH, A U.S. SENATOR FROM MISSOURI

Senator DANFORTH. Mr. Chairman, Senator Moynihan has made, I think, two good points and come up with one idea that is not so good.

The two points relate first to the masking of the deficit in the Federal budget; and second, to the equity of the tax system as it now exists. It is true that the surplus in Social Security receipts does mask the deficit in the Federal budget and will until 1993 under current law.

This, I think, is regrettable. I think Senator Moynihan has done a service by pointing out the seriousness of the budget deficit. We talk a lot about it here in Congress; we do not do very much about it. We use, as we say, smoke and mirrors to try and conceal the budget deficit. I think anything that can be done to highlight the seriousness of this economic problem to our country should be done and Senator Moynihan has made a contribution in that regard.

With respect to the equity of the tax system as it now exists, again, I think a service has been done. We hear about reading lips and whatnot. I think that the notion that we get is that the tax law as we created it in 1986 is set in stone. I would hope that it would not be set in stone. I think that there are some serious problems with the current state of the tax law. I do not see anything that should be viewed as permanent or a holy rite in suggesting that the higher your income goes the lower your tax rate goes.

That is now the case. Your marginal tax rate actually goes down as your income goes up. I believe that the 1986 tax law was one that discouraged savings and investment, encouraged immediate consumption; and, therefore, I would hope that our committee at some point would look at the tax structure from the standpoint of equity and economic effect.

The idea that Senator Moynihan has put forward, I think, is not such a good idea. Back in 1983 with a lot of difficulty, we put together a fix for the Social Security system. It was an intergenerational fix. In doing this we could assure younger people that the Social Security system would be there when they retired. I cannot count the number of people who are 20 or 30 years old who come to me and say, "Will it be there when I retire? I'm putting all this money in."

We have been able to assure them the answer to that is yes, that we did create a long term solution to the Social Security problem when we passed the 1983 Act. Senator Moynihan's proposal would undo that 1983 fix. It would break the compact between generations that we created in 1983. And, therefore, I think it is not a good idea.

The CHAIRMAN. Thank you, Senator.

Senator Chafee?

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Mr. Chairman, would you object if I didn't take my full time? [Laughter.]

The CHAIRMAN. Senator Chafee, whatever you would like.

Senator CHAFEE. Mr. Chairman, first of all I believe that if the Moynihan proposal were enacted, a jump in our deficit to over $210 billion would be extremely damaging for the country in many ways.

Secondly, I am troubled by the provision in the Moynihan proposal that in effect would have it on a pay-as-you-go basis. All of us enjoy a tax cut, but it would be disastrous for the out years—the amount that would have to be paid then. In other words, I see it as moving from an insurance program to something else. It is an insurance program; that is what it is. That would be changed.

So, for that reason I am not in favor of the Moynihan proposal, but I think it is worthwhile for us to hear some of the testimony and some of the light that will be shed upon the suggestion.

Thank you.

The CHAIRMAN. Senator Riegle?

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MICHIGAN

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

I think what we are going to hear from our witnesses today helps illustrate the dilemma that faces us. I am told that two of our most distinguished witnesses—Mr. Ball and Mr. Myers—come out on different sides of this issue with respect to the Moynihan proposal.

I have not made a final judgment on it myself because I think the problem is now so severe in terms of the looting of the Social Security trust fund that an answer is needed. This may be the best answer we can find. I am reserving judgment on that until we have had a chance to study it in some detail.

But I think two points need to be made. They go along the lines of a couple of the points that Senator Danforth just made. That is that I think if you look at the changes in tax policy over the last decade, the Reagan tax cuts are increasingly being paid for by Social Security tax increases. You really have a tax transfer in effect.

The inequity of that takes several forms. But one form is that if you look at the overwhelming amount of the value of the tax cut—the Reagan tax cuts, if you will—they tended to accrue to higher income people. So on the one hand that is where a lot of the money or the benefit from those tax cuts went. Whereas, the increases in the Social Security taxes, in part to replace that revenue, are in effect coming from people who are basic wage earners for the most part.

So we have had a replacement of the source of the taxes. That replacement is hidden in a misleading way due to the way we calculate the Federal budget deficit. So we are not honestly telling the American people that that is what has happened here.

The second thing is this: The workers today, if we stay with this plan, will be asked to pay twice for their Social Security. They are paying now. Their money goes into the fund but it is not being protected. It is being taken out of the fund and spent for the normal conduct of Government. It is being replaced by an I.O.U. And then down the line those same workers are going to be asked to pay off the I.O.U.s. So in effect they are going to be asked to pay for their Social Security twice.

That is a profound change in what we have had in the past. I think we have to find a way to put a stop to that. Maybe the way we do it is revise our deficit targets. I think the fact that we are working against the arbitrary nature of the Gramm-Rudman numbers causes us to go through distortions of this kind.

To ask workers in this country to pay for their Social Security two times, rather than one time, which is the effect of the current looting of the trust funds, I think, is just—it is wrong and it is unfair. And by the time this debate is over and we get to the time where we vote on the Moynihan proposal—and I know you have said that there will, sir, be votes on that proposal—I think the public will be fully educated.

As a result I do not think there will continue to be the masking of the budget gyrations; and the dishonest accounting will have been stripped away by then. I think that this will have a great bearing on how this vote goes when it eventually comes.

But I want to say particularly to our witnesses—King, Bowsher, Ball and Myers; and very particularly Mr. Ball and Mr. Myers—that I for one appreciate very much their service on this set of complex issues as to how to make Social Security strong and secure in the future. I appreciate the fact that they are appearing as expert witnesses today.

The CHAIRMAN. Thank you very much, Senator.

As you can see from the preliminary comments, it is a very complex issue as to whether we should develop it on pay-as-you-go or follow the more traditional insurance pattern. It has also been stated time and time again that Social Security is in excellent shape and the surplus has been building even faster than the actuaries had anticipated that it would.

But in putting this hearing together one of the things I have insisted on is that we get the very best expertise that we can have, that we have people of integrity, a commitment to Social Security, and people with experience in the field, and that we have varying points of view.

I think today's witnesses are superbly equipped to answer these questions. Our lead off witness will be Gwendolyn King, the Commissioner of Social Security: and she is accompanied by Harry Balantyne, the Chief Actuary of the Social Security Administration. Commissioner King will be followed by the Honorable Charles Bowsher, the Comptroller General of the United States. His organization, the General Accounting Office, has prepared a most useful study on the Social Security trust fund reserves and their implications for the economy.

We are also going to hear from Robert Ball who was Commissioner of Social Security for more than a decade, serving under three Administrations. And our final witness this afternoon will be Robert Myers whose distinguished career with the Social Security Administration covered close to 40 years, including some 23 years as Chief Actuary.

I do not believe we have any more knowledgeable witnesses in the nation on this subject than the witnesses we have brought before us today. We are very honored to have them.

Mrs. King, if you would proceed with your testimony.

STATEMENT OF HON. GWENDOLYN S. KING, COMMISSIONER, SOCIAL SECURITY ADMINISTRATION, ACCOMPANIED BY HARRY C. BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, BALTIMORE, MD

Mrs. KING. Thank you, Mr. Chairman. Mr. Chairman, if you will, I would like to place the full text of my testimony in the record as if read.

The CHAIRMAN. That will be done.

[The prepared statement of Mrs. King appears in the appendix.]

Mrs. KING. I am very pleased to be here today to participate in this hearing because I know this issue is of utmost importance for our nation's future. And, Mr. Chairman, if I may, I would just like to commend you for holding these hearings so quickly. There are so many people who are so very concerned about this issue. It is good that we are taking the time early on to get these matters before the public.

When you announced these hearings, Mr. Chairman, you said you would be seeking answers to questions concerning Social Security financing. Let me say to you, as the Commissioner of Social Security, I can honestly report to you that the Social Security trust funds are in good shape. Last year alone our investment in U.S. backed securities earned $13 billion, at an interest rate of 9.6 percent. And that, sir, I would offer is a lot more than simply worthless I.O.U.s. It is an investment backed by the full faith and credit of the United States.

I believe very strongly that the American people need to be fully aware of the current health of Social Security and its reserve, as well as current legislative proposals and their impact on Social Security's well being. The Bush Administration and the Congress share a solemn commitment to protect and preserve Social Security. We want to assure its continued solvency, the integrity of its trust funds, and the growing public confidence in the system.

The only question, of course, is: How do we best achieve these noble goals? It was just 7 years ago that we stood on the brink of disaster. Social Security trust fund reserves were nearly exhausted. Since that time the system has made a remarkable turnaround, a turnaround largely attributable to the courageous actions of the Bipartisan National Commission on Social Security Reform. And as everyone here has noted today, four members of this committee served on that panel as well.

We are on the right course, Mr. Chairman. Social Security has for 50 years paid benefits every month on time to millions of Americans and we continue to provide prompt and accurate service. As the program's trust funds continue to build, public confidence in the program grows as well. And much of the credit for this success belongs to you, your colleagues and your predecessors.

Now, though, we are faced with the question: How do we keep Social Security on that steady track? As the person mandated by the President and the Congress to assure the health and well being of Social Security, I believe major surgery at this time would be ill advised. To alter Social Security's financing formula and abandon our strategy for trust fund reserves at this time would have some severe consequences.

But I am more concerned, Mr. Chairman, that in this debate there have been some distortions. Two in particular are of concern to me. The first is the charge about worthless I.O.U.s. If I may I would like to submit for the record in the interest of saving time excerpts from a statement from May of 1938 by Mary Dewson, who was an early member of the Social Security Board.

I think she addressed the issue of worthless I.O.U.'s better than any of us could when she said, "These criticisms aim most of their fire at the fact that the Treasury is directed to invest old-age insurance funds in the U.S. Government obligations. This line of reasoning implies that it would be safer to hide the currency under a mattress or to bury it in an old iron pot."

And she goes on, "To call the government obligations purchased for the old-age reserve account mere I.O.U.'s gets nowhere. The same thing could be said—and would be just as meaningless—about every bank deposit, every insurance policy, every private security investment in existence."

I submit this, if I may, Mr. Chairman, for the record.

The CHAIRMAN. Without objection.

[The statement appears in the appendix.]

Mrs. KING. Mr. Chairman, the other statement that I think needs to have a little bit of amplification is the charge about payroll tax regressivity. That argument ignores the fact that Social Security is a social insurance program with a benefit structure that is highly progressive, and that it also pays benefits to people if they become disabled or to survivors in the event of an early demise of a working person.

So I just want to offer that to rebut a couple of those arguments that we hear all the time.

Mr. Chairman, in conclusion, let me just say that I welcome this debate. I thank you for the opportunity to participate in it.

The CHAIRMAN. Mrs. King, do not pay any attention to that clock. You go ahead.

Mrs. KING. Thank you. I believe that when people of good will and noble intentions discuss important issues such as these at least three positive developments can result. First, there can be a better understanding of Social Security—and that means most of those who participate in the program. Second, we will achieve stronger, more effective protection for Social Security trust funds. I am confident of that. And third, at the end of the day, Mr. Chairman, I and the 63,000 employees of the Social Security Administration stand ready to continue to make this program work for the millions of working men and women who have earned eligibility in it.

Mr. Chairman, members of this committee, Social Security is headed in the right direction. We have stability. We have continuity. We have the opportunity to assure continued security for generations. That is our goal and we are indeed achieving it.

Mr. Chairman, I would be happy to answer any questions that you have.

The CHAIRMAN. Thank you.

Mrs. King, in the President's State of the Union Address he said, "don't mess around with Social Security." Now, if by that he meant, "do not cut the benefits," well then we are delighted to have him as a part of the choir. A lot of us have fought for a long time to be sure that we did not cut those benefits. But making an adjustment in the Social Security tax rate could be something quite different.

Mr. Myers, one of the foremost authorities on Social Security, says that for a long time we did just what Senator Moynihan is now proposing—ran the program on a pay-as-you-go basis. It served us well for years. Mr. Myers contends that that would not be a major, drastic change for Social Security, but rather a fine tuning.

How do you respond to that kind of an argument?

Mrs. KING. Mr. Chairman, I would suggest that going back to pay-as-you-go puts us back on that same roller coaster we were facing at the end of the 1970's and the beginning of the 1980's when we did not anticipate that we would be caught with only 14 percent of the assets needed to pay a year's worth of benefits and we were frightfully close to becoming bankrupt.

I do not believe this is the time to go backwards. I believe we must always look ahead. I believe that intentional or not the 1983 reforms did put us in a posture of moving ahead.

The CHAIRMAN. Well let me make another point or two then. I heard one of my colleagues saying all of this was the Congress' fault. I do not happen to agree with that at all. I think there is enough blame to go around. I think it is partially the Congress' fault. I think it has also been the Administration's fault, that is the masking of the budget deficit. And I do not think either side has lived up to the kind of discipline that should be exercised.

I heard my friend from Michigan talking about a change in the burden of taxes. I was looking at some numbers over the weekend which show that—and these are OMB numbers—the percentage of tax paid, as related to the GNP, is more today than it was in 1980. More today than it was in 1980. Moreover, the shift has been for lower income people to pick up more of the tax—on a percentage basis—than higher income people. And that has to give us some concern as we look at these projections.

Would you care to make any comment on that?

Mrs. KING. Yes, I would, Mr. Chairman. I would only suggest to you that as you look at that broader issue of where revenues should fall you consider that changes to Social Security have always come in the thoughtful context of the kind of expert discussion that looks at the long term impact on the Social Security program. Social Security has never been a program to lend itself to short term fixes.

And certainly if we are talking about the broader revenue picture or even budget deficit reduction, Social Security should not bear the burden of trying to solve all those problems. This is a program that you know has been delicately handled over the years and most of the amendments have come as a result of deliberations by the quadrennial Social Security Advisory Commissions that come together every 4 years.

I would suggest, Mr. Chairman, that even this year, since there is a duly constituted quadrennial advisory council looking at some of these very issues for Social Security, we would do well to await their recommendations as well.

The CHAIRMAN. Well I think we are all agreed that we should not see the deficit masked by Social Security surpluses. And I think Senator Moynihan has provided a service in calling attention to that. But my concern is what replaces the loss of revenue when I look at the overall budget. You could have a very substantial impact there that would be of concern to all of us. That requires, obviously, further probing.

I see my time has expired.

Senator PACKWOOD. Mrs. King, in this argument about progressivity and regressivity, you very carefully and correctly touched upon the benefit structure in addition to the tax structure. It is a very progressive benefit structure.

Would you like to comment also about the earned income tax credit which was of course passed to give back to them the money that they were paying for Social Security taxes.

Mrs. KING. Indeed it does, Senator. When we talk about revenue burden falling on individuals we tend to look at FICA taxes, EITC and income taxes. In this debate—and the reason that I brought it up—is that the unfair comparison has always seemed to fall on FICA taxes and income taxes. And it has been exacerbated by the fact that people have pointed to the amount of payroll taxes paid, not only by employees, but also by employers.

So they have put together an illogical comparison of what an employee and an employer pay for FICA with what an employee alone pays for income taxes. But indeed full earned income tax credits are available to workers who have a child and who earn up to $10,730, I believe, a year.

Credits begin to be reduced by income for over $10,730 this year. The credit goes up every year according to the CPI. And it supplements a $10,700 salary to the tune of some $953. When all of that is factored in, indeed we can see that there is some reduction of the burden on lower income workers.

But again, when we are talking about Social Security I must urge that you consider it as a program that also pays benefits. And on the benefit side of things, lower wage earners do receive back in benefits each month some 57 percent of what they were earning at the time of retirement. And they get back everything they paid into the system, plus interest earned, in 4 years.

Whereas, those on the higher end of the scale receive back in benefits each month only 24 percent of what they were earning and it takes approximately 7 years for them to get a return of what they paid into the system, including the interest earned.

And I would also point out that Social Security does pay disability benefits and pays benefits to survivors. It is not just a tax. And that is the only point on which I have been trying to correct the record. It is not just a tax. It is a social insurance program. And as I have said before, we do not get monthly benefits from the IRS when we retire or when we become disabled. The payroll tax is for Social Security. So we must look at the program in its entirety.

Senator PACKWOOD. Well, the reason I particularly asked you about the earned income tax credit is because I see stories frequently in the press that talk about nothing but the Social Security tax. The stories don't mention the benefits or the earned income tax credit, making it seem as if the lower income people were actually paying all of the Social Security tax and getting none of it back.

Mrs. KING. I know.

Senator PACKWOOD. And that may partially be the fault of the way we account for things in the budget. The earned income tax credit is not found in the same section as Social Security. But if you mean: Do people earning roughly below $10,000 a year technically pay a Social Security tax? Technically, yes.

But do they get it back? Actually, yes, through the earned income tax credit. But happen to be in two different categories.

Mrs. KING. That is true. That is exactly right.

Senator PACKWOOD. Let me ask you a last question about pay-as-you-go. You indicated even if we now to a pay-as-you-go system we are only at about 75 percent of the reserves necessary to keep the system going. Is that correct?

Mrs. KING. Currently, that is right. And our estimates, if we use the alternative II-B assumptions, are that it would be about 1991 before we have 100 percent contingency available. And for those experts who believe—and I am not an expert—but I do too happen to believe that you need probably about 150 percent contingency just to insure safety and that we do not go back to where we were. We will not be there until 1993.

Senator PACKWOOD. Then all we need is 1 year of 8 or 9 percent inflation and 1 year of recession and we are back to 1983.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I thank Mrs. King once again and welcome Mr. Ballantyne.

If I could just make two preliminary points. The bill that we put in at the beginning of this session, as we said we would, will only have a budget cost of $4 billion in this calendar year and next calendar they are scoring it at $38 billion. That is just a clarification.

The other thing is to say that with respect to benefits, if we were to go back to a pay-as-you-go basis, employees, workers today would have that tax reduction for 25 years. We would not go back up to the current rate until 25 years from now—2015—and they would still get the same benefits.

But let me just ask you, you being the first person to come before us in the Congress and the most appropriate person, to comment on the President's proposal in his budget to establish the Social Security Integrity and Debt Reduction Fund. Now without trying to be clever here, I would assume that the President, by proposing that there be a Social Security Integrity and Debt Reduction Fund is implicitly suggesting what is going on now is something less than integrity.

We have heard the word "looting." We have heard the word "embezzlement." But no matter. Could you describe the plan?

Mrs. KING. Yes, of course, Senator. As you know, the current downward glide path for Gramm-Rudman Hollings takes us to a zero deficit in the unified budget in 1993.

Senator MOYNIHAN. Yes.

Mrs. KING. The proposal in the President's budget continues a zero deficit out into the future. Beginning in 1993, each year there would be set aside and included in the budget outlays, an amount of revenues eventually equal to the increase in Social Security trust fund reserves. The monies so set aside would be used only for buying down debt.

And the idea here is that you would create a fund which would stand behind the investment, and that fund could not be used for anything other than buying down debt. And the ultimate purpose, of course, is to ensure a sound economy because it is only to the extent that our trust funds can contribute to national savings and investment and to building a stronger economy that we can reduce the relative burden of future Social Security costs.

Senator MOYNIHAN. Right. And this would be what the GAO proposed as the preferred alternative?

Mrs. KING. Yes. Well, I suggest again that within the context of the current law—Gramm-Rudman Hollings—that downward glide path to 1993—a set path—so many of the——

Senator MOYNIHAN. Could I ask you then when you get back—and Mr. Ballantyne you sit down and get your pencils out—could you tell us how much of the trust funds will be used as general revenues between now and the time when you have a true balanced operating budget and all the surplus goes into the buying down debt, if you follow me?

Because clearly you anticipate using trust fund revenues for general purposes of Government between now and the final moment of that plan. Which is out to 1996, is it it?

Mrs. KING. Yes. Because the original proposal will come in three increments of 15 percent——

Senator MOYNIHAN. Could we get that information? It would help the committee a lot.

Mr. BALLANTYNE. Sure.

[The following information was subsequently received for the record:]

The following table shows the amounts of offsets to the deficits in the President's 1991 Budget that are attributable to the annual increases in the combined OASDI and DI Trust Funds during fiscal years 1990-95. The figures for fiscal years 1993-95 reflect the effect of the Administration's proposal to establish a "Social Security Integrity and Debt Reduction Fund."

Fiscal year	Amount (in billions)
1990	$62.0
1991	80.3
1992	93.1
1993	93.2
1994	70.7
1995	35.4

Senator MOYNIHAN. Thank you.

The CHAIRMAN. Thank you very much.

Senator Dole?

Senator DOLE. I just wonder, as a practical matter, if you are getting any reaction to this proposal. Are you getting any letters or phone calls?

Mrs. KING. Very few, Senator. I did poll our 800 telephone number. We have minimal response there—approximately 60 calls that we could count as of Friday.

Senator DOLE. I think we have had two. The media plays this up every day. They must be calling each other. [Laughter.]

No one is calling us, but maybe the media can call us and get our numbers up. I think it was a slow day the Friday this story broke and it was a slow weekend, and then Moynihan left the country. When he came back he had all this firestorm created.

I seriously wonder if there is a lot of support for this proposal. I have had town meetings since it was introduced and I think most people do not want to make any changes. I think, Mrs. King, that is what you indicated in your statement. The Boston Globe was 7 to 1.

Mrs. KING. Seventy-two percent of those polled in the Boston Globe poll indicated they do not want to reduce pay roll taxes. The other poll that we cited, the Wall Street Journal poll, indicated that some 53 percent of the people polled did not want to lower those taxes.

Senator DOLE. I think, following up on the very valid point made by Senator Heinz, that if this bill passed half the cut would go to the employer—General Motors, Fortune 500. Have you figured out how much employers might get back?

Mrs. KING. Not in total. But what we have taken into account—half, of course.

Senator DOLE. Well, half, yes.

Mrs. KING. What we have taken into account is that currently no one talks about the fact that employers also write that off when they file their income taxes as well. And the charge that that money would go back to the employees has not held true yet.

Senator DOLE. I have been told that 60 percent of the benefits would go to companies with 10,000 or more employees. That is a pretty good size business. So I think there is that consideration, as well.

In addition, if I understand the Moynihan proposal correctly, there is a tax increase involved in the out years. You do ultimately have to raise the payroll tax.

Senator MOYNIHAN. 2015 you move back up towards where we would otherwise have been for 25 years.

Senator DOLE. Right. So, I think Senator Moynihan's proposal is something there are a lot of questions on. I am going to ask that I might submit some questions for the record—we have a Clean Air meeting going on in Senator Mitchell's office—questions for Bob Ball and Bob Myers and Mr. Bowsher.

The CHAIRMAN. Correct.

Senator DOLE. Thank you.

[The questions appear in the appendix.]

The CHAIRMAN. Senator Heinz?

Senator HEINZ. Mr. Chairman, thank you.

Commissioner King, the Administration's proposal is certainly complicated. If we were to devise something clearer, that made sure that Congress did not continue to engage in what Pat Moynihan and I have described as deficit deception, and which put the Social Security trust funds in an appropriate status where people could not get their hands on them for unintended purposes, do you know if the Administration is wedded to the specifics of the so-called Darman plan or is it willing to entertain a reasonable alternative to it?

Mrs. KING. Senator, I believe the Administration is open to every reasonable alternative. I think Director Darman made that clear to Senator Moynihan. I think he has made it clear every time he has spoken publicly about it.

Our concern is protecting the trust fund and ensuring the continued sound financial footing that this committee, and the Congress, and the Administration have seen Social Security on for the last 7 years. We simply do not want to go back.

And while I am not here suggesting that I will thereby cut a deal with every great suggestion that comes to the floor, I am suggesting that the Administration is willing to work cooperatively with this committee and with anyone who has an interest to try to solve this problem.

We must do it, again, in the context of protecting that trust fund and certainly not adding immeasurably to the deficit that we are struggling with. Because therein we undo all the good work we could do.

Senator HEINZ. In my opening remarks I referred to Table 32. Table 32 is provided to us by the Social Security Administration, Office of the Actuary, dated January 31 of this year. It is an analysis of the effects of the Moynihan plan on the Social Security's net increase or decrease in funds and on the funds at the end of the year, assuming the adoption of the Moynihan plan——

Senator MOYNIHAN. And assuming Alternative III.

Senator HEINZ. Yes, I am going to get to that. As I read Alternative 3, starting in 1992 if we adopted the Moynihan plan, and if the assumptions of Alternative 3 were correct or represented the most likely scenario for the future—and that is another issue—is it not correct that we would see net decreases in Social Security funds every year beginning in 1992 on through 1998 in ever increasing amounts?

Mrs. KING. That is correct, according to this chart, using Alternative III assumptions, Senator.

Senator HEINZ. Well let me—I have a couple of questions I want to ask you.

Mrs. KING. The answer to your question is yes.

Senator HEINZ. Secondly, is it not accurate—if I understand this chart correctly—that again if we adopted the Moynihan plan that the system would be totally out of funds sometime in 1998? Isn't that what the −6.1 billion means in the third column over from the right? That there would be a negative fund balance.

Mrs. KING. Yes.

Senator HEINZ. And therefore it would be accurate to say that under these circumstances, if we adopted the Moynihan plan, the Social Security system would not only be in common parlance bankrupt, but you would be unable to issue a single benefit check as long as there was a negative balance; is that correct?

Mrs. KING. You are exactly right, under Alternative III assumptions, Senator. Because if the trust fund is in a negative balance, the law does not allow for the Federal Government to pay those benefits for us.

Senator HEINZ. Now, obviously, then it is not Senator Moynihan's intention to cut off benefits to Social Security beneficiaries. He has a very different objective, I think, which is to stop what he calls thievery and I call embezzlement.

By the way, I would like to make clear, Senator Moynihan and Senator Bentsen, for the record, the difference between thievery and embezzlement just in case the Senator from Texas, I think, said there is a difference that is the one that has been ascribed to Senator Moynihan. It is this: Thievery is thought to be rather petty and opportunistic and every day. Embezzlement usually deals with serious sums of money and is thought to be a premeditated white collar crime.

I notice that that describes members of the Congress and the Administration better than it does the average working person. And so I would only make the point, for the record, that while I think the intent of our descriptions is met in either case, embezzlement fits this crime better than other terms, notwithstanding a certain, shall we say, white collar versus blue collar differentiation between the two.

Senator MOYNIHAN. Granted. [Laughter.]

The CHAIRMAN. Senator Symms?

Senator SYMMS. Thank you, Mr. Chairman and Mrs. King. Do you have any figures—and maybe Mr. Ballantyne might have them—but comparing how a young worker would do on investments today at various rates of return if all of the Social Security contributions could be saved in a defined contribution account? That is the first question.

The second question: Does a young worker who will retire about 35 years from now, do you project that they will get anywhere near as good a deal as the current retirees are getting?

Mrs. KING. Harry, would you like to respond?

Mr. BALLANTYNE. Okay.

Senator Symms, we do not have with us an answer to your first question but we could look at that.

Senator SYMMS. I would appreciate it if you could get that.

Mr. BALLANTYNE. On the second question, the return would not be as favorable for people who retire in the future as it is today because of increasing tax rates. But considering only the employee's share of the tax, it would still be a favorable return for a young worker retiring in the future.

We could supply figures for that as well.

Senator SYMMS. All right. Thank you.

[The figures follow:]

ACCUMULATED VALUE OF A WORKER'S OASI CONTRIBUTIONS AT AGE 67, FOR A WORKER AGED 20 IN 1990 WHO HAS LOW, AVERAGE, OR MAXIMUM EARNINGS IN 1990-2036, FOR VARIOUS RATES OF INTEREST

[In thousands]

Annual interest rate	Level of earnings		
	Low	Average	Maximum
6%	$339	$754	$1,796
7	428	952	2,267
8	548	1,218	2,900
9	710	1,577	3,757
10	930	2,067	4,924

Note Average earnings are assumed to be $21,537 in 1990 "Low" earnings are assumed to be 45 percent of average earnings "Maximum" earnings are the maximum earnings subject to the OASI tax rate—$51,300 in 1990 All levels of earnings are assumed to increase at an annual rate of 5 5 percent after 1990 The OASI tax rate for an employee is 5 6 percent in 1990-99 and 5 49 percent in 2000 and later

Year of retirement	Normal retirement age	Number of months to recover OASDI contributions, with interest		
		Low	Average	Maximum
1990	65	48	67	86
2010	66	81	111	153

Notes

1 Contributions are accumulated at rates equivalent to the average effective yield on investments in the OASI and DI Trust Funds in each year

2 Future annual increases in earnings and benefits and the future annual interest rates are based on the alternative II-B set of assumptions in the 1989 Annual Report of the Board of Trustees

3 Only employee contributions are considered in the above examples

4 Life expectancy at age 65 in 1990 is 181 months for males and 227 months for females Life expectancy at age 66 in 2010 is 181 months for males and 230 months for females (The "normal retirement age," or the earliest age at which full-rate benefits are payable, is 66 in 2010)

Senator SYMMS. Mrs. King, I share your view about Government bonds being secure investments. Even though I agree with that, would you agree with me that Government bonds are promises by Treasury to allocate tax dollars at some future date and they do not really represent true capital formations such as what private sector bonds do?

Mrs. KING. Senator, while that is true, it may not be the whole truth in the instance of a Social Security trust fund. Because what we would not—I don't believe—want to see is the benefits of 39 million beneficiaries of Social Security today of the 70 million beneficiaries expected at the height of the baby boom rising and falling with the numbers from Wall Street.

When we talk about a safe investment we are talking about an investment backed by the full faith and credit of the United States. It is the reason that T Bills are owned, not just by individuals in this country, but by banks and businesses and pension funds and foreign governments as well.

Senator SYMMS. But if you agree that they do represent an allocation of tax dollars in some future year, don't you have to agree in part at least with Senator Moynihan that the surplus is really a bookkeeping device? Because at some point in time this has to be paid for.

Mrs. KING. Well it is as much a bookkeeping device as any bank account is a bookkeeping device. It is not a situation where we take the money and put it in an iron box and stick it in a closet or slide it under the bed. But when you look at any investment, when you look at any monies that you put away to earn interest, whether it is in a Government insured bank account or some other investment, what you are doing in effect is expecting that investment to grow.

And people who place their assets with U.S. backed obligations expect their assets not only to grow but to be safe as well.

Senator SYMMS. Well I appreciate that. I want to ask another question with the projections say to the 110th or the 112th or 113th Congress will be facing say down the road 20 to 25 years from now. What assumptions did you make with respect to immigration? What would be the case? Did you assume there would be zero immigration?

Mr. BALLANTYNE. No, Senator Symms. We have assumed that ultimately there will be a total of 600,000 per year net immigration into the country for our intermediate alternative II-B assumptions.

Senator SYMMS. And at what age group do you assume that those people would be eligible?

Mr. BALLANTYNE. Well, we have them at various ages. There are some limited data on that, and we do have a reasonable age distribution for those who are coming into the country as immigrants.

Senator SYMMS. Well it seems to me that if the immigration—if the age of people that come in are workers, well you are going to get a positive impact on the transfer payment in the system as it—the immigration would be a very positive net impact. So that in Senator Moynihan's bill one of the differences between his proposal and mine is that I give your trustees the authority to increase or lower the FICA tax rate as needed to keep an 18 month fund balance for the current beneficiaries and current benefits that are now in the system.

He is assuming that you may have to have an increase at the year 2010. But it seems to me like it might be possible that we might get to the year 2010 and you would not need an increase.

Mr. BALLANTYNE. Well that is possible. We do not think it is very likely under Senator Moynihan's proposal that we would not need it around 2010 or soon thereafter.

Senator SYMMS. You are assuming though that there will only be 600,000 people coming into the country.

Mr. BALLANTYNE. Right.

Senator SYMMS. And you are projecting what for birthrates? I think my time is up.

Mr. BALLANTYNE. Well for the Alternative II-B assumptions it is 1.9 children per woman, which is about where we are today.

Senator SYMMS. All right. Thank you very much, Mr. Chairman.

Senator MOYNIHAN. May I simply say to Senator Symms and Commissioner King that when you said that a banking arrangement is just, you know, bookkeeping too. If a bank were to accept deposits and spend those deposits entirely on the salaries of the officers of the bank, it would not exactly be saving your money would it?

Mrs. KING. No, Senator, it would not. But again, all I was talking about was the bookkeeping.

Senator MOYNIHAN. That's right, bookkeeping. But we have run into some of those banks.

Mrs. KING. Yes, in fact. And we did not exactly call them banks, but we want to in the future.

Senator SYMMS. Thank you, Senator Moynihan.

Senator MOYNIHAN.The Senator from Michigan, Mr. Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

I think another way to express that point would be in a private company. Senator Moynihan, if a company took the retirement program of the workers, that the workers were paying into, and took and in effect looted the retirement program and spent it on other things—the day-to-day operations of the business—and then later on down the line the money was not there to pay the retirement benefits you would have something analogous to what is happening here.

And I must say——

Senator MOYNIHAN. It is what Senator Heinz calls embezzlement.

Senator RIEGLE. Yes.

Senator MOYNIHAN. And what happens to people who do that? This is not for you to hear Mrs. King.

Mrs. KING. That is perfectly all right, Senator.

Senator RIEGLE. I thought Senator Heinz was revealing some of his Harvard Business School training there when he used that phrase; and maybe I was using my background from Flint, Michigan when I used the phrase "looting" in terms of the——

Senator HEINZ. The record ought to show that Senator Riegle is no stranger to the Harvard Business School. But he has overcome it. [Laughter.]

Senator RIEGLE. Thank you.

Mrs. King, I think you have an obligation to go beyond what you have said here today. I say that respectfully. I think you have an obligation to blow the whistle on what is happening here. Because I think what is happening here is far more serious than the way it is papered over. And it is not just the Social Security trust fund.

If you look at all of the trust funds that the Government manages, we are systematically milking all of the trust funds today and using the surpluses for other activities of Government and not really facing up to it. We are reporting lower deficits. We are doing that with respect to the Highway and Airport Trust Fund, the Military Retirement Fund, and so forth.

It just happens that Social Security is the largest area trust fund where this is happening. If you look at the actual Federal funds deficit, which I consider to be a much truer measure of our Federal budget deficit year by year, for fiscal year 1990 the deficit is $270 billion according to this document put out by the Congressional Budget Office. I assume that is not a strange number to you. And it keeps rising as you go out in terms of the baseline—$273 billion in 1991; $280 billion in 1992.

I think you have an obligation not just to manage the Social Security fund properly from an actuarial and check printing point of view and so forth, I think you have an obligation to understand what is happening to the trust funds.

If the trust funds are being spent and replaced with an I.O.U. that the workers themselves are going to be asked to pay off in the future, at some point I think you have an obligation to say that. It is not just to run the machinery; it is to really take a look at the question of whether or not we are creating a liability for workers in the future.

It is very interesting—if you look at this chart. This chart has been done by the Senate Budget Committee and it shows—in reference to a point I was making earlier—the effect of the tax law changes during the 1980's, from the period of 1980 to 1988. And these 10 columns show each 10 percent of the income levels of the people of the United States who have had their taxes either go up or down.

And as Senator Moynihan would know, if you look here, the people who earn the least amount of money—the lowest 10 percent of wage earners in the country—have seen their tax burden go up. Then as you come across here, the second 10 percent group and the third and so forth, you see up to the halfway point, all of those families have had their net taxes as a percentage of family income go up. And as you get out here into the high income levels, all the way out finally to the final 10 percent, who are the highest income earning families in the country, they have a very substantial tax cut.

The reason that this chart looks this way is you have the basic tax cuts offset by the Social Security tax increases. So we have a very substantial redistribution of the tax burden going on in the country where the people who earn the least, percentage wise, are paying more and more taxes.

And if that were not bad enough, we have the problem of the Social Security surplus being spent on other things and then needing to be repaid in the future. And you have not said anything like that here today.

Now I am all for people investing in Government bonds as well. But if you are running an actual Federal funds deficit of anything above $200 billion, and approaching $300 billion, anybody who understands mathematics—and you folks are experts at it—has to realize that somebody is going to have to pay that money back in the future.

Now where is it going to come from? Who is going to redeem all these I.O.U.'s that you have in the drawer these days?

Mrs. KING. Senator, as you well know, under Section 201 of the Social Security Act, we are required to invest dollars paid into the trust funds in U.S. backed securities.

Senator RIEGLE. I understand that. But that does not relate to the fact that we are running deficits at these levels.

Mrs. KING. And we are running deficits. And I would respectfully suggest that budget deficits must be addressed. And the question of what we accomplish through reducing Social Security payroll taxes is something that we are facing by the discussion we are having here today.

The question of what we do about budget deficits I think is a very relevant one. That is the one that I have indicated to Senator Heinz and to Chairman Bentsen and to Senator Moynihan that we want to work cooperatively on. But I would suggest to you that the American people understand their investment in Social Security, which has paid benefits for the last 50 years, and which they have seen work for their parents and their grandparents; they understand that the changes made in 1983, in effect, were going to provide some partial intergenerational payment of what could be a very steep bill in the future.

They were willing to do that. I do not think that is the part of the problem that we need to focus our energies on. It is the other part of the problem that is getting away from us. It is not Social Security.

Senator RIEGLE. Well let just say one other thing, if I may, Mr. Chairman. I will be very brief.

If you were to put a plain language insert into next month's Social Security checks and also send it out to the wage earners that are paying in their Social Security taxes now, and said, "By the way, we in Social Security would like you to know that we are taking the trust fund surpluses, we are investing them in Government notes, and they are being used to pay the normal activities of Government, totally unrelated to Social Security, and we are incurring a huge debt in the future, and we want to be honest with you and just warn you that you may have to pay twice. You are paying in your Social Security payments now and we may very well have to come back—as we are almost certainly going to have to—and ask you to pay a second time in the future to redeem the I.O.U. that is owed to you in terms of your benefits."

I think if you were mandated to put that disclosure in the envelopes—and something like that needs to be sent out. People do not understand this. It is too complicated. I think you have some obligation to uncomplicate it. I say that not just to you personally. But I think the Social Security Administration has an affirmative obligation to help people understand what is going on here. I do not think people presently understand it. I do not think they think these funds are being drawn down that way and replaced by an

I.O.U. which in many cases they, themselves, are going to have to repay a second time.

I thank the Chairman.

Senator MOYNIHAN. Gentlemen, let's hear it for Ida Mae Fuller, the first Social Security beneficiary. She paid $22 into the fund and she retired in January of 1940 and collected benefits for 25 years. That is what widows are like up in Vermont. [Laughter.]

Commissioner, we thank you so much for your coming. As always, you have been open with us. You know you have a friend and supporter in this committee. You are earning our confidence at a rate accumulating as fast as the Social Security reserve itself.

We would like to hear as early—at your convenience and Mr. Ballantyne's—your assessment of the money flows, cash flows, if you like, in what we will call the Darman plan. Is that all right?

Mrs. KING. Yes.

Senator MOYNIHAN. Thank you very much.

Mrs. KING. Thank you.

Senator MOYNIHAN. Thank you, Mr. Ballantyne. It is always good to see you, sir.

Mr. BALLANTYNE. Thank you.

Senator MOYNIHAN. And now for our second witness, it is a very special privilege for us to have the Comptroller General of the United States, Mr. Bowsher; and Mr. Lawrence Thompson is with him, who is the Assistant Comptroller General, and who was particularly associated in the preparation of the report which we mentioned earlier.

We welcome you, Mr. Bowsher and, of course, Mr. Thompson, and would you proceed, sir.

STATEMENT OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY LAWRENCE H. THOMPSON, ASSISTANT COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

Mr. BOWSHER. Thank you very much, Mr. Chairman. It is a real pleasure to be here to discuss this very important issue. As you know, we have been trying for 2 or 3 years to make well known just how much masking is taking place with the Federal deficits.

In other words, we have been very concerned at GAO that we are using so much blue smoke and mirrors in trying to convince everybody that we are meeting the Gramm-Rudman targets that I think we are doing the country a disservice. And last year, I put a chart together to point this out to the Secretary of the Treasury—the new Secretary of Treasury—and the new Director of OMB.

I pointed out to the two of them in November of 1988 that they were inheriting a Federal Government—the Bush Administration—that was in much deeper financial trouble than what the official records indicate. I also took along that day the OMB reports from 1977 and 1981 and pointed out just how optimistic the official figures looked when President Carter and President Reagan came into office. So I said to them, the deficit is much greater than what these official numbers indicate.

Now I have updated this chart for this hearing, and it is the next to last page in my testimony. I would like to quickly walk you through that chart because I think to a great extent it describes the problem that we are facing here today.

If you look at the top two lines you see the revenues, the outlays, and next the total deficit. That is on the unified budget basis. You can see that this is using CBO estimated numbers in the out years, but it is using actual OMB numbers for fiscal year 1985, fiscal year 1986 and fiscal year 1989.

Now if you go down to the bottom line you will see the same numbers. But then let's work back up. In other words, if you work back up on fiscal year 1985, which was the year before our Gramm-Rudman process began, we were using only $9 billion of Social Security trust funds as surplus in computing what the unified deficit was. We were using $45 billion of other trust funds, as Senator Riegle pointed out, so we had a $54 billion trust fund surplus in total, which brought us down to that unified deficit of $212 billion.

Of course, that was the figure that worried everybody in the summer of 1985 because it showed how big the Federal deficit had gotten.

Now if you look across to 1989 you will see that our total deficit, officially, is $152 billion. But again, if you work up you will see that now we have $52 billion of Social Security trust funds; we have $71 billion of other trust funds; and so by borrowing those $123 billion we compute the $152 deficit; but we are really running a $275 billion deficit, which shows that we have not really made any progress on the Federal funds deficit, or what I call the general government operations deficit.

Now if you move to the out years where you see fiscal year 1990, fiscal year 1991, fiscal year 1993 and fiscal year 1995, and if you look at the Federal funds deficit line, you will see that in 1995, according to the CBO figures, you will be moving up to a $303 billion Federal funds deficit, but that would be masked by a $128 billion Social Security surplus and $57 billion of other trust fund surpluses. You can see there that the other trust funds really are not growing that much. It is really the Social Security trust fund that is growing significantly. This results in a net or unified deficit of $118 billion.

Now OMB, of course, presents the deficit somewhat differently. They say we will be down to a unified balanced budget in 1993. I think it is important to emphasize, though, how much debt are we going to add if we accept the numbers of the Gramm-Rudman process. If we accept those numbers we are going to add about a trillion dollars to the debt between now and 1993, going up to $3.9 trillion in 1995. And if we accept the CBO numbers, we add about $1.5 trillion. So we would be up to $4.5 trillion in debt.

Now if we were to pass your legislation we would add another $300 billion. So you can see, many people focus only on what this proposal would do to the deficit. But I think you also have to recognize that we are on a budget reduction plan that is not really reducing the budget as far as the general funds of the Government are concerned.

As the debt is increases, we are also running the interest costs up at quite an amazing pace. The interest cost in the Treasury report for the year just ended is $240 billion. It is now the second largest item in the Federal budget. This $240 billion includes what we owe to the trust funds, so we have to make that entry.

If you accept the numbers of CBO and add that $1.5 trillion of debt you will see your interest costs go to $334 billion. It could well pass the defense and all other items in the Federal budget. So I think the real problem we are facing here, and I think the one that you tried to highlight with this proposal, is how poorly we are doing on the budget reduction and on using the Social Security surplus funds for real net savings.

We are not making progress and that is why I think we have to solve this problem. In other words, I think that if we could get the general fund of the Government in balance, then as Senator Symms quoted from our report, we think the present plan to accumulate reserves, as devised by the Commission in 1983, is a very valid plan for the Social Security trust fund.

But if you are going to use this money just to pay current operating bills indefinitely then these figures indicate to me that you are doing nothing more than using Social Security income to meet general government operations.

Now, Mr. Chairman, I think that the concerns that we have expressed here and in our report do indicate that the real problem is in the budget for the rest of the Government—in the general funds. We would hope that this problem could be solved by a multi-year, bipartisan, plan to reduce the budget deficit.

I am often asked the question: Would you have to look at the revenue side? I do believe that if you have a deficit this large, it is hard to exclude the revenue side.

I think, though, where we ought to start is with the Treasury report last year which highlighted the increase of the major items to $80 billion. What makes up the $80 billion? It's defense, it's interest costs, it's health care, it's agriculture, it's the savings and loan problem. What you had in there was a $10 billion surplus on the Social Security income versus the Social Security outgo.

Mr. Chairman, I think these are the major points that we would like to make. We would be happy to answer any questions any of you might have.

[The prepared statement of Mr. Bowsher appears in the appendix.]

Senator MOYNIHAN. Well thanks a lot. No one has ever accused you of ambiguity, sir. We appreciate that very much. Those are devastating numbers and they just show us living off trust funds to an extraordinary degree.

Can I ask two things? First of all, it does legitimately characterize your study for us last year that you said, save this money or go back to pay-as-you-go.

Mr. BOWSHER. That is right. Our first preference is to save the money.

Senator MOYNIHAN. Is to save the money.

Mr. BOWSHER. To buy down the debt, yes.

Senator MOYNIHAN. You could not have been more clear.

Mr. BOWSHER. That is right.

Senator MOYNIHAN. As our Comptroller General, would I be fair to suggest that you find it simply inappropriate to be using trust funds for purposes other than the trusts for which the trust was created?

Mr. BOWSHER. Yes. We put out another booklet this year recommending a new way of summarizing the Federal budget because of this concern. We think it should be split into three major categories—the general government operations, the trust funds, and the enterprise funds—and still have the total column to show the unified budget. But then you would see exactly what progress you are making.

I think that would be full disclosure, which is what you really want and what the average worker in this country expects when he looks at a set of financial statements, whether it be from his company or from a bank or from the Government, I think.

Senator MOYNIHAN. He gets the full disclosure.

Could I ask you this. This may be just a little speculative. The President's budget has given us a Social Security Integrity and Debt Reduction Plan which presumably gets to a completely balanced operating budget by 1996. That is implicit as far as I can see—a true balanced operating budget--not counting Social Security.

Mr. BOWSHER. Yes, in the non-Social Security budget.

Senator MOYNIHAN. Yes.

Mr. BOWSHER. I believe it still has the other trust funds in there.

Senator MOYNIHAN. Yes.

Do you think that is doable at the rate we are going?

Mr. BOWSHER. Well the CBO, which is the organization for the Congress that makes the projections on the budgets, would indicate that you are not going to get there. In other words, they are showing a Federal funds deficit of over $300 billion.

Senator MOYNIHAN. Yes, $300 billion at the year—just before the year we are supposed to be at zero.

Mr. BOWSHER. That is right. Then you would offset that by $128 billion of Social Security trust funds and get down to the net.

Senator MOYNIHAN. But I would have thought—and perhaps you will give us an explanation—can we ask you, Mr. Thompson, to give us an explanation of how you see the cashflows with this integrity fund. Because if the integrity fund is to be integrity——

Mr. BOWSHER. Well I think what they are——

Senator MOYNIHAN [continuing]. There would have to be an effective surplus of $128 billion at that point.

Mr. BOWSHER. I think what they are trying to do is when they get to a balanced budget—and they are basing it on the Gramm-Rudman process is what they are doing—they are making the assumption that they will achieve those targets. Then they are making the assumption that they will gain the further surpluses that would equal the Social Security trust fund and then what they want to do is protect the Social Security surpluses at that point in time.

The two major problems I have with that are that we are adding so much debt between now and then——

Senator MOYNIHAN. Another trillion.

Mr. BOWSHER. Another trillion. Really another trillion and a half before you really start to address the problem. I think that is a very worrisome situation. Then you have to buy that debt down with Social Security trust funds surpluses and all. So you have added another trillion and a half to the problem.

Senator MOYNIHAN. But you do agree that statistics prove that the U.S. Government budget is always balanced 3 years from now.

Mr. BOWSHER. That is the point I made to Mr. Darman and Mr. Brady, using the OMB reports in 1977 and 1981, and that it always looks good 3, 4 years out.

Senator MOYNIHAN. But it is true. It is always balanced in 3 years.

Mr. BOWSHER. That is right.

Senator MOYNIHAN. It is just never now.

Mr. BOWSHER. Yes.

Senator MOYNIHAN. Thank you very much, sir.

Senator PACKWOOD. Mr. Chairman, let me make sure I understand what you want to do with the money. You would prefer not to cut the taxes. You would prefer to actually keep the taxes and invest them in something solid.

Mr. BOWSHER. That is right. And with having such a large debt that I think you get net savings by paying down on the debt.

Senator PACKWOOD. You would have the Social Security fund buy existing debt?

Mr. BOWSHER. That is correct.

Senator PACKWOOD. So that they would still hold Treasury notes?

Mr. BOWSHER. That is correct.

Senator PACKWOOD. And presumably——

Mr. BOWSHER. But this is the debt to the public. In other words, you have so much debt out to the public, and if you finally got your general budget in balance and you had surpluses coming in on your trust funds, then you could literally buy down some of the debt that the other people have bought in the public, including some of the people overseas.

Senator PACKWOOD. I hear what you are saying. But you are going to have them buy existing debt, existing notes that are already out?

Mr. BOWSHER. Yes. What you really would not do is refinance some of the debt that you already have out there.

Senator PACKWOOD. Okay.

Mr. BOWSHER. Yes.

Senator PACKWOOD. So you are still going to presume at some stage that whatever it is Social Security holds will be redeemed by the Government whether they buy existing debt or not?

Mr. BOWSHER. Absolutely.

Senator PACKWOOD. Okay. That is what I thought.

Mr. BOWSHER. Now I do have one worry that on that, Senator Packwood. That is, if you continue on the budget glide path that we are on right now and keep adding to this debt, then you have a real problem down the road as far as making payments to the people who want to get their money back on that, plus making payments to people on Social Security.

In other words, you do run into the problem that some people have raised about the I.O.U.'s because at some point it is going to take an awful lot of financing to satisfy both the debt holders and the people who have claims on the Social Security system.

Senator PACKWOOD. Let me ask you this.

Mr. BOWSHER. So I am saying, that is why I think we have to get our fiscal house in order.

Senator PACKWOOD. Let's assume theoretically that we cut the payroll tax sufficiently; that we go to a pay-as-you-go system now as well as for the next 20, 30, 40 years. At some stage in the future you are going to have to raise taxes a whale of a lot to make the payments.

Mr. BOWSHER. You are going to have to raise taxes if you cut it now to keep on.

Senator PACKWOOD. In your opinion, which is more likely to guarantee future Social Security benefits—Social Security holding Treasury bonds, which every Treasury Secretary will say we've got, and which we cannot renege or the United States credit will go to hell—or a hope that future taxpayers would increase the taxes on themselves to pay the Social Security benefits?

Mr. BOWSHER. It is very hard for me to make a judgment on the best timing for the tax. But I think the important thing is that if we do not close this gap right now that we are digging that financial hole deeper and deeper.

Senator PACKWOOD. I agree with you. Let me ask you one last question now. At the moment, people say we need to raise the taxes to finance the debt. Indeed Social Security taxes are taxes and we are paying for the debt with these taxes. Let's say we went to a pay-as-you-go system, eliminating the roughly $55 billion surplus in Social Security taxes next year. If we keep it pay-as-you-go, we increase our annual deficit. We just change the Gramm-Rudman totals and borrow more.

Which would be better for the economy? Going to the pay-as-you-go system now and simply increasing our borrowing, or keeping the present system of collecting the surpluses and investing them to reduce the current deficit?

Mr. BOWSHER. Well I think if you do nothing but just reduce the Social Security income then you are adding to the problem and then you are adding to the financial risk, I think, in financing your debt.

Senator PACKWOOD. Thank you very much, Mr. Bowsher.

Mr. BOWSHER. What I would hope is that this proposal could force what the original intent was of Gramm-Rudman and that is for the decision makers to come to the table, put everything back on the table and solve the budget problem or come much closer than we are now. That's really the real answer.

Senator PACKWOOD. Thank you very much. I appreciate it, Mr. Chairman.

Senator MOYNIHAN. Mr. Bowsher, may I just point out—the record probably should have this—that spring a year ago there was the continued talk all over this Capitol, was that later in the year we would have a grand accord, that it would—people downtown said they knew they had a pretty hokey budget, but it was not theirs really. The next one will be a real budget and it will come about in the aftermath of a grand accord; and then no grand accord occurred. Most importantly, none was attempted.

Instead, they looked at the Social Security surpluses and said, "That is our answer." Well, obviously, we do not think so. But I thank you.

Senator Heinz?

Mr. BOWSHER. If I could make just one comment on that.

Senator MOYNIHAN. Yes, sir.

Mr. BOWSHER. I often say this is very similar to New York City. A lot of people do not think it is because they think we have the printing press. But you have to sell bonds before you run the printing press. I think that what the Government needs is a jolt of some sort to force this issue.

I think last year with the S&L crisis there would have been hope that people would have recognized it. But what we did is exactly what New York City did in 1973 and 1974. We moved operating costs over and we sold bonds. In other words, just like New York City balanced their budget by moving operating costs to the capital budget, and then they sold bonds and said, well, look, we balanced our budget.

That is what we did last year. When we closed up the books for fiscal year 1989 and we also declared that we met the Gramm-Rudman targets, it was all based on off-budget financing and phonying up some of the numbers so that we could declare a victory.

Senator MOYNIHAN. Phonying up, did you say, sir?

Mr. BOWSHER. Phonying up. That is right.

Senator HEINZ. What is the difference between thievery and embezzlement?

Senator MOYNIHAN. The grand accord is emerging despite.

Senator Riegle?

Senator RIEGLE. Just for one minute. We tried very hard to avoid that.

Mr. BOWSHER. Yes, I know, Senator.

Senator RIEGLE. You testified very importantly before the Senate Bank Committee.

Mr. BOWSHER. Yes.

Senator RIEGLE. We tried to make sure that it was handled on budget, that we got the lower financing costs. We got part of it handled that way, although it had to be put behind us a year. But for the lion's share we were not able to win the support of the Administration. So we did precisely there what is happening here—that is, out of sight, out of mind. And in that case, there even was a financing premium.

I thank the Chairman.

Senator MOYNIHAN. Thank you, Senator Riegle.

Senator Heinz?

Senator HEINZ. Thank you, Mr. Chairman.

Mr. Bowsher, I would like to ask you a couple of questions about the economic assumptions that we use to project the health of the Social Security system. In my opening remarks I indicated that I felt that there was a terribly high degree of optimism in the assumptions that most people use, assumptions so- called II-B when we talk about the health of the trust fund.

As I look at the assumption about real GNP all the way through the year 2000, II-B assumes that there will be no recession and no economic down turn. Would that be a correct characterization of those tiny little numbers on page 25?

Mr. BOWSHER. I think that is correct.

Senator HEINZ. Would you say that that is a realistic assumption? What are the chances of going 12 years without either a recession or an economic downturn? Would you say they are a little slim?

Mr. BOWSHER. Well I think if you look at the top there you see the history of the previous years. You can see that we generally run into a recession. It was amazing here in the 1980's that we did not. So what you would be banking on is another decade, literally, of the same type of growth.

Senator HEINZ. In that period, 1975 through 1987, as you look at those numbers, how many downturns or recessions did we have? I see three of them—1975, 1980 and 1982.

Mr. BOWSHER. That is about right, yes.

Senator HEINZ. Now obviously interest rates are rather important. Alternative II-B assumes an average interest rate over the next 10 years of 7.1 percent. By the way Alternative III, which is thought to be a draconian set of assumptions by some, assumes an interest rate of about 8 percent, and presumably the performance of gross national product and interest rates does have a quite close relationship.

As you look at the Table up above, how many times in the last 8 years—that is to say between 1978 and 1987—how many times have interest rates been under 8 percent?

Mr. BOWSHER. Only once. I think what you are seeing——

Senator HEINZ. What year was that? Between 1978 and 1987, when were they——

Mr. BOWSHER. If I can read it right, I think it is 1978 or 1977.

Senator HEINZ. It is only in 1977.

Mr. BOWSHER. Yes, 1977.

Senator HEINZ. So the answer is: not once have interest rates during that 10-year period been under 8 percent. Yet that is the assumption of III. Would it be a fair or unfair characterization to say that II-B, which assumes interest rates of practically a percentage point, given all the borrowing that you have talked about that we have done over the last 10 years, would you say that interest rates are likely to be closer to 7.1 percent or 7.7 percent or 8 percent and above?

Mr. BOWSHER. Well Paul Volker told me one time never to estimate interest rates. So I think I had better take his advice. But I will grant this, that I think with what you are looking at with the pressures from the capital markets, to assume that you are going to go down too much on interest rates I think is more hope than it is——

Senator HEINZ. Reality.

Mr. Bowsher—reality, possibly. Of course, I would also like to point out one of my main concerns with some of the numbers that the Administration uses in projecting the budget and the trends there, because they are down there at 5 percent and I think we should be realistic. I think, again, Senator Riegle would agree with me, that one of our problems last year on the S&L problem was trying to get some realistic assumptions which were all tied to the President's budget submission the previous year.

I think again I would much sooner see on all these difficult situations realistic assumptions.

Senator Heinz. I think all of us here agree. The reason this is so pertinent is that if we get this wrong, the Social Security system goes bankrupt.

Now one last question has to do with something that is rather a mouthful. It is called the "real wage differential." It is the extent to which, annually, wages rise faster than prices. And of all the assumptions that are pertinent to Social Security, the assumption about the real wage differential is critical. Because if wages rise faster than prices you do not have to be a Ph.D. in economics to understand that more wages rising faster means more income, lower inflation means less outgo.

May I have 30 seconds, Mr. Chairman?

Senator MOYNIHAN. Sure.

Senator HEINZ. In the II-B assumptions, my rough analysis is that the real wage differential average roughly 1.4 percent per year, either looked at from 1988 through the year 2000 or 1991 through the year 2000. Does that look about right to you?

Mr. THOMPSON. That looks about right.

Senator HEINZ. Under III, what some people say are pessimistic assumptions, it was about 0.5 percent—the real wage differential, the grow of wages faster than prices. Is that about right?

Mr. THOMPSON. It looks about right.

Senator HEINZ. My question is: What was the growth of the real wage differential for the 13 year period, 1975 through 1987?

Mr. THOMPSON. You may have calculated that. The period obviously of the 1970's was very bad on this indicator.

Senator HEINZ. Yes.

Mr. THOMPSON. It has been better since 1982.

Senator HEINZ. I get .57 percent for that 13 year period or very close indeed to the III so-called pessimistic economic assumptions. Does that look about right to you?

Mr. THOMPSON. Yes.

Senator HEINZ. Would you say that based on what we have talked about—on interest rates, on GNP, on the real wage differential—which corresponds more closely to the future, if the future is anything like the past—III or II-B?

Mr. BOWSHER. Let me let Larry answer and then I want to add something.

Mr. THOMPSON. I would say that III is probably closer to the situation as we experienced it in the 1970's; and II-B is probably a little closer to what we have experienced in the 1980's and we hope would continue to experience.

Senator HEINZ. But how can you say that since we have experienced recessions, higher interest rates and lower real wage differentials?

Mr. THOMPSON. Well in general III is closer to the situation in the 1970's. From 1972 or so up through 1980 or so.

Senator MOYNIHAN. For the time in the oil shock.

Mr. THOMPSON. Yes. And since we came out of the recession in 1982 we have had unusually good growth, probably actually a bit better than II-B.

Senator HEINZ. Would you guess that oil prices are more likely to go up than down?

Mr. THOMPSON. I defer to the Comptroller General on that.

Mr. BOWSHER. Again, I do not make predictions on interest rates or where the stock market is going or oil prices, Senator.

But I think that is true. What Larry said is, if you look at the 1970's you do not get the more favorable pattern. That was one of the reasons I think your Commission estimated lower than the actual results you got as far as building up the reserves in the 1980's. I think in the 1980's we had——

Senator HEINZ. My time has expired. But would you supply for the 1980's, not the 1970's, the real wage differential number?

Mr. BOWSHER. Sure, we would be happy to.

[The information follows:]

The real wage differential is defined as the difference between the percentage change in average annual covered wages and the percentage change in the average annual Consumer Price Index (CPI-W). The data found below were obtained from the *Annual Report of the Board of Trustees, OASDI* for 1989 and the Office of the Actuary, Social Security Administration.

The actual real wage differential (in percent) for the 1980s is as follows:

1980	-4.7
1981	-0.4
1982	0.5
1983	1.8
1984	3.0
1985	0.9
1986	2.5
1987	2.2
1988	2.4

These figures average 0.91 for the period 1980-88 compared with the real wage differential assumptions for 1989-1998 of 1.36 in Alternative II-B (intermediate) and 0.31 in Alternative III (pessimistic). For years after 1998, the intermediate and pessimistic assumptions are 1.3 and 0.8, respectively.

The actual experience of the real wage differential in the 1980s was rather dichotomous. The early 1980s were characterized by poor economic conditions, including inflation and recession. This is indicated by the large negative (−4.7) real wage differential in 1980. After 1982 the economic recovery was characterized by robust growth in real wages and much higher real wage differentials. The table below summarizes the actual average real wage differential (in percent) for selected periods within the 1980s and the Trustees' assumptions for Alternatives II-B and III.

REAL WAGE DIFFERENTIAL

History		Assumptions	
1980-1988	0.91	Alternative II-B:	
1981-1988	1.61	1989-1998	1.36
1982-1988	1.90	after 1998	1.30
1983-1988	2.13	Alternative III:	
		1989-1998	0.31
		after 1998	0.80

Senator HEINZ. I might say, it is going to look very much like III, not II-B.

Mr. BOWSHER. Okay.

Senator MOYNIHAN. I have a hypothetical question, but Senator Heinz can answer it right here and now. If we go back to a pay-as-you-go system based on Alternative III, do we have your support?

Senator HEINZ. I would not like to take the chance, Mr. Chairman, with balancing Social Security on any knife edge.

Senator MOYNIHAN. Knife edge? That is allowing for the most pessimistic prospect.

Senator HEINZ. If we were to balance the—to premise the——

Senator MOYNIHAN. No, I said it is a hypothetical question. You do not have to answer it.

Senator HEINZ. Yes. And the answer is, if we were to go to pay-as-you-go on III, my guess is there would be a 50/50 chance that Social Security would go bankrupt within 10 years and that is a chance I would not want to take.

Senator MOYNIHAN. Do you really want to use that word bankrupt?

Senator HEINZ. Yes.

Senator MOYNIHAN. The Social Security system has never been anywhere near bankrupt.

Senator HEINZ. Mr. Chairman, you and I were on that Commission.

Senator MOYNIHAN. The worst event would have been checks would have gone out 3 days late. The system would continue to be in place and Congress would have fixed it.

Senator Symms?

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

Mr. Bowsher, I share your view that running a true surplus and buying down the public debt would be superior to our current practice of whether we want to call it looting as Mr. Riegle did or thievery as the Chairman said or embezzlement as Senator Heinz has called it.

But I want to ask this question: Do you make any distinctions in your model between an increase in the national private savings in contrast with the Government surpluses? Is that what—on page 6——

Mr. BOWSHER. Yes. Well, go ahead.

Senator SYMMS. No, go ahead. I'm sorry.

You make no distinction?

Mr. BOWSHER. No, we do not.

Senator SYMMS. Okay. On page 6 you say, "A preferable course of action would be to make accumulation of Social Security trust fund reserves an economically meaningful process, one that represents a net addition to national savings." Now some economists argue that Government surpluses can cause a slow down in the economy.

Do you agree with that?

Mr. BOWSHER. Well I think in all of the work that we have done, going back even to the original role we played in Gramm-Rudman, that you have to be very careful to bring this down in an organized fashion and not to bring it down too fast so that you can throw yourself into a recession.

I think that the monetary policy and the fiscal policy has to be kept together.

Senator SYMMS. Senator Packwood gave you a hypothetical choice between paying off the Government bonds in the year 2015 versus raising taxes. Let me give you a hypothetical choice. Between saving for retirement with higher yield securities, such as AAA rated corporate bonds versus low yield Treasuries, if all this money that is in between these two lines were put into higher yield AAA very secure savings, which way would the country end up being the strongest in 35 years?

Mr. BOWSHER. Well, Congressman Porter has asked us to study his plan which has some similarities, I think, to your plan. I think it would be better, rather than me giving a quick answer here, to study some of the features of your plan, if you would like, and to get back with you.

Senator SYMMS. The reason I asked that question is that on your Table I, I noticed that revenues from general taxes have increased from $257 billion since 1985, but spending has only gone up $197 billion. Now that shows that we are on the track to get rid of the deficit in the future.

But if I look to 1990 to 1995, when I look at those numbers, you have made an assumption that spending goes up to $350 billion and revenues up by $371 billion. So it is an increase in the rate of spending. Are you assuming that the sequester process is not going to work?

Mr. BOWSHER. Now these are the CBO numbers. In other words, we have just arrayed them here to show the interrelationship of the unified budget with the trust fund surpluses. So we have not made any assumptions, other than what they have made.

They do make the assumption in their numbers. The way they have put their numbers together, they are saying that you will not get to a balanced budget by 1993. That is right.

Senator SYMMS. That is CBO numbers?

Mr. BOWSHER. That is CBO numbers. That is right.

Senator SYMMS. Are they assuming then there will not be a sequester?

Mr. BOWSHER. They are just giving you the base line costs in that. So they are not making an assumption one way or the other of how the sequester would work out. That is right.

Senator SYMMS. I want to say one thing you said that I agree with. You said that we really should not have ever had the sequester and had all the sacred cows that did not get to participate in it. It would have been much easier to make the thing work. I said that, and I still continue to believe that, that it is possible to have that program work and be very lack of pain to any one particular group. Even in our modified sequester that we now have now, I have not heard very much complaints about the 9 months that the Government was under sequester last year.

Very little complaints. And if I were the President I think I would call for another one this year and tell Congress to go on home. It obviously would meet his targets and he would probably end up about the same on the defense as he does on the other side. He would have some real savings.

Mr. Chairman, there are many questions I would like to ask but I think we are out of time. So I will save them and maybe send a few of them by letter.

Senator MOYNIHAN. Please do. Because there is a particular quality of the Comptroller General that when you send them a letter you get an answer.

Senator Riegle?

Senator RIEGLE. Thank you very much, Senator Moynihan. We are fortunate to have this particular Comptroller General that we have with us today. I think the country is well served by his efforts.

Senator MOYNIHAN. If I may just interrupt.

Senator RIEGLE. Yes.

Senator MOYNIHAN. The public might not know this, but the Comptroller General serves one 15-year term and his pay continues for life thereafter. He has no obligation or interest to say anything but what he actually thinks.

Senator RIEGLE. And I think in the case of this particular individual we got lucky. We got somebody who is outstanding professionally and who calls them as he sees them. That is of great value to the country.

I want to try to take this issue to one more level of complexity, Senator Moynihan, which I think you have helped frame more so than anyone. We were discussing the other day—and as I am sure Mr. Bowsher knows—that is that the median income in the United States in real terms has really not changed in the last 15 years. That is another way of saying that half the people who earn money up to the median income level are right where they were as a group 15 years ago. They have had no net gain in real incomes.

It is an astonishing fact. Because to have literally half of our working families, in a sense, treading water for 15 years of burgeoning economic circumstances is really an extraordinary fact and it is a very troubling fact because a lot of things have become more expensive. Housing has become more expensive, health care, health care insurance policies, college educations, things of that kind.

So a very substantial part of the working class of our society have either been standing still or in many cases sliding backward in their living standard over the last 15 years.

That relates very importantly, Mr. Chairman, to this chart. I want to just take a second and go over it with you, Mr. Bowsher. Because what this chart does is to show the changes in tax burden on income groups in the United States over the last decade. It relates directly to what is going on here in terms of this dishonesty with the Social Security trust funds and the taxes that are associated with it.

What is so interesting is that you notice that over this 8-year time period families at the lower income levels—and it is split in 10 percentage point categories—have actually seen their tax burdens go up. And, in fact, the people at the lowest income level, the lowest 10 percent of wage earners in the country, have actually had the highest increase in tax burdens of any of the groups.

Whereas, if you come all the way across the income spectrum out here to people that would include—I do not say this disrespectfully to him but—Don Trump and others who are in the high income categories, these are the folks that have had the best outcome in terms of their tax rates going down.

I think, quite frankly, this is why you see Donald Trump buying a bigger boat. No disrespect to him personally. But symbolically, that is what you see going on. The prices of wonderful paintings at Sotheby's go up in the $10, $20, $30, $40 million price range when finally the bidding stops.

Whereas, down at this end of the income scale an awful lot of our working families are literally sliding backward and are being asked to pay more. Now the reason they are paying more is the Social Security taxes are going up. And the increased Social Security taxes are paying for the tax cuts in personal income tax rates that have helped the folks out at the high end of the income scale.

And, in fact, if the capital gains tax cut goes through, which disproportionately benefits people at the high income end of the spectrum, you are going to see these folks doing even better because they are the ones who tend to have the greatest number of capital gains at the highest dollar values. So you are going to have the situation where this group that is struggling just to hold their place economically is, given these tax changes together, actually paying for the improvement in the circumstances of those at the high income levels.

Now if we leave this out of the debate we are not going to get very far in deciding what we want to do with Social Security taxes. Because if the tax increases on Social Security for folks at this end of the scale are, in fact, being passed out to the folks at this end of the scale because their total tax burdens have been reduced because of income tax cuts, it is just like taking the money out of the hand of the pocket of the family that is earning maybe $18,000 a year, two people working, and taking that money over and putting it in the pocket of somebody who is earning $4 or $5 million a year.

Now we do it under the guise of collecting the money for Social Security trust fund. But the fact of the matter is, we are not even protecting the money in the trust fund. In other words, we are replacing one tax with another and using that money to fund regular government operations rather than saving it for future benefits. We are turning around and spending that money so the working people down at the lower income levels who are paying all this money into the Social Security trust fund will find that later on they are going to be asked, in my view, to pay a second time, because somebody has to redeem all of these I.O.U.'s. If it is not going to be the working people in the country, who is going to pay the bill?

Maybe we will shift the tax rates around at that point. But my hunch is that a lot of that increase in tax later to pay off the I.O.U. is going to fall right back on that same family that right now is struggling to try to get a downpayment together, send kids to college or what have you.

Now somehow or another, even though this is complicated, we have to get this part of the discussion into the debate. Because this is really the thing, I think, that Senator Moynihan has helped illustrate, not just that the trust funds are being looted, in my terms, and being taken off and used for a purpose for which they were not intended; but in fact we are tilting the tax laws of the country way off their axis and we are hurting working families—who are finding it more and more difficult to get ahead.

Somehow or another they deserve a place in this debate. I hope they will find a place. I mean, isn't that in effect what is happening here? Aren't we seeing a replacement of one tax with another? Isn't that why these things are skewed this way?

Mr. BOWSHER. Yes. I think that is basically right, Senator. I do not know all the backup of those charts. But I think you are basically right. Some tax people would say that the rates have gone down for the wealthy, but the amount of taxes being paid is higher because they are no longer in those tax shelters and they never did pay 50 percent. So, therefore, you have to look at the amount of taxes paid in addition to the rate.

But I think your point is still well taken. The wealthy people are only paying 28 percent on their higher earning and you have had the payroll taxes go up fairly dramatically here. I think it isn't just the people at the lowest end. I think it is the people who are in that middle—the $40,000 and the $50,000. The truck drivers, the auto workers, they are seeing as one Senator told me a lot of deducts as they refer to it coming out of the pay checks. So it has been a major switch. There is no question.

If I could make one more point.

Senator MOYNIHAN. Please, sir.

Mr. BOWSHER. That is, when you think about what we have done here with this money too on the trust funds and the way we have run up this huge debt and this terrific interest cost that we have, that we have really created a large transfer payment program that nobody I think ever really voted for, of sending money out of the Treasury, bringing it in literally from the workers and then sending it out to the insurance funds to fairly wealthy people who can buy Treasuries, who can buy bonds and that.

So you have a situation here that I think eventually people are going to focus in on too and that is, who is getting the interest income and who is paying the interest costs. I think that is one thing you might want to give some thought to too here.

Senator MOYNIHAN. Yes. I can give you a number. It now requires half of the personal income tax to pay the interest on the debt.

Mr. BOWSHER. That is right.

Senator MOYNIHAN. As a transfer of wealth from labor to capital, there can have been nothing like it.

Mr. BOWSHER. I think that is the main reason that I would hope, instead of waiting until 1993 or 1995 or 1996, that there would be hope that your amendment or whatever else can do it, would force the people into making the tough decisions on this budget. That is what we have to do or we are going to keep getting deeper and deeper into the financial hole.

Senator MOYNIHAN. Mr. Bowsher, we thank you very much, sir. We hope to have you back. We are deeply in your debt, as are we in Mr. Thompson's debt. We recognize you as absolutely independent. You are the Comptroller General. You call it as you see it. And as you see it, you do not like it one bit for the moment.

Mr. BOWSHER. Right.

Senator MOYNIHAN. Thank you very much, sir.

Mr. BOWSHER. Thank you very much.

Senator MOYNIHAN. Thank you again, Mr. Thompson.

We are now, in the interest of our audience and the occasion, I am going to take the liberty of asking those two most distinguished and eminent career officers of the U.S. Government, Hon. Robert Ball, Former Commissioner of Social Security, and Hon. Robert Myers, Former Chief Actuary, if they would come together and form a panel, as they have often done in the past.

Mr. Ball, you are first in this sequence. Mr. Myers, you are second. And since you have somewhat opposite views we will be all the more instructed.

STATEMENT OF ROBERT E. BALL, FORMER COMMISSIONER OF SOCIAL SECURITY, AND CONSULTANT, SOCIAL SECURITY, HEALTH AND WELFARE POLICY, WASHINGTON, DC

Mr. BALL. Mr. Chairman, I think you are going to find that we have agreement on a lot of facts.

Senator MOYNIHAN. Your divergent view perhaps.

Mr. BALL. And a difference on the prescription. I have forgotten how much time you are allowing.

Senator MOYNIHAN. We are allowing as much time as you require. Just take your time. You have been there all afternoon.

Mr. BALL. Mr. Chairman——

Senator MOYNIHAN. Not as much time as you could—I mean we do not wish to test the extent to which you can talk about the subject of Social Security, but take all the time you want to.

Mr. BALL. Mr. Chairman, I would like to have my full statement included in the record.

Senator MOYNIHAN. Of course.

[The prepared statement of Mr. Ball appears in the appendix.]

Mr. BALL. I will start at around page 4 of my statement and summarize it as I go.

Senator MOYNIHAN. Sure.

Mr. BALL. I find that as far as the fundamental question of pay-as-you-go versus partial reserve financing that there are conditions for either one that ought to be observed. And that under proper conditions, either one is appropriate for Social Security financing. I am not saying that it has to be partial reserve financing or it has to be pay-as-you-go. I am saying, if there is going to be partial reserve financing then we have to do certain things.

I would support partial reserve financing as the General Accounting Office suggests only under circumstances where the annual surpluses are saved. The most fundamental economic point to make about all of this is that there is no way that we can avoid supporting future retirees out of the goods and services that are produced in the future. There is no way to change that.

So the only present actions that make any difference about our ability to support them in the future, are actions that increase production. A partial reserve financing plan, that is saved and is a net addition to the unified budget—or a reduction in the deficit below what it would otherwise be—does translate into savings and investment. That does have the potential if the rest of Government finances are handled correctly, of increasing the pool of goods and services in the future, making it easier to pay for Social Security benefits.

The cost of the Social Security benefits are still the same. It just makes it easier to pay for them.

Senator MOYNIHAN. That is right. I am sure you would agree with the statement that under the present arrangement—this is Mr. Bowsher's summary—these surpluses will have no real economic meaning. And what you would want is for them to have a real economic meaning.

Mr. BALL. Yes.

Senator MOYNIHAN. Yes.

Mr. BALL. Doing partial reserve financing and spending the money on the operating costs of Government as you go does not make it any worse or any harder, but it certainly does not make it any easier. Pay-as-you-go works just as well under those circumstances.

I would like to make a couple of points before getting to the conditions I think ought to be attached to pay-as-you-go. There is always in the media considerable discussion about the nature of Social Security taxes as if they were inherently a bad way of raising money. They use the word regressive.

Actually, I think the way the money for OASDI is raised is ideal for a social insurance system. Deductions from workers earnings, matched by employers, up to the maximum that is counted for benefits is a very good way to finance this system and it is progressive when you take into account the benefit structure which has a heavily weighted benefit formula.

And as I think Senator Packwood suggested earlier, if you also take into account the earned income tax credit, the whole arrangement is very progressive. But, by the same token, if you separate it from the benefits and look solely at the payroll tax—the deduction from workers' earnings and matched by employers—and think of it as a way of raising money for general purposes, then it is mildly regressive and certainly not a good way to do it.

Senator MOYNIHAN. Yes.

Mr. BALL. It is proportional to earnings for all but about 7 percent of the workers in the country. But those above the maximum all pay the same and income from capital is not included at all. So it is no way to raise money for the general purposes of Government.

So that leads to the conclusion that partial reserve financing is desirable only if you are using the build up to actually increase future production and that contrary-wise, borrowing the funds that are developed by these taxes and using them for general purposes is not a good idea.

On the other hand, I would like to suggest some conditions for going to pay-as-you-go. My basic view is that pay-as-you-go is perfectly appropriate for a social insurance system, just as I think partial reserve financing is under certain circumstances. It is more of an economic question than a Social Security question.

But to go to pay-as-you-go for Social Security I would want to see first that the size of the contingency reserve, which is necessary in a pay-as-you-go system to take account of unexpected economic change, is not just estimated to be enough in the future but is in place. And I believe we need a contingency reserve with a real cushion in it.

When one considers the wrenching experience of the mid-1970's and again in the early 1980's when the country was so concerned about Social Security financing, I think we should be leaning over backwards.

Senator MOYNIHAN. One hundred fifty is the number you use in your statement.

Mr. BALL. Yes, I would like 150 percent, before a move to pay-as-you-go.

Another point is that the Social Security taxes support more than OASDI. The 1.45 percentage points that are dedicated to the Medicare program out of the 7.65 percent total Social Security tax is clearly not sufficient. And before cutting the overall Social Security rate, I would like to suggest that after one got to an adequate contingency level for OASDI that some thought be given to moving part of the OASDI rate over to the Medicare program so that too would be adequately financed.

Finally, Mr. Chairman, I would like to suggest that if one were to move to cut the overall Social Security rate right away and not take into account what I have suggested, but just go ahead and do it, that there are three possible consequences.

One would be that in order to make up for the loss of income in the unified budget that Social Security, Medicare or some other programs of the Federal Government would have to be cut to come out at the same place in the deficit.

The second would be, alternatively, to raise some other taxes. Thirdly, you might just add to the size of the deficit. Or, it might be a combination of all three.

I am assuming that the third alternative of just adding to the deficit is not acceptable. That is the problem that we are all dealing with. So that to just cut Social Security taxes and let the deficit rise, I do not think is really anything that Congress will want to do or that the President would want to sign. So I am assuming it is one of the others. Either other cuts or tax increases.

It seems to me these things need to be considered together. So that as one considered moving to pay-as-you-go, if that were the decision, I think in the same breath one has to consider what program cuts, what tax increases elsewhere should accompany that, so we are not faced with an unacceptable increase in the total deficit.

It is also possible that this idea of partial reserve financing has enough merit and potential for increases in our future productivity that we ought not to give up on it too quickly. For example, your proposal and Senator Heinz's proposal of last year would move in that direction of protecting those savings. In fact, it would do it—not just move in the direction. And this new proposal in the President's budget moves in the direction, albeit, perhaps too slowly.

There are other possibilities for modifying the whole present plan of financing of Social Security. We now have in place—more by accident than design—this huge build-up in the reserves of the system and then its dissipation—cashing in the entire fund in order to pay the benefits.

Instead of that, another possibility might be to have a tax increase before the funds are all exhausted This huge build up and dissipation might make sense if the baby boom retirement costs were of a one-time cost. I think that has gotten fixed in the public mind, that its sort of a rabbit through the Python phenomenon, which is not the case. The baby boom generation brings the system to a new level of cost that remains relatively flat on into the future.

So one possibility would be, say, to leave the 6.2 percent in place until about 2020 and then you could raise the rate in 2020 to the same rate that is in your current bill that we are discussing—7 percent—and that would see the system through without further increase to the end of this current 75 year period at least—through 2065.

I am not suggesting necessarily that any of these are the thing to do. But I am suggesting that there is time to consider all of these alternatives. Because if you accept the idea that you ought to work the system up to at least 150 percent of the next year's outgo before reducing OASDI income, it should not be done until sometime between 1993 and 1996 in any event. And there is plenty of time to consider whether pay-as-you-go or partial reserve financing is the best policy for the country and plenty of time to consider these other alternatives and what should be put in place if we do go to pay-as-you-go to offset the loss of income.

Thank you.

Senator MOYNIHAN. Thank you, sir. We will get back to some questions that you obviously raised in our minds with your usual clarity and generosity.

Mr. Myers, would you tell us your views on these matters. We will put your statement in the record as if read, but you take all the time you wish to explain to us that man is innately a sinful and prodigal creature. [Laughter.]

STATEMENT OF ROBERT J. MYERS, FORMER CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION AND CHAIRMAN, COMMISSION ON RAILROAD RETIREMENT REFORM, SILVER SPRING, MD

Mr. MYERS. Thank you, Mr. Chairman. As Chairman Bentsen said, the Social Security trust funds are now in very fine financial condition. At the end of 1989, the balance in the funds was $162 billion. At the end of 1988, the fund balance was $71 billion higher than we estimated that it would be then, in 1983 under the pessimistic assumptions; and also $51 billion higher than the Alternative II-B estimates, which in my view are not overly optimistic.

So I think it is not fair to characterize the II-B estimates as optimistic. They intend to hit the middle as closely as they can. Although they do not show recessions, they also do not show times when the economy is much better than average. For example, if we look at the real wage growth, in the last 5 years it has averaged about 2.0 percent per year. The assumption for the future is 1.4 percent in the II-B estimates. I do not call that being too optimistic.

Now, as has been brought out, under present law if the II-B assumptions hold we are going to build up a huge trust fund of some $12 trillion and then dissipate it. And often people say that if current cost financing is adopted, according to the tax schedule in your bill, that means higher tax rates in the long run forever. That is not the case. Under present law, if the benefits are going to be kept as they are, and not changed, when the trust fund runs out, you then go to pay-as-you-go financing and at exactly the same tax rates as under your proposal.

So that is why I say that this proposal of yours, which I strongly support, is not an unraveling of the 1983 legislative agreement. It is merely fine tuning. There would be lower tax rates for perhaps the next 20 or 25 years, about the same for about 10 years, higher for the next 10 or 15 years, but thereafter they would be the same as required under present law.

I think that there are several disadvantages to building up a large fund. If a fund were built up and maintained as Mr. Ball suggested, the tax rate that would be needed at that point would be just about as high as the pay-as-you-go rate anyhow. So you will not have achieved a great deal by building up a fund. The disadvantages against having a large fund are more of a political nature than of a theoretical or actuarial nature.

One problem would result from the huge amounts of investments involved, which could absorb a very large portion of the national debt, or even all of it, and that would not leave sufficient for the general investment market. Another problem might be that the ready availability of funds for the General Treasury to borrow would encourage excessive governmental spending. Yet another problem is that the presence of a very large fund balance could create politically irresistible demands for greatly liberalized benefits on the grounds that "all that money is there, why not spend it."

Then, if benefits were liberalized, as you know, it is very difficult later to cut back on them. So, when the baby boomers come along to retirement age, the costs and financing problems involved at that time would be that much greater.

I recently read a statement made by the late Dean J. Douglas Brown of Princeton University, who was one of the key figures in the development of the program in the beginning and over the years. He was Chairman of one of the Advisory Councils and so forth. I put his statement in the record. I do not want to read the whole thing, but part of it is very pertinent to our discussions today.

Dean Brown stated, "If the system became an instrument of fiscal policy, the precious confidence of the American people would be undermined. The system in its own normal operation provides a stabilizing factor in the American economy. But its primary purpose is to provide security to the individual American worker and his family. It should not be distorted into a mechanism for the manipulation of fiscal balances."

I believe that the time to return to a pay-as-you-go basis is now. The fund balance at the end of this year will be almost exactly 100 percent of outgo, which in my actuarial opinion is sufficient to safeguard the system against any economic changes. And under your bill, Senator Moynihan, that figure at the end of this year will also be very close to 100 percent—94 percent.

One thing that perhaps people do not realize when they criticize pay-as-you-go financing is that the schedule that would be put in the law today is not "set in concrete." The rates in the future may go above those scheduled, or they may be lowered.

Furthermore, as you know, a stabilizer provision is in the law that was introduced by the 1983 amendments to take account of very bad economic times, when wages do not rise as rapidly as prices. That stabilizer provision could help if we were to have bad economic times in the future. I think that it needs a little more fine tuning, but that general principle is fair. I think that people would agree that beneficiaries should not get larger increases than workers are getting, with the understanding that later on, as in the law, any cost-of-living adjustments withheld would be repaid when the trust fund built up once again.

This scenario of trust-fund bankruptcy under Alternative III is one that just would not occur. Because, under a responsible pay-as-you-go philosophy here is what would happen: Under Alternative III, it is true that, by 1999, if nothing were done, the fund would run out of money. But the point is that, if a close watch is left on the operation of the system—as the Congress and the Administration would do—and, by say 1993, the conditions in Alternative III had eventuated, one could see that the fund ratio had fallen to 70 percent, and at the end of 1993, it will be 60 percent. It would then be obvious that something would have to be done about the situation.

And what would be done is very simple. Just put in a tax rate as high as in the present law, or even less than that, and this would get the trust fund through quite satisfactorily. So, there really is no danger that I can see, once you have built up a fund as large as 100 percent, if action would be taken in the next 2 or 3 years after the potential problem is noted, there should never be any difficulties.

In 1977, we had financing problems. At the beginning of 1977, the fund ratio was only 50 percent. And the 1977 amendments, unfortunately, cut the safety margin too low for the first few following years, and that is why the fund got into trouble in the 1980's.

Senator MOYNIHAN. Is that what we did?

Mr. MYERS. Yes.

And the financing in the 1977 amendments was based on the intermediate estimate, but the conditions experienced in the next few years were much, much worse, and there was not a 100-percent fund balance to start from.

I believe that pay-as-you-go financing would increase public confidence in the OASDI system because there would no longer be all this talk, as some people here have mentioned, about thievery and embezzlement. If the people see that the system is financed adequately over the long run, and do not need to worry about the money being spent for things outside of the Social Security program, they will have proper confidence.

So, Mr. Chairman, I very strongly believe that the time has arrived when the OASDI program should be rationalized, stabilized, and made crystal clear by going to a pay-as-you-go financing basis as has been proposed by Senator Moynihan. The system would then be financed in a clear, visible, and understandable manner and would be actuarially sound. Such a change would not endanger the benefit rights of either current beneficiaries or those who will come on the rolls over the long-range future.

At the same time, this would give the nation a better and clearer opportunity to solve the problems with the budget and with the savings capacity of its citizens.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Myers appears in the appendix.]

Senator MOYNIHAN. Thank you, sir. Thank you for bringing J. Douglas Brown back into our counsel. You, of course, were present at the creation in 1934 and 1935. It is astounding how energizing that period of American life was.

I guess I would like to ask a question of both of you— you have identical interests and concerns here—and go back to that point of Brown. It seems the sheer size of the present income flow just invites being distorted into a mechanism for the manipulation of fiscal balances, does it not? Don't you feel we didn't quite see this coming in 1983?

Mr. BALL. Senator, it seems to me that there is no way that you can ignore the economic effects of this large an operation. I do not think that you would want to deliberately plan the system on the basis of changing from year to year as economic conditions change in order to strengthen or cut back on the growth of the economy.

But I certainly believe that there is no way that you can or should ignore the consequences of major changes in the Social Security income or outgo and its effect on the economy.

Senator MOYNIHAN. Well then can I ask Bob Myers—and then I will get to our colleagues here—help me on the history. My impression is that what really walloped us in the late 1970's was that prices ran ahead of wages and that is a very rare, if not unprecedented, thing. Isn't that right?

Mr. MYERS. That is correct.

Senator MOYNIHAN. A lot more than just a drop. I mean, unemployment goes up a bit or down a bit. It is that, when we tied benefits to prices and prices ran ahead of wages. I do not think that it ever happened in our 50 years, had it?

Mr. MYERS. Not to that great an extent. I think that there might have been a few minor fluctuations.

Senator MOYNIHAN. A few moments, but it did not really surge. I do not think, frankly, any of us absorbed what happened to us in 1973. I mean as Senator Riegle was saying, you know, median family income in 1988 finally got back to 1973—that trebling in oil prices in 1973 and, what, they doubled again later in the Carter years. It just, you know, has rattled this economy to its teeth. But we funded trust funds.

Mr. BALL. Let me say one thing about making estimates and the future of the program. I agree with Bob that the II-B assumptions are not unreasonable. I would tend to rely on the II-B assumptions.

But, when it comes to a question of safety—of making sure that you have adequate reserves and that you do not have to raise taxes when you do not want to raise them—and you want to be absolutely sure, then I would take a pessimistic view. Not because I expect the pessimistic to be the one that happens. I think it is the less likely.

But I think for safety you might want to be thinking in those terms or else have an exceptionally high trust fund reserve. I would guess that probably 100 percent would turn out to be enough.

Senator MOYNIHAN. But you would like 150 percent?

Mr. BALL. I want safety. I want 150 percent to be absolutely sure.

Senator MOYNIHAN. Would you mind, your friend here saying, that when one learned man says 100 percent and another learned man says 150 percent, there are grounds for reaching agreement somewhere in between?

Mr. BALL. You mean you want to make it 125 percent?

Senator MOYNIHAN. For talking.

Mr. BALL. I would prefer 150 percent for complete safety.

Mr. MYERS. Mr. Chairman, I would like to say that, if you have a responsible pay-as-you-go system, this also implies that not every year are you going to juggle the tax schedule around, but every 3 or 4 years you ought to look at it, see where you are going and proceed on from there.

Further, I would like to point out a little past history. If, in 1977, we had had a fund ratio of 100 percent, and if we had a stabilizer provision so that the COLAS would have been the lesser of wages or prices, we would not have had the delightful occasion, I guess you might say, of getting together the way we did throughout 1982 and 1983, when the National Commission on Social Security was functioning.

In other words, the system would not have had a financial problem.

Senator MOYNIHAN. No. That stabilizer is an important issue.

My time is up. Senator Symms?

Senator SYMMS. Thank you, Mr. Chairman.

I want to thank both of you for your tireless efforts to try to help this committee understand this important program. You both have been very helpful to all of us. I have two questions.

I wanted to ask you first, Mr. Myers, when you discuss the options before Congress, if scenario III, the pessimistic view occurred, let's put it a little bit differently, isn't it true that we also get into fiscal trouble if the equally likely scenario I, the optimistic comes to pass? Because in the 1980's have been closer to scenario I than they have to scenario III and that is part of the reason why we are here today talking about what to do about this surplus.

Now, please, if you would, comment on—you may not be familiar with my proposal. But I allow in my proposal for the Social Security trustees to annually appraise where they are and adjust the rate of the trust fund contributions. Now I happen to want to measure this on the conservative side so I have 150 percent, or 18 months, in the fund to protect the benefits of current benefits before any money can go into the defined contribution accounts.

Would you comment on the ability of just allowing for Social Security trustees to just adjust that rate annually? And then I will go on with the second part of my question. Maybe I should do that first and you both want to comment on both questions, because they are linked together.

This program, I have designed it around the pay-as-you-go level, as I said, but with an 18 month average. Do you see any philosophical objections to using the excess tax revenues between now and the year 2015 to start funding a new defined contribution supplement to the basic Social Security pensions in view of the fact that the defined contribution feature is one of the most popular ones in all the private pensions as well as here in the Federal thrift savings plan, in the Federal employees?

Now I have two questions out there so maybe you could take a—number one is: Do you have any objection to letting the trustees adjust this on an annual basis?

Mr. MYERS. Personally, I would have no objection with that. However, I would go a little further and do something that was contained in a memorandum to the National Commission on Social Security Reform. I would change the tax rate on an automatic basis. When the trust-fund level got above a certain figure, the rate would be cut back, or vice versa.

Senator SYMMS. Right. In other words, you would just kick it back to the taxpayers, so to speak.

Mr. MYERS. The objections to that sort of a proposal always have been that the Congress does not want to let other people decide the tax rates. I think that Congress certainly could not want to give that authority to the trustees unless the procedure was a completely automatic one, like raising the maximum taxable earnings basis. Although the Administration does that, it is done on a purely mathematical calculation, and no judgment is involved.

On your second point about defined—contribution plans and using any "excess" taxes for that purpose, I think that defined—contribution plans are fine. They are growing. This is a way for small businesses especially to have pension plans. I would prefer, however, to see the entire process in the private sector. In other words, lower the Social Security tax rate to a pay-as-you-go basis and then strongly encourage people to use that extra money which they have for a defined—contribution plan.

Senator SYMMS. Rather than having a mandatory program like this would be?

Mr. MYERS. Yes.

Senator SYMMS. Mr. Ball, would you want to comment on those two questions?

Mr. BALL. Yes. I can hardly think of anything that would be more disturbing of people's confidence in the Social Security system than annual adjustments in the tax rate. We now have a situation where the last tax rate schedule has taken effect—6.2 percent. It is estimated by the trustees under the middle range estimates that both Bob and I are supporting as the most likely, that that would last until 2047. That is security. That is the sense that the program is soundly financed.

Senator SYMMS. That is stability.

Mr. BALL. If you start every couple of years changing that rate up, down and around, I think that would be very, very disturbing to people. Business could not count on what the rate was going to be and the individual could not count on it. And it would look as if the system were continually unable to plan. So I would very much oppose that.

On the other one, I would agree with Bob that I would rather keep defined contribution places entirely in the private sector.

Mr. MYERS. May I add one thing? I think that, if there were an automatic-adjustment procedure such as we were talking about, it would not necessarily mean that the rate would have to changed every year or even every 2 or 3 years.

Senator SYMMS. Right.

Mr. MYERS. If a good mechanism was present, it would not be so sensitive that every year the tax rate would change. But rather, as in Senator Moynihan's proposal, if conditions were right, as I show on a chart at the end of my testimony, the trust fund ratio stays between 100 and 120 percent throughout the next 75 years. Of course, the experience is not going to be exactly that way, but it is conceivable that the rates in the schedule would never have to be changed.

Mr. BALL. The rates in the schedule are one thing. But the schedule itself changes in the Moynihan bill. I thought the question was, how would you feel about making changes as you needed them; and that might occur fairly often if you were on a real pay-as-you-go basis.

Senator SYMMS. I see I am out of time. But one point I would like to ask both of you, if I could, just for 10 seconds, Mr. Chairman, is on the question of immigration.

Senator MOYNIHAN. Sure. Of course.

Senator SYMMS. It always appears to me that the Social Security Administration underestimates the numbers of people that are actually coming into the country and are working. I have often made the comment that why not be a little more liberal on viewing what our immigration policy is if we really get into a problem, and bring in more younger workers to help the rest of us as we reach retirement age, to pay into the system.

Isn't it a fact that more and more people are coming in seeking good jobs in the United States, more so than the numbers would indicate? I mean the dollar numbers indicate that somebody has got these jobs and are paying taxes.

Mr. MYERS. I agree thoroughly with you on that. I do not like to play Monday morning quarterback with my actuarial colleagues at the Social Security Administration, whose assumptions I generally support. But one point I have made frequently in the past is that I think that they have understated the immigration assumptions. Because as I see it, if fertility is at the low level of 1.9 births for women, when a 2.1 rate is needed to replace the population, how that is done is by immigration.

It seems to me that, when the assumed fertility rates are lowered, the immigration assumption should be increased. I certainly agree that, over the long run, we are either going to have a higher birth rate, or we are going to have more immigration.

Mr. BALL. I agree. I think that the actuaries have recently raised their estimates of what immigration would be. And, of course, they only are making estimates, they are not trying to decide the policy. They are trying to guess what is going to happen. I think the 600,000 they are using probably is low.

Senator SYMMS. Well except that a Government Agency is not supposed to admit that there might be some illegal entrance into the country. I suppose that is the problem.

Senator MOYNIHAN. Now, now, now, now.

Mr. BALL. They did add some illegal entrants the last time.

Senator MOYNIHAN. I think they estimate about 200,000.

Mr. BALL. But not——

Mr. MYERS. But not nearly as many as there are likely to be.

Mr. BALL. Could I, Mr. Chairman, make one additional point?

Senator MOYNIHAN. Please, go ahead.

Mr. BALL. That is, I wanted to point it out to the committee a place where Bob and I did disagree. I was saying that if you were to leave the 6.2 rate up to 2020 and then put in the rate that is in your bill for that year of 2020, 7 percent, then you could keep that rate for the rest of the 75 years.

Senator MOYNIHAN. For the 75 year period.

Mr. BALL. Yes. Which is considerably lower than having to put in a 7.7 rate later and an 8.1 rate later.

Senator MOYNIHAN. 8.1, yes. That 75 years keeps rolling. I won't even get into that.

The last question to the Chairman of the Committee on Banking and Urban Affairs. The last question period.

Senator RIEGLE. Thank you, Chairman Moynihan. As I have previously said, I have great respect for both of you, as you know; and we could not have two more important witnesses on these questions than the two of you.

I think it is also fair to say that over the last decade no two people have fought harder to protect Social Security benefits in the Senate than have I and Senator Moynihan. When they were threatened by cuts during the Reagan years, we had to fight against cuts on the floor and for COLAs and other things. My friend from New York and I were—one or the other of us inevitably were the ones who offered those amendments to protect this system with the support of the other. So this is not a sudden interest by either of us on these questions.

I am very much concerned about what I was demonstrating earlier. Because I think as people who have devoted their lives in very large measure to the Social Security system and its protection and its soundness, I think there is a corruption of the tax system that has been going on, together with these manipulations of the budget and the use of the trust funds over the last decade that are undoing, unhinging some critical aspects of how this system is supposed to work. I think it starts to jeopardize not only the system, but people's faith in it.

I do not think you can have a situation where personal tax rates at the high income levels are taken down and in effect replaced by increases in the Social Security tax rates. That is what has happened here. I do not know that anyone set out to do it—whether that was part of the scheme of Reaganomics or it was just an accidental occurrence. But the bottom line is we have shifted the tax burden over a period of time in such a way that what is now happening is that a broad base Social Security tax is being used to finance more and more of the general operations of the Federal Government at the same time we have relieved people at the high income level from the high tax levels that used to apply in years past.

And you cannot separate one from the other. I mean as people who are pioneers and authentic national heros in my view in terms of the structure and the protection and soundness of the Social Security system, I do not think we can afford to ignore what has happened here. The system is jeopardized by this complex looting. What would happen if we were to have a serious recession and a loss of revenues and an increase in payments because people are in dire circumstances.

I think what is happening here is more diabolical than that. I think it is harder to understand, and it is more serious. I am not sure we have fully penetrated the problem. I think Senator Moynihan has taken us further now than we had managed to get before because he stripped away the dishonesty of the use of the trust funds.

But now that we have got through the level of dishonesty, we have to go down through the next level in terms of how this tax system has been tilted this way and put more on the backs of general working people in terms of the amount of their incomes that are being used to pay for the general operation of this Government in the guise of putting the money in the Social Security fund where it is not because it is being taken out to spend and pay for the defense budget and other things.

In addition to the backward slide, many people who I call working class people in this country who are in family income terms about the same place they were 15 years ago—15 years have gone by and they really have no net gain in real income to show for their work despite the fact that prices of housing and education and health care and everything have gone through the roof. In most of those families you now have at least two people working to earn the amount of real income that perhaps one person was able to earn 15 years ago.

So it is not just a matter of not having made any real progress—and I am talking about half the population of the country. I am not talking about a handful of people. We are talking about half the American families who are on a treadmill here and working harder to stay on the treadmill which, of course, raises other questions. If you have two members of the family working and there are children, then this brings in child care expenses and other burdens associated with it.

So what is happening is that I think we see some very perverse economic occurrences being cloaked in the goodness of Social Security. And I think it has to be stripped away. We do not want to turn working people of this country against the way the system is geared and even turn them away from Social Security, as strongly as they believe in it because it is the one program we have done in this country that has worked.

But I will tell you this, if Social Security had to send out a notice in next month's envelopes about the looting of the system that is going on and the way it is being done today, you would have an outcry in this country. There would be pressure to change it. Because people will not stand for it once they find out what is going on.

And frankly, to ask the people at the lower income levels whose effective tax rates have gone up, to not only pay those higher tax rates, and then through the gimmickry of Gramm-Rudman draw that money off and spend it for other things, but to tell them in the future that the money they have put aside is not going to be there and their tax rates are likely to have to go up again to provide the money to pay off the I.O.U.'s for their own retirement, they are going to be very angry and they are going to have a right to be. Because it is just dishonest. It is just dishonest.

It bothers me because there are other people that are waxing fat off of these circumstances. There are people who have so much money they cannot spend it all. And they are in effect taking it right out of the hides of others, and we are allowing it to happen.

So I think those of us that care about Social Security—and I mean really care about it, have a profound commitment to protecting it—have to strip away these kinds of dishonest connections that have been put in place, and it is not easy to do. And I say to the Senator from New York, I think he has done as much to advance the debate of at least getting honest with what is happening as anybody in the country, for which I thank him very much.

Senator MOYNIHAN. Thank you, sir.

Gentlemen, do you want to say something about that? I am sure you agree.

Mr. BALL. Senator Riegle, what you have said gives the main reasons why I would support the continuation of partial reserve financing only if the excessive income over outgo is actually saved.

I would differ with you a little on one part of the final statement you are making. There is no way to avoid the future paying for future Social Security benefits. These workers you are speaking of are going to have to pay for future Social Security benefits. There is no way out of it. The only thing we can do is make it easier for them by having the total pool of goods and services higher so that their paying for Social Security will not be as big a drain on them as it would otherwise.

But the idea that you could sort of, by not using the Social Security funds in a certain way, relieve people of actually having to pay the same costs for Social Security later I do not think is quite right. I think what is correct is that we put them in a position of making it easier to pay Social Security benefits, but they still will have to pay for them.

Senator RIEGLE. No. But we do have a difference on this. And there are several ways to illustrate it. If we took the surplus and we put it aside and we put it in corporate securities which were to be paid back by somebody else—by somebody else, by the corporation in that sense and not the individual worker—what is going to happen here is like a boomerang. It is going to come back around and an awful lot of these people that are paying, I think, a very high effective tax rate now because of the way the tax structure as a whole is put together, are going to find that later on down the line when these I.O.U.'s have to be redeemed, that they are going to be asked to have their individual tax rates increased to pay back the amount of money that was taken out of the Social Security fund that they first put in.

That is what I am telling you. In other words, there is a deficiency in the system that is building up with people who are not paying a fair share and that money is being spent for other things. It is being dissipated. It is being dissipated.

Mr. BALL. We agree on so much about what you have said that I am not sure it is worth my——

Senator MOYNIHAN. There is no point in finding those small bits of disagreement.

Mr. BALL. I agree.

Senator MOYNIHAN. Bob Myers wanted to say something.

Mr. MYERS. I agree with Senator Riegle about these two matters—the shift in the tax rates and the build up of the fund from the payroll taxes. In my view, this was merely accidental. I do not think that it was planned to substitute one for the other—anybody's plot to do that. I think that it is like the build up of the trust funds and their decline corresponding with the build up of the baby boomers and then they pass from the scene. These trends were just coincidences.

On the other point, I do not think that there is any way of assuring that the money will be saved. For this reason I believe that the approach in Senator Moynihan's bill is desirable—if there is not a big build up, there is no problem of whether it can or cannot be saved. As I see the situation, if in a given year $60 billion more in Social Security taxes are collected than are needed to pay the benefits and administrative expenses, that money goes into the general fund, and nobody in the world can say what it is going to be used for.

It could be argued that the $60 billion this past year was used to pay off bonds that were maturing. It should be argued that it was used to pay Government salaries or to build bombers. There is just no way of telling. It all goes into a big pool and it comes out in various directions. So, I think that, when you come right down to it, there is no way of assuring that any of these excesses will be saved.

Mr. BALL. The important point here is that Social Security surpluses have to be a plus in the unified budget and then they are saved.

Senator MOYNIHAN. Then that is the working of economics.

Gentlemen, we have——

Senator SYMMS. Mr. Chairman.

Senator MOYNIHAN. Yes, of course.

Senator SYMMS. Could I just ask unanimous consent that my entire statement and the supporting charts and graphs be put in the record at the beginning when I made my statement?

Senator MOYNIHAN. Most assuredly.

Senator SYMMS. And if I could just make one more comment, Mr. Chairman. You have been very patient.

But I think there is one thing that should be said and I appreciate Senator Riegle has been saying. But if you go back, if you try to go back and implant what rates people would be paying, we are forgetting the fact that by getting rid of tax shelters and lowering the rates we have unlocked a lot of capital. And so if you go get the rest of that chart, I think, Don, you will find that the higher income people have paid more dollars in revenue to Treasury than they were before.

Senator MOYNIHAN. They were paying much less than people thought.

Senator SYMMS. They were paying less.

Senator MOYNIHAN. Mr. Bowsher made that point.

Senator SYMMS. Mr. Bowsher made that point. But I think that should be, you know, that——

Senator MOYNIHAN. We thank you, sir.

Senator SYMMS. Thank you. Thank you both.

Senator MOYNIHAN. I would like to put my own statement in the record at this point. Thanks to the Senators who have stayed. Thanks to these two heroes of the American republic.

Senator SYMMS. Correct.

Senator MOYNIHAN. This hearing will resume at 10:00 on Thursday morning when we shall hear from the Director of the Office of Management and Budget, Mr. Darman; and a number of distinguished economists.

We thank our audience; we thank our very careful recorder. I thank the Staff here that has been so patient through it all.

[Whereupon, the hearing was recessed to reconvene at 10:00 a.m. on Thursday, February 8, 1990.]

SOCIAL SECURITY TAX CUT

THURSDAY, FEBRUARY 8, 1990

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to recess, at 10:08 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Bradley, Pryor, Riegle, Packwood, Dole, Roth, Heinz, Durenberger, and Symms.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. This hearing will come to order. I see we have some additional, very distinguished witnesses here. So with that in mind the Chairman will get equal time by making his opening statement.

On Monday the committee's hearing was devoted to an examination of the Social Security system, its financing and its prospects for continued solvency. The witnesses discussed a range of issues, including the merits of the approach to financing implemented as part of the Social Security amendments of 1983 versus the historic pay-as-you-go system.

At today's hearing we will consider the larger issue of Social Security's role in the unified budget and the part the surplus plays in reaching deficit reduction targets established by the Gramm-Rudman Hollings amendments to the budget act.

Now before we begin, I would like to say a few words about some of the testimony I anticipate from one of our witnesses—the Office of Management and Budget Director, Dick Darman. Director Darman will describe to us the President's plan to move the Social Security program and its surplus out of the G-R-H calculation on a gradual basis beginning in fiscal year 1993.

I have to say that I am troubled with the idea that we postpone until 1993 definitive action on the practice of using Social Security surplus to disguise the deficit. Furthermore, I am deeply concerned about the message the proposal sends to the American people, that somehow protecting the trust funds from budget gimmickry must be delayed.

I understand that former OMB Director, David Stockton, tells an anecdote about the time in 1981 that he was talking with Director Darman about the budget proposal they were developing. They knew it would create very serious deficit problems in the future. "Should they try to fix it," Stockton asked, "Win now. We'll fix it later." Mr. Darman says, "I can think of worse choices." "What?" Stockton says. And Mr. Darman, with that quick wit, for which he is known says, "Give me a couple of weeks and I will come up with an answer."

Well my hope is that we do not have to postpone efforts to craft the right answer to the challenge posed by Senator Moynihan. That is what we are after today—the right answer. There is no question about budget deficit problems. I listened to one of my colleagues who said it was the Congress' fault the other day. Well, there is no question in my mind but the fault lies with the Administration and the Congress. Because there is blame enough to go around on that one.

And over the last few years we have rolled up more debt than all the Presidents from George Washington through Jimmy Carter combined. That deficit has crippled our ability to compete abroad. It has cost us jobs. It soaks up the funds we could use for fighting drugs, fighting crime, rebuilding our crumbling bridges and keeping our air and our water clean—not to mention the areas of responsibility that we deal with in this committee, such as providing child care, reducing infant mortality, inoculating our children.

Just the interest on the debt alone last year took all the income taxes of everybody west of the Mississippi. This year's budget contains an introduction warning us to be serious about the deficit, yet the Administration's budget proposes to postpone removing the trust funds from the G-R-H calculations until after we have added another $1.5 trillion to the Federal debt.

Now to the use the words of the Comptroller General at Monday's hearings, the growing trust fund surplus has had the effect of just phonying up the budget. For it has not only hidden the true size of the Federal deficit, it has fostered the illusion that the American people have had their taxes cut during the last decade. Not true. Not true at all.

On the average, Americans were taxed 20 cents on the dollar in 1980. They are taxed 20 cents on the dollar today. And when you talk about average Americans, working Americans, the picture is worse. CBO tells us that since 1980 wealthier Americans saw their taxes go down. But 60 percent of Americans have seen them go up. Well let me put that another way--three out of five American families pay more taxes.

We saw a tax policy that gave money back to people living off of dividend checks, but it took money from people who live on a pay check.

I yield now to my colleague, ranking minority member, Senator Packwood, for any comment he wants to make.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Thank you, Mr. Chairman. You quoted the exchange between then Director Stockman and Richard Darman in early 1981. But I think it is fair to remember—and Senator Moynihan will recall when I used these statistics of the floor and then gave him a copy—what budget deficit and surplus projections we were working with in late 1980 and early 1981.

From roughly August 1980 until July 1981, OMB, CBO, and private forecasters were estimating that we would have between a $140 billion and $200 billion surplus by 1985. All of them estimated that. So when we enacted the tax cuts in 1981 we assumed that we would be reducing a surplus. And the debate was, if we did not reduce the surplus, will we spend it, as governments are want to do.

Now in fairness to the projections of that time, a common mistake was made by all of the groups. We were in an era of 13 to 14 percent inflation, and the projections assumed that inflation would come down very gradually. And because we had not indexed the tax code, we were well aware that with every 1 percent of inflation our revenues would increase by about 1.7 percent. So from inflation alone we could count on a significant increase in revenues.

Also, no one predicted the 1981-1982 recession. Inflation came down sharply. The recession hit us badly and our revenues fell as they always do in recessions. In hindsight it is easy to say that the tax cut caused the deficits. But at the time we passed the tax cut we intended to have a balanced budget by 1985, rather than $150 billion to $200 billion in surpluses.

Secondly, there are those who say we should raise taxes to narrow the deficit. That is a fair debate if we were to use the money for that purpose alone. The Chairman indicated that in 1980 Americans were taxed at roughly 20 cents on the dollar and today they are taxed at roughly 20 cents on the dollar. That is an accurate statement if you are counting only Federal taxes. But I think a more relevant statistic is what has happened in the United States with respect to the GNP, compared to other industrialized countries throughout the world.

We have seen over the past 40 years dramatic increases in taxes in all the industrialized countries of the world as well as dramatic increases in spending. But I will confine myself to the United States.

In 1950, the combined taxes of all of the Governments in the United States—Federal, State and local—were 21 percent of the gross national product. We spent 22.7 percent of the GNP. In 1988, we taxed 29.3 percent of the gross national product and we spent 31.4 percent. Taxes have gone up rather significantly, but so has spending. But we have been one of the lower tax and spending countries in the world. Japan is slightly above us; and all of our European defenders are about as open on taxes and on spending.

So it is fair to ask, do you want to increase taxes to narrow the deficit; and if so, should they be regressive or progressive taxes. But I think a bigger question is: Would the money be used to narrow the deficit or would it be used to simply increase spending for things that we all want—education, environmental clean up, drug interdiction, and all the other programs that we think are legitimate government spending programs.

In that case, the States ought to be apprised that we are going to increase taxes to increase spending or, short of that, we are going to increase taxes—any kind of taxes—Social Security taxes or otherwise—and narrow the deficit. I think a more relevant question is: How are we going to guarantee the tax increase will be used to narrow the deficit.

Thank you, Mr. Chairman.
The CHAIRMAN. Are there other comments at this point?

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Mr. Chairman, I am in no position to disagree with anyone at this point. I would like to agree with both of you and to make two points.

The first is, one has to accept Senator Packwood's statements about the projection of revenues under levels of high inflation. That is true.

What was happening in this case was that when the Reagan Administration came to office they saw a deliberately contrived deficit as a means of imposing a certain discipline, in their view, onto the Congress. This was not a concealed matter. This was an open matter. In the first address the President gave to the nation in 1981 after he was inaugurated, he said, what do you dc with the child who will not be behave. You can talk until you are out of voice or breath or you can end the extravagance by cutting his allowance. A simple proposition.

And here we are 10 years later, on our side of the aisle at least, anytime anybody talks about any subject, especially of new problems, it is, yes, but where is the money coming from. They add the tax. So I think both of these are so. The fact was that it was a deliberate calculation.

Could I just say, Mr. Chairman, two other things? It is not generally known, but last year this committee approved a bill to create an independent Social Security Administration. It was not included in the end in reconciliation like many, many other things. But we did approve it. And lastly, Mr. Chairman, there were two public trustees established by the 1983 legislation. Both of those positions are vacant and we are yet to act on these.

Thank you, Mr. Chairman.
The CHAIRMAN. Thank you.
Are there any other comments?
Senator SYMMS. Mr. Chairman.
The CHAIRMAN. Senator Symms?

OPENING STATEMENT OF HON. STEVE SYMMS, A U.S. SENATOR FROM IDAHO

Senator SYMMS. Mr. Chairman, I am please that you have continued these hearings and that we are going ahead today. I welcome the witnesses that will be here today. I think as the public learns more and more about this issue of the Social Security surplus and how the Government intends to use the money or how they used the money over the next 30 years, I believe more and more people are going to come to the same conclusion that I have reached currently.

That is, I believe we should structure the Social Security system so that it maintains an 18 month reserve and then save the rest of the revenues in a secure way for the retirement of those who are paying Social Security today. That will do two things—increase security for our people, increase savings for our nation—which are so important to our current economic impediment position in the world.

I noticed in the statement Director Darman made before the Budget Committee last month that indeed the current generation of taxpayers will have to pay twice for the Social Security benefits that they receive. In my opinion, Mr. Chairman, this is bad public policy. We should save the money now. That is why I have introduced my bill—S. 2026—to save the surplus and invest it for each taxpayer today so they will have a much larger retirement benefit when they retire in the next century.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Symms.

Are there further comments?

Senator DURENBERGER. Mr. Chairman, if I could just briefly.

The CHAIRMAN. Senator Durenberger?

OPENING STATEMENT OF HON. DAVE DURENBERGER, A U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER. I have a statement that I would like to make a part of the record. On Monday of this week, at the hearing, I complimented Senator Moynihan on the generation of this issue; and today I welcome a colleague with whom both of us has worked a generation for.

But one of the points I would like to inject, not only in the debate, but in the discussion we are having here—is that there are a couple of pillars to the social insurance stage. The one that is in real trouble right now is the HI trust fund. If you look at what the elderly and the disabled of this country really worry about, it is the catastrophe of either medical illness or long term care.

Currently, we are spending $550 billion a year in this Nation just on the medical side. Next year we will be spending about $2500 per person on this. And as Dick Darman has told us, the HI trust fund has got about $250 billion or a quarter trillion dollars in unfunded liabilities right now. And the net effect of that is, that by the time the first baby boomer retires this is going to be in bankruptcy and we are going to be back doing, what happened earlier in 1983 with Social Security.

One approach we are considering is to reallocate contributions from the OASDI trust fund to the HI trust fund, raising the HI tax up 2 percent of payroll. So that this potential problem we face can be in some ways addressed. This is not the best way to address it. The best way to address it is to do something about the cost of health care, as everybody on this committee knows, but to make sure that people do not carry the financial burden, it will be appropriate that we look at transfers from OASDI to the HI trust fund in the future.

The CHAIRMAN. Thank you.

Senator Heinz?

OPENING STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Thank you, Mr. Chairman.

Mr. Chairman, I want to join Dave Durenberger in commending you on this second day of hearings. I want to reiterate what I believe is the importance of doing what Pat Moynihan and I, up until December 29, both have strongly advocated, which is not only making sure that the Social Security surplus is not used to mask the size of the deficit but that it is not used to fund other spending programs, but in a very real sense of the word, is saved.

If we really want to have both an economic and a social insurance system, including Dave Durenberger's very correct comments on health insurance for the HIs, medical and Social Security system, we have to have a healthy and growing economy.

I think every economist have ever had before this committee or the Banking Committee on which I serve agrees that we must increase our national savings rate. And the proposals that Pat and I have advanced, as well as that of Dick Darman, to stop this annual game of deceptive, in effect have the same goal of making sure that we don't spend our national savings but reserve them as the seed for growth capital for this country.

Therefore, it seems to me that if you believe it is important for this country to grow in order to meet its future needs, if you believe in the old-fashioned virtue of savings—and I think we Americans still do—if you believe in setting something aside for the rainy day and building for the future, then the right answer is the one that Pat Moynihan and I used to advocate, not the one Pat currently advocates.

If, on the other hand, you believe that we should consume, without regard to income, if you believe that the moral way is deficit spending and the addition of $55 billion in deficits next year is the right approach, or if you believe in having it good today at the expense of others by charging everything up on that big national credit card with the bills going not to us but to our kids, then cutting the payroll tax is a very good idea.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Gentlemen are there further statements to be made?

[No response.]

Senator Kasten, we are very pleased to have you.

Gentlemen, with the number of witnesses we have, I would ask that you limit your oral statements to 5 minutes and your written statement will be put in the record.

Senator Kasten, we will start with you. Thank you.

STATEMENT OF HON. ROBERT W. KASTEN, A U.S. SENATOR FROM WISCONSIN

Senator KASTEN. Mr. Chairman, thank you very much. I have a longer prepared statement and I will set that aside. At the back of the longer prepared statement are a number of charts that I will be referring to in the testimony.

Two years ago, then Representative Jack Kemp and I proposed payroll tax cuts as part of an omnibus job and economic growth package and called it the "Plant Opening" bill. We were right back then. The tax increases were not needed.

Today the case is even more compelling. The working men and women of America need a tax cut. A tax cut would help the economy and it would create new jobs. And we're only using excess payroll tax receipts to mask the true size of the budget deficit.

The Social Security tax is now imposing a larger burden on the average taxpayer than the Federal income tax. A full 74 percent of all taxpayers pay more in combined payroll taxes than they do in income taxes. The impact on America's family budget has been devastating. From 1955 to 1988, the tax burden on Americans rose twice as fast as income. These are middle-income Americans. The tax burden rose twice as fast as their income. That is Chart 1 in my prepared testimony.

The chief culprit in the 35-year long tax hike has been the payroll tax, which has skyrocketed from 4 percent in 1955 to 15.3 percent today—that is nearly a 400 percent increase. Today the maximum Social Security tax for working families is a $3,180—and that, Mr. Chairman, is for only one wage earner in the family. If you have two people working, you have two people paying in and you can double that amount.

The Reagan tax cuts resulted in income tax savings for the median income two-earner family. The tax reforms in 1986 removed 5 million low-income workers from the income tax rolls, and that is why the payroll tax now accounts for such a disproportionate share of the tax burden borne by these Americans. We took them off the Federal tax rolls for income tax purposes, but they continue to pay their Social Security, FICA tax.

We have made great progress in cutting the income tax on middle America, but a lot of these savings, as you pointed out in your testimony, Mr. Chairman, have been eroded by the simultaneous 22 percent increase in the payroll tax burden. If effect, we have given with one hand and taken away with the other.

America's retirees have children and grandchildren who are now raising families, paying mortgages and saving for retirement security as they did when they were young. The difference is that today's tax burden has made it harder for their children and their grandchildren to make ends meet. That is why I believe that millions of America's senior citizens will support a payroll tax cut for their children, despite the current opposition of some of the senior groups.

Mr. Chairman, according to a recent study by the Institute for Research on the Economics of Taxation, IRET, the payroll tax hikes of 1988 and 1990 will increase the tax burden on working Americans by $500 billion over the next 15 years, costing the economy an estimated 500,000 jobs and reducing gross national product and capital stock by $100 billion. By contrast, IRET estimates that every dollar of reduction in Social Security taxes would expand economic growth and economic output by 68 percent.

In short, the tax increase will have a negative effect on economic growth.

That is why I agree in principle with the payroll tax cut approach that Senator Moynihan has proposed. I think nonetheless there is room for improvement. I recently introduced a payroll tax cut bill, S. 2052, the Social Security Integrity and Tax Reduction Act of 1990.

My bill would reduce the 1990 Social Security tax on both employers and employees from 6.2 percent to 5.9 percent, and further reduce the rate to 5.6 percent in 1991 and 5.3 percent in 1992. The result is an annual tax cut of up to $519 per worker. That is in Table 2.

Allowing Americans to keep more of their money would help the economy. IRET estimates that by the year 2000 my tax cut plan would add between 450,000 and 920,000 new jobs; raise gross national product by almost $300 billion; and increase the capital stock by $180 billion.

A tax reduction to 5.3 percent provides a reserve "cushion" in a trust fund to protect benefits in the event of an economic downturn. Using the Social Security tax surplus to cover the general government deficit is dishonest and irresponsible. My bill takes Social Security out of the budget and extends the Gramm-Rudman process in the out years so that we can achieve a honest balanced budget by 1997.

I believe this is a plan that can unite. All Americans—Republicans, Democrats, young and old, business and labor. We have support coming from groups on the left like the Institute for Policy Studies, the Progressive Policy Institute to conservative groups on the right such as Heritage, Citizens for a Sound Economy, the American Conservative Union.

Business groups like the NFIB and the U.S. Chamber have endorsed the payroll tax. The AFL-CIO supports a payroll tax cut similar to mine—one that maintains 125 percent to 150 percent of the OASDI reserves; takes Social Security out of the budget; and adjusts the Gramm-Rudman targets accordingly.

I see that my time has expired, Mr. Chairman. Let me just make one concluding remark. I simply want to point out the point that you have made, Mr. Chairman—and I believe made it in the last hearing—that at no time in 1983 was it projected that we would have this huge surplus, no matter which of the different economic projections you were following.

And I just have a quote that I want to read from the congressional Research Service Report. "An examination of the record of the committee proceedings leading up to the 1983 amendments, and the earlier deliberations of the National Commission on Social Security Reform will show only passing references to the possibility of future surpluses. No record exists showing that Congress seriously considered building a fund or how such a fund would actually save resources."

It is important to recognize that we find ourselves now in a position that was never anticipated. We are taxing American workers in a way that they should not be taxed because it is unnecessary for us to raise those dollars. I hope that we can come together on a bipartisan effort to reduce the Social Security tax.

The CHAIRMAN. Thank you, Senator. That is very interesting testimony.

[The prepared statement of Senator Kasten appears in the appendix.]

The CHAIRMAN. I would ask that we wait on questions until we have heard from all three of the distinguished witnesses.

Our next one will be Hon. Timothy Penny, the United States Representative from the State of Minnesota.

STATEMENT OF HON. TIMOTHY J. PENNY, A U.S. REPRESENTATIVE FROM MINNESOTA

Representative PENNY. Thank you, Mr. Chairman, for the opportunity to testify before your committee today. As a sponsor of H.R. 3865, a bill similar to Senator Moynihan's that would rescind the Social Security tax increase, I am extremely interested in the progress and consideration of this legislation.

I want to applaud Senator Moynihan for his determination to end the great budget charade of the 1980's. It is clear that the Administration intends to continue to allow Social Security revenues to mask the deficit and further use the Social Security payroll tax as a continuing source of funds for other Federal budget programs.

Senator Moynihan's proposal forces the Administration and Congress to be honest about the deficit and to talk about how to set national priorities and get back to a balanced budget. To me, that is the real significance of this legislation.

I am well aware that reducing the payroll tax now could be a mixed bag. A tax break would put money into the hands of working men and women and that would stimulate the economy. But it may not be enough to offset the effect of the economy on increased government borrowing if we do not deal with the other budget deficit concerns as part of this measure.

That is why I feel strongly that any reduction in the FICA tax should not be done in isolation of the big picture—that being a more fiscally responsible treatment of the rest of the budget. In fact, if we would be honest about the need for cuts and revenues in order to balance the rest of the budget, the original promise that Social Security funds would be protected exclusively for future retirees would be met.

As a baby boom legislator, I would also like to request that your committee take another look at the long-term solvency of the Social Security system. Whether Social Security is returned to pay-as-you-go or not, it is likely that payment of future retirees' benefits will require burdensome increases in the FICA tax on future workers.

It might be prudent for Congress to enact benefit adjustments that would take effect 20 to 30 years in the future. This would signal today's workers that they should make their retirement plans accordingly; and it would signal tomorrow's workers that we do not intend to resort to higher and higher FICA taxes to sustain benefit levels.

I plan to introduce several bills in the near future that would address some of these concerns. As we have heard many times in the past month, reducing the payroll tax is a dramatic and controversial step. But I believe the proposal may finally bring us to our senses about the deficit.

There are many options available to achieve deficit reduction. However, unless we face the deficit honestly, American taxpayers, both now and in the future, will be the real losers.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

[The prepared statement of Representative Penny appears in the appendix.]

The CHAIRMAN. Our next witness, Hon. John Edward Porter, U.S. Representative, State of Illinois.

Mr. Porter.

STATEMENT OF HON. JOHN EDWARD PORTER, A U.S. REPRESENTATIVE FROM ILLINOIS

Representative PORTER. Mr. Chairman, thank you very much for the opportunity to testify this morning.

I want to address my first remarks to Senator Moynihan. Senator, although some of your colleagues are deserting you, I want to start by paying you two compliments before I also desert you. [Laughter.]

First, you have put the future of Social Security on the table for discussion. There is craven fear in the Congress, and has been for years, to even breathe the words Social Security for fear someone would say you are against it. I think now we are talking about it. I think that is a very, very positive development. It needs to be talked about.

Secondly, you have pointed out very forcefully and correctly that we are consuming the Social Security reserve to cover current deficits and this is a breach of faith with future generations of Americans. I agree completely with that. I have been saying that myself for years. You are exactly right.

Third, however, you have made a correct diagnosis that we are misusing the reserve and that if we were not misusing it we probably would be spending it on new programs sometime in the future. Your diagnosis is right. I think the prescription that you have prepared for it, I am afraid, sir, is pure poison. That is not because it will make the deficit larger. The deficit is, in fact, larger. Your prescription would make us face the true deficit and presumably do something, as Representative Penny says, truly to bring it down and under control.

It is not because we should not be messing around with Social Security either. We are, in fact, messing around with Social Security and we have to decide that we should stop that and begin to treat the future of Social Security in some rational way that will make it work not only for people retiring today, but for people that will be retiring 30 and 40 and 50 years from now.

I disagree with you because I think if you cut the tax rate now and in effect pass out that cut to individual Americans, that tax cut will be consumed with more German cars and Japanese VCR's and that when we need the reserve to support the baby boomers retiring, beginning about the year 2017, the money simply will not be there to provide for that retirement.

In 1983 we decided that we needed a build up in the trust fund for the first time. We decided it rationally because we knew that demographics were going to show that when the baby boomers reached retirement age there would be far fewer productive workers supporting far more retirees. And it seems to me that was good rational policy. The difficulty is that the reserve is now being misused and probably will be misused in the future.

And if you do not have the funds in the reach of Congress, that is good; but if you do not have any reserve, that is not good because the benefits will not be there for the retirement of people who deserve to have them.

President Bush, I think, correctly said that if you cut the tax now you are simply going to have to increase it later and I would say to very, very high levels later, or you are going to have to cut the benefits; and neither of those alternatives are ones that any Congress would ascribe to, neither now nor then.

So what should we do? It seems to me, and it is the only way I know of of properly addressing this problem, it seems to me that we can do this right if we in effect cut the tax rate and rather than consume it we save it and invest it. And there is only one way to do that.

What we should begin to do, I believe, is to refund annually the amount not needed for current benefits and for disability into individual Social Security retirement accounts for every American worker, that they would own and invest, that they would hold according to certain standards in the law and that would be available to them upon their reaching retirement.

It would work this way: Each worker would get a refund annually. That refund would be payable to his or her Individual Social Security Retirement Account (ISSRA). It could only be invested in that account, which would be held by what would be called a Social Security trustee, which would be a bank, insurance company, a stock broker or other money manager. They would have to be bonded. They would be criminally liable to invest that according to certain fixed fiduciary investment standards and would hold that money, invest it, and reinvest it, have the interest compound to the benefit of the individual until that individual reached retirement age, at which time it would form a portion of their retirement benefit through the purchase of a life time annuity.

The economic effects for the individual, I think, would be very, very profound. It would give every American worker a direct financial stake in the success of the American economy. People who had never been able to save a dime would become the owners of a savings account that would have tens and eventually, perhaps, hundreds of thousands of dollars in it that they would own. If they die prior to reaching retirement age, that that account would pass to their families or children.

The effects for the economy, I think, would also be very profound. We are very, very heavily dependent upon foreign capital in the United States today. This would tend to build a base of domestic savings in capital that would get us off of that dependency on foreign capital, tend to increase the pool of capital in our country, drive down interest rates and help expand the economy for the future.

There would have to be certain features worked out, that can be worked out. We have a skew in our system today toward lower income people—people who have not worked very long and have not qualified more than the minimum for Social Security benefits. That skew would have to be retained and should be retained through a Social Security trust fund, the same way we have it today. The disability program would have to be retained that way also.

But as you can see, this is a forced savings system. And I have to say, there was an article in the Wall Street Journal this morning that indicated this was supposedly voluntary. It has never been a thought of mine; although it may have been the thought of others. This would be a forced savings program and it would, I think, provide well for the individual, well for the U.S. economy. It would protect the reserve that will not otherwise be protected. It would stop us from using the reserve to cover deficits and have it consumed currently and not be there when we need it in the next century. And finally, it would amount, in effect, to a tax cut that is rather saved than consumed.

I commend it to your thinking and I hope you give it serious consideration. I thank you for the opportunity to testify.

[The prepared statement of Representative Porter appears in the appendix.]

The CHAIRMAN. Thank you, gentlemen.

Mr. Porter, there are a number of basic protections in the Social Security system for retirees, and they are basic protections that are terribly important to the American people. One of them I think you may have touched on and that is the question of a young breadwinner in a family who dies of cancer or has some severe disability.

Did I understand you to say that you would provide for survivor and disability benefits?

Representative PORTER. I wouldn't change the disability portion, nor would I change the skew toward lower income people reaching retirement.

The CHAIRMAN. I heard that. Let me ask you another one.

We get concerned about inflation and what those benefits will be once retirement is reached and the Social Security system protects on that so far as the cost of living. The ones so-called privatizations of Social Security that I have seen have not protected against that, now would yours?

Representative PORTER. Well as you can see, this would be a mixed system for a long, long time. Part of the benefits would come from individual Social Security retirement accounts for most people and part would come from the Social Security trust fund. I am not worried too much about the inflation problem because I think the investments in the private sector would be substantially better in terms of real interest rates than could be received from Social Security, from investments in the public sector and so forth.

The CHAIRMAN. But I don't understand what it would be.

Representative PORTER. I think that part could be handled both through the trust fund and through the fact that there would simply be more resources available to provide for that kind of adjustment.

The CHAIRMAN. But I do not see a defined benefit from what you are talking that is correlated, tied specifically to cost-of-living increases.

I, frankly, have never seen one that has been offered by the private sector. I used to be in that business. I do not see quite how you would do that.

Representative PORTER. I think it can be done, Senator.

The CHAIRMAN. Are there further questions of the members of the panel?

Senator SYMMS. Mr. Chairman?

The CHAIRMAN. Yes.

Senator SYMMS. I would like to ask a couple of questions. I thank the witnesses for being here.

Congressman Porter, as I understand your proposal, it is the same as mine on the savings side. And I admire and respect what your goal is, to have real savings for peoples' retirement.

I think the differences are on the benefit side where you would address the demographic problem of Social Security financing in 20 years by linking the benefits in the savings account to benefits in the pension formula. Is that correct?

Representative PORTER. I would adjust the draw.

Senator SYMMS. In other words, like you have tier one and tier two.

Representative PORTER. I would adjust the draw. As you move gradually along in this system, I would adjust the draw on the Social Security trust fund for the amount distributed annually into individual Social Security retirement accounts. Yes.

Senator SYMMS. Well just to carry that. The only difference, basically, between your plan and my plan is that I do not change the tier one benefits.

But to carry that one step further, as you look into the future—and I want to compliment you on some of the things I have seen you do in the House with respect to immigration, particularly people from Hong Kong—I think that the demographic problems in 20 years that a Congress many come in here, the 110th or 112th Congress, and look at this and think that maybe what they need to do is to make some adjustments on immigration policy if our birth rate is out of whack or slowed. Do you agree with that?

Representative PORTER. Do I agree that——

Senator SYMMS. Yes, I mean that immigration might have the impact so that there would not be a necessity as you have in your plan to even adjust the tier one benefits.

Representative PORTER. Well I think these things are unknowable in the nature of the future of this country and the various assumptions that are made try to anticipate them. But, yes, certainly we could have a far different situation regarding the availability of more productive workers than anyone would anticipate. Sure.

Senator SYMMS. And then just to——

Representative PORTER. Thanks for your compliments on that.

Senator SYMMS. Mr. Chairman, just to point out, if we had a 2 percent compound interest for a worker who was 18 today and retired at age 67, they would have a $37,700 secondary defined benefit as in the Porter plan; at 5 percent, they would have $91,800; at 7 percent they would have $176,300+. So it would be a substantial portion of their benefit by that time. I think it could be done.

Senator Kasten, I understand that your proposal is the same as Senator Moynihan's but you do not increase taxes in 20 years. Is that basically it?

Senator KASTEN. The Moynihan proposal ends up down at 5.1 percent; we end up as low as 5.3 percent. Ours is phased in and the big difference is that we do not force tax increases elsewhere. By taking Social Security off of the budget, which I think is the only fair thing to do, and by, therefore, adjusting the Gramm-Rudman targets you will not have to increase taxes and in fact will encourage economic growth.

Senator SYMMS. And you do not try to destroy the Gramm-Rudman by just leaving all those numbers out there in an impossible task, you just slip the target date.

Senator KASTEN. What the difference will be is that we will balance Gramm-Rudman in an honest way with our plan and our schedule to 1997, as opposed to meeting Gramm-Rudman targets in what I believe is a deceptive way before that by including the Social Security surplus.

Senator SYMMS. One further question. I noticed that the AARP have supported an 18 month reserve. What did you say about that? I think we should have an 18 month reserve also. Do you have a 12 month reserve or an 18 month reserve in yours?

Senator KASTEN. Our reserve reaches 123 percent in 1996. It is Table 3 in the back of my statement. But we are at 102 percent in 1992; we are at 123 percent in 1996; and we go to just over 150 percent in the year 2000.

Senator SYMMS. So that would be 18 months then.

Senator KASTEN. It is not only the AARP, but the AFL-CIO was interested in reaching those kinds of targets. I think we do need to establish at least 100 percent. We go beyond that, as you see, to 125 percent and then to 150 percent.

Senator SYMMS. Now if I could ask one last question, because I like your plan also, second, of course, to mine. But it has merit.

In the Porter plan and in the Symms plan it for savings. We openly say that. People will be forced to save. How much do you predict through your numbers of how much potential family savings would increase voluntarily with that tax cut?

Senator KASTEN. Well the difference is that I do not want to in any way privatize or threaten the existing Social Security system. I know that there are different degrees of concern about that and I am not suggesting that the Porter plan is doing that. As he mentioned, the Wall Street Journal wrote about it this morning. My plan preserves the Social Security system—the benefits, the increases, et cetera—that Senator Bentsen was talking about.

I believe that rather than the dollars going into a forced savings program, what we want to be doing is encouraging private savings. I think that if we allow families to make the right decisions they will make decisions, including decisions to save, not government mandated savings. I think that we should go further and enact tax incentives, such as the President's Family Savings Act, and also individual retirement accounts.

People need extra take-home pay in order to make the private decisions—the private savings decisions that they are going to make. Government should not mandate those decisions.

Senator SYMMS. Thank you, Mr. Chairman; and thank you, my colleagues for your testimony.

The CHAIRMAN. Yes, Senator Durenberger.

Senator DURENBERGER. Mr. Chairman, I cannot pass up the opportunity to ask three elected political figures—all of whom will not threaten the Social Security like the rest of us—if they have any views of sort of other issues involved in the reform of Social Security.

We have talked about what to do with the surplus and all three of you are experts on that subject. Pat Moynihan is an expert. I suggested we ought to be doing something to make sure we concern ourselves with the health insurance problems we have for the elderly as well.

But there is another issue which the Chairman implicitly raised in his opening statement, which is the regressive nature on the tax on work in this country, and how in effect we relieved the progressive tax on income of some of its progressivity. And this is an arguable point, I guess, created some regressivity with the substantial increases or accelerations on the payroll tax and some people have solutions to that. Chris Hollings has a solution, which is a value-added tax which takes some of it off. That is one thing I would like your observation on.

The next one is that social insurance tax or the OASDI tax or the HI tax really is not a tax. The old fashion notion was articulated here again on Monday by Gwen King and that is that it is kind of like a premium. It is an investment you make and it is inappropriate to take the earnings cap off, for example, and convert it into a tax. But the Democrats on this committee have already proposed we take the earnings cap off at whatever it is now—$52,000—and let it ride.

The fourth is the potential for reform on the payments or the receipts from this. Many of us voted for the catastrophic bill which began to change this very progressive nature of the receipt of Social Security and to skew that in the direction of those who have perhaps paid a little more or receive a little less. I wonder if any of you are prepared to make any comments on those three issues.

Senator KATSEN. Senator, first of all the chart that I referred to showing middle class tax burden, this chart, makes your point. And Senator Bentsen is correct. Dividend checks might be treated better now, but checks for work are treated worse. Just go back and look. A median income family of four, in total Federal taxes in 1955, they paid 9 percent; total Federal taxes in 1970, they paid 16 percent—this is a median income family of four, working family—and in 1988 they paid 24 percent.

And then you go back and look at why and the answer is that the payroll tax has gone from 4 percent total—2 for employees plus 2 for employers—to 15.3 percent today. That is why. And that is the problem we have in putting people to work in that initial entry job—the first rung on the ladder. We have reduced their income tax—and we did that in tax reform—but we did not reduce their payroll tax. So the welfare family, the welfare mother, whatever, making that decision to take the first job at McDonalds, she has not been helped, she has been hurt by this increase in the payroll tax. That is bad. That is wrong.

I believe that we have a compact between generations. But that compact does not provide for tax increases in the name of Social Security which only serve to mask the Federal deficit and take away incentives for work.

Representative PENNY. If I might jump in just to add a couple of observations. I recognize the resistance to Senator Moynihan's legislation. But there are other opportunities available to us that would achieve many of the same objectives. Simply moving Social Security off budget and applying Gramm-Rudman to the remaining accounts alone would force that fiscal responsibility in much the same way without raising the question of whether we are going to need these Social Security dollars in the future.

But we are not protecting them right now. That is the key issue. If we do not balance the rest of the accounts, we are going to have to borrow money to repay these Social Security funds when the baby boom generation retires.

The first question you asked had to do with the regressivity of the payroll tax. We might want to consider not implementing—rolling back the last increase, not implementing the next increase since we are only using this money to finance the deficit anyway, and raising a similar amount of revenue through the income tax structure.

That is a possible trade off. The same dollar amount. But I would guess that for most wage earners it is going to be a net tax savings, if we would take that kind of action.

Secondly, you said what about the long-term. I do not think any retiree today or anyone nearing retirement age has to worry that this Congress or this Administration is going to modify the benefit structure under the Social Security system. But I think it is increasingly doubtful that we are going to have a sustainable system in the future if we do not look at some modifications.

When Social Security was first enacted in the 1930's the life expectancy was in the mid-sixties, as I recall. And we set the retirement age at 65. I do not know that there is anything out of the realm of the acceptable to look at a somewhat higher retirement age than the one we have already slated, 67 under the Social Security reforms of 1983, and maybe moving that to 70 by the year 2020 or 2030 and also looking at the question of how high should these COLAs go.

Should the wealthiest retirees get a full COLA or not? And if we signal my generation, the folks that are not going to retire for another 20 or 30 years, that there might be some changes in the benefit structure in those two areas, it reduces the payout of the fund in those future years and eliminates the need for us to raise taxes on our kids to finance our retirement. If we know that far in advance, we can make other plans accordingly.

The CHAIRMAN. Thank you, gentlemen. I believe your time has expired.

Were there other questions?

Senator MOYNIHAN. A comment, Mr. Chairman.

The CHAIRMAN. Yes.

Senator MOYNIHAN. Just a comment to thank our panel for some very fine testimony. Mr. Porter, President Bush has already referred to your proposal as innovative thinking. I welcome Mr.

Penny as a baby boom representative, he says, and he will be around here a long time, longer time than we will. But also, particularly to thank our colleague, Senator Kasten, for having gone to the congressional Research Service or whatever you did to get their statement, with respect to the surpluses, that no record exists showing that Congress seriously considered building a fund or how such a fund would actually save resources.

Mr. Chairman, if I could say to you and to Senator Packwood, I think it is the case that those of us on the Commission knew there would be large surpluses coming. But we did not think anybody would believe it; and we thought we would wait until they were in place to say, "You see, now here they are." And the last year and a half our Subcommittee has been saying, sort of, "Here they are."

What I would like to suggest is that we are now having that debate. We are beginning that debate—perfectly open, sensible thing to be doing. And I thank Mr. Kasten for pointing it out.

The CHAIRMAN. Are there further comments?

[No response.]

The CHAIRMAN. Gentlemen, you have contributed to the debate and we are appreciative of your attendance.

Representative PORTER. Thank you, Mr. Chairman.

Senator KASTEN. Thank you.

The CHAIRMAN. Our next witness will be Hon. Richard Darman who is the Director of the Office of Management and Budget.

Mr. Darman.

Mr. DARMAN. I DO NOT KNOW ANYBODY IN TOWN THAT IS ANY BUSIER THAN YOU ARE OR THAT HAS A TOUGHER JOB AT THE MOMENT. We are very appreciative of having you here.

I hope this will be the beginning of a serious and a bipartisan effort to extend real protection to the Social Security trust funds. That kind of protection means we are really going to have to work together to have true budget deficit reduction. That means some unpleasant choices that have to be made.

We are delighted to have you here and prepared to hear your testimony. And then I am sure there will be quite a number of questions that will be asked of you.

Senator Packwood, do you have any comments?

Senator PACKWOOD. No comments, Mr. Chairman.

The CHAIRMAN. If you would proceed, Mr. Darman?

STATEMENT OF HON. RICHARD DARMAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. DARMAN. Thank you, Mr. Chairman. If I might I would read a relative brief introductory statement.

The CHAIRMAN. Surely.

Mr. DARMAN. Thank you.

Chairman Bentsen, Ranking Republican Senator Packwood, Senator Moynihan, distinguished members of the Senate Finance Committee, it is a pleasure to appear before you. You asked that I be prepared to respond to questions concerning Senator Moynihan's recent proposal to cut Social Security trust fund receipts by $55 billion in fiscal year 1991 and by substantially more thereafter; and the Administration's proposal to protect the integrity of the Social Security trust fund, while reducing publicly-held Federal debt.

Mr. Chairman, I appreciate that you had Congressmen Penny and Porter and Senator Kasten here also this morning. I did not know when I prepared this statement that they would be appearing directly before me—and I do not mean in any way to suggest disrespect for their own proposals by failing to comment on them at this time, I simply did not know that they would be appearing immediately before me.

I know that members of the committee will recall rising at the State of the Union address when the President said, "The last thing we need to do is mess around with Social Security."

The President's statement and the overwhelmingly favorable reaction to it underline our mutual commitment to protect the structure of benefits and receipts enacted in 1983 and known as the bipartisan Social Security compromise. Many of the members of this committee played important roles in the development of that historic compromise. Indeed, Senator Moynihan himself played a leading role. He participated as a key member of the core negotiating group—a matter about which he has spoken and written with justifiable pride.

I, too, was a member of that core negotiating group. And I, too, feel privileged to have had an opportunity to participate in what has been widely viewed as one of the more favorable examples of our political system rising to meet its responsibilities.

The 1983 compromise, and the related work of the bipartisan National Commission on Social Security Reform, recognized the need to move away from what had been intended to be a "current cost financing" system. The compromise, the Commission Report, and the 1983 Act consciously, specifically, and explicitly moved away from the near-bankrupt pay-as-you-go system, and moved toward a system with much higher reserves for the 1990's and the early part of the twenty-first century.

This shift, to build up higher reserves, was adopted for two basic reasons that are as relevant today as they were in 1983.

First, for the short term, lower levels of reserves made the Old Age and Survivors Trust Fund vulnerable to the possibility of economic downturn. I would note that even now the OASI trust fund has reserves that are less than sufficient to cover a full year's costs.

Second, for the longer term, the disparity between the large baby boom generation and the smaller succeeding generation necessitated the normalization of the Social Security tax burden across generations or else a current cost tax burden on future workers might be perceived to be prohibitively high, thus threatening the ability to pay the expected retirement benefits of the baby boom generation—that is, today's workers.

I would note that since 1983 neither the demographic nor the political facts have changed in a way that should dictate a different conclusion today. If Social Security reserves are not built up for today's workers there would be more than sufficient reason to question whether their expected benefits would, in fact, be paid.

The practical reality is that a proposal to switch back to the current cost financing system that was rejected in 1983 could have one or both of the following undesirable effects: It could threaten a return to the days of short-term trust fund financing crises; it could—and likely would—jeopardize the retirement benefits of today's workers.

Unfortunately, Senator Moynihan's recent proposal runs not only these risks; it also risks creating fiscal policy havoc. It would either abandon budget discipline altogether; or it would require offsetting deficit-reduction measures amounting to $55 billion in fiscal year 1991 and more thereafter. Since additional spending reduction of this magnitude is not contemplated, it would seem to suggest a major offsetting tax increase (such as that proposed by Senator Hollings). But this, of course, would hurt the very workers Senator Moynihan's proposal is ostensibly intended to help.

Indeed, it would hurt them doubly: First, by jeopardizing their future retirement benefits; and second, by taking back in new taxes what it pretended to give in the way of a tax cut.

For all these reasons, it is understandable that not only the Administration and many distinguished members of Congress, but also the American Association of Retired Persons have concluded that—and I quote from their February 2 statement: "The first preference remains retaining existing Social Security policy to continue to build the reserves for future generations."

For its part, the Administration is unwilling to give up on the 1983 bipartisan Social Security rescue and compromise. We are unwilling to give up on funding the retirement benefits of the baby boom generation and unwilling to give up on the effort to restore fiscal discipline.

Accordingly, we must respectfully reject the recent proposal of Senator Moynihan. We would urge instead a return to consideration of the type of approach with which Senator Moynihan was previously associated—indeed as late as 1989—when he argued for a combination of a build up in trust fund reserves, as in the 1983 Act, a reduction in the non-Social Security deficit, and renewed emphasis on savings and investment.

We do not mean to suggest that there is not a problem to be dealt with. We mean only to suggest that Senator Moynihan's latest proposal, as opposed to his earlier approach, seems to give up on the problem just when I believe the political system is preparing to deal with it.

It is important to be clear about what the problem is and is not. Our problem, at the moment, is not an excess of revenues relative to spending. Although that would seem to be the problem that Senator Moynihan's recent proposal would address. Nor is our problem thievery or embezzlement, as some have suggested, if those terms are intended in any way to suggest something illegal or something of which the Congress was not fully aware. Social Security taxes are being collected in accordance with the law. Social Security reserves are being built up in accordance with the law. The reserves are held in the form of Treasury securities backed by the full faith and credit of the U.S. Government as is required by law. Social Security is treated as off-budget, as required by law, except with respect to calculations for Gramm-Rudman-Hollings, which include Social Security as specifically decided and required by law.

The problem is a derivative of this set of existing legal requirements. It is simply this: By including the intended Social Security operating surplus in the Gramm-Rudman-Hollings deficit calculations, as required by law, the full magnitude of the non-Social Security deficit is masked. To the extent that this, in turn, causes the non-Social Security deficit to be higher than it might otherwise be, Federal debt held by the public is also correspondingly higher. And to the extent that publicly-held Federal debt continues to rise, it threatens to leave an undue burden for the future, when the intentionally rising Social Security trust fund obligations—that is, the reserves—will have to be redeemed.

Our proposal to establish a Social Security Integrity and Debt Reduction Fund is intended to address this problem. It would allow reserves in the Social Security trust fund to be built up exactly as under current law and as in the 1983 compromise; it would require the non-Social Security budget to be balanced, after an orderly phase-in; it would extend the Gramm-Rudman- Hollings law beyond 1993, requiring a balanced G-R-H budget in 1993 and permanent balance thereafter; and it would allocate the equivalent of the annual Social Security operating surplus to a Debt Reduction Fund, requiring that this transaction be charged as outlays in the G-R-H deficit calculations; and requiring that an equivalent amount of publicly-held Federal debt be retired in the process, after a phase-in period that would be complete in fiscal year 1994.

This approach effectively leaves Social Security subject to the Gramm-Rudman-Hollings discipline, while it adjusts the G-R-H deficit calculations to remove the masking effect of the annual Social Security operating surplus.

Among its useful practical consequences would be the following: The Social Security trust fund would be protected and would not be a victim of raids on the reserves, which would build up exactly as under present law for the protection of future retirees; the national debt held by the public would be reduced by substantial amounts each year with favorable effects on interest rates, investment and the future capacity to fund Social Security obligations; the total G-R-H budget each year would be balanced, without using Social Security operating surpluses, and there would be no G-R-H "surplus" to create a temptation for additional spending.

We are aware of several other proposals and possible changes in the accounting and budgeting systems that are being considered by various Senators. Some of these could have the same favorable effects as the Administration's proposal, although they may be structured somewhat differently. We are not wedded inflexibly to our own proposal, and we are happy to work with any and all Senators who might advance a responsible way to correct the deficit-masking problem that inheres in current law.

We believe that this can and should be done without giving up on the obligations of the 1983 Social Security compromise. Indeed, we believe that by correcting the accounting and budgeting systems in a manner that accomplishes what we recommend, generations of the future will be better able to honor the Social Security commitments that we have made.

Thank you very much, Mr. Chairman and members of the committee, for the opportunity to introduce the Administration's position. I would look forward to responding to your questions.

The CHAIRMAN. Thank you very much, Mr. Darman.

Just for the record, in defense of Senator Moynihan, I note your quote here of AARP saying that their first preference remains, "retaining existing Social Security policy to continue to build the reserves for future generations." But then I have the AARP statement that goes on to say, "No pay-as-you-go financing should be implemented until the trust funds accumulate a prudent level of reserves equal to 18 to 24 months of benefits." So it is a qualified statement that they have put in there.

Now, Mr. Darman, when are we going to get on with real deficit reduction? What we are looking at here, as you know, is a budget that you sent us that gives us an illusion of progress toward deficit reduction. It shows a 1985 deficit of $212 billion being cut to zero by 1993. But a lot of that, of course, is by counting the reserves built up in Social Security.

CBO's numbers show that the deficit, excluding Social Security, will actually grow by $17 billion between 1985 and 1993. And we have nearly doubled the national debt since 1985.

According to the General Accounting Office, the Administration's decision to wait until 1996 to fully resolve the Social Security budget issue will add an additional $1.5 trillion to the national debt.

Why do we wait?

Mr. DARMAN. Senator, we would be prepared to work together with you and your colleagues on an approach which could achieve deficit reduction more quickly, if that is what you are suggesting. We have, as you know, submitted a budget that would reduce this year's deficit by $37 billion. Some might say that is way too little in relation to the size of the problem.

I think you would find—and I know you have other economists speaking today—I think you would find that many of them would suggest that we ought not to go too much faster than, say, 1 percent of GNP a year in deficit reduction—that would be $50 billion, roughly, if we were to move up from $37 billion.

I would note that at least so far I have testified before the Senate Budget Committee, the House Budget Committee, the House Appropriations Committee, the House Ways and Means Committee, and several others in the last week and a half. I have so far not received a single suggestion in all of this testimony for how we should do more than $37 billion—not one suggestion. And we do have two proposals on the table, one from Chairman Sassar and one from Chairman Panetta, the two chairmen of the Budget Committees, to achieve deficit reduction on the order of $30 billion a year. Actually Senator Sassar's is a net of $17 billion a year.

So if there is a disposition to do more than $37 billion we are certainly prepared to discuss that on the merits.

The CHAIRMAN. Let's talk about the merits then of how you accomplish it. One of the deep frustrations that I have had in chairing this committee in reconciliation the last time—and I know some of the other members of this committee share it—is the difficulty of pinning down what counts as deficit reduction.

I can recall—and I sent you a letter on this and you have answered it, but I would like to further explore it—last year you specifically opposed proposals to delay Medicare payments by one or 2 days. So we did not include that provision in the budget bill, partly due to your admonitions on it. Then, much to my surprise, the Health Care Financing Administration issued a notice in December indicating a rather unusual way for paying Medicare claims. Payment would be speeded up during fiscal year 1990 and then slowed down again during 1991. And the CBO estimates the net effect of this plan would shift about $1.5 billion out of the deficit calculations for fiscal year 1991. That sure looks like a double standard to me.

Medicare pay shift is deficit reduction for OMB, but not for the Congress. Now if the payment speed up were in effect for all of fiscal year 1990 the Medicare trust funds would lose about $100 million in interest.

How do you justify that? I just want to be operating under the same set of rules when we try to come down with numbers and we have the problem here in this committee of trying to decide what is acceptable.

Mr. DARMAN. I think that is an entirely fair point, Senator Bentsen, and I do not mean to reopen a sensitive subject. I do not think it helps any of us, but I am obliged to mention it.

When you refer to a double standard, we felt in the development of the budget and in reconciliation last year that when we came over to the Senate after the House action many, many months into the process we were suddenly informed that a standard was going to be applied to our proposals which would reject certain proposals on grounds that either they shifted in timing as in the case of capital gains or that they would lose revenue in one of the out years that is the so-called Byrd rule which is appropriate.

And in that context a new set of standards was applied——

The CHAIRMAN. Let me say, Mr. Darman, I shared in some of that problem with what we proposed——

Mr. DARMAN. Yes, sir. We were both victims.

The CHAIRMAN [continuing]. Out of this committee. That is right.

Mr. DARMAN. We were both victims, but maybe the system was the beneficiary. Because what happened is, though we were very upset initially with that set of standards being applied against us, what we then asked was if that set of standards is going to be applied against us, then let's apply it uniformly, at which point you became an innocent victim just the way we had become an innocent victim as we saw it.

On the other hand, there is a legitimate good Government argument that can be made for the no gimmicks rule so we adopted it. And in putting together our budget this year, we tried to put together a budget with a minimum of gimmicks of the type that were discussed at the end of last year. We did include two timing shifts on the tax side—one of the them on the payroll and the other the telephone excise. But we specifically excluded them from our effort to meet the Gramm-Rudman target. We said that they make sense for a variety of reasons but they shouldn't count.

Now the one you refer to is a special case. It is not a policy proposal; it is something that has already happened. It is an estimating question about what has already happened. And CBO agrees with us as to how it has to be estimated.

So then we have to ask the question: Well should it have happened in the first place? And as I have explained to you privately but would repeat here for the benefit of the other Senators, what happened was, catastrophic health insurance was repealed. The people who were administratively intended to be responsible for catastrophic health insurance were left without a job, but they were still paid.

The question is: What should these people do who were going to be processing catastrophic health insurance bills and other things? The answer rendered by HCFA and HHS was, "Let them pay bills." The effect of their paying bills is that you are right, there are more bills paid than if they did not pay the bills.

The CHAIRMAN. Well let me make this point then. Because here you allege the support of the CBO. Now let me read to you——

Mr. DARMAN. Just on the scoring. Just on how it should be scored, not on the policy issue.

The CHAIRMAN. All right. Let me read to you what the Director says. Here is the letter dated February 7: "While we have made the decision to include the timing shift in our revised base line, this decision should not be construed as supporting the policy."

Mr. DARMAN. Right.

The CHAIRMAN. "This plan is clearly a budget gimmick." Clearly a budget gimmick.

Mr. DARMAN. May I add one further point?

The CHAIRMAN. That is what CBO says.

Mr. DARMAN. May I add one further point, Mr. Chairman? All I suggested was that they agreed with the scoring and I said they could disagree on the policy issue.

But let me try to put it aside this way. We have done in response to the two Budget Committees a little compilation of gimmicks over the last 2 years and have a list of 116 gimmicks that have been legislated. Of those, about 10 or 12 originated in the Executive Branch and about a hundred and a few originated in the Congress. I think we would all be better served if we get rid of gimmicks.

If it would help us advance the debate this year to say, put that billion and a half aside, I would be more than happy to do it and say we have some obligation to continue to try to reach the target without scoring that. But I think you will find that compared with the budgets adopted by the Congress and those even advanced by the Administration in the last 5 to 7 years, that this one is much, much closer to gimmick free than any recent budget.

The CHAIRMAN. Integrity by degrees. All right.

Senator Packwood, any questions you might have?

Senator PACKWOOD. Mr. Director, do you know of any way to narrow the deficit other than by cutting spending or increasing taxes?

Mr. DARMAN. Yes, increasing growth which would increase revenues.

Senator PACKWOOD. All right, we all presume some growth, which increases revenue. People say your projection is higher than it should be. Last year you projected roughly on target and everybody else was a bit low. At some stage we will enter into the record the GAO study that was done in 1986 on your projection, CBO's projections, and private projections. It basically says OMB is slightly more likely to be accurate than the others.Your projection was slightly better, but no one has a lock on exactness.

[The study appears in the appendix.]

Senator PACKWOOD. Given the growth, and the question the Chairman asked—when are we going to get down to serious deficit reduction—we get into a debate about payment shifts of a billion or a billion and a half dollars in operating deficits, if you do not count the trust funds, which are in excess of $200 billion.

I would come back again to the question I raised at the start of these hearings. If we are going to have a genuine tax increase—I do not care if it is payroll taxes; or an increase the upper rate to 38 percent, which I would not support; or a value-added tax, which Mr. Reischauer talks about in his testimony—how do you guarantee that the money goes for deficit reduction?

Mr. DARMAN. You cannot by any way that I know guarantee it, unless you have some much more tightly disciplined automatic control system to correct on the spending side if you deviate from what would be the necessary spending targets to assure that the increased revenue went to deficit reduction.

In other words, you would need something like Gramm-Rudman, but considerably tighter and tougher. It could not have the Gramm- Rudman loophole. It would have to have a number of tougher characteristics than the current G-R-H law.

Senator PACKWOOD. Well you almost need a Constitutional sequester or equivalent. Anything short of that is easily changeable by all of us when it is inconvenient.

Mr. DARMAN. Right.

Senator PACKWOOD. Are you familiar with the Congressional Budget Office's arguments about the change in the progressivity of total taxes in this country?

Mr. DARMAN. Yes. I was given their study as I testified before Ways and Means Committee on the day before yesterday; and I have a copy here, actually.

Senator PACKWOOD. Do you agree with their analysis?

Mr. DARMAN. I have not had a chance to look it over in depth, and we are going to do that. But on a quick examination, I would not say it is the kind of thing one should agree with or disagree with. But you could make these comments: It has a number of methodological peculiarities that are arguable.

For example, if one is really trying to look at what is happening with this system, I believe—I am not certain this is correct—that if somebody does not pay any tax at all they do not include them in the average, just to pick an example. And so tax reform which took 6 million people off the rolls, you do not get credit for that, in that those people do not count because they are not paying any taxes. So the lower end of the system which is actually improving does not look as if it is improving because they define the lower end of the system, I believe, to be only the lower end of those actually paying taxes. That is an example.

They do not seem to include at all the effect of transfer payments. And, of course, what has been happening over the same period is that transfer payments—and over a longer period—have been going up just as some of the social insurance portion of the tax burden has also been going up. If you were to include those, you would get a very different picture.

And then they do some things which are correct, but they are sort of misleading—traditional, statistical tricks. Let me pick a quick example. What they do is they take percentages of very small bases. Let me see if I can quickly find an example.

I do not have the right table handy quickly. I will look for it if I get a moment. But essentially, to make my point, if you take the lowest quintile, even flawed in the way it is defined, as I believe it is, and you say what was the effective tax rate in 1980—I do not have it handy, but I am going from memory—it was a number like 8.7, 8.8, something like that. It moves to a number like 9.1 by 1990 in their calculations.

They then take that very small change and they take it as a percentage of the small base. So it looks like a very large percentage change. And then they make that great big bar chart that makes it look as if there is this great big change, which is a percentage of a percentage that is a small percentage in the first place. So they convert a very small change into what looks like a very big percentage change.

If you take the same table and you compare 1990 with, say, 1985 you find that the conclusion can be reversed. It is not wrong, but there is something a little bit artificial about using 1980 versus 1990.

Now we have not had a chance to go through this fully. But just prima facie, there would appear to be a whole host of what I would call displays intended to support a conclusion.

Senator PACKWOOD. Thank you.

Senator Moynihan?

Senator MOYNIHAN. Mr. Darman, we thank you for your thoughtful testimony and even more complex responses as we go around here.

I could not but recognize the passage from David Stockman's book that the Chairman quoted in his opening statement about a situation where you were talking to Mr. Stockman in July of 1981 and you suddenly realized that the tax measure going through the Congress was going to produce tremendous deficits, particularly as you began to buy votes—when one particular delegation called up and such and such a State was for sale, you bought it. And Stockman asked "Well, what will we do?" and you replied, "We win it now, we fix it later."

Well I could not resist sending for my copy—and Mr. Stockman got paid $2.5 million for this, so it must be true. [Laughter.]

Think about that.

Mr. DARMAN. Do you accept all of his views in there as true, Senator Moynihan?

Senator MOYNIHAN. In the roaring 1980's one who got paid $2.5 million did the right thing. [Laughter.]

He says, "The following Monday,"—that is after your conversation where you said "We win it now, we fix it later"—"the following Monday evening, July 27, the President addressed the nation on TV. He delivered a masterpiece of propaganda. If Presidential speeches were covered by a full disclosure law, the true meaning of this one would have caused an absolute panic. Our bill was going to reduce the Federal revenue base by $2 trillion over the course of the decade."

That is exactly what happened. And he said there was not a hint, not one centilla, about what all this fabulous giving actually meant. It meant you would have a permanent deficit. And, indeed, you did try to fix it and so forth. It never got-fixed; it does not get fixed.

It was devised as a mode of disciplining Congress about behavior which was not approved of—social spending, basically. That is the issue we have here.

You say that this deficit is now structural. We have the Comptroller General say to us the other day that very shortly now debt service, interest on debt, will be the largest item in the budget—reach out 5 or 6 years and it is there—more than Social Security, more than defense. And more and more we pay for it with this regressive Social Security tax.

In your budget which you sent up, sir, you have I think $13.9 billion in additional revenues—$4.9 billion comes from the capital gains tax, which will pick up money for 2 years and then lose it indefinitely, so the deficit gets higher; and then you have another item of $4.7 billion in additional Social Security payroll tax revenues which would come from extending Social Security coverage to State and local government employees.

Now I guess I have to ask you this, because your proposal for a Social Security Integrity and Debt Reduction Fund is a thoroughly serious proposal, it is a thoroughly comprehensive and internally logical proposal. Mr. Dale of OMB came up last night and walked us through it. It makes a great deal of sense.

But, sir, it does two things—and I ask you if you would agree—it assumes we will have a balanced budget including the Social Security trust funds by the year 1993, and it assumes that that after 1993 we will have and maintain a balanced budget excluding the Social Security trust funds.

Mr. DARMAN. Yes, Senator Moynihan. Thank you for your kind comments about the proposal. I should just like to underline my appreciation of them.

Senator MOYNIHAN. Sure. They were meant.

Mr. DARMAN. I believe you said it was thoroughly serious and quite a number of other favorable things which I want to just make absolutely sure the record is clear.

Senator MOYNIHAN. But how serious is the assumption that we will have in perpetuity 25 years of unbroken balanced budgets?

Mr. DARMAN. Well I have absolutely no way of knowing. But I do believe that we have an internally consistent approach, as you have suggested. And that in effect what it means is that you would be buying down publicly-held debt in the amount of the Social Security surplus each year, which is analogous to running a traditional consolidated budget surplus in that amount, which is the proposal you—if I may say respectfully—used to be for.

Senator MOYNIHAN. I was for it until I decided it was never going to happen.

Mr. DARMAN. Well we have done something which I do not think would be necessarily too popular, but I think adds to the internal consistency. In order to help make this happen we have tried to tighten the discipline associated with Gramm-Rudman. We have—I do not think I should divert the discussion in this direction—but we have a second sequester built into our proposals on budget process reform.

And unless we somehow improve the discipline of Gramm-Rudman itself, which we would be relying upon as a mechanism to assure that the non-Social Security budget were in balance on a continuing basis, you would have no real basis to believe that the political system would run what would amount to, by traditional ways of looking at it, a surplus over all those years. But I do think it is an internally consistent proposal.

Senator, could I ask one privilege?

Senator MOYNIHAN. My time is up and I thank you.

Mr. DARMAN. Senator Bentsen, you and Senator Moynihan have both referred to that Stockman book. If I could, I would just like to attempt to clarify one thing for the record.

First of all, I do not recall the exchange in exactly the way David Stockman does. But what he was saying is not inconsistent with what would have been some of my thoughts at the time. But I do not recall it in exactly the way that he put it.

But to the extent that I was talking about "winning" at that time, which was June, and fixing it later, may I please make this very clear. The later we were talking about was in September of that year in conjunction with the second budget resolution, which then used to exist and does not now. And we were in the process of negotiation with Senator Dole, Senator Domenici and a number of other members of the Senate and House on a correction. It was very close to agreed as a potential compromise—fiscal policy correction—for the later that was September/October, when all of a sudden we had another Stockman publication, which was the Atlantic Monthly article. At that time, as you will recall, everything blew up.

But the later we had in mind was a matter of months, not a matter of decades.

The CHAIRMAN. I have said a number of things in my past I would like to go back and reinterpret too. [Laughter.]

Senator Heinz?

Senator HEINZ. Thank you, Mr. Chairman.

Dick Darman, you were in Washington, D.C. during 1982 and 1983, guilty or not guilty?

Mr. DARMAN. Guilty.

Senator HEINZ. You are quite familiar with the deliberations, you have said as much, about the Social Security Solvency Commission. One of the issues that is very pertinent to the idea of reducing the revenues to the Social Security system as the Moynihan plan does to the tune of $55 billion next year and increasing amounts in future years is to what extent returning the system to a so-called pay-as-you-go system might jeopardize our ability to meet commitments to both today's retirees and future retirees.

It is argued that even if you returned the system to a pay-as-you-go basis senior citizens would have nothing to fear because Congress would make sure that they always got their money.

Nevertheless, Congress attempted on two occasions to avoid Social Security going into bankruptcy—once in 1974, another in 1977—neither of them worked and the result was the impasse we got into in 1982, resulting in the 1983 amendments. People may have forgotten how difficult it was to get consensus on solving the Social Security solvency problem. People forget that as of November—in spite of the fact the Commission had been meeting for a year—there was absolutely no agreement. People forget that had the Commission waited just 2 months longer, checks would not have gone out in 1983. And people forget that what was required to get an agreement was three things: (1) an increase in Social Security taxes that a lot of people opposed; (2) a decrease in benefits, both for existing and future beneficiaries; and (3) substantial contributions from general revenues because the first two groups did not want to be taxed or take benefit cuts anymore than they already had. You remember that process.

Would you say that reaching agreement, even with the eminent insolvency of Social Security at that time was easy?

Mr. DARMAN. No, it was exceedingly difficult. And as you will recall, and Senator Dole, and Senator Moynihan, we were all working until late at night, day after day, secret meetings, because people felt that it was so explosive politically—which it was—and it was only with the most remarkable combination of cooperation and I would even say delicacy or artfulness that we were ultimately able to reach agreement.

Senator HEINZ. Only one-third of the revenue short fall in that first period between 1983 and 1989 was made up through increases in payroll taxes. One-thirds of it were made up, as I recollect, from general revenues, or if you will, increased deficits, and the other third was from benefit reductions. Is that not about right?

Mr. DARMAN. I think it was one-third, one-third and it was an in between third that each side could interpret any way it wanted.

Senator HEINZ. Very well. Fair enough.

But no more than one-third was made up from payroll taxes; is that not correct?

Mr. DARMAN. Right.

Senator HEINZ. I guess my point, Mr. Chairman, is that if you cut payroll taxes, it is not very easy for Congress based on history to increase them again. And, in fact, that is not what we did do in 1983.

I would like to put in the record the statement of Mr. Roland E. King, fellow of the Society of Actuaries, member of the American Academy of Actuaries, the chief actuary of the Health Care Financing Administration. It comes from page 64 of the 1989 Trustees Annual Report on Social Security.

What it says in part is this—and this is very relevant to the projections about whether or not Social Security, if we adopt the Moynihan plan, will be in a state of financial crisis in the future.

He says, "During the 30 year period ending with 1987, real earnings increases averaged less than .9 percent annually." Thirty years. "But the Trustees long-term intermediate assumption, Alternative II-B, is 1.25 percent—over 40 percent higher than the experience of the last 30 years."

Anybody who does not think that the so-called intermediate assumptions are optimistic has to go up against the informed opinion of the Chief Actuary of the Health Care Financing Administration. What that tells me is that if we sign on to a so-called pay-as-you-go system that drains $55 billion to start with this year from the fund, we are going to invite crisis after crisis, and under a less optimistic set of assumptions, total insolvency and bankruptcy of the fund in calendar year 1998 under the so-called III.

[The statement follows:]

APPENDIX E.—STATEMENT OF ACTUARIAL OPINION

It is my opinion that, subject to the qualification described below, (1) the methodology used herein is based upon sound principles of actuarial practice and (2) all the assumptions used and the resulting cost estimates are in the aggregate reasonable for the purpose of evaluating the actuarial and financial status of the Federal Hospital Insurance Trust Fund, taking into account the experience and expectations of the program.

Although the projections in this report do not extend beyond December 31, 1991, the board of Trustees has adopted assumptions which underlie projections of the operations of the Federal Hospital Insurance Trust Fund 75 years into the future. During the first ten years of the projection period, the Trustees have assumed that real earnings in covered employment will increase at the rate of nearly 1.5 percent per year. This assumption is significantly different from actual experience during the ten-year period ending in 1987, when real earnings in the U.S. economy actually declined. During the 30-year period ending with 1987, real earnings increases averaged less than 0.9 percent annually, but the Trustees' long-range intermediate assumption (Alternative II-B) is 1.25 percent, over 40 percent higher than the experience of the last 30 years. Because of these large discrepancies between past experience and projection assumptions, with no plausible explanation for thesignificant improvement in future experience, I recommend that in future reports the Trustees reduce substantially the real earnings assumption to make it more consistent with reasonable expectations regarding future experience.

ROLAND E. KING, *Fellow of the Society of Actuaries, Member of the American Academy of Actuaries, Chief Actuary, Health Care Financing Administration.*

Senator HEINZ. Would that be your interpretation or not, Mr. Darman?

Mr. DARMAN. Just let me check the Alternative III assumptions for a second.

Senator HEINZ. Maybe you just want to give me your opinion on the first part.

Mr. DARMAN. What year did you say?

Senator HEINZ. 1998.

The CHAIRMAN. The time has expired but you go ahead and see if you can give him an answer.

Senator HEINZ. I'm sorry, Mr. Chairman. I am all done.

The CHAIRMAN. Do you want to give him a chance for an answer.

Mr. DARMAN. A quick look suggests that that is right.

Senator HEINZ. Thank you very much.

The CHAIRMAN. All right, thank you.

I see our Minority Leader is here, and with the many demands on his time I am sure that members will agree that we give him a priority from the early-bird arrival list.

Senator DOLE. Thank you, Mr. Chairman. I am just going to take a minute or two. I know you have some other outstanding witnesses that have not had an opportunity to be heard.

I want to thank Mr. Darman and thank you, Mr. Chairman, and ask that my statement be made a part of the record.

The CHAIRMAN. Without objection.

Senator DOLE. The main issue that I wanted to discuss is everybody keeps talking 1983. As I recall we did not raise payroll taxes in 1983, we went back to the 1977 Act and accelerated implementation of higher rates a year or two. It was a very difficult thing to do, I think we were finally successful because the Speaker and the President got together on the telephone and both said yes at the same time. That, essentially, is how it was worked out—late at night as I recall—10:00, 11:00 or midnight at the Blair House.

In any event, I also believe that when you look back at the 1981 tax cut you have to remember Congress added a lot of things too. I do not know how many billions. I know I added some and I assume other members of the committee did as well. Eventually, the add-ons grew into billions and billions of dollars over a several year period. We offered some change that the Administration later agreed to in estate taxes and other things, which I am certain were not originally recommended not because the President disagreed, but because of the revenue loss. So, we in Congress, may have contributed some to the increasing deficit.

Mr. Darman, the one problem I have when I go to town meetings in Kansas is trying to explain to my constituents how buying down the debt under your plan ought to please them. Maybe you could give us a 30-second explanation of why everybody should understand the advantages of your plan which we could pass on to our constituents.

Mr. DARMAN. Senator Dole, I think that we have a very difficult problem, politically, which is that Senator Moynihan's latest proposal is simply understood and because it is a tax cut or at least in its first bounce promises to be a tax cut, everybody understands that.

If you go try to explain to the ordinary people—even I would say many, many sophisticated people—in this town what is actually going on in the trust funds, and how the accounting works, and why you really have to be buying down debt held by the public, and why the trust funds are not really being looted because, what is happening to the trust funds is they are getting Treasuries. There is no better investment than that.

The question really is: What happens when it comes time to redeem those? And when it comes time to redeem those, if you have also built up this enormous pile of debt held by the public, it is going to be harder to redeem them on satisfactory terms. Every time I start down that path I see everybody's eyes glaze over.

So I am almost inclined to say we have to treat these as two separate kinds of issues. One of them is Senator Moynihan's proposal and those like it, which I would call at least in the first bounce the cut Social Security receipts proposals and the different ways to do that. And you have to decide, do we or do we not want to cut Social Security receipts. The flip side of the question is: Do we or do we not think we should be still building up the reserves? We are not even at 1 year's benefits at the moment.

If you think we should still be building up the reserves then you cannot start entertaining what I would call the Senator Moynihan type proposals. Settle that.

Then a wholly different issue, even though they are related—a wholly different issue. Now how can we fix up our accounting system—which is really much more of a local issue—so that we do not mislead ourselves into believing that we are solving the non-Social Security deficit problem when in fact as we build up the reserves it is masking the true size of that problem under our current legal accounting system?

The second one I cannot see as a matter of general national debate. It is something we ought to straighten out here and figure out how to do right. We are prepared to work with, as I have said earlier, all those interested in trying to do that right.

I appreciate that Senator Moynihan believes our proposal is a respectable way to go at that problem.

Senator DOLE. I think there is probably not a lot of support for the Moynihan proposal. I mean there is support. Senator Moynihan's plan has certainly started the debate and may have encouraged the Administration to come forward with its own plan—I am not certain whether you were working on this before the Moynihan proposal.

In any event, most people in my State do not want to change Social Security. I said the other day, we have had exactly two phone calls on the subject. I asked Gwendolyn King, the Social Security Administrator, how many calls they had had and she said 60. I am not certain how many the President had after his State of the Union message on Social Security, probably quite a few.

Although I think there may be some confusion, most people say, let's don't mess with Social Security. It was difficult enough to fix in 1983. Senator Moynihan should get a lot of credit for stimulating the debate, even though he may not get a lot of votes.

Mr. DARMAN. Thank you, Mr. Leader.

The CHAIRMAN. Senator Symms, would you mind deferring for a minute? Senator Pryor has an urgent commitment.

Senator SYMMS. I'd be happy to.

The CHAIRMAN. Senator Pryor.

Senator PRYOR. Thank you, Senator Symms.

Mr. Chairman, I just have a couple of questions. I would like first, Mr. Chairman, to insert a Table in the record. I think this may have been referred to while I was out of the room. It is a CBO Table on Total Federal Effective Tax Rates for all Families since 1977. One bottom line result or indication of that Table is that we see about a 16 percent increase in the effective family tax rate for the lowest percentile of the income of families in this country. In other words, a major tax increase creating a greater tax burden. And on the upper or top 5 percent we see a 9.5 percent decrease. These are CBO figures.

The second point I would like to bring up, Mr. Chairman, is that now we find that 74 percent of the American population—this is including employer's share—74 percent pay more tax under FICA today than they pay under income taxes.

Now we have a situation here, Mr. Darman, where we see a huge percentage of the population paying more into Social Security than they are paying income tax. We see a tax structure today that appears to be leaning definitely toward benefitting upper income individuals in tax burden. I wonder if that is where you think we ought to be on this so-called glide path at this point, because I do not think the Administration's proposal in anyway ameliorates any of these two concerns that I have.

Mr. DARMAN. Thank you, Senator Pryor.

I wonder, Mr. Chairman, if I could ask to submit to the committee for your further consideration an analysis of the same issue that we would prepare to follow up on some of the comments I made to Senator Packwood about methodological problems that I see here just looking at it quickly, in this CBO Report. I am not saying that it is wrong; it is done one way. But I would like to demonstrate what these numbers would look like if you did it another way.

The CHAIRMAN. I would be delighted to have them. It would be helpful, I think.

Mr. DARMAN. Two further points, Senator Pryor. I think you may not have been here when I tried to make this point with Senator Packwood. I didn't have the right Table in front of me.

[The table follows:]

FEDERAL EFFECTIVE TAX RATES FOR DIFFERENT KINDS OF TAXES FOR ALL FAMILIES—TOTAL FEDERAL TAXES

Quintile	1977	1980	1985	1990	1980-90 (percentage change)
Lowest	9.5	8.4	10.6	9.7	16.1
Second	15.6	15.7	16.1	16.7	6.0
Third	19.6	20.0	19.3	20.3	1.2
Fourth	21.9	23.0	21.7	22.5	−2.2
Highest	27.1	27.3	24.0	25.8	−5.5
Top 10%	28.7	28.4	24.4	26.4	−7.3
Top 5%	30.5	29.5	24.5	26.7	−9.5
Overall	22.8	23.3	21.7	23.0	−1.0

Source Congressional Budget Office Tax Simulation Model, as appearing in "Background Materials on Federal Budget and Tax Policy for Fiscal Year 1991 and Beyond," Committee on Ways and Means, WMCP 101-21, February 6, 1990, p 14

Mr. DARMAN. Do you have that CBO Report there?

Senator PRYOR. I do, yes, sir.

Mr. DARMAN. If you look at page 14, that is the Table I——

Senator PRYOR. I only have a summary, Mr. Darman. I do not have the full report.

Mr. DARMAN. Okay. Let me just tell you one of the points that I was making. They compare 1980 with 1990 and in 1980 they say that the lowest quintile for families had an effective tax rate of 8.4 percent, then in 1990, 9.7 percent. Then they take that change and they take a percent of the small percent—the 8.4 percent—and that is how you get that big 16.1 percent number.

Now if you look at—I do not know if you have the same Table—1977, for example, the differences between 9.5 and 9.7 percent. So if you took that two-tenths of a percentage point as a percent of the 9.5 percent you would reach an entirely different conclusion in terms of order of magnitude. So because they are taking percentages of percentages, they are rather seriously misleading.

And as I suggested also, I think they do not count people who have been taken off of the tax rolls, which as you will recall is one of the main things that tax reform did.

The second general point I would like to make in addition to suggesting methodological problems with the CBO report, I would like to show you this chart. I could just hold it up, but you may not be able to see, but I will provide it for the record. If you look at what has been happening to social insurance taxes, to which you referred, as a percent of the total budget, you are correct, they have been rising. That is this dotted line you see here.

[The information appears in the appendix.]

Mr. DARMAN. But if you now look at what has been happening to social insurance benefits payments as a percent of the budget over extended time periods, and shorter time periods, you will find that they are rising more rapidly and they are in all cases higher than the insurance taxes themselves.

So it is not fair simply to look at what is coming in. You have to look at where is it going when it heads out the door. And where it is going when it heads out the door is in the form of social insurance payments on a rather progressive basis back to individuals.

The reason that is relevant is not just to make a debating point, but also because it is not by chance that our system had these move together. If we start reducing the flow in on the social insurance side, I think we should expect that the political system at some point will reduce the flow out on the social insurance side.

Senator PRYOR. Mr. Darman, my time is expired and I took this time from Senator Symms, and I apologize. But just to summarize, the Chairman in his opening statement said that three of five Americans are paying more taxes today than they paid in 1980. I believe that was the Chairman's statement.

My conclusion is that that tax burden is falling very unfairly on the wrong shoulders.

Let me at this point leave. I thank the Chairman and Senator Symms.

The CHAIRMAN. Thank you.

Senator Symms, I appreciate your cooperation.

Senator SYMMS. No problem, Mr. Chairman.

The CHAIRMAN. I now recognize you for your comments.

Senator SYMMS. Thank you very much.

Mr. Darman, thank you very much. I think if I recall our history correctly President Jefferson was the first President that started paying down the public debt. It was finally paid off by President Madison and then we had to reborrow to keep the British from trying to undo the Revolutionary War. But we did establish a principle of trying to pay down public debt with surpluses. So, you know, compared with what we do today under current law, I would like to compliment you on your idea to at least take surpluses to start paying off public debt.

But I have one question that I would like to ask you about that and then I have another question to follow up.

How many trillion dollars of public-held bonds do you project or do your number counters project that we may have if we use all this surplus to buy bonds in Social Security? Is there a projection? Do you have those numbers?

Mr. DARMAN. I am not sure I quite understand the question.

Senator SYMMS. Your principle is that you want to pay down the public debt.

Mr. DARMAN. Right.

Senator SYMMS. Which I do not argue with the idea to try to do that. It has always been an established principle up until the 1960's.

Mr. DARMAN. I think I understand it now. Let me try this as an answer. You have two things happening simultaneously—or at least you can think of it this way. One is that the obligations to the trust fund would be rising under current law, and we propose to continue to have that happen. So Treasury obligations to the Government in the trust fund would continue to rise. And those would rise to very high levels, depending on your estimates, it could be in the low tens of trillions of dollars before they start to turn down when you start redeeming and paying the benefits to the baby boom generation.

That is one set of transactions. That does not change under our proposal.

A separate set of transactions—or at least you can think of it this way—is what is going on with the consolidated budget deficit. If it is running a surplus it will be buying down or retiring debt held by the public. Now that debt held by the public is on a path headed toward $3 trillion. It does not ever get as high as this big mound over here that I first treated.

What happens to it under our proposal is it gradually gets reduced. In fact, it rather rapidly gets reduced starting at the rate of $100 billion a year, rising to about $150 billion a year, to the point where it is retired altogether, down to zero, in around 2005.

Senator SYMMS. Thank you. Now on the other side of the equation, as Budget Director, in my opinion, under the current Budget Act as it now operates under Gramm-Rudman-Hollings, going into this fiscal year and this budget fight, I think you and the President—you as the President's representative in the budget game—have the upper hand because of the sequester. If Congress does not want to cooperate with the President we can take a sequester and I think we established last year that this Government and this country will survive under it. So that would work.

However, if this so-called bomb of removing the $55 billion from the current fix, as the Moynihan proposal suggestions, as Budget Director, do you ever get the feeling that the—and the reason I say that is because when the President gave his speech on the floor of the House, we talked about how everybody cheered and yelled and hollered when he said, "Don't mess around with Social Security." But then a few minutes later he said, "We are going to do this budget with no new taxes." It was only the minority of Republicans that stood up and cheered and the majority who run the Congress were silent when he talks about no new taxes.

Do you ever get the feeling, as Budget Director, that this Moynihan bombshell could end up really as just a major frontal attack on the Gramm-Rudman-Hollings and the Budget Act itself?

Senator MOYNIHAN. Be careful. [Laughter.]

Mr. DARMAN. Well first of all, I believe——

Senator SYMMS. If you were a lesser man I would have never asked you that question.

Mr. DARMAN. I believe that two or three Democratic Senators may also have stood when the President made his comment about taxes. So I will——

Senator SYMMS. I hope so. I was looking.

Mr. DARMAN. I was just told that; I didn't actually see it. But I say that in the spirit of bipartisanship.

As to Senator Moynihan's proposal itself, I really do not see any way that it could be accommodated within the existing system. So from that standpoint, I am not sure what expression you used, but it was relatively strong as to what effect it would have. We are not going to have a sequester that is, let's say, $37 billion plus $55 billion. Our political system is never going to accept that.

I do not think financial markets would welcome simply removing $55 billion in revenue and saying, forget it, let's abandon the Gramm-Rudman-Hollings targets. But for these and several other reasons which deal with the budget process and the state of the economy as well as Social Security, I think the political system might decide that it would prefer to head toward what I would call Moynihan I, rather than Moynihan II.

The Moynihan I approach is the type that I think the system would welcome for its economics and it actually would strengthen and improve the budget process.

Senator SYMMS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MICHIGAN

Senator RIEGLE. Thank you, Mr. Chairman. I passed on the opportunity for an opening statement at the beginning. So I want to make an observation before posing a question.

The CHAIRMAN. Good.

Senator RIEGLE. We have had another hearing on this subject already as you know, that predates today's session. I think what that hearing demonstrated clearly is that we are taking money out of the Social Security fund. We are spending it for other purposes. It is really not fair and honest the way it is being done. One can say it is legal, but that I do not think is a sufficient justification for what is happening here.

As it relates to what is going on with the shift of the tax burden, I thought Senator Moynihan's reference to David Stockman's book was important. And it was important in terms of looking back over what has happened over a decade's period of time. I do not say this is your sole responsibility. You have been part of the team over that period of time, but so have others.

If you look at this chart that has been prepared by the Senate Budget Committee—and I know you don't much like this chart and I can understand why because I think it is a very revealing chart. This chart takes into account all Federal taxes as they come down on working people in the country. What it shows is it comes across by decile in 10 percentage point segments across the income scale is that the people at the very lowest income levels have in fact had a very substantial increase in terms of the Federal tax as a percent of their total family income.

Now you are a family man as most of us are in this room. We belong to families. And you understand as well as anybody what the impact is if you have family income being diminished by a larger share of Federal tax. And very interestingly as you come across all 10 income segments, roughly about the middle you reach a cross over point, and as you come all the way out to the high income people at the far end, you will find that their Federal tax as a percentage of family income has actually gone down quite substantially.

There are a lot of ways to do this. I found your PAC MAN terminology interesting with respect to the budget. But using that kind of thought process one might say here that the low income people who are out working, paying a higher share of their family income in taxes—a man or woman who is working down at the Burger King or somewhere today at something close or slightly above the minimum wage—is actually paying in a larger percentage of income over the last decade now in terms of these tax changes, accumulative tax changes, of which Social Security is a major part; and the people at the far end are paying less.

It is as if the person who is down at the low end, in effect, is chipping in for Don Trump's new boat or things of that kind for people who are out at the high end of the income scale and who are paying less in Federal taxes.

Now I do not know whether this was the intention or not. I do not know whether the plan back in the early 1980's was to carry out this tax shift in this fashion or whether it is an accident. Perhaps it is an accident of a pile up of a lot of tax changes. But the cold fact of the matter is that you and the Government are using Social Security receipts, to pay for tax cuts in other areas and also at the same time to hide, and I think cover up the size of the Federal budget deficit.

I think it is wrong. We can talk about different ways to do it. But one of the great ironies of this is the working people in the country who are paying into Social Security now in many cases are going to be asked to pay twice. They are putting their money into the fund, the money is being taken out and spent for things in other areas of the Government, totally separate from Social Security, replaced with an I.O.U., which, increasingly, these same low-income people will have to redeem when the I.O.U. has to be paid off.

So in effect they are paying now for their Social Security. Their money is being used for a different purpose. An I.O.U. is going in in its place and they are going to be asked to pay off the I.O.U. later on down the line. I do not think it is fair. People, frankly do not understand it. If they understood it, they would be greatly outraged by it.

And that is why when anybody says, don't mess with Social Security, we are messing with Social Security. That is exactly what we are doing today. We are taking the money through this series of transfers and we are spending it on other things and replacing it with I.O.U.'s that are going to have to be paid off increasingly in terms of a percentage of family income by people who are at the low end of the income scale.

I do not think that is good economics, frankly. I mean this is sort of trickle down economics. The notion is that if you have tax cuts at the high end that somehow or another it works its way eventually down to people at the lower income levels. But the numbers are not showing that. The numbers are showing that the total Federal tax burden has gone up for the people who are out there working each day and who are paid the least for their work.

So I am troubled about it and I would hope that we can find a way to change that. I think Senator Moynihan has made a very good suggestion in that regard.

But having made that comment I want to make a suggestion and ask a direct question of you. When the President wanted to get the savings and loan reform legislation package through he called several of us, as you know, into the Cabinet—and you were there—and there were good bipartisan discussions. And out of that in record time we came up with a package that was enacted with bipartisan support.

We have 112 days in this legislative session left. Would you be willing to recommend or do you think the President might be of a frame of mind to maybe convene the key players on the budget now, not play the budget showdown game, and see if we cannot come up with—if not a grand compromise—something that represents a serious effort to do this. I think it is important to have the President involved in face-to-face discussions. It worked on the savings and loan package in record time; I think it could work here.

Would you be willing to suggest that to him and do you think he is of a mind to do that?

Mr. DARMAN. Senator Riegle, I think at some stage that might be very useful. If we were fortunate enough to have events develop in a way that made it look as though it would be constructive, I would certainly recommend that to the President and I would hope that events would develop that way.

At this moment, the climate each day is getting a little bit better I would say. You may have seen the television version of the response to my initial testimony before the House Budget Committee. I do not think it would have been constructive on that particular day to get the group together.

But, frankly, the reception has been a good deal more cordial and constructive in other committees as we have gone along in the last week and a half. If the mood continues to get better, then we will have a context in which it makes sense to get together.

I would note that we have never said we did not want to get together. There are a couple of very important people, key to any such negotiation, who have said that they do not think that it would be desirable to have such a negotiation. But I am hopeful that the mood will get a little bit better and confidence will get a little bit better, and we will get past the early partisan—what I call partisan—posturing stage and get down to serious work on a bipartisan basis.

Could I make one comment on your introductory points?

Senator RIEGLE. Sure.

Mr. DARMAN. On the statistics you referred to I have asked, and Senator Bentsen has agreed, I am going to provide an alternative way of looking at the same issue. And, of course, you know there are limitless ways you can look at it. But I think those statistics as presented are in fact misleading and I will just provide you an alternative set and rationale for looking at those.

Senator RIEGLE. If I may ask you, will it be a set that is designed to show or prove that low income people actually spend a lower percentage of their income on taxes?

Mr. DARMAN. Actually, our set will not be designed to prove anything, as distinguished from this. It will just be the facts as fairly presented in my opinion. We will let things fall where they may.

A second point is, when you talk about what we are doing with the present accounting system you use the second person you—that turns out to be me.

Senator RIEGLE. That is in the large inclusive sense.

Mr. DARMAN. Well the "you" is very inclusive, if I may say. It is all the way around this half horseshoe here—or half circle.

The Gramm-Rudman-Hollings Act prescribes the way we do the accounting now. It is prescribed by law. It was originally set in 1985. The Congress had 2 years of experience with it. By that time in 1987 when the targets were adjusted, everyone knew what the effects of the Social Security mounting surpluses were and those who participated in the negotiations of that redrafting say—I was not in Government at the time—they say that the issue was specifically and consciously addressed, and as you know, the Act treats Social Security as off budget for every purpose but the Gramm-Rudman-Hollings calculation.

So it is evident that it was extremely conscious what was going on there and it is not only the law, but it is the law that was decided upon, not by some wayward Administration, but by the Congress. Now it was signed by President Reagan. We agree with you and Senator Moynihan and other Senators that that accounting procedure is flawed and so we wish to work with you on changing it.

But there is a bit larger group in the "you" than just the people on this side of the table.

Senator RIEGLE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

I want to go back to the question first raised by Senator Packwood. Because I think we have witnessed today this charge that the Reagan tax reforms have resulted in less taxes being paid by the rich and more taxes by those on the low end. I look forward to your report as to how CBO made its calculation.

But I think it is important that this morning we try to answer that charge, which is not, as I understand it, accurate. Now my understanding, Mr. Darman, is that according to the Treasury Department the share of personal taxes paid by the top 5 percent of the taxpayers—and that would be the richer in this Nation—has jumped from 35.4 percent in 1981 to 42.6 in 1986; and then on up to 43.2 percent.

Now does that bear out as far as the income taxes are concerned that the rich are paying less and the poor are paying more?

Mr. DARMAN. I think your statistics would suggest that by that way of looking at it the rich are paying more. They are not only paying more, they're paying more and more.

Senator ROTH. So isn't it true that in the 1970's and early 1980's that there were tax shelters that enabled the rich to escape taxes and what happened with the Kemp-Roth Act and other reforms, that the rich are no longer "ducking" taxes that way and are paying more?

Mr. DARMAN. Yes. In fact, the Ways and Means Committee itself has put out a study which argues just that. They actually put it out yesterday.

Senator ROTH. Furthermore, Mr. Darman, as you have already pointed out, these income tax reforms have actually dropped roughly 6 million people from the income tax. So that is a very significant factor that is not given any recognition in CBO. Is that correct?

Mr. DARMAN. I am not sure that—it is correct that there has been something like 6 million people dropped from the rolls. I have been sitting here, when I have had a moment, paging through to try to see whether in fact those people are or are not counted. In an earlier draft I read of this they were not counted. I have not found the point in this final version to see whether they are or are not. But I think they are not.

Senator ROTH. Now let me ask you this, Mr. Darman, the basis of the CBO proposal is to include Social Security taxes together with income taxes. But isn't it a fact that the increase in rates of the Social Security taxes were not during the Reagan years but during the Carter years? That is when those rates were increased.

Now it is true that in the bipartisan 1983 proposal that they were accelerated. But the original rates were established back in the 1970's.

Mr. DARMAN. Right. The current rates I believe were set in the 1977 Act and then they were accelerated in the 1983 Act.

Senator ROTH. Now is it also true that one of the reasons for adopting the earned income tax—which is giving a cash allowance to the poor—wasn't one of its purposes intended to offset the higher Social Security taxes being paid?

Mr. DARMAN. Yes, definitely. And it was also to provide greater incentive for work. Both of those are worthy objectives. It does have the effect that you suggest. In fact, I think it reimburses more than the amount of the Social Security tax while you are still on the 14 percent credit line.

Senator ROTH. Then let me ask you this question: The benefits of Social Security, are they progressive in nature?

Mr. DARMAN. Yes, I think they are universally agreed to be progressive in nature.

Senator ROTH. Which means that those on the lower economic scale get greater benefits than the more affluent?

Mr. DARMAN. Yes.

Senator ROTH. And finally—my time is running up—as I understand the testimony of Mr. Schultze he foresees that adopting the Moynihan plan could cause an increased deficit—I believe as much as $95 billion—because of higher interest payments on the public debt.

There are those that feel that this kind of situation means no alternative but to increase taxes. So that really when you say that the so-called Moynihan plan is going to cut taxes, many people would argue that it is a Machiavellian scheme to actually raise other taxes.

Mr. DARMAN. Well I would never wish to attribute to Senator Moynihan Machiavellian scheming. I prefer, as I have done several times here, to simply note the distinction between what I have called Moynihan I and Moynihan II. I do believe that Moynihan I represents very sound thinking about what needs to be done to build up savings and continue to be concerned about deficit reduction; and that Moynihan II is interesting, but not viable.

Senator ROTH. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Darman, thank you very much.

Mr. DARMAN. Thank you very much, Mr. Chairman.

The CHAIRMAN. We appreciate your testimony.

Mr. DARMAN. It is nice to be here.

[The prepared statement of Mr. Darman appears in the appendix.]

The CHAIRMAN. Let me state for those in attendance that we are going to try to end these hearings at 1:00 if we can, so if we keep that in mind as we progress.

Our next witness is Dr. Robert Reischauer, who is the Director of the Congressional Budget Office.

Dr. Reischauer, we are very pleased to have you.

STATEMENT OF DR. ROBERT D. REISCHAUER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. REISCHAUER. Mr. Chairman and members of the committee, it is a pleasure to be here today.

I am going to focus my summary remarks on three areas.

First, the ways in which current budget policy can enhance the nation's ability and its willingness to support Social Security benefits.

Second, the likely economic effects of S. 2016.

Third, the impacts that payroll tax deductions would have on the distribution of tax burdens and after-tax incomes.

In that vital discussion, I am going to have to take issue with several of the characterizations that Mr. Darman visited upon CBO's numbers.

As a number of your witnesses have already told you, tomorrow's Social Security benefits will have to paid out of the resources that are available at that time, irrespective of how we choose to finance Social Security today. The government will have to pay for the baby boomers' retirement either by raising taxes or by reducing spending. The nation will be better able to bear these increased taxes or reduced programs if overall GNP is as large as possible.

The primary way that the Government can augment the size of the economy in the future is to take actions that add to national saving. Reducing the Federal deficit is the most straightforward way to do this. Increased national saving will increase the economy's productivity and the amount of income that will become available to be shared between future workers and the retirees. These improvements should make the reallocation of resources to retirees less of a strain on the working population.

The reason for this is not that the share of GNP required for Social Security benefits will be smaller if growth is faster and the economy is larger. The share of GNP that goes to retirees increases about as fast as GNP when growth is faster because the higher wages associated with the faster growth beget increased benefits. But presumably a society with more income is better able to devote a fixed share of that income to retirees than one that is not so well off.

If deficit reduction is the primary way in which the Government can ease the burden imposed by future increases in Social Security expenditures, the question becomes one of whether the increases in the Social Security surpluses that have occurred over the last few years and will occur over the coming years will reduce the overall deficit. This question is basically unanswerable.

Nevertheless, most commentators have assumed that the Social Security surpluses have encouraged larger deficits in the non-Social Security portion of the budget. They argue that sharper reductions in the Federal deficit would have been made had the Social Security surpluses not helped obscure the fact that the deficit in all the other Federal accounts combined has changed little since 1983.

There are several reasons to be skeptical about this line of argument. First, when the Balanced Budget Act's deficit targets were set in 1985, and then reset again in 1987, it was well known that Social Security would generate large surpluses. Had those surpluses not been anticipated, the targets in all likelihood would have been set higher. If they had not been set higher, the gap between the targets and the actual deficits probably would have been commensurably larger.

The reason the deficit has not been cut by more is not that the deficit targets were insufficiently ambitious or that the size of the problem as measured by the total deficit was not large enough to frighten the American public into demanding action. Rather, it was that the steps needed to bring about deficit reduction were too painful and could be avoided by various kinds of budgetary gimmickry.

Second, it is difficult to make a case that Social Security surpluses have hidden or masked the deficit in the remainder of the budget from the view of policymakers or the American people. The Balanced Budget Act took Social Security off-budget precisely to highlight its importance in the overall deficit. Since early 1986, CBO, OMB, and the budget resolutions passed by the Congress have explicitly shown Social Security surpluses and the deficit in the rest of the budget.

Let me turn now and say a few words about the likely economic repercussions of S. 2016. If the measure were enacted without offsetting actions, the baseline deficit would increase by about $40 billion in 1991 and by larger amounts in later years. Because the economy is operating close to full capacity now, a significant payroll tax cut of this sort could increase total demand for goods beyond the economy's capacity to produce them.

Potentially, this excess of demand over capacity could lead to increases in both inflation and the trade deficit. The Federal Reserve would be likely to try to head off the extra inflation by raising interest rates. Higher interest rates could reduce investment and complicate the problems faced by the heavily indebted domestic corporations that we have in the thrift industry.

Over the longer term, significant increases in the Federal deficit could exacerbate such current economic problems as slow growth in productivity and our Nation's faltering international competitiveness.

Let me now say something about fairness and efficiency in the Federal tax system, which, of course, has been a major impetus behind the move to reduce the payroll tax. As Mr. Darman mentioned in discussing the tables, a great deal of attention has been paid to CBO data indicating that the tax system is less progressive than it was in 1980 or in 1977.

Mr. Darman took issue with that conclusion and suggested the conclusion was based on "traditional statistical tricks and displays intended to support a conclusion." This is not the case at all. We have provided to this committee and to other committees a broad array of numbers. How those numbers are displayed by the committees is up to them.

I think if you refer to the handout I have provided, and the tables and figures in my testimony, you will agree with the basic conclusion. On the last page of the handout, we have shown total effective tax rates for 4 years—1977, 1980, 1985, and 1990—and the percentage changes. Those percentage changes indicate the changes in effective tax rates for various subperiods. As you can see, for the most recent period—1985 to 1990—they show an increased progressivity of the tax system. They also clearly indicate the level of effective tax rates. You can draw your own conclusions there.

Over the 1980-1990 period, the lowest quintile had a 1.3 percentage point increase in its effective tax rate. The highest quintile had a 1.5 percentage point decrease. The first three figures provide the information that I am about to talk about in three different metrics, clearly indicating that there is no attempt to display the information in a way that tilts the conclusion.

On this score, I would also say that Mr. Darman was wrong when he said that the CBO numbers exclude individuals with zero tax liability—that is, the people who have been taken off the tax rolls. Those people are included in these figures. We exclude people with negative incomes. Anyone with an income of $1 or more, whether or not that individual or family has a tax liability, is included in these tables.

The figures show that there has been a reduction in the progressivity of the tax system over the decade, although the tax system is marginally more progressive than it was in 1985. The major explanation for this trend over the entire decade is our increased reliance on payroll taxes.

The CHAIRMAN. What about 1985? I did not understand that.

Dr. REISCHAUER. The progressivity of the overall tax system is slightly greater in 1990 than it was in 1985.

The CHAIRMAN. Right.

Dr. REISCHAUER. Although in 1990, it is still less progressive than it was in 1980 or 1977.

The CHAIRMAN. Yes.

Dr. REISCHAUER. Lowering payroll tax rates without taking any other kind of offsetting actions obviously would ameliorate the increased regressivity of the tax system. On the other hand, if the Balanced Budget Act target deficits are adhered to, offsetting changes will have to be made in other taxes or in spending programs. The nature of those changes would determine whether the end result was more or less progressivity.

If payroll taxes were reduced by $50 billion, tax burdens on the fifth of families with the lowest incomes would fall by 10.5 percent while those among families in the top quintile would be reduced by 3.4 percent. You can see these patterns in the middle panel of Figure 1, which is in the handout that I provided.

Although low income families would receive the largest percentage decreases in their taxes, the effect of these reductions on their disposable income would be considerably smaller because they pay relatively little of their incomes in taxes. The average tax reduction among the one-fifth of families with the lowest incomes would be $81, while that received by the one-fifth of families with the highest incomes would be $974. This can be seen in the top panel of Figure 1.

If the $50 billion in lost revenue from the payroll tax were replaced with a 10-percent surcharge on individual income taxes, the tax system would be made slightly more progressive, as Figure 2 indicates. About four-fifths of all taxpayers would receive a net tax cut. This cut would average $75 among the one-fifth of families with the lowest incomes and $239 for the fifth with middle incomes. The top fifth of households would pay added net taxes that would average $703.

If the revenue loss from lowering payroll taxes were made up by imposing a value-added tax, the tax system would become less progressive. This is shown in Figure 3 of the handout. The net taxes paid by the two-fifths of families with the lowest incomes would be raised by between $22 and $147, while the remaining families would receive net tax deductions that amounted to between $43 and $106.

Let me close by making a few summary points. The large Federal deficits are combining with our relatively low saving rate to threaten the future growth in the standard of living of all Americans. Without significant economic growth, future taxpayers may be both less willing and less able to support existing Federal commitments, including those for Social Security. Therefore, S. 2016 raises two issues for the American people.

Senator MOYNIHAN. Dr. Reischauer, I have to say that I am sorry that your time is up.

Dr. REISCHAUER. I was on my last sentence.

Senator MOYNIHAN. All right. Because we have other economists just as learned and even more patient and we have a problem with our time this morning.

Go right ahead.

Dr. REISCHAUER. That is okay.

Senator MOYNIHAN. We thank you very much. Finish your sentence.

Dr. REISCHAUER. Excuse me?

Senator MOYNIHAN. You said you were about to finish.

Dr. REISCHAUER. I said I was in the middle of my last sentence, and I will swallow it and you can ask a question.

Senator MOYNIHAN. I urge you to finish it.

Dr. REISCHAUER. I was saying that your proposal had raised two important issues. The first is how we structure our taxes to finance Social Security; the second issue, which should not be overlooked, is what our overall commitment should be to saving, investment, and economic growth.

Senator MOYNIHAN. Right you are and thank you very much, Dr. Reischauer.

[The prepared testimony of Dr. Reischauer appears in the appendix.]

Senator MOYNIHAN. I wonder if we could have a panel now of our remaining witnesses, all who are distinguished economists.

Charles Schultze should be here, which is a tribute to this committee's capacity to engage learned men and women; Carolyn Weaver who is an authority on Social Security and is head of the Social Security and Pension Project of the American Enterprise Institute; Eugene Steuerle who is the senior fellow of the Urban Institute; Alice Rivlin, formerly our Director of the Congressional Budget Office, now Senior Fellow at the Brookings Institution; and Gary Hufbauer, who is the Wallenberg Professor of International Finance at the Georgetown University School of Finance.

We welcome you all and thank you for your great patience in hearing and listening to the previous speakers. Now we will listen to you.

Dr. Rivlin.

STATEMENT OF ALICE M. RIVLIN, SENIOR FELLOW, BROOKINGS INSTITUTION, WASHINGTON, DC

Ms. RIVLIN. Thank you. I have a short statement but I think I will not even read that in the interest of time.

Senator MOYNIHAN. We will put all your statements in the record as if read.

Ms. RIVLIN. Fine.

The burden of it is as follows, very quickly summarized.

Senator MOYNIHAN. Do not be too quick. You have been very patient and we should show a little respect for that.

Ms. RIVLIN. I believe it is very important for the U.S. Government in 1990's to run a surplus in the unified budget. The Government should be adding to national saving, not using it up. A surplus would reduce interest rates. It would encourage investment. It would reduce our dependence on foreigners for capital.

The best way to run that surplus, I believe, would be to leave Social Security alone. Building up a reserve in Social Security is a good idea; it is not the only way to finance the system, but it is a good one. It preserves the contributory principle of the baby boom generation of paying for their benefits.

I think the best way to run a surplus in the unified budget is to reduce the deficit in the general fund. I agree then, really, with Mr. Darman: I like Moynihan I better than Moynihan II. The current proposal which you are floating would, in my opinion, make things worse. It would add to the deficit. It would raise interest rates and it would give us a bigger problem than we had before. And I would urge this committee and the Congress to commend Senator Moynihan strongly for having focused attention on the issue and helped us all understand it, but I do not think the proposal is a good one.

Thank you.

Senator MOYNIHAN. Thank you.

Could I just say as I commented to Mr. Darman as he was leaving that what he chose to call Moynihan I and Moynihan II, Moynihan II always followed Moynihan I. They were always together. That is, if you will not save this money you cannot keep it. But these are not suddenly out of nowhere proposals. For one long year we said, if you do not——

Ms. RIVLIN. I understand that. But I am not ready to give up on reducing the general fund deficit.

Senator MOYNIHAN. Oh, no, you never are ready to give up. Alice Rivlin, you are not a giver upper.

[The prepared statement of Ms. Rivlin appears in the appendix.]

Senator MOYNIHAN. Nor is Carolyn Weaver who has been working at these subjects for a very long while and was indispensable to the National Commission on Social Security Reform.

Dr. Weaver.

STATEMENT OF CAROLYN L. WEAVER, PH.D., DIRECTOR, SOCIAL SECURITY AND PENSION PROJECT, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH, WASHINGTON, DC

Dr. WEAVER. Thank you. I appreciate being here today. My bottom line conclusion is very similar to Dr. Rivlin's. You have commenced a debate that is extremely important and also overdue, but I do not support the Moynihan bill.

A return to pay-as-you-go financing at this point would be a big mistake. Social Security faces an enormous liability in the years ahead and every effort should be made to increase saving in anticipation of that liability.

I am sure you have heard from other witnesses on the economic advantages of advanced funding and I know you have addressed yourself to that topic, so I will not repeat these agreements. And certainly there are very serious political perils in advanced funding which you have helped bring to light—not only that savings through the trust funds can be offset through actions in the rest of the budget, but also that subsequent expansions in Social Security can undermine effective saving. I would include in the latter both outright benefit increases and transfers monies to Medicare, which are two equally effective means of frittering away those savings. So while advanced funding offers a potential of increasing national savings, it also poses great risks.

Evidently, you are to the point of concluding that these risks are not worth taking. I agree under present fiscal arrangements. But I think the answer lies in trying harder to make advanced funding work, not simply in abandoning it.

I will come back to this, but first I would like to clarify a few points about the likely impact of your bill on future payroll tax rates. First of all, a cut in the payroll tax cannot be sustained indefinitely. As you know, in switching to pay-as-you-go financing we will lose considerable interest earnings that, under your bill, will be met through subsequent increases in the payroll tax. In addition your bill goes one step further to close a long-range deficit in the retirement program, which forces another set of tax increases.

As spelled out in the bill, in the span of just 15 years—2010 to 2025—the overall FICA tax would rise 40 percent, climbing to 18.3 percent of taxable earnings. That is the total FICA rate, including Social Security and Medicare, for the employee and employer combined. Twenty years later the tax bounces to 19.1 percent, which is fully 25 percent higher than the maximum rate scheduled in the law since 1977. And unfortunately, that is before dealing with Medicare.

There are those who argue—Robert Myers among them—that the ultimate rate under your bill is the same as it would have to be under present arrangements. But that ignores the fact that one of the options available in the long range is benefit-side adjustments. Scaling back long-range benefit growth makes a lot of sense, given the strong demographic trends we face in the decades ahead.

Senator MOYNIHAN. You mean cuts?

Dr WEAVER. Cuts in long-range benefit growth, yes.

Senator MOYNIHAN. Benefit-side adjustments. Very elegant.

Dr. WEAVER. Second, the Moynihan bill raises the prospect of renewed financing problems periodically in the future. Obviously, apart from the implications of having to modify Social Security any more frequently than necessary, this opens the door for additional tax increases. In the 1977 and the 1983 financing bills there were hefty increases in payroll taxes—on the order of $450 billion in the 1980's alone.

Finally, moving back to pay-as-you-go financing, while retaining a reserve fund equal to a year's worth of benefits, your bill leaves uncorrected the central problem we are trying to grapple with now. The trust funds will still accumulate several hundred billion dollars in Government I.O.U.'s and there is no plan to ensure they are meaningfully saved.

In the end I think we have to own up to the very large liability that is coming due in the decades ahead, concentrated particularly in the period when the baby boom retires, between 2010 and 2030. The proportion of people on the benefit rolls is projected to rise by 50 percent while the labor force effectively remains flat. Without any program modifications, benefit costs will have to increase 50 percent as well. We need to structure our Government policies to increase savings in light of this.

One option for trying to make advanced funding work is in the area of budget reform. Require balance in the overall budget in 1993 and establish goals requiring surpluses thereafter equal to the surpluses in Social Security. The President has offered one such proposal. Obviously, meeting these goals is the critical problem, not setting them.

If this is not possible, other more major reforms should be considered to get the surplus monies back into the private sector. Congressman Porter described one such proposal this morning. Options such as these require some restructuring of benefits to more closely align taxes paid and benefits received. On the other hand, they create direct mechanisms for controlling the Government's misuse of monies in the long term.

Failing this, I am with you. If we cannot or will not make advanced funding work, we must cut taxes and move back to pay-as-you-go financing. However, this should be coupled with restraints on long-range benefits that bring spending back into line with available resources.

Senator MOYNIHAN. I think we are so much more in agreement than disagreement here. The question becomes one of the practical, almost political, as against an economical question. You know, what is likely actually to happen.

[The prepared statement of Dr. Weaver appears in the appendix.]

Senator MOYNIHAN. Dr. Steuerle, what do you think exactly happened or should happen?

STATEMENT OF EUGENE STEUERLE, PH.D., DIRECTOR, ECONOMIC STUDIES PROGRAM, BROOKINGS INSTITUTION, WASHINGTON, DC

Dr. STEUERLE. Senator Moynihan, I will repeat the efforts of my colleagues to save time. I will summarize my testimony by just pointing out three basic themes.

The first is that throughout most of the post-war era this nation financed its major changes in both expenditures and taxes through increased taxes on workers and on households with dependents. Moderate to low-income workers saw their burdens increased from almost nothing to over one-fifth of their income. I believe this era is over.

Second, recent proposals to reduce Social Security tax rates should be considered analogous to proposals to increase the personal exemption in the early to mid-1980's, rather than to the tax reductions in 1981. As you well know, Senator, because you were part of a coalition—a liberal conservative coalition to increase the personal exemption—it was possible in the context of tax reform to create a fairer and more efficient system without increasing the deficit.

And third, some package of changes in Social Security is both desirable and to some extent inevitable. Not only is the system insolvent over the long run but individuals with equal incomes pay very different taxes. The system discriminates against working women and minorities who are likely to receive their compensation in the form of cash. It discriminates against secondary workers, again primarily women, by often giving them zero benefits for their tax contributions. It discriminates against those who work most of their adult years by giving them absolutely no benefits for several years of work. The system is becoming more regressive as the number of years in retirement increase. And I could go on.

In summary, Social Security tax rate reduction is a logical consequence of moving away from an era where most Federal policy changes were required to be paid for by workers and those who care for dependents. Social Security rate reduction should be made part of a package that takes into account deficit concerns in the short run and the structure of Social Security and Medicare in the long run.

Rate reduction is a reasonable and essential component of a broad-based attempt to come to grips with some of the clearly regressive, inefficient and inequitable aspects of the combined Social Security tax and benefit structure.

Senator MOYNIHAN. That is very powerful. That work that you and Wilson did is really quite striking, that the direct tax burden of a family that earns cash wages at one-half the median income has gone from almost nothing in 1948 to about one-fifth of income today. That is kind of striking.

The other striking thing is that you all know, but I think it keeps getting missed. It was not until 1988—we just have the numbers—that median family income in the United States got back to a level of 1973—15 years below the 1973 level. The total loss was about $20,000. If it had been flat for 15 years you would have had $20,000 more.

Dr. STEUERLE. Senator, I would like also to point out that workers at about $20,000 of income are the ones who face this tax increase. There are other individuals with about similar income who did not face that tax increase.

So when you see an income distribution table or hear the type of debate that went on earlier today, be careful when it does not distinguish between different people within the same income category.

Senator MOYNIHAN. Different kinds of income, yes.

[The prepared statement of Dr. Steuerle appears in the appendix.]

Senator MOYNIHAN. Charles Schultze—Dr. Schultze, it is an honor to have you back for the fourth generation before this committee—the fourth decade before this committee.

STATEMENT OF CHARLES L. SCHULTZE, PH.D., DIRECTOR, ECONOMIC STUDIES PROGRAM, BROOKINGS INSTITUTION, WASHINGTON, DC

Dr. SCHULTZE. I was thinking, Senator, it is a heck of a lot easier to do it now than to sit there in Dick Darman's place.

Senator MOYNIHAN. The record should show that Dr. Schultze was in Mr. Darman's position in years past.

Dr. SCHULTZE. Mr. Chairman, painful as it is to cut out some of the pearls of my wisdom, I will try to shorten this also.

Obviously, and you know it as well as and probably better than anybody else, the whole purpose of building reserves in the Social Security trust fund is defeated if the surplus is not accompanied by something approaching balance in the rest of the budget. And when under unified budget accounting the mounting surplus in the Social Security trust fund masks and in effect helps justify a large deficit in the remainder of the budget, the inequity imposed on the next generation who will be paying retirement benefits to a large retired generation which has not saved for it, will be compounded by an inequity to the current generation.

The topping of the payroll tax at about $50,000 of wage income is justified, I think, when it is a payment to a retirement systems whose benefits are progressive and similarly capped. But it is an inequitable way to levy a tax for the general operating expenses of government.

The Moynihan proposal rightly calls attention to this double inequity of current budget policy. But it would deal with the one inequity in a way that I think sharply worsens the other. In the process, it would greatly exacerbate America's already serious problem of under-saving, under-investing, and under-competing. S. 2016 would increase the overall shortfall of Federal revenues below expenditures and that is what counts when determining how much the nation saves. And in a few years it would be adding substantially to the overall Federal budget deficit, in an amount that I want to show in a moment is much greater than the $55 billion to $60 billion loss of payroll tax revenues.

National saving in the United States, which is equal to private saving, less the amount absorbed in financing the overall budget deficit, would fall still further below the abysmal level to which it sunk under the policies of the past decade, far below its historical level in this country and the lowest saving rate of any modern, industrial nation—in most cases by a wide margin.

My Brookings colleague, Ralph Bryant, has employed a variety of econometric models to project the consequences of reducing payroll taxes by the amounts suggested in your bill. If enactment of S. 2016 were accompanied by unchanged monetary policy, prices would rise substantially in the United States as the higher deficit generated inflationary pressure. And so Bryant also examined the more realistic scenario in which the additional budget deficits generated by the bill—the payroll tax cut—induced the Federal Reserve to tighten monetary policy sufficiently to offset the inflationary potential of the added budget deficits.

His estimates of the economic consequences of that scenario—lower payroll taxes accompanied by offsetting monetary policy—are summarized in the table in my testimony. The table reports the average results from all the models. They obviously range around that average. I do not pretend they are precise, but they give you a flavor.

As the effect of higher deficits and tighter money work their way through the economy, interest rates would rise substantially above the path they would otherwise have taken. Short term interest rates by perhaps 2 percentage points and long term rates by one and half percentage points—without not really pretending the answer is that precise.

The budget deficit would increase by much more than the loss of payroll tax revenues. By 1992 something like $35 billion in extra interest payments would be added to the almost $60 billion loss of payroll taxes, increasing the overall budget deficit by a average figure, on the different estimates, of $95 billion. And with the CBO estimate of the 1992 budget deficit as a base, the total unified budget deficit in that year would soar to $230 billion.

The higher interest rates would boost the value of the dollar and increase the U.S. balance of payments deficits in 1992—the models' average effect is a $20 billion worsening. Much more importantly, the nation's net saving rate—public and private combined, which is already at an appallingly low 3.5 percent of national income—would fall to under 2.5 percent.

Senator, I agree with you that our current budget policies are atrocious, but they are atrocious not only—indeed in my view not principally, because they use regressive payroll taxes to mask large deficits elsewhere in the Federal Government. They are especially obnoxious because they lower national savings, reduce national investment, productivity, and income growth, and leave the next generation with the worst of both worlds—a bulging population of retirees whose benefits have to be paid for, and a national income whose growth has been depressed by this generation's consumption binge. But we should not correct that first inequity by perpetrating an even worse one.

I realize, Senator, that for the moment lip reading has substituted for real deficit reduction. But as Europe reinvigorates itself by forming a true common market and opening economic ties with Eastern Europe, and as Japan continues to grow in productivity, technological capability and market power, I continue to hope, perhaps a bit naively, that this country will finally take the painful steps to end its own decade long consumption binge and restore its national saving, investment and productivity growth to levels worthy of a modern industrial power.

One component of that solution will have to be a substantial tax increase, dedicated, however, not to lowering taxes elsewhere, but to reducing the budget deficit—eventually to the point where it at least comes close to balance without reliance on the surplus in the Social Security fund.

I think where we fundamentally disagree, Senator, is in our priorities. You place equity at the top. I put equity maybe third or fourth, and put way up at the top the future of the American economy. If we add another $60 billion to $90 billion to the budget deficit I suggest we put the key in the envelope and mail it directly to Tokyo.

In sum, I welcome the renewed debate about budget fundamentals that you have launched by fervidly hoping your proposal never gets enacted. I recommend to you the sentiments of an old saying, whether Chinese or Irish or Biblical, I cannot recall, "Be careful, you might get what you ask for."

Senator MOYNIHAN. It is French. [Laughter.]

[The prepared statement of Dr. Schultze appears in the appendix.]

Senator MOYNIHAN. Why don't we hear from Dr. Hufbauer and then talk a little bit about what we have said. Dr. Hufbauer, of course, I said is a Wallenberg Professor of International Finance at the Foreign Service School of Georgetown.

Dr. Hufbauer.

STATEMENT OF GARY C. HUFBAUER, PH.D., WALLENBERG PROFESSOR OF INTERNATIONAL FINANCE, SCHOOL OF FOREIGN SERVICE, GEORGETOWN UNIVERSITY, WASHINGTON, DC

Dr. HUFBAUER. Thank you, Senator. I used to live in New Mexico. As you know, there are many Indian tribes there. In the 1950's and 1960's those tribes started looking at their treaties and they decided that they were entitled to various water rights and land rights and mineral rights. The counter argument was heard, when I lived in New Mexico, that these rights had so long been used by non-Indians that the non-Indians simply could not live without continuing appropriation of the Indian rights. There is a parallel here.

The Social Security surplus has been appropriated now for a few years and will be appropriated in the foreseeable future by a Federal Government that it says it cannot live without. In both cases there is a violation of trust. In the Indian case, it came to be recognized that the victims were indeed entitled to their land rights, their water rights, their mineral rights, however inconvenient it was to the non-Indian society.

Senator, you have raised the question about the trust owed to Social Security beneficiaries. Your bill raises the point that they are entitled to have these surplus monies invested in a more productive and prosperous America so that there will not be political pressure for future Congresses to slash benefits.

In my story, Indians were lucky. They got their rights vindicated in court. There is no comparable court remedy for the violation of trust in the instance of Social Security. The only remedy is the path you have embarked upon: to start the debate and try to grab the attention of the Congress and the Administration.

We all remember the supply side promises. The supply-siders told us that a decidedly less progressive tax system coupled with temporary deficits would pave the way to higher productivity and greater prosperity in our nation. If these supply side promises had materialized we would not be having this debate today. Instead, Japan and Europe would now be cringing over American economic triumphs, U.S. industrial might and technological superiority. But when I travel to Tokyo and Brussels I hear far more sympathy than envy over U.S. economic prospects. So I conclude the time has come to start afresh.

Since the promise to save the surplus has been broken, since the trust has been broken, and will be broken so far as the eye can see, our Nation needs to unmask this hoax and get on a new path. In my written statement, Figure 1 summarizes everything I have to say. "Save-the-surplus" would be good policy. "Pay-as-you-go" would be good policy. This present system of bogus financing really has put us in the valley of broken promises and is the worst possible policy.

Senator MOYNIHAN. Well that sounds like a New Mexican site, the Valley of Broken Promises.

Dr. HUFBAUER. In my statement, I called the Social Security Integrity and Debt Reduction Fund a preposterously named prescription for procrastination. Let me say why I regard it as preposterous. One, nothing happens until after 1993 which, as has been observed, is after the next Presidential election; and secondly, there is no effective hammer to make anything happen, even in 1993.

Here is my analogy. If I offered to sign a 4-year contract with the Brookings Institution in which I promised to deliver a book only after my contract expired, the Brookings Institution would be rightly skeptical. And further, if I said, well if I do not deliver the book, you take my contract price and deduct it from Charlie Schultze's salary—that would be very close to what the Social Security integrity and Debt Reduction Fund Bill promises.

In this bill, the hammer is an extension of G-R-H. The bill has nothing on the tax side. As you have said Senator, in the Moynihan I proposal, the hammer should be a reduction of the Social Security taxes. Another possibility, suggested in my statement is an automatic increase in the tax on rich Americans—the people earning more than $200,000 a year in this country.

It is not a fair criticism of your resent bill, S. 2016, that it does not solve all our problems. In 1981, Mr. Stockton and Mr. Darman appreciated that a journey of 1,000 miles starts with a single step. They slashed taxes, and they gave especially tender care to the upper income groups in our Nation, and many consequences followed from those first steps.

I submit it is the right time to use that same logic for the benefit of middle America.

Senator, to conclude, my only problem with my distinguished colleagues on this panel—and they are genuinely distinguished—is that they are ready to give up before they have gotten the Administration's attention. Your proposal, S. 2016, got Mr. Darman's attention. Mr. Darman has now come close to, but not yet all the way, to Moynihan I. I do not think you will get the Administration's full attention until S. 2016 is closer to enactment.

Thank you.

[The prepared statement of Dr. Hufbauer appears in the appendix.]

Senator MOYNIHAN. Well I thank you.

Would the panel want to comment on what any of you have said, sort of have a little conversation here. I think we—from Charlie Schultze to Dr. Hufbauer—we very much have the same set of facts in our hands. Everybody is entitled to their own opinion but not of their own facts. I think we are all working from about the same fact. Wouldn't you say?

Dr. SCHULTZE. Let me make one comment that I think is relevant. I think fundamentally all of these problems stems from a premise which runs through this Government, through this town, through Gramm-Rudman; and the fundamental fact is that we can do what we have to do as a country by way of our budget deficit and our saving only with a tax increase. It all stems from that.

Everything else, it seems to me, is a diversion from that. I think we with or without the Moynihan proposal will continue to face a major problem until that fact is faced up to.

Senator MOYNIHAN. Here is a point I would like to make, if I may, to this group of very distinguished economists.

In trying to be rational in your economic thinking here I do believe we miss the political dimension. The purpose of those events in 1981 was deliberately to create a protracted crisis—a protracted crisis, which would inhibit all manners of behavior which it was desired to inhibit. And it worked.

There was an initial enthusiasm of the supply-siders and Stockman—you know, Stockman's book was a thoughtful book about the politics of the budgets in those years. I mean you used to have a conservative coalition which was very much opposed to government, expenditure, and a more liberal coalition with a very advocated government.

In the course of the 1980's that conservative coalition essentially reversed itself. It found that deficits were acceptable, and were politically very powerful. There has been no change in those politics.

Remember in 1984 when Vice President Mondale said "the next President is going to raise taxes, whoever he is. He will not tell you. I just did." Well he was wrong and he lost the election and after that lost the next election.

Dr. SCHULTZE. Can I make a point on that? I agree with your recital of history that it captures what happened and I think it is exactly what happens when people are too clever by half. I just finished a little bit of work looking at budget numbers over the past 10 years. If you take the Federal civilian operating budget, outside of Social Security, of course, and exclude net interest, everything else the Federal Government has done, the share in GNP has come down noticeably. But almost, not quite, to the tenth of a decimal point, the decline in Federal civilian operating spending, for programs whose benefits might have been a little less than their costs was exactly replaced by an increase in spending which has no benefits whatsoever—namely interest on the public debt.

Senator MOYNIHAN. Right.

Dr. SCHULTZE. I worry about the success of extremely clever political devices—like running a large deficit as a way to hold down spending—then backfire.

Senator MOYNIHAN. Right.

Dr. SCHULTZE. They get enacted and then——

Senator MOYNIHAN. Would you agree with me that even so they did happen?

Dr. SCHULTZE. Oh, yes.

Senator MOYNIHAN. And would you also agree—I want to ask you this—and, Carolyn, you speak and Alice.

The idea of deliberately creating a crisis is a little bit beyond the reach of the American political imagination. I used to go around in the early 1980's saying, "Look they have done this deliberately." And people would blink at you. Stockton wrote this, you know, huge book. Charlie, have you ever had a $2.5 million advance? No, you haven't.

You've written some damn good books.

Dr. SCHULTZE. If you move the decimal point.

Senator MOYNIHAN. And he said it and no one believed him. I found myself saying, hey, you know, Lenin was not a problem solver and still people blinked at you. I happen to be of the view that until we understand the political dimension, arguing the economic response produces what you get. By golly, we are going to balance that budget just as soon as—guess what, the next election.

Alice Rivlin, I see skepticism.

Ms. RIVLIN. I think we have learned a couple of things from having the deficit which I believe was partly an accident and partly deliberately created to put downward pressure on government spending. We have learned it is very hard to live with a deficit. You get dependent on the rest of the world and you have very strong downward pressure on domestic government spending.

That is why I am worried about more of the same. I think we have learned something else. The public cannot get very excited about a deficit as long as a popular President is saying a deficit is better than raising taxes. The deficit will just continue and will have its deleterious effect. That is why I am so worried about your proposal.

It might pass. We might have a bigger deficit and we night have more years of struggling with this very difficult situation, of being dependent on the rest of the world and of having no money we can spend for good things that people would like to spend money on both overseas and domestically.

I do not want to add to that problem.

Senator MOYNIHAN. That is what you said the first time.

Dr. Hufbauer?

Dr. HUFBAUER. I would like to comment briefly on a point that Charles Schultze made, which is that, with the rise of Europe and with the rise of Japan, eventually America will take more seriously its competitive position, starting with the budget deficit.

I think there is a lot of truth to that. But I think the time horizon is a long one. Here is what I think will be the decisive event. Europe will probably adopt a single currency before the end of this decade. That will be a very powerful currency in the world picture. It will begin to supplant the dollar. No longer will the United States be in the happy position of being able to emit dollars to finance our domestic imbalances on an indefinite basis, which has been our national privilege throughout the post-war period.

At that point the crisis bites. The United States will have to get its fiscal house in order. But in my view that scenario is 10 years away. I would like to see our Nation act before this decade is up.

Senator MOYNIHAN. I think that is a good note on which to thank you all and to end this morning's hearings. We very much appreciate your papers which we request would be part of the record and would be printed. And we will see. I think Dr. Hufbauer makes a very nice conclusion. I think you probably all agree on that, don't you. Can I ask the panel, do you agree?

Charles agrees.

Dr. Weaver?

Dr. WEAVER. Yes.

Senator MOYNIHAN. Dr. Rivlin?

Ms. RIVLIN. I agree.

Senator MOYNIHAN. Unanimity.

Thank you all very much.

[Whereupon, the hearing was recessing to reconvene at 10:00 a.m. on February 27, 1990.]

SOCIAL SECURITY TAX CUT

TUESDAY, FEBRUARY 27, 1990

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to recess, at 9:35 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Bradley, Pryor, Riegle, Rockefeller, Daschle, Roth, Heinz, and Symms.

[The press release announcing the hearing follows:]

[Press Release No. H-11, Feb. 20, 1990]

SENATOR BENTSEN ANNOUNCES THIRD HEARING ON SOCIAL SECURITY TAX CUT

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, announced Tuesday the Committee will hold the third in a series of hearings on a proposal to reduce Social Security taxes.

Bentsen (D., Texas) said the hearing will be at 10 a.m. on Tuesday, February 27, 1990 in Room SD-215 of the Dirksen Senate Office Building.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. This hearing will come to order. Today is our third meeting in a series of meetings as we look into the financing of Social Security and what its budgetary implications might be. These hearings were generally occasioned by Senator Moynihan's very dramatic proposal, which brought sharply into focus the fact that the Administration and the Congress have been engaged in a charade in which there is a pretense that we have been increasing national savings whereas, in actuality, what we have is a surplus in the Social Security fund masking deficits in the budget.

I think that this series of hearings has borne out the concern which led Senator Moynihan to make his dramatic proposal. Today we are continuing to seek the very best advice as to how this committee and the Congress can address that concern.

Our first witness today is Hon. Alan Greenspan, Chairman of the Federal Reserve Board. Mr. Greenspan was the Chairman of the 1983 National Commission on Social Security; and in those two capacities, Mr. Greenspan is particularly well qualified to advise us as to the need for an increase in national savings and the role that the Social Security surplus can or should play in meeting that objective.

We will also be hearing from Hon. Robert Strauss, who was cochairman of the National Economic Commission. He, along with

Senator Moynihan and others, produced the minority report of that Commission which addressed itself to the topic before us today, and spoke of both the need for vision and the risks of wishful thinking. That is a crucial distinction, one which I hope this testimony today will help us to draw accurately.

In addition, we are going to receive testimony from a number of other individuals and organizations who have interest and expertise on this subject. These include representatives of labor, business groups and organizations concerned with our older citizens.

I would like to now defer to my colleague, Senator Moynihan, for any comments he might have.

Senator MOYNIHAN. None, Mr. Chairman, except to welcome Dr. Greenspan and say that I look forward to this morning.

The CHAIRMAN. Dr. Greenspan, we look forward to hearing from you. If you would proceed.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN OF THE BOARD OF GOVERNORS, FEDERAL RESERVE BOARD

Mr. GREENSPAN. Thank you very much, Mr. Chairman. I am pleased as always to be here today to discuss the government's role in providing retirement security to present and future generations—an issue that has moved to the forefront of the policy debate. Senator Moynihan has introduced legislation to cut payroll taxes and return Social Security to a pay-as-you-go basis, and others would like to move its finances fully off- budget.

I believe that the Senator has raised a very important issue and I think that very few can appropriately question his diagnosis and the concerns that he raises with respect to this issue. I regret that I disagree with his solution; and I do that reluctantly, because I usually can accept his insights on issues such as this almost without evaluation. I will try, however, to go into detail as to my concerns about the specific proposal.

In large part, I believe, as I think the Senator has implied, such proposals arise out of frustration with the slow pace of deficit reduction and they have helped to dramatize the seriousness of the current budget situation. But I am concerned that they will ultimately be counterproductive and will hamper the efforts needed to meet our longer-term fiscal responsibilities. And, as I hope to make clear, they will increase the difficulty of providing for the needs of an aging population in a way that is equitable across generations. I shall address in particular how the Social Security system can contribute to those objectives; this issue was a main focus of the National Commission on Social Security Reform in the early 1980's. I shall also touch on the relationship of Social Security to the rest of the budget and its role in the setting of overall budget goals.

I have testified often before committees of the Congress about the corrosive effects that sustained large budget deficits have on the economy and about the way our economic prospects in coming years will hinge on our ability to increase national saving and investment. One factor that argues for running sizable budget surpluses by later this decade is the need to set aside resources to meet the retirement needs of today's working population. Although the share of the total population that is in the labor force has risen steadily over the past few decades, that percentage will shrink considerably after the turn of the century as members of the so-called "baby boom" generation begin to retire. Barring a sharp upturn in the birth rate, a large influx of immigrants, or a significant increase in the age of retirement, growth of the labor force will slow appreciably.

The demographics are compelling. In 1960, there were 20 beneficiaries for every 100 workers contributing to Social Security; currently, as I am sure you have been told many times in the past, there are 30. The Social Security Administration— under intermediate economic and demographic assumptions—expects that number to approach 50 by about the year 2025 and to remain at that level at least through the middle of the 21st century.

Assuming their living standards keep pace with those of the working population, the elderly will of necessity consume a growing proportion of total output in the future. They will finance their consumption out of private and public pensions and by drawing down their own assets. Nonetheless, the goods and services they buy can only come from the output of then-active workers. The allocation of production to meet the needs of retirees necessarily will cut into what is available for consumption by the rest of the population and for investment in new equipment and structures.

We can do little to change the demographic forces. We can, however, take actions now that will help to lift the size of future output above that implied by the current pace of capital formation and the trend in productivity. Such actions will improve the likelihood that future workers can maintain their living standards while satisfying the retirement expectations of current workers. Your decisions will also influence how much of the burden of its retirement the baby boom cohort will shoulder for itself and how much will fall on its children. Indeed, this is one of the few instances in which policymakers have had the luxury of being able to foresee a problem that a thoughtful policy response might ameliorate. Thus far, I believe, the plan for Social Security, given the conflicting political pressures, has been reasonable.

One element in the strategy is the accumulation of sizable balances in the Social Security trust funds over the next few decades. As you know, before the Social Security Amendments of 1977, the system operated, in effect, on a pay-as-you-go basis. The 1977 Amendments set in motion an accumulation of trust fund assets that can be drawn down as required to meet the retirement needs of today's workers. This shift towards a funded system was given careful further consideration by the National Commission on Social Security Reform in the early 1980's.

The deliberations of the commission identified several complex issues. They included difficult questions of equity within and across generations and assessments of the effects Social Security has on incentives to work and save. We recognized, too, the political riskiness of accumulating large surpluses. On the whole, however, we concluded that each cohort of workers and their employers should make contributions into a fund that, with interest, at least approached the actuarial value of the benefits the workers will eventually receive. Notably, this requirement forces today's workers—including the baby boomers—to pay more in payroll taxes than is needed to cover the benefits of the relatively small group of current beneficiaries, so that sizable surpluses build up in the trust funds. In essence, the commission reaffirmed the intent of the 1977 Amendments; our recommendations were largely accepted by the Congress and hence shaped the legislation of 1983. The current structure of Social Security may not be appropriate in all circumstances. But, at present, it is still the best option.

One reason to build surpluses in the trust funds is to set aside saving, and thus to divert part of the nation's current production away from consumption—both private and public. Assuming, of course, that the surpluses are not offset by reductions in the saving of households and businesses or by larger dissaving, that is deficits, elsewhere in the Federal budget, they should boost investment and thus foster the growth of the nation's capital stock. And with more capital per worker than would otherwise be in place, productive capacity will be greater, and we will be better able to fulfill our promises to the retirees, while maintaining the standard of living of future workers.

The relationships among saving, the aggregate capital stock, and labor productivity are complex and difficult to pin down quantitatively, in part because productivity depends not only on the amount of physical capital but on factors such as the education and skill level of the work force and the rate of technological progress. Nonetheless, I have little doubt that a larger, more modern capital stock will improve labor productivity and hence overall real income levels in coming years.

Building surpluses in the trust funds also contributes to fairness across generations. Given the demographics, the generation after the baby boomers will have to shoulder a fairly heavy burden to meet the retirement claims of their parents. This burden can be ameliorated only if current workers save enough during their working years to fund, in effect, their own retirement. Saving today will not reduce the share of GNP that will be transferred to retirees tomorrow; however, current saving directed toward capital formation will help to ensure that overall incomes in the future will be large enough to provide benefits to retirees without denting the standards of living of their children too deeply, if at all. The current Social Security system, when used properly, has such a focus and affords an opportunity for today's workers to lighten the burden on the workers of the next generation.

Pay-as-you-go financing does not have that focus. Rather, each year, workers and employers contribute only enough to cover the cost of providing benefits to current recipients and to maintain a contingency reserve sufficient to carry the system through periods of poor economic performance. Thus, returning to pay-as-you-go now would confer a significant windfall on the baby boomers who, in effect, would benefit doubly from the size of their age cohort. Given their numbers, each would make a disproportionately small contribution during his or her working years to the retirement of their elders. Yet in retirement, each would expect to receive full benefits, which could come only at a disproportionately high cost to their children. At that time, pressures may well emerge to stretch out benefits by, for example, increasing the retirement age to reflect rising life expectancies.

Linking an individual's benefits to his or her contributions has generally been considered equitable and desirable. Under the present system, the current generation of workers and the next will face the same OASDI tax rate of 12.4 percent, summing the employee and the employer shares. Assuming that benefits evolve according to existing laws—and that Social Security revenues are set aside, rather than used to lower other taxes or raise other outlays—the system moves in the direction of actuarial soundness; it confers no windfall gains or unforeseen losses on any particular generation. Accordingly, it offers some assurance to current and future workers that the government will keep its promises.

Senator Moynihan's proposal cuts the OASDI tax rate to 10.2 percent of covered wages in the 1990's. However, as his bill makes clear, with pay-as-you-go, rates will have to rise sharply once the baby boomers begin to retire; the proposed rate for the years 2025 through 2044, for example, is 15.4 percent. Support for the system may erode when the next generation is asked to take on a tax bill that their parents were unwilling—or too short-sighted—to assume during their working years.

The choice of financing mechanism can also influence the mix of Federal taxes. Indeed, the increase in the share of payroll taxes in total revenues—and the regressiveness of these taxes—is frequently cited as a reason to return to pay-as-you-go financing. However, looking at just the tax side presents an overly narrow view of the relationship between Social Security and the distribution of income in the United States. When considered from the perspective of an individual's life time—and when the formula for benefits as well as contributions is taken into account—Social Security clearly appears progressive.

In any event, although the current system assigns them a leading role in providing retirement incomes in coming decades, the trust funds are only part of the story. In reality, the Social Security reserves are merely a bookkeeping entry within the Federal sector. Ultimately, their size matters only to the extent that they lead to smaller overall Federal budget deficits—or larger total surpluses—and thus to higher national saving than would otherwise be the case, an issue which Senator Moynihan has raised, I think, very cogently.

At present, the contribution of the trust funds to national saving is greatly diluted by the large deficits in the rest of the budget. As long as the non-Social Security deficits remain sizable, Senator Moynihan and others are correct in pointing out that we are doing little to solve the future retirement problem. If, however, actions are taken to bring the rest of the budget into balance, the trust funds will no longer be financing current government consumption, but will translate dollar-for-dollar into national saving.

Where in the total unified budget the saving takes place—in Social Security or elsewhere—is of secondary importance. What matters in terms of reaching our long-term growth objective is the government's net contribution to national saving. The important policy issue in the current context, therefore, is whether any of the major proposals regarding Social Security will help to achieve that goal. For example, is the Federal Government more likely to shift towards a position of positive net saving if Social Security is returned to pay-as-you-go financing? Given the large revenue loss implied by the plan, I think not.

Another proposal is to move the Social Security system fully "off-budget," so that the trust funds would be excluded from the official summary budget figures and from the setting of deficit targets. Unlike Senator Moynihan's plan, a switch in budget accounting systems in isolation would not change the government's contribution to national saving and thus would have no direct effect on the economy. But the proposal raises other concerns.

First, splitting off Social Security—or any other program—would highlight a distinction that has little macroeconomic or analytical significance. Regardless of which numbers are reported, government saving or dissaving would continue to be well-approximated by the surplus or deficit in the total Federal budget as currently defined in the National Income and Product Accounts, a close variant of the total unified budget.

Moreover, the way budget numbers are presented can influence public perceptions of important fiscal issues and thus—for good or ill—shape the debate among policymakers. As a consequence, methods of accounting and presentation can play a role in determining the size of the overall deficit or surplus. In particular, I fear that adopting a system that draws attention to the surpluses in the trust funds might foster the illusion that we already are putting enough money aside to meet future obligations. Furthermore, it would tend to remove Social Security from the broader fiscal policy debate.

In large part, my concerns are grounded in the analytical issues I discussed earlier. But they are compounded by a technical factor that affects the interpretation of the commonly cited statistics on the Social Security trust funds. For example, the Congressional Budget Office projects that the annual surplus in the OASDI trust funds will increase from $66 billion in fiscal year 1990 to $128 billion in fiscal year 1995. But, as CBO points out, fully half of the difference between those two figures is accounted for by the interest received on the trust fund holdings of government debt, which is forecast to grow from $16 billion to $50 billion over that period.

That latter figure represents nearly 0.7 percent of the GNP projected by CBO for that year. Moreover, in their report for 1989, the Social Security Board of Trustees projects that ratio to rise to 1.3 percent of GNP by the year 2030. Such intragovernmental interest payments are both an inflow to the trust funds and an outlay from the general funds and wash out when the accounts are consolidated. But, because they result in an overstatement of both saving taking place in the trust funds and the dissaving elsewhere, they can contribute to a significant misreading of saving trends when either part of the budget is considered in isolation.

The figures over longer time horizons are even more dramatic, magnified by the wonders of compound interest; but the story is much the same. For example, the trustees project that net inflows to the trust funds—apart from interest—will remain at their current level of about 1 percent of GNP over the next 20 years, then turn sharply negative once the baby boomers retire in force.

However, because of the surging interest payments trust funds assets will continue to grow for a time, reaching a peak of about

$12 trillion around the year 2030. Excluding interest payments, those assets will rise to only about $3 trillion around the year 2020 before turning down. Thus, the peak trust fund balance in 2030 will essentially represent interest receipts that are offset elsewhere in the Federal accounts. While the contribution of Social Security to national saving is sizable—over both the medium and the long term—it is clearly much smaller than the conventional calculations suggest.

More generally, I fear that moving away from the unified budget concept will impede the achievement of the sizable deficit reductions that the nation so sorely needs. The arguments are well-known. Many of them center on Social Security itself and on the inevitable pressures that would develop to expand benefits or cut payroll taxes if the system were not subject to the discipline of an overall deficit constraint. In the absence of offsetting changes elsewhere in the budget, such actions would reduce national saving and over time worsen the burden on the generation after the baby boomers.

Moreover, responsible budgeting requires a comprehensive framework for setting priorities and assessing competing claims on national resources. That function currently is filled by the unified budget process. If deficit targets are to be set exclusive of Social Security they could be met—at least in part—by moving related programs into the Social Security account or by shifting other trust funds off the books. Such actions would shrink the on-budget deficit but would not reduce Federal demands on private saving or credit markets.

Most important, we must not allow the choice of a budget accounting system to divert attention from the pressing need for meaningful deficit reduction. In other words, the Congress must take actions to set the Federal Government's claim on saving—however the budget deficit is measured—firmly on a downward track. Making a serious commitment to eliminating the unified deficit within the foreseeable future is an essential first step, and meeting that commitment will be a formidable challenge. But it is just a first step. If households and businesses continue to save relatively little, then the Federal Government should compensate by moving its budget in the direction of greater surplus.

Let me reiterate that the source of our fundamental budget problem is the persistence of enormous deficits at the time when demographic trends call for increases in private and government saving. Undoing a Social Security system that is the result of many years of careful consideration and compromise, in my judgment, will not address our fundamental policy needs. Indeed, it could be counterproductive.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Chairman.

I certainly agree with the comment, Mr. Chairman, that what we have to get is net savings up. I think the base for future security for Social Security is increasing productivity of our economy and eliminating the deficit that we are undergoing at the present time.

But looking at what Robert Ball said earlier this month, the former Commissioner of Social Security, I think it is a reasonable summation to say that he thought the present system is ideal insofar as the collecting of the funds for the Social Security fund. He talked about the taxes being proportional, rising as earnings rise, with a cap at a level when the earnings no longer contribute to higher benefits; and levied both on employees and employers. And he states that the system overall is progressive, once you add in the benefits and how they are paid out. As I understand it, that is where you are headed in your testimony.

Mr. GREENSPAN. I think that is analytically correct.

The CHAIRMAN. On the other hand, the tax has been criticized for being regressive, and I think aptly so where you are spending the surplus on the general administrative expenses of the country, and having an overall net deficit in the unified budget, and in that instance that you ought to be paying for that excess through the progressive income tax system.

Would you comment on that?

Mr. GREENSPAN. Yes, Mr. Chairman. I think it is essentially a question of the displacement in time. If one looks at the issue from the point of view of the full life time of a worker and subsequent Social Security recipient, it is fairly clear that the present value of the benefits that that individual receives at the time of retirement will generally be in excess of the sum of all contributions, plus interest, up to the time of retirement.

But the individuals who are in the below-average income categories mainly through their life time of work will tend to receive a disproportionately more amount of benefits than will the higher income groups.

The difficulty that we see at this issue is that the monies are coming in before the benefits are going out; and as a consequence, as we build the trust funds it does indeed look as though we are using a regressive tax to fund—as we are doing now—the rest of the budget. And that—I would agree with Senator Moynihan—is most improper.

However, if you view the Social Security contributions that are coming in now against the benefits that will be received by those same individuals in the future, then it is a progressive system.

The CHAIRMAN. I agree with that. Let me get on with this point of net savings for the country to increase its productivity. Because in the international competition today I look at real interest rates, where many other countries have a substantial advantage over us. If we had equal management, equal labor, and the cost of capital is much less in some of our competing countries, the cost of whatever product they produce puts them at an enormous advantage over us.

My concern for the balance of trade is raised to an even higher level by what I see from Commerce News, talking about the new orders for defense capital goods dropping $3.5 billion or 36 percent. The lowest one-month volume of order since January of 1987. That does not give us much comfort.

Would you give me some further comment on that? Because I had understood earlier in the month you had been a bit more optimistic in what you were anticipating.

Mr. GREENSPAN. We expected a decline in those orders because they had gone up sharply in December. A substantial part of the decline is in automobiles, which are measured on a shipments basis and assemblies were down very sharply, and in aircraft, which went up fairly significantly earlier. It is true that those orders are lower than I would have expected. But that is a highly unstable series and, in addition to looking at those very detailed numbers, we keep a fairly continuous evaluation of the underlying orders patterns. On that basis, our judgment is that orders are essentially flat. They are not, at this stage, undergoing in any measurable way the type of weakness which those data show.

The CHAIRMAN. But this is lower than you had anticipated?

Mr. GREENSPAN. Oh, it is, yes. But that is a highly unstable series. I must say to you that while the orders figures are quite important, other data that we have suggest that the orders pattern is soft, but by no means accumulating on the downside.

The CHAIRMAN. Thank you. I see my time has expired.

Senator Moynihan?

Senator MOYNIHAN. First, thanks for your usual, which is clear, thoughtful and altogether appropriate for the Chairman of the Federal Reserve.

Now may I just say first on this question of progressive/regressive Social Security. There is no real study. We have looked high and low. The Social Security Administration has never inquired much into its own work. If you start asking who gets benefits, who lives longer, who dies before—that kind of expectation—you find there's just no work. So there is an item when you get back to the——

Mr. GREENSPAN. I agree with you, Senator. It is a complex issue. As you point out, the demographics show there is a relationship between average age expectancy and income, but there is also a relationship between the disability part of the OASDI which works in the other direction.

Senator MOYNIHAN. It could use some inquiring.

Mr. GREENSPAN. I grant you it can. But I would say this, that from what data one can see, at least on the replacement rates by income group, the burden of proof that is on those who claim that it is a nonprogressive system.

Senator MOYNIHAN. And I agree.

Let me ask you at this point, to your essential question as to whether we will incur a very difficult surge in the next century, to provide retirement benefits for the people then retiring, if we do not increase our savings now. Can I ask you, if we continue to use the Social Security surplus as if it were general revenue and spend it on current consumption of government, or if we just took away that surplus by cutting back the tax rate, would there be any real economic difference to our situation in the year 2030?

Mr. GREENSPAN. None.

Senator MOYNIHAN. None, sir. That is all I mean. None. That is why you are a National Treasurer, you can say what has to be said, none. And if we do what we do now or do what I have proposed—I am sorry about the "I"—it makes no difference since we are not saving.

Mr. Chairman, that is my point. The difference between what we are now doing and what would happen if we rolled back the rates would be none in the year 2030 says the Chairman of the Federal Reserve.

Mr. GREENSPAN. No. However, what that merely stipulates is that that is not an acceptable solution either.

Senator MOYNIHAN. That is clear from your testimony. It was clear from the National Economic Commission Report; clear from the GAO report which we commissioned a year and a half ago.

But could I just then offer you the thought to which I do not ask a one-word reply. You speak about reaching meaningful deficit reduction in the foreseeable future. Can I ask you, has any President in the last 15 years sent a balanced budget to the Congress? I think the answer there is none.

Mr. GREENSPAN. It depends on what year you had in mind subsequent to the year in which it was initiated.

Senator MOYNIHAN. Well I was trying to be nonpartisan. Shall we say the last 8 years?

Mr. GREENSPAN. I would say every President has introduced a balanced budget somewhere out there in the future.

Senator MOYNIHAN. Five years from now. Statistics prove that 5 years from now the budget is always in balance, but never now. My point is this: Would you accept that some of us are thinking that we do not have a balanced budget because there is a basic structure, political force, that does not want one, that sees the deficit as an instrument of social control and is prepared to see it persist indefinitely?

Mr. GREENSPAN. No, I would not agree with that, Senator. I think that——

Senator MOYNIHAN. You would hope that is not true.

Mr. GREENSPAN. No. I think that there is a very general desire within the Congress to bring the deficit down, and I think there is a desire to find a means where enough compromise can be made to do so. I fear the problem is that we have so much complexity with respect to the various different trade offs involved, that we have not as yet found the appropriate formula, which is a critical mass within this government, to resolve this question.

Senator MOYNIHAN. Thank you.

Mr. GREENSPAN. But I think the desire frankly, as best I can read it from all parties concerned, is to get that deficit down.

Senator MOYNIHAN. Thank you very much.

The CHAIRMAN. Thank you.

Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman.

Chairman Greenspan, as I went over your testimony, I noticed on page 5, I believe, that you really set out the philosophy that we say we want to follow—namely, that we have the rates in place today to collect funds in an amount sufficient to build a surplus that is available in the future to meet future retirement needs that anticipates changes in demographic patterns.

Very specifically you say here on page 5, "This burden can be ameliorated"—this means the future payments—"only if current workers save enough during their working years to fund in effect their own retirement." And then you drop down and say, "The current Social Security system when used properly has such a focus." You then go from that to state at this point, you say, "Pay-as-you-go financing does not have that focus."

I would agree that pay-as-you-go financing seems to cut against this. But there is a contradiction, I think—I would say unintended, I presume—in your presentation here. In that, I think if we stay on the track we are now on we are going to have pay-as-you-go in the future. You do not like pay-as-you-go and I can understand why. But I do not see why pay-as-you-go 20 or 30 years from now is not just as bad, in fact, if not worse, than pay-as-you-go today. And I think staying on the track we are on now gives us pay-as-you-go in the future because we are squandering the trust fund reserves. They are being spent on other things; they are not going to be available in the future in line with the philosophy that you have laid out here.

But if we do not find some way to change that now—and I am talking about a specific definite concrete workable plan, what is going to happen to those people who are working now and retiring later? The money is not going to be in the fund. It is just not going to be there.

Now what is our answer to that? If we stay with the strategy we have now, doesn't that give us pay-as-you-go later?

Mr. GREENSPAN. Well I think, Senator, the crucial issue here is that we keep Social Security as a system which will be, if not exactly fully actuarially funded as a private system, nonetheless an approximation of that, so that what each individual gets as a benefit is related to what he puts in.

Pay-as-you-go essentially breaks that link and that concerns me.

Senator RIEGLE. Yes. But shouldn't it concern you 30 years from now? I mean that is the problem. People are putting the money in now as savings to be drawn out later. The money is being spent for a different purpose. It is not going to be there in the future.

Mr. GREENSPAN. No, no. I was going to say there were two issues. One is this and the other is the issue that you raised. Obviously, if those funds are not used to increase national savings, then they have, in fact, been squandered and that defeats the purpose of putting aside real resources—which really is what is involved here. Essentially what has to happen when people retire is that they consume real resources to live. And those real resources are either going to come out of the standard of living of the next generation or from an increase in goods production because the savings of the baby boomers were put into net capital investment that boosted productivity.

Senator RIEGLE. Yes, but that is not what is happening.

Mr. GREENSPAN. Well that is the reason Senator Moynihan asked me, you know, if we stay with exactly what we are doing does that solve the problem and the answer is, it does not. I said in my opening remarks that I think that the Senator has appropriately diagnosed the problem. It is just that I think the solution of pay-as-you-go does not solve that.

Senator RIEGLE. No, I know. But what I want to draw your attention to is the failure to offer a solution today that does work. I do not ask you to produce it all by yourself. It gives you exactly what you don't like, and that is, pay-as-you-go in the future. We are going to be asking the future retirees, in effect, to pay twice. They are paying now. They are putting their money, they think, into a fund, but the fund is being drained; and then later on down the line they are going to be asked in effect to pay additional taxes to restore the money that was taken out for other purposes. They are actually going to be asked to pay twice.

Mr. GREENSPAN. No, I think that is right. It depends on the way you handle this. I think the answer is not either/or, but the answer is, in my judgment, to do both—namely, to keep the current system, fund it appropriately as it is currently structured under law, but then solve the other problem, which essentially is the fact that we are not using those moneys to add to national saving.

I do not see how going to pay-as-you-go now does anything other than throw in the towel on an issue which will inevitably confront us. It does not solve anything. All it does is say, "That is what we are doing, so let's continue to do it." I am saying that we are confronted with an inevitable demographic shift as we get into the early part of the next century; and if we do not prepare ourselves for that demographic shift, we are going to find that the average standard of living of the children of the baby boomers could very well go down.

Senator RIEGLE. My time is up, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator HEINZ?

Senator Heinz. Mr. Chairman, thank you. Chairman Bentsen, you said something at the beginning of this hearing that was not only accurate but one of the most profound and useful statements I have heard; and Chairman Greenspan agreed with you. It was this: That the Social Security system as a whole—the revenues and the expenditures—is a progressive system when the benefits are paid to beneficiaries and not used for some other system, that the structure of the benefits is such that it helps the less fortunate most. But that when the system is used for other purposes, such as financing the current operating deficit and the general expenditures of the government, the system becomes regressive because the payroll tax is flat. And, therefore, depending on how you use the system it is either progressive or regressive.

Chairman Greenspan, you have said that if we use the system properly, we get another benefit—we increase national savings at a time when we need to. That increased savings is good for everybody in this country—working people, people who want to enter the work force, retirees of the future—because we will have a healthier economy—and will thus be in a better position to fund our needs, whatever our national priorities may be 10, 20 and 30 years from now.

You have said that the key to doing that is to get the operating budget in balance. How would you recommend that we do that? What mechanism should we impose or retain or modify so that we do in fact build up national savings and prevent ourselves from squandering—that is your word and I endorse it wholeheartedly, squandering—those savings financing the general operations of the Federal budget?

Mr. GREENSPAN. Ideally, it would be the historic process by which the President offered a budget and the Congress deliberated and we came out with a budget which was in financial terms appropriate. Short of that, I have found myself defending Gramm-Rudman-Hollings as a procedure even though I am fully cognizant of the fact that in Public Finance 101 one would look at that process and say it is absurd. But it is the only operation that we have which seems to have the capability of eventually, if necessary, wrenching the budget deficit down to negligible proportions.

So I would say I hope we can avoid the Gramm-Rudman process, including the sequester process. But if nothing else is on the agenda to resolve the budget problem, I would say that is the only choice that we have. Because all other alternatives, in my judgment, are worse.

Senator HEINZ. If we could not agree on some method of budget discipline or of building up savings and insuring a substantial kitty for the retirees of the future, and all we could agree upon—at least on a very short term, and in my judgment, short-sighted basis—was simply to slash the revenues by $55 billion or more a year as proposed by Senator Moynihan's bill, what would be the consequences?

Mr. GREENSPAN. Well if we start with the proposition that when we go beyond the immediate Gramm-Rudman-Hollings law which brings us down to zero and recognize that to get the savings from the Social Security system we have to go to a surplus on the unified budget account, clearly if we start off $55 billion in the hole, it is going to be extremely difficult to get there.

I am fearful that if we endeavor to use the Gramm-Rudman sequester process to try to do that, the wrench would be so horrendous that the Congress would not allow that process to continue. I acknowledge and I agree with the many problems about the way we are financing that Senator Moynihan is raising, but continuing to do it strikes me as not a solution.

Senator HEINZ. It didn't—I'm sorry.

Mr. GREENSPAN. Continuing the budget deficits merely because we have allowed the surplus on the Social Security account to go through to the regular budget is not a solution to the problem. It makes it worse if anything.

Senator HEINZ. You mean by using the surpluses to finance the current operation of the government?

Mr. GREENSPAN. Yes.

Senator HEINZ. And whether it is intended or not, to make the deficit look smaller than it is, that that is an unhealthy proposition?

Mr. GREENSPAN. Well that is a different question. All I am saying is that we need to solve this problem. Cutting Social Security taxes at this stage without anything else happening in the process is going in the wrong direction.

Senator HEINZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Symms?

OPENING STATEMENT OF HON. STEVE SYMMS, A U.S. SENATOR FROM IDAHO

Senator SYMMS. Thank you, Mr. Chairman; and thank you, Chairman Greenspan, for your testimony here this morning.

Chairman Greenspan, I would like to commend you and my colleagues here on the committee's attention to some testimony that will be heard later this morning by Stuart Sweet and Anne Canfield. Anne used to work for me and Stu Sweet worked for Senator Heinz on this committee. I think they were the first two people, to my knowledge, that starting bringing to the public's attention this proposed surplus in the Social Security trust fund, even prior to the passage of the 1983 Amendments.

Now they did a significant amount of analysis on this proposal in 1983 which is described in their testimony. Since they have both left the Senate to better, higher paying, private endeavors, they have continued their work, just as an interest in good sound public policy. So I would hope that we could all look at that.

I would ask, Mr. Chairman, that the remaining part of my opening remarks be inserted in the record.

The CHAIRMAN. Without objection, it will be done.

[The prepared statement of Senator Symms appears in the appendix.]

Senator SYMMS. I have done a considerable amount of work on this proposal myself. I appreciate your comments this morning. I have come to the conclusion that we now have a proposition. You made, what I think was a very, very good point, when you said that much of the accumulated surplus is really just interest—if I understood what you said correctly in your statement.

But isn't there actually a real excess of payroll taxes over the monthly benefit payments for the next 20 years? Isn't that actually a fact?

Mr. GREENSPAN. It depends on the time frame. If you are saying that the payroll taxes are contributed by the baby boomers, and are higher than the benefits being paid to the earlier generation, the answer is correct. If you are saying that the payroll taxes paid by the baby boomers are higher than the benefits that they will receive subsequently as a consequence of those payments, then the answer is, in fact, the reverse.

Senator SYMMS. Well that, I think, makes my point that when the 74th Congress passed Social Security then President Roosevelt made the statement that the promise to Americans was to create a nest egg for every American's retirement. And the Social Security program as it now operates is a defined benefit program, and the benefits based on a formula.

Now I have offered a proposition to the Congress of a defined contribution program where the benefits are contributions, plus compound interest. I can just show you here, if we actually would do this—now I happen to like the idea—philosophically, I like the idea of denying Congress access to this huge pool of money. In other words, protect the American people from the politicians getting this money and spending it on the regular operations of government.

But if we would take the surplus funds and actually put it in a savings account for their people as a second tier benefit, they would end up, if they got 7 percent on it, as much as $175,000. It just seems to me like if we took the Moynihan plan to deny Congress the money and then slipped the targets on Gramm-Rudman out of Bob Kasten's plan, and then take this money and put it into a savings, then America would truly have a real savings base for each American and Social Security would then—the Congress of say the 112th Congress would have to relook at, as Senator Moynihan is suggesting, they would have to relook at where they are on the first tier payments and benefits.

Let me just show that second chart. All this money in here is what I am saying, if you took the Moynihan plan you are going to stretch out balancing the budget over here to 1996 or the Kasten plan. I am saying, take all that money, stretch out balancing the budget over here, but start putting it in individual accounts for each American for savings.

Wouldn't that strengthen the—this sounds like something Alan Greenspan would say here. I don't think it was him. "In our view an acceptable course of action would be to make a few layers of the Social Security trust fund to reserve an economic meaningful process, one that represents a net addition to national savings." Because if the politicians spend all this money it won't be saved. Isn't that correct?

Mr. GREENSPAN. You are essentially bringing the private sector more into the savings process. The problem that exists is not that; the problem is simultaneously finding a means of funding the obligations for the current retirees. And in order to bring forward a plan that affects the structure of Social Security, I think it is important to make certain that we look not only at the individual program, but also whether or not we are diverting funds that are now going into the trust funds and paying existing retirees, and make certain that we find a means of financing the obligations that are already there.

Senator SYMMS. Thank you, Mr. Chairman.

The CHAIRMAN. Surely.

Senator Daschle?

Senator DASCHLE. Thank you, Mr. Chairman.

Chairman Greenspan, I would just like to follow up on some questions that Senator Heinz had asked with regard to the alternative. I think we all share your view that using Social Security trust fund surpluses to enhance savings in a macroecononmic sense is important.

I understood you to say that, of all the options we have, you find the Gramm-Rudman-Hollings concept of deficit reduction the most palatable. Is that your view?

Mr. GREENSPAN. I would rephrase it. I would say it is the least worst.

Senator DASCHLE. It is the least worst. That is probably as appropriate a term as one can attribute to it. But given our record in the last 10 years—the fact that the national debt has increased to $3.1 trillion, and that interest on the debt has increased in the last 10 years from $74 billion to $241 billion—do you really believe that it is the least worst? If you could design something that would work better, what would it be?

Mr. GREENSPAN. You mean as a budgetary process?

Senator DASCHLE. Not necessarily a process, but a set of priorities that would bring about some other outcome, I cannot believe that the "least worst" concept would provide us with a $241 billion interest payment today.

Mr. GREENSPAN. That is the figure including interest to the trust funds.

Senator DASCHLE. That is correct?

Mr. GREENSPAN. It is still huge. It is $175 billion when trust fund interest is subtracted out, or thereabouts.

But the issue really gets down to: How does one judge the various priorities to resolve the particular budget deficit problem that confronts us?

I can give you my own personal views.

Senator DASCHLE. That is what I would like.

Mr. GREENSPAN. But I think it is inappropriate in a sense. I am one citizen. I have my own views. But I have my representatives in the Congress for the basic purpose of making the choices and the compromises which I hope will reflect my particular point of view. Anyone can tell you arithmetically how to resolve the budget.

But I think what the crucial problem that confronts us at the moment is to make choices, to make tradeoffs, to make compromises which reflects as best we can the national will—if there is such a concept.

Senator DASCHLE. But you are denying us the value of your expertise and your thinking by saying that that is somebody else's responsibility. I do not want to put you on the spot here, but I must say, you are the Chairman of the Federal Reserve and we have here a rare opportunity to ask you what you would do in a situation like this. We are looking for alternatives. Frankly, for the Chairman of the Federal Reserve to say to us, "Well the least worst option is the one I subscribe to," but then, beneath his breath to say, "You know, if I could really say what I wanted to do, it might be different than that" really denies us an opportunity to make the most out of this hearing.

Mr. GREENSPAN. No, Senator. I appreciate that, but let me just say that what I was talking about with respect to Gramm-Rudman is a process. I mean I can give you my views on whether or not I think there are enough F-16 wings in the U.S. Air Force and, frankly, that should not be worth very much.

Senator DASCHLE. Well give us your views with regard to revenue. Have they changed at all in the last 24 months, given our apparent inability to reduce the deficit through Gramm-Rudman-Hollings? Have your views about the need to increase revenue, from whatever source, changed at all?

Mr. GREENSPAN. I have said, Senator, that over the longer run, in my judgment, permanent reductions in the budget deficit and the creation of surpluses are probably more sustainable from the expenditure side because I am concerned, as a number of my colleagues are, that an increase in taxes, while it may reduce the deficit in the short term, probably in the long term gradually fritters away as expenditures rise to meet the level of receipts.

So my priorities are very strongly on reducing the growth on the expenditure side to come to grips with this problem. The sole area of taxation that I think is useful to raise is, as I have said over a number of years, including before this committee many times, an increase in the gasoline tax. I say that, however, not so much as a revenue raiser but because it has other extraordinary capabilities with respect to energy conservation, the environment and a variety of other things. It is nonetheless a significant revenue raiser and it has that advantage.

Senator DASCHLE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

Today much of the focus has been on the Social Security trust funds. But I think it is also important that we do not forget about the Medicare trust fund. It is my understanding that under the so-called II-B assumptions, the Medicare trust fund would begin to run annual deficits beginning in 1993. Now I understand that the Administration's estimates are more optimistic. But if II-B turns out to be more accurate, I wonder what recommendations you might have for us to ensure the solvency of this trust fund.

Mr. GREENSPAN. When the Social Security Commission first met, precisely this question was on the agenda. Two of the members of the Commission—Senators Moynihan and Heinz—and the rest of us in appraising this decided that the issue was very complex, beyond our ability to deal with at that time, and therefore we stayed with only the old-age and disability fund analysis.

The concerns that we had back then as to the difficulty of resolving the problem of medical costs and the proper financing of medical expenditures I do not think have changed very much. We are confronted with a remarkable technological advance. The growth in medical infrastructure is really beyond anything any of us would have imagined 20, 30 years ago and certainly even at the beginnings of the Medicare fund.

This country, I think, is extremely disinclined to ration medical care, for very understandable reasons. And hence we find that as the technology moves forward, while a good part of the technology reduces costs, nonetheless the amount of medical care that is being offered in our system is really extraordinary and growing. My suspicion is that we will not resolve this issue strictly from the financing side, but we have to look at what it is that our total medical system should be providing, especially since there is no evidence which suggests that either morbidity or life expectancy is superior in this country relative to other countries whose application of resources is in fact far less both in absolute terms and as a percent of GNP.

Senator ROTH. Would it be advisable to try to create some kind of a national commission much like we did in Social Security?

Mr. GREENSPAN. It might well be. Because I think that it is a type of problem which probably does not lend itself readily to hearings of this nature. Because it requires much more of a research project and a type of information development which probably a commission would more readily approach in an effective manner.

Senator ROTH. Mr. Greenspan, you have said on numerous occasions that our individual savings rates is one of our most serious problems—economic domestic problems. Last year we held a number of hearings at which there were economists who came before us and testified that upon careful study the IRAs had resulted in significant new savings. A number of these economists were doubting Thomases prior to their study—in fact, had taken an opposite position.

There seems to be some consensus beginning to develop that we ought to do more in that area. Both the Chairman and I have made specific proposals, somewhat different, but to encourage individual savings. The President has urged that a new plan—a family savings plan. I wonder if you would care to comment at this time generally on the need to provide some kind of incentive such as an IRA or family savings plan to increase individual savings, the importance of individual savings, and finally whether—particularly under the Gramm-Rudman legislation, there are not certain advantages to an IRA or family savings plan where the tax advantage comes up a conclusion rather than the beginning.

Mr. GREENSPAN. Senator, I think you state quite correctly that there is no more urgent economic problem in this country for the years ahead than to bring our savings rates up. I think the Chairman raised the crucial issue with respect to savings, namely our competitive disadvantage with respect to the cost of capital internationally. But that also reflects itself here in the United States as well in creating a much lower rate of productivity growth than I think we are capable of producing.

When the IRAs originally came out and the early evaluations were made, the general conclusion was that they were very largely a transfer of assets from one account to the other; they created tax benefits, but had zero effect on savings. Some of the more recent studies that have had access to the Statistics of Income—that is, the income tax returns of individuals since IRAs went into place—have concluded that there is a net benefit to savings.

In my judgment, the conclusions are not definitive. But I do think they change somewhat the wholly negative view that existed in an earlier period. We probably need additional information to make judgments as to whether or not IRA's actually did increase savings, in part because some analysts say that what actually created the increase in saving from IRAs was not so much the tax incentive but the publicity associated with them and the advertising that a number of financial service institutions undertook in order to get those accounts.

I, frankly, do not know the extent to which either argument is valid. But I do think that something of the type that you are suggesting, Senator, does require thoughtful evaluation; and anything which can be demonstrated to increase national saving, meaning that the private saving increase exceeds the loss of tax revenues, is something which we should very seriously consider.

Senator ROTH. My time is up, Mr. Chairman. But just let me make the observation that it was my understanding that if we had moved forward with an IRA—and frankly I would like to move forward with a combination of the Chairman and mine, because I think the more incentives we have the better off we are. But it was my understanding that the private sector was willing to move forward with a very strong advertising campaign. I hate to see us wait forever and a day on studies when in the meantime we are suffering in our competitive position because of the high cost of capital to American business compared with the Japanese.

So that it is my hope that we can move significantly in this area during the current year.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Pryor?

Senator PRYOR. I have no questions, Mr. Chairman.

Senator DASCHLE. Senator Bradley.

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

Mr. Greenspan, it is good to see you. If we took the surpluses that are projected for the trust fund and essentially left them in the trust fund as is anticipated, and took those funds and essentially bought down the government debt, and on the regular operating budget side balanced the budget—take the trust fund out of the budget, balanced the operating budget, used the surpluses in the trust fund to buy down government debt—what would be the impact on interest rates?

Mr. GREENSPAN. They would go down.

Senator BRADLEY. What would be your best judgment? How much would they go down if we retired, say, $191 billion worth of the Federal debt, which is what the projected surplus in the fund would be in 1996?

Mr. GREENSPAN. It is very difficult to judge. But we know that the minimum level of nominal interest rates would be real interest rates—in other words, those interest rates that would exist if there was no expectation of any meaningful price change in the future. Under a noninflationary environment U.S. Treasuries would probably be in the 2.5 to 3 percent area on long-term rates versus the 8, 8.5 percent that we have seen recently.

Senator BRADLEY. So that if we took the money that is in the trust fund and used it to buy down the debt, it is your judgment as the Chairman of the Federal Reserve that interest rates would be in the 2 to 3 percent range?

Mr. GREENSPAN. No, the answer is no, I don't, because I think there are other factors involved.

Senator BRADLEY. If you were able to balance the budget.

Mr. GREENSPAN. If we were able to balance the budget over the longer term, and in fact create a surplus equal to the Social Security surplus, and there were not adverse other policies involved, then I think we could at a minimum expect the rates to fall, certainly to 4 percent and very likely they could fall lower.

Senator BRADLEY. Now I think that that point is not understood. From 1950 to 1980 real interest rates—not nominal—real interest rates in the country were about 35/100ths of a point. Real interest rates from 1980 to 1989 have been 4.5 percent. That means you cannot buy a home; that means you cannot float money to invest; that means essentially that you cannot be competitive in international markets because the cost of money is so expensive.

You are saying—and I think that this is enormously important—that if you were able to take Social Security out of the budget, balance the budget, which means closing it by expenditure cuts or revenue increases, and then take what is in that trust fund to reduce the national debt by that amount, that interest rates would be 2 to 3 percent.

When was the last time that we had 2 to 3 percent interest rates in this country?

Mr. GREENSPAN. We had it earlier in the post World War period.

Senator BRADLEY. Like in the 1950's?

Mr. GREENSPAN. In the 1950's, yes. In the early 1960's.

Senator BRADLEY. What would be your thought as to what that would mean for economic growth, and job creation, and investment in the country?

Mr. GREENSPAN. It would all be quite positive.

Senator BRADLEY. Yes, but can you give us a little more sense?

Mr. GREENSPAN. Senator, I hesitate to get into that type of forecasting game because it implies that we can fine tune an amount. Let me say what we can say about that.

Senator BRADLEY. But chances are that just as interest rates were 20 percent or 19 percent in 1980, and they would be 2 to 3 percent——

Mr. GREENSPAN. Well I wouldn't go down to 2, but I would say certainly close to 3 percent.

Senator BRADLEY. Three percent.

Mr. GREENSPAN. Long term.

Senator BRADLEY. I mean there would be a lot of homes people could buy; there would be a lot of investments people could make.

Mr. GREENSPAN. Yes.

Senator BRADLEY. Let me thank you very much for your point. Now let me ask you one other question. The Social Security tax does burden wage earners significantly. Let us assume that you gave an income tax credit to wage earners for a portion of their Social Security tax, which would mean basically a tax cut for wage earners; and you increased revenues on the other side by your favorite tax, the gasoline tax. Wouldn't that be positive?

Mr. GREENSPAN. Well it——

Senator BRADLEY. You would not be increasing the deficit, you would just be giving wage earners a tax cut.

Mr. GREENSPAN. If you tie it to their Social Security contributions, I think you are beginning to break the relationship between contributions and benefits.

Senator BRADLEY. Let's just say that wage earners, between income level X to Y, would get a tax credit equal to a specific number. Your income tax revenues would go down, but your Social Security trust fund contributions would be unchanged. So there would be no connection there. It would be like a tax cut for people between up to $40,000 to $50,000 in income.

Mr. GREENSPAN. What you are basically doing is you are substituting one tax for another. And the question is: What are the consequences of those different types of taxes on the economy? They have rather significantly different effects, both positive and negative. I would hesitate to give you an off the top of my head——

Senator BRADLEY. You would be paying less income taxes if you were a wage earner under this proposal?

Mr. GREENSPAN. You would be paying less income taxes, but you would be paying more other taxes. True.

Senator BRADLEY. More other taxes?

Mr. GREENSPAN. Well you said that you would put a gasoline tax on.

Senator BRADLEY. Well that is just your favorite. I might have another favorite.

Mr. GREENSPAN. Oh, okay.

Senator BRADLEY. So the wage earners might not have to be taxed.

Mr. GREENSPAN. Oh. Are you asking me whether I would approve of that? Once I start to get involved in the various priorities——

Senator BRADLEY. No, no.

Mr. GREENSPAN [continuing]. In the budget, then as I said to Senator Daschle, I get involved in an area where I don't think the Federal Reserve Chairman really ought to be, because I'm then talking as a citizen, as an economist, and not in my institutional position.

Senator BRADLEY. I appreciate that. But I do appreciate also your projection on interest rates if we use the trust fund in a responsible way.

Mr. GREENSPAN. Yes. Mr. Chairman, may I just take one second to respond to an element that I think requires something to be said here.

We have to be very careful about balancing the non-Social Security part of the Federal budget because we are going to be confronted with very large and rising of intra-governmental interest payments from the general fund into the Social Security trust fund. These interest payments are one of the major reasons the Social Security surplus rises.

They also show through in a corresponding deterioration in the non-Social Security budget. I think we talk very blithely about balancing the non-Social Security part of the budget without recognizing what we are dealing with. There is a very large intra-governmental interest payment there.

Senator BRADLEY. But if you reduced the overall government debt, wouldn't you also decrease the non-Social Security interest payments?

Mr. GREENSPAN. Only to the extent that interest payments come down because so long——

Senator BRADLEY. Which is a budgetary expense?

Mr. GREENSPAN. Sure. Yes.

Senator BRADLEY. Right?

Mr. GREENSPAN. Agreed. But so long as the trust fund builds up and is invested in U.S. Treasury securities the interest has to be paid.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, two points at the end of an extraordinary testimony as usual from Dr. Greenspan.

You go to the question of what will happen to interest rates if we were to save the surplus and such like. And Senator Bradley raised that. You will recall, sir, that this committee began to address this subject 2 years ago. We asked the General Accounting Office in 1988 would they give us a study of the effect of these Social Security trust fund reserve accumulation.

They gave it to us January a year ago. It is called "Social Security—The Trust Fund Reserve Accumulation, The Economy and the Federal Budget." And they said, now if you will save this money interest rates will go down, the savings rate will go up, markets will respond. It was all very clear. But they said if you are not going to save it, give it back.

Then we had the National Economic Commission. We are going to hear from a distinguished member very shortly—and you testified before us about the deficit. If you recall, we asked, could we expect to grow out of the deficit, and you said no. And in the report, both Majority and Minority, they said save those Social Security trust funds. But in the Democratic report we added, if you are not going save them, give them back.

May I just say to you, or for the record really, not to you, we never had 5 minutes conversation with anybody in the Administration about either of those proposals. No one ever said to us, all right, you're talking about that, let's think about it; here is what we want to say. We never heard a word, which led us to conclude that they were not going to save, as they are not saving, and therefore we went to option number two.

I do not ask you to comment. But I mean it was after a long year's waiting in silence. But then could I just say to your point about whether we ought to mix up the Social Security contributions with the income tax. We were looking to see what Franklin D. Roosevelt thought about this. And sure enough we found something. In the summer of 1941, Luther Gulick, who I am sure you probably knew, a professor at Columbia, a great public administrator, he was an assistant to the Secretary of the Treasury and he called on President Roosevelt and in a kind of neat government manner at the time said, you know, isn't it perhaps time to get rid of that payroll tax and put it back into the general revenue stream and finance Social Security that way.

And then he records a memorandum of conversation. He has President Roosevelt saying, "I guess you are right on the economics. But those taxes were never a problem of economics. We put those payroll contributions there so as to give the contributors a legal, moral and political right to collect their pension and their unemployment benefits. With those taxes in there no damn politician can ever scrap my Social Security program." So he was thinking ahead, Mr. Chairman. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Chairman, you have done your usual great job. We are most appreciative of your contribution this morning, your answers to the questions; and we thank you very much for your attendance.

Mr. GREENSPAN. Thank you very much, Mr. Chairman and the committee.

[The prepared statement of Mr. Greenspan appears in the appendix.]

The CHAIRMAN. Well we have another gentlemen before us this morning who was a co-chairman of the National Economic Commission, helped develop that minority report, along with Senator Moynihan; and I would say if he wasn't so young he would be approaching the status of a senior statesman for this country of ours, a man whose candor has sometimes bordered on the outrageous. But we are very pleased to have you, Mr. Strauss. We look forward to your statement.

STATEMENT OF ROBERT S. STRAUSS, SENIOR PARTNER, AKIN, GUMP, STRAUSS, HAUER & FELD, WASHINGTON, DC

Mr. STRAUSS. Thank you, Mr. Chairman. May I respond by saying it is always a source of pleasure and a great deal of pride for me to be before this committee; and as you well know, it is a committee in which I feel very much at home.

Testifying today after Chairman Greenspan and prior to this distinguished panel, I have decided to devote my opportunity to a subject I do know pretty well, and that is the political process in this country and its relationship to the Moynihan proposal and to our current budget dilemma.

Let me commence by saying that as my absolute conviction with regard to the subject matter of today's hearing, that the political process has failed this Nation. Those of us who live in the public arena from the Executive and the Legislative branches to the so-called public spokes people must all take a major part of the blame. Simply put, we have all, without so intending—without so intending—become a part of a conspiracy of silence and participants in the politics of fear in my judgment.

On a personal note, I well recall the failure of the National Economic Commission which you mentioned earlier, and which I co-chaired, our failure to stand firm and speak out. We Democrats have concluded and with some justifiable reason that if we mention the word "tax" our Republican friends will destroy us with a tax and spend label. And contrary wise, our Republican friends has concluded also with good reason that if they mention entitlements or Social Security we Democrats will use it to destroy them. And believe me, as much as any of you, I understand the realities of such fear on both sides.

I know the power of negative advertising and the risks of being down wind of a well orchestrated attack of half truths aimed at raising constituents insecurities. Conventional wisdom tells us that Walter Mondale lost his presidential election because he kicked off his campaign by saying he would raise taxes. Conventional wisdom further tells us that George Bush won the Presidency because he said he wouldn't.

Now you can take it from one who has been at this game a long time, Mr. Chairman, that is baloney. Mondale was going to lose anyway; and Bush was going to win anyway. Yes, we have all been convinced that we had better be silent on these issues or we will be hung out to dry. It is simply amazing to me that we seem to be able to talk openly about sex and violence and war and condoms and deviant behavior on television, in the newspapers, and on the floor of the Congress, yet we can't seem to talk honestly and openly about whether or not we need more or less taxes, more or less spending or what, if anything, we should do about the rising cost of entitlements.

We all recall George Bush of being accused in the press of boring us to death. I never thought in those days that President Bush would be guilty of scaring us to silence. So what are we going to do?

My first answer is that whatever we decide to do, we must do it together—Republicans and Democrats alike. My second answer is that we can start by telling the American people the facts as they really are. And with that as a predicate, let's look at the problem. To do so, let me offer a few propositions that I think are reasonably well accepted givens.

First, we haven't had an honest examination of the issue confronting us in the budget and Social Security areas for many years. Senator Moynihan's proposal gives us a clear opportunity to do so. Maybe it has forced a crack in our own Berlin Wall of indifference. Whatever happens to this proposal in the Congress, this country should be grateful to Senator Moynihan for getting this issue out on the table.

Second, we do not collect enough money to run our government at its current level of activity. The unified budget deficit has dropped from the $221 billion high in 1986 to around $150 billion where it seems to be stuck. But as Senator Moynihan's proposal has demonstrated, if you take out the Social Security surplus, there has not really been any improvement. And on this basis, CBO projects a $249 billion deficit in 1993, a very disheartening number.

Third, a peace dividend, when and if it happens, will come slowly as we reorder our military priorities and as our economy adjusts to a slow down in defense spending. We cannot spend what we do not have, particularly when we have demonstrated an inability to deal with those constituents who are adversely affected.

Fourth, even with this huge persistent deficit the $249 billion figure does not include the major unmet needs of the nation, to pay for our real environmental demands, and fund a proper drug program, clean up nuclear production facilities, called for in the Administration's budget, meet the full cost of the S&L crisis, improve our educational standards of our poor citizens, repair infrastructure. All of this costs more money than we are currently spending.

Fifth, by any measure the rate of private savings in this country is low as we have been talking about earlier today—low by international standards, and low by our own historical experience. We need savings to sustain the level of investment upon which long-term growth depends.

Now despite the above, most say well we have certainly done all right over the last few years. I disagree. In fact, we have borrowed and consumed, and borrowed and consumed, until we appear to have fashioned our fiscal policy out of May West's personal philosophy that there is just no such thing as too much of a good thing. By 1990 the trends of the last decade are obvious. We were building up our net asset position in the world until 1982. We reversed that trend, and in 3 years, by 1985, we became a net debtor nation. Few realize it, but we were also losing market share in almost every industry today. A startling fact.

If the rest of the world were to let us continue this level of borrowing for the next 20 years, when the baby boom retirement begins, as we are concerned about, we would be in hock to the rest of the world to the tune of well over $5 trillion. I would remind you of the British experience. They once operated as we are now operating and they finally had to pay for it by selling off, in a few short years, a British empire that had taken them 300 years to build.

This may seem either foolish or alarmish, Mr. Chairman, but as we all know the gross public debt of this country, including that held by Social Security and other trust funds, has grown from $900 billion in 1980 to $3 trillion today. Today gross interest on the debt alone represents 22 cents of every dollar we spend.

It has been my long held political belief that if the American people are given clear alternatives by their leaders, with an explanation of the costs, the benefits of each, they will make the right choice. This is not the same thing as saying they will respond rationally to every question put to them in public opinion polls. The voter has plenty to do without becoming an expert on how fast we can decrease our military commitments in Europe or why Medicare costs are rising so fast. Poll takers are not the answer; it is the responsibility of the political system to articulate options in a way that provides responsible, meaningful and understandable choices.

Sometimes events make that easy—high inflation, high unemployment, fighting wars—can focus elections around key issues. At other times it may be far more difficult. Civil rights legislation and the Marshall Plan are examples of the very complex issues that were settled by the political process in ways we can all look to with pride today.

However, when it comes to dealing with this budget, the political process has become somewhere between timid and irrelevant. The last presidential election was a perfect example. One candidate said, better enforcement; the other said, read my lips. The choice offered up to the electorate was a public relations gimmick on the one hand and a speech maker's phrase on the other. No wonder the public has lost confidence in us individually and institutionally.

Instead of hearing answers that even approximate common sense, they are confronted with budgetary doublespeak and questionable numbers. I am told that over 60 percent of the votes of the U.S. Congress in every given year are budget related and still we seem to make no headway.

Why did Senator Moynihan's proposal cause such an uproar? Because by focusing our attention on the way we are using the Social Security surplus, he has demonstrated that the cost of our government falls squarely on the large middle class who earn between $20,000 and $58,000 per year. This is patently unfair.

We all know that taken alone the Social Security tax is proportional, not progressive. But the American people are comfortable with that because the Social Security benefit structure, as a whole, is progressive. But as has been so clearly annunciated earlier here today, that holds good only as long as the costs are tied to benefits. When that is no longer the case, when it becomes a question of the general cost of government, the entire issue is opened up with far reaching ramifications for the political and economic lives of our nation.

In my opinion, the Moynihan proposal standing alone is not the answer. The only thing worse than using the Social Security surplus to run our government is to continue to borrow the money from the Japanese and Germans to run it. But the questions asked by Senator Moynihan that led him to make this proposal are very valid. How can we maintain a real budget deficit of a quarter of a trillion dollars indefinitely?

Did anyone ever contemplate that the Social Security trust fund was to be used for general government expenses? When was a conscious decision made that the cost of government were to be born substantially by our middle income earners? These are the type of questions that this committee must ask if we are to collectively find the answers.

My expectation is that these questions are profound enough that this debate can finally go forward and every legitimate means of governmental solution, including reduced spending and/or additional taxes should be explored. I would then urge that this committee, and the other leaders of the Senate, call upon their counterparts in the House, together with the Executive Branch, to join in a bipartisan effort to deal with the issues we are talking about.

It cannot be conducted as just another charade. I must say I think the President who won the last election and proposed the Federal budget we are now considering bears the most responsibility to lead and work with the members from both sides of the aisle to begin a meaningful process. Indeed, to take the lead in the creating of this Executive/Legislative summit, to address these problems in 1990. This Executive/Legislative summit should have everything on the table, including, but not limited to (1) our overall budget problem; (2) the savings issue, so that middle America can again participate; and (3) the inequities in our tax structure, specifically that pointed out by the Moynihan proposal.

I understand and fully sympathize with the difficulty our political parties and our elected officials face in dealing with the subjects I have discussed. They are political mine fields waiting to explode. But together, Mr. Chairman, Democrats and Republicans, Legislative and Executive leadership, can move forward to give the public the kind of choices they are entitled to. Good politics is about hard choices and the wise use of power by elected officials.

I submit to you that we had better address where we are heading for the rest of this century now when the economy appears to be doing well. Later, if we are faced with a less prosperous time, we may not have the luxury of choice.

Now I do not want to conclude by sounding overly dramatic, but when one looks around the world, from the young people on Tieneman Square to the clerk in Mandela in South Africa, to Howell who spoke so movingly before you last week, to the election process in Nicaragua just yesterday, I say we are selling the American public and indeed ourselves short if we do not think our political process can face and indeed solve these budgetary problems if we give the effort bipartisan leadership.

Someone recently said that President Bush had it upside down in his inaugural address when he said, "We in the United States have more will than wallet." I say to you, Mr. Chairman, the fact is, "We have more wallet than will." We are still the richest country in the world, but seem to lack the will to take the steps to stay that way.

Mr. Chairman, the final question must be, why should this effort that I am describe succeed now when others have failed before? And my answer, I guess, is that we have a popular President in the White House, with an 80 percent approval rating. We have strong leadership in the House and Senate on both sides of the aisle, and in the committees deciding these issues, and in particular, in this committee. Every individual involved gives a damn, Mr. Chairman, about what is going on, even if we have different approaches.

So with this solid political base, and with the climate of positive change that seems to be sweeping the world, this effort simply cannot afford the luxury of failure; it would have to succeed.

Thank you.

The CHAIRMAN. Mr. Strauss, that is a fine statement. We are the richest nation in the world—the largest economy in the world. But when you see an increasing deficit in trade, when you see American creativity invent the products and now they are all made outside of this country, when you see the color TV invented in this country, now over 90 percent of them made outside of this country, and the VCR right there beside it, it has to be of concern to us. When we see productivity half of that of our major competitors—the increase in productivity—when we see the national debt triple in the last dozen years, it means some tough choices have to be made to turn this thing around—tough choices that have not been made by either the Congress or the past Administrations.

I think there are many that are ready to walk that plank together and make those difficult political choices. It is going to take some leadership on both sides to accomplish that. So I share that concern and that call to that kind of responsibility that you have made today.

Let me ask you a question as to what you think would happen. Do you think we could maintain the kind of Social Security surplus that you call for in your report on the National Economic Commission—you, and Senator Moynihan, and others—to move from a deficit to a surplus in the overall budget, and then have Social Security surplus that would climb to $180 billion in the year 2015 without an invasion of that surplus for the general expenses of the government; do you think we can muster that kind of will?

Mr. STRAUSS. Yes, Mr. Chairman; I think we can muster that kind of will. I certainly do. As a matter of fact, we have never given a real examination that I have seen in recent years of what we might do on the spending side. I look and see what is taking place in entitlements. I look at a fellow like me. I get a Social Security check and a big part of that check isn't even subject to income tax. That is kind of crazy.

We have heard the Chairman of the Federal Reserve speak about what we could accomplish with a gasoline tax or maybe a broad-based energy tax. There are so many things that we could look at and tackle if we did it together.

I think the American people, as I said, if you could give them clear alternatives—we tell them what the cost is and what the benefit is, if we talk about what it does for interest rates in this country, if we talk with leadership clearly about what it does for productivity and for the standard of living, my answer is, yes, our people would support it.

The CHAIRMAN. Thank you.

Senator Moynihan?

Senator MOYNIHAN. I would just like to say again how much we admire and approve what Ambassador Strauss has said. You got the whole world together on the Tokyo round. I don't know whether you can get this country together. I don't know.

You mentioned, just an item again, in our sense here of what doesn't happen. You referred to the Presidential campaign in which one campaign said better tax collection enforcement and the other said read my lips. Well the one that said read my lips won; and then he also came out for better enforcement. If you look at the President's budget you will find in the next fiscal year we are going to pick up $2.5 billion through better tax collection enforcement.

Mr. STRAUSS. I saw that, Mr. Chairman.

Senator MOYNIHAN. So that is something to look forward to.

Two points, one about your call for a summit—a real effort to reach an agreement. May I say that since the Social Security issue has been raised, if anybody on our side of the aisle has heard from the President, we do not know it. There has been silence.

But more importantly, a year ago we produced that National Economic summit. There was never any discussion of it from the Executive Branch and now, if I could say this, sir, you probably know this, the kind of summit you are talking about was in fact not just hinted at but promised in conversation after conversation that came from the Executive Branch to the Congress at this time last year. They said, give us a year to get through this clinker of a budget, and then we will sit down. Last summer, last fall—nothing ever happened, sir.

Mr. STRAUSS. That was one of the reasons the Economic Commission was supposed to silently go away, Senator, because we were going to sit down in a bipartisan way and we haven't.

Senator MOYNIHAN. Yes, sir.

Would you say that again so it gets clear in the record. The Economic Commission did not have to be responded to because there was going to be a more or less formal mechanism working at this. Isn't that right?

Mr. STRAUSS. Well I would say to you that while it was never formally stated, it was a general understanding that I had that it was the intention that we would sit down and bipartisan—not we, but elected officials would sit down——

Senator MOYNIHAN. Yes, sir. Yes, sir.

Mr. STRAUSS [continuing]. In a bipartisan climate and deal with these issues. And it is my judgment that if elected officials, leadership, sat down from the Executive and Legislative in a bipartisan climate today and looked not just to get us through the next budget cycle or get us through the next election year, but get us through where we are going for the rest of this century, my answer to you is, I think we would be successful.

Senator MOYNIHAN. Right, and I share that. You have to believe that. But you will confirm—because, you know, you are in the center of most things going on in this city—that a year ago there was an understanding that there would be such an effort and that effort never came about?

Mr. STRAUSS. Senator, let me say that I am vain enough to enjoy your characterization of me, and foolish enough to enjoy, but I am sensible enough not to pay too much attention to it. But I would say to you, while there was no formal understanding, it was my—I thought there was an informal understanding that it was going to be dealt with my elected officials on a bipartisan basis in the leave us a year to get started to settle down and we will get to this.

Senator MOYNIHAN. Sir, you are, in my understanding, exactly right; and that did not then thereupon happen.

Mr. STRAUSS. No, sir; it did not happen and has not happened.

Senator MOYNIHAN. And that is why this bill went in on the first day of this session of Congress.

Mr. STRAUSS. Well I commend you for entering the bill. I was delighted to see it.

Senator MOYNIHAN. Thank you very much, sir.

I think the next Senator is Senator Symms.

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

Thank you, Mr. Strauss, for your what I consider excellent testimony. Just to give you a little update on the past, one time in 1988 or 1987—I believe it was maybe early 1988 during the primary process—you and William F. Buckley were hosting a program in Houston of Democratic presidential candidates and I happened to watch the program and I enjoyed it a great deal. So I sent William F. Buckley a letter and suggested that the only chance they had was to take the moderator, Strauss, and put him in as a candidate.

Mr. STRAUSS. I will tell you, I had a copy of that and I endorsed it wholeheartedly, but no one else seemed to, but the two of us, Senator. [Laughter.]

Senator SYMMS. Your problem may be that when you get endorsements from people like me it doesn't help you in your party. But anyway, I wanted to say that I really appreciate your testimony and I totally agree with you about your viewpoint of saying people should be able to tell it like it is. I think you have a quote here about "Good politics is about hard choices and wise use of power." I like to say that principal politics make the best pragmatics.

I have always said that I am willing to tell it like it is from my point of view. And if the voters want the person who tells it like it isn't, they are welcome to him. I think it is true what you say and what you outline here, that we could make responsible choices and still people might be surprised at how many of them would get reelected.

Mr. STRAUSS. That is right.

Senator SYMMS. But I wanted to ask you two points. Number one is, on this National savings rate, would you agree that there is some distortion in our national savings rate with vis-a-vis the Federal budget, based on the way we do our accounting when we buy airplanes that will last 30 years and buildings that will last 60 years and highways and bridges and other things, that there is some distortion in how much is consumed and how much is a long-term investment?

Mr. STRAUSS. Yes. And a big item you left out of there is homes, Senator.

Senator SYMMS. And homes.

Mr. STRAUSS. Homes is a big item in that. Yes, I would say there is some distortion there. But I still would say that it is an outrage where our national savings rate, when you compare it to Japan and to Germany and others, and when you try to keep up in productivity with them, we cannot do it. We are fighting a battle with one arm tied behind us.

Senator SYMMS. Well back to that. That brings you back to my next question. The plan that I have been proposing would be that we would take—it would really literally be a forced savings plan for Americans, that 2 percent surplus that is now being consumed by the Congress or spent, I should say, no matter how the accounting is. Don't you believe that if we in fact piled this money into private individualized defined contributions that that would be great competition to foreign investment in this country?

Mr. STRAUSS. Yes, if we could make that effective, unquestionably that it would be useful and meaningful.

Senator SYMMS. I have to say that your comments about don't tamper with Social Security, you know, I really totally agree with you. I do not think the public, if they understand the facts on the table, are that opposed to it. I mean I am standing here as living proof, coming from a State that has a record of bipartisan—you know, a two-party State—very close elections every year.

I suggested some serious—three major amendments to the 1983 bill that would have defined the benefits that people get to a slower fashion and everybody told me, well, you will never be reelected after doing that and it didn't happen. But I do think that we have an opportunity in 1990 with this surplus in Social Security—and I think, Senator Moynihan, that I share your view—that he has given us a great opportunity.

I frankly think my party is on the wrong side of the issue. I am one of a few in the party that thinks that. But I do believe that there is a good argument for having this money in the private sector. I think my plan is better because it would take care of the savings question and we would have several trillion dollars, and we could have money to invest in our own private development without having to sell the farms to the Japanese.

Mr. STRAUSS. Senator, let me respond to that by saying, without passing judgment on one plan as opposed to another, let me just say this, that it is so easy for people to demagogue and put fear into any discussion of Social Security. I think we need a slowed down, deliberate discussion of the issue you raised with your plan, certainly of the Moynihan proposal, and take a few months to look at that and let people understand it.

My recollection is that the AARP came out in opposition to the Moynihan plan as tampering with Social Security. My judgment is—and I know nothing about it—but my judgment is that they were sort of frightened into that. And if you take a bit of time to educate the American public, they understand any issue, as I said, if you give them clear choices. And if the members of the AARP were educated in the fact that what Senator Moynihan's proposal suggests, there would be no—they might support it; they might not. But there would be no reason for them to fear that it affected adversely the Social Security plan.

Senator SYMMS. I thank you very much for an excellent statement. And in any event, in the year 2012 I hope we are still going to have a Congress and they will be able to look at the situation again to figure out how they are going to get out of the mess that we have created for them.

Mr. STRAUSS. Senator, I hope to still be here drawing Social Security.

Senator SYMMS. Okay, thank you.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Pryor?

Senator PRYOR. Mr. Chairman, thank you.

I apologize to Mr. Strauss, I had to be out of the room and I was not here to hear a great deal of his statement. I always enjoy hearing Mr. Strauss come before this and other committees.

Mr. STRAUSS. Thank you.

Senator PRYOR. My very worthy staff member, Mr. Chairman, has gone through the list of witnesses today and in a one line definition has staked out their respective position. I will not name the various parties—opposes Moynihan; another one, vague on Moynihan; another one, supports Moynihan if two conditions are met; then supports Moynihan, but does not want to raise other taxes to offset it. Here is one, opposes Moynihan, but doesn't want to see corporate taxes increased.

So I would say, Mr. Chairman, that we have folks all over the lot on this. What is the one political force in our system that can achieve a budget summit situation? Is this going to be ultimately the President? Is this a congressional role? What has to happen for us to get where you are suggesting we should go?

Mr. STRAUSS. I said in my testimony that I would hope this committee might call for its counterpart in the House, and the leadership in the House and the Senate, to join with the Executive Branch in calling for it. I also said that I thought the President, having been elected President with an 80 percent popularity rating and obviously with the same concerns we all have about this budget, should take the lead in it.

I might add that I did not say that I would hope this process would continue deliberately through the year, that we would not be rushing into something to come up with some quick answers to get us through the next budget cycle or the next President campaign. I think the force could come from here; I think it could come from the President. It needs to come from someone. We need leadership so desperately.

Senator PRYOR. As I understand President Bush's program or his proposal we would do really nothing until about 1993, which is after the next President election. What happens to us if we wait that long?

Mr. STRAUSS. The great danger, in my judgment, that we face in this country is that we try to play it too cute and too close to the mark. You cannot fine tune and just barely avoid recession by having just barely enough economic growth in this country. That is what we are doing right now.

I have no way of assuring anyone that the world is going to come tumbling down if we do not deal with this deficit this year or next year or the year after. But what I do know is, when you play it that close to the line, if we get a bad break or two along the way, we will be in very, very serious trouble. And the way we are playing it, we cannot have the kind of growth productivity increase that this Nation needs.

Senator PRYOR. Mr. Chairman, I thank you for the time; and thank you, Mr. Strauss.

Senator MOYNIHAN. I think we both thank Mr. Strauss for that statement.

Senator Bradley?

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

Mr. Ambassador, it is always a pleasure to see you; and thank you for your testimony. I think that when it comes to process questions you are a fountain of wisdom and I think you were again today.

I would like to ask you just a couple of specific things as to what your specific recommendations would be. I just take them based upon how they were raised during the course of the hearing.

On Senator Symms' proposal, are you basically for or against that?

Mr. STRAUSS. I do not know enough about Senator Symms' proposal to respond to it. What little I heard of it today, it is worthy of consideration.

Senator BRADLEY. All right.

And then Senator Moynihan's proposal?

Mr. STRAUSS. Senator Moynihan's proposal, if we would be willing—Senator Moynihan has attacked what is patently unfair about our structure, and that is these dramatic sums of money that are being taken from the middle class and going to pay for the costs of government. I think it is going to—as I said in here—this gets into large questions. But my answer to that is, I think Senator Moynihan's proposal is a luxury the country cannot afford as bad as it needs it unless we are going to supplement the loss of revenue we would get if we cut that out.

What I would like to do is see the Social Security program addressed along the general lines that Senator Moynihan has proposed and I would like to see that shortfall in revenue made up in sensible, responsible ways, and we can do it.

Senator BRADLEY. All right.

On Social Security benefits above a certain level of non-Social Security income?

Mr. STRAUSS. I would go for that in a minute. I think that it is an outrage that a fellow like me who earns in very, very large figures, having getting substantial sums of Social Security money paying no income tax on it. It is crazy. In fact, I have a devil of a time getting my wife to let me spend it she thinks it is so outrageous.

Senator BRADLEY. And income tax credit for Social Security wage earners?

Mr. STRAUSS. I don't know. I have no real opinion on that. I do think getting—excuse me, go ahead.

Senator BRADLEY. No, that's——

All right. Thank you very much.

Mr. STRAUSS. Thank you very much, sir.

Senator MOYNIHAN. Mr. Ambassador, I just want to—I do not know whether we should do this in public, but in the interest of open government, may I plead with you to pay income tax on one-half your Social Security benefits.

Mr. STRAUSS. I do it on one-half.

Senator MOYNIHAN. It is the law, sir. [Laughter.]

Mr. STRAUSS. I do it. I am complying with the law you wrote, Senator Moynihan.

Senator MOYNIHAN. We want you back here frequently and not with a Federal Marshall sitting over there.

Mr. STRAUSS. I want you to know that I am marginally complying with the law you wrote.

Senator MOYNIHAN. And you are supremely helpful to us. Your proposal that there be a true summit meeting between these committees—House Ways and Means, Finance and the President—it seems to me a compelling matter. It has not happened. We are well into an Administration in which it ought to have done. I see my friend, Mr. Pryor, agreeing.

We thank you very much for coming, sir.

Mr. STRAUSS. Thank you so much for having me.

[The prepared statement of Mr. Strauss appears in the appendix.]

Senator MOYNIHAN. And now our third guest this morning, Mr. Calvin Johnson, who is the Legislative Representative of the AFL-CIO. We welcome you this morning, Mr. Johnson, and you are accompanied by——

Mr. JOHNSON. Thank you very much, Senator. I am accompanied by—and I take great pleasure in introducing to you and the committee—the new Director of our Department of Employee Benefits, Ms. Karen Ignani.

Senator MOYNIHAN. Good morning and welcome. We are very happy to have you and we will see more of you over the years.

Mr. JOHNSON. In an effort to make this hearing, for you, a bit more pleasant, I think it would be far more proper to have her deliver our statement to you this morning rather than myself. So with your indulgence she will deliver our testimony.

Senator MOYNIHAN. We welcome you to your solo before the Finance Committee. Please proceed.

STATEMENT OF KAREN IGNANI, DIRECTOR, DEPARTMENT OF EMPLOYEE BENEFITS, AFL-CIO, WASHINGTON, DC

Ms. IGNANI. Thank you, Mr. Chairman. We have submitted our written testimony for your review, and with your permission I would like to take this opportunity to briefly summarize my remarks at this time.

On behalf of the AFL-CIO we are indeed pleased to be here to share our views with you on the important issue of financing the Social Security fund in the short term as well as in the long term. We believe this hearing is timely because once again events have called into question the long term health of the Social Security trust fund. Although ironically, as many have said, you yourself, that we are now in a very different situation of course than we were in the 1980's, when the contingency reserve plunged to a dangerously low level of only 8 weeks of benefits; at present, concern centers around the program taking in too much money and having its surpluses used to substitute for general taxes in meeting the Federal Government's current operating expenses.

Once again, it is time for Congress to take steps necessary to prevent a crisis of confidence in the system. Therefore, Mr. Chairman, we believe that this committee and the Congress should seriously consider your proposal to reduce the Social Security payroll tax, returning to a modified pay-as-you-go system, provided two conditions are met. I would like to take a moment to describe those two conditions at this time.

Senator MOYNIHAN. Please do. Take all the time you want.

Ms. IGNANI. First, we believe that protections must be added to ensure that an adequate threshold of assets is maintained in the system before—and I emphasize before—any changes are made. Second, measures must be taken to avert massive cuts in Federal programs once the trust fund surplus revenues are removed from the deficit calculations under the Gramm-Rudman-Hollings law.

I would like to explain our rationale for this position. Because of the broad population group the Social Security program serves, we view Social Security as a safety net for families. And in our view, the key goal always must be to ensure the financial integrity of the system. While the bipartisan 1983 legislation to put Social Security back on firm financial footing was prudent at the time, it is time, we believe, to evaluate whether the current financing method is adequate for the long term.

In the 1983 report, as you know well, Mr. Chairman, the members of the Commission made it clear that they favored a fund build up that would increase the national savings rate and through investment would produce a larger pool of goods and services in the future. Unfortunately, as previous witnesses have indicated today and in other hearings, this has not happened, nor in our view is it likely to happen in the near term, because Social Security surpluses are being used to offset the deficit in non-Social Security programs.

In our view we should not continue to rob Peter to pay Paul by borrowing from Social Security to cover the Federal government's operating expenses. On the other hand, removing Social Security surpluses from deficit calculations without addressing the underlying budget issues could produce higher interest rates and/or crippling cuts in essential Federal programs.

Mr. Chairman, there has been much discussion this morning about two key issues that I would also like to address. The first is the relative progressivity of the Social Security system; the second is the question of using Social Security to finance non-Social Security expenses in the government.

On the first question, we believe the system is sound and fair. On the second question, we resoundingly say that we do not believe that it is appropriate to finance the Federal government's non-Social Security expenses from the Social Security trust fund. Many witnesses have commented on the percent of the population that has income which exceeds Social Security's maximum level of taxable earnings, capital is not taxed, et cetera.

So, therefore, while we believe Social Security is an appropriate system—social insurance program—compared to general taxes it is a regressive way to finance government operating expenses.

However, I would be remiss if I concluded my remarks at that point. I do think, and I hope the Congress will also look in addition to the macro issue of financing the system, the whole question of whether or not the system is working appropriately for beneficiaries, which brings up some micro issues that I think we need to put on the table.

Senator MOYNIHAN. Let's hear them.

Ms. IGNANI. We are very concerned about whether or not the Social Security Administration has the necessary staff resources to do the job. At present, SSA is working with a staff that has been reduced by almost 30 percent over a 5-year period. This down-sizing has led to serious problems in a number of key areas, including the following: posting of earnings, beneficiary appeals, disability applications, service provided by field office, and needless to say, employee moral.

We believe Congress must take steps immediately to assure that enough money is being allocated to obtain the staff necessary to provide high quality services to beneficiaries.

Finally, as part of the process of protecting Social Security, we would recommend establishing a separate Social Security agency administered by an independent board.

To summarize, the Federation would like to offer a six point plan for your consideration. First, continue the present financing system until the Social Security trust fund surplus reaches 125-150 percent. Once this cushion is reached, and only then, reduce the payroll tax to a level that would return to a modified pay-as-you-go financing system maintaining the 125-150 percent contingency reserve. Remove the Social Security trust fund surplus from deficit calculations under the Gramm-Rudman-Hollings legislation. Lengthen the time period over which deficit reduction would occur or raise revenue by making the income tax system more progressive. Create a separate Social Security agency administered by an independent three person board. Finally, provide a level of staffing necessary to assure that beneficiaries review high quality services.

Thank you very much.

Senator MOYNIHAN. Well thank you very much. May I ask, do you pronounce the name Ignani?

Ms. IGNANI. Yes.

Senator MOYNIHAN. That is very clear and very concise and very much in keeping with the long tradition of the AFL and then AFL-CIO in being knowledgeable about this system which is central to the economic well-being of the retired workers and is paid for by people in their working years.

I would like to respond, if I can, just quickly before colleagues have a chance to say, to your proposal that the Social Security Administration be reestablished as a independent agency with a three person board. May I just, for the record, say that that is the way it was established in the first place by President Roosevelt, who earlier you heard me quote as saying, he didn't want any damn politician getting his hands on that money—a bipartisan board.

And you do know, but again for the record, let me just say that last year this committee approved a proposal to establish an independent agency. It was with a one person head, but it is obviously a matter of judgment. You could argue it either way.

It was intended for the budget reconciliation legislation. Then we stripped that legislation and, in fact, did not do any legislating in the last session of Congress. But that has come out of this committee. We agree with you.

Ms. IGNANI. I might say, Mr. Chairman, that while you are again looking at Social Security and putting the issues of financing on the table, we raise it now because we do think it is an integral part of those questions.

Senator MOYNIHAN. Yes, raise it now and raise it again, and raise it yet again. I think you and I and our fellow members in the room here are about the only people who know it even happened.

The second thing to say to you is, just for the record, that your proposal that we get to about 125-150 percent reserve, a very sensible one, that is about 18 months out. I mean we are not far away from that. The reserves are rising a billion dollars a week.

Your third point about the reduction of staff at the Social Security Administration is very real; and it is the major argument for having it an independent agency in my view. They cut that staff by 20 percent in the 1980's and nobody in Social Security said a word, as if it did not matter. The agency is out in Baltimore. I think if you look up the Department of Health and Human Services in the Congressional Directory you go through six pages of officials before you get to the head of the Social Security Administration, with a very able, attractive head now, Mrs. Gwendolyn King.

We are trying to restore this agency. We did pass a law last year which will require the Social Security Administration to send out to each worker who is paying into the system a personal earnings and benefit statement. But we had to fight the Social Security Administration to get them to do it. You know, if you put $3500 a year into a bank—I wonder if I could ask Senator Pryor, down in Arkansas, if you put $3500 into a bank every year for 25 years, you would expect to hear from them once in awhile, wouldn't you?

Senator PRYOR. I would at least expect a toaster for Christmas.

Senator MOYNIHAN. A toaster for Christmas. [Laughter.]

Exactly. Well I know my personal experience. I joined the Social Security system in January 1943. That is very close—disturbingly close—to half a century ago, but what are you going to do? And I have not heard from them since. [Laughter.]

I do not know if I spelled my name right in that first encounter. I was nervous, I was in a government office. I do not know if they got it right. We have now an arrangement that every other year, starting in the higher age groups, you are going to get a statement that says this is what you have contributed; if you were to die, your spouse and children would receive these benefits; if you were disabled, you would get that; and if you keep on about the way you're going, you can expect about this much in the way of retirement benefits.

But they ought to come every year, you know. The largest cost involved is the postage stamp. And yet somebody out in Baltimore does not want you to know. I mean I can imagine, you know, if I got those statements, in my twenties I would not even open them; in my thirties I would lose them; but by the time I was forty, I would find a drawer where those things would go every year.

But that is one of the reasons a majority of non-retired adults do not think they are going to get Social Security, because they never hear from it. They do not know that the Social Security Administration knows your name and has a record.

But we take your proposals as very positive. I mean, not that the committee agrees with your position on returning to pay-as-you-go, but I think we do agree on an independent agency. We have so committed ourselves. And I, for one, am very much of your view that we should attend to the way that system works out there.

Ms. IGNANI. Mr. Chairman, I would like to take this opportunity to make a couple of quick comments.

Senator MOYNIHAN. Please.

Ms. IGNANI. First, we do applaud the start on getting more information out to beneficiaries about what they have paid in and their entitlement, so they can begin to get a better sense of what they will be getting at the end of their income stream.

However, it would be remiss of me not to make a point at this juncture that we really need to do a better job; and this really deals directly with the whole question of staffing. The issue of beneficiary appeals, the whole question of the 800 numbers.

Senator MOYNIHAN. Right.

Ms. IGNANI. As you know, 50 percent of those who call the 800 numbers are given the busy signal. I do not think we can allow that to continue.

Senator MOYNIHAN. No, I don't either.

Ms. IGNANI. Disability applications, there is lots of trouble in that area; and overall service provided by field offices. So although we think that Congress has made a very good start in improving the infrastructure of the system, we think that more needs to be done.

Finally, I would also say in a way that is a bit tongue in cheek that, of course, we will continue to weigh in on the three person versus the one person board for obvious reasons.

Senator MOYNIHAN. Sure. You can make an argument either way. May I say to you that the Subcommittee will be happy to hold hearings on the whole administrative question; and we want to hear you out on this. If those 800 numbers are busy half the time, the argument would be more 800 numbers.

Mr. Johnson?

Mr. JOHNSON. I would like to add just one thing. Although the trust funds are no longer considered in Gramm-Rudman in the sequestration situation, the Agency, because of sequestration, suffered some massive cuts in income out there. At the same time, the Administration in providing increases to Federal workers has made the determination that those increases have to be borne totally within the current budget, which means that you lose even more people.

So, you know, those kinds of situations really need to have a hard look taken at them.

Senator MOYNIHAN. Sir, we will—we have oversight responsibility, not just to the funds, but to the administration of the program; and we will have that hearing, and we will look forward to seeing both of you again soon.

My time is up and I want to ask Senator Symms.

Senator SYMMS. Mr. Chairman, I know the hour is late and we have a long witness list. I want to thank the witnesses and maybe just ask you one question. And first say that in your conclusions and recommendations, one point that I wanted you to know is that my plan calls for 150 percent surplus to be carried indefinitely in the Social Security fund. Now I do not know whether you have had the opportunity to look at this plan or not, but if you have I would be happy to hear your comments on it.

If you haven't, I would really appreciate having you take a check with some of your membership across the country and ask them if they had—and the way I'd pose the question is, if they had to chose between not having this money returned and leaving it in the hands of the Congress and Social Security Administration to accumulate or have a defined contribution second tier that would not interfere with their current benefit contributions that they now have, based under the benefit plan, how they would feel about the potential that if they could get 7 percent interest, starting out at age 18 earning $20,000 a year, what their attitude would be about the opportunity that they might be able to have $176,000 at retirement age. And whether they would rather have that as a choice or put their confidence in Congress and Social Security.

Do you see what I am getting at? Maybe you want to comment on it now.

Ms. IGNANI. Senator, we have not had time to appropriately study your proposal in the way it deserves serious study. However, I would say, as you know, the AFL-CIO has long been concerned about proposals to vitiate the notion of the social insurance nature of Social Security and substitute a defined contribution plan in lieu of a defined benefit plan.

We have some very grave concerns in that area, as we do in the private pension system where that is being done.

Senator SYMMS. Right.

Ms. IGNANI. Unfortunately, with increased frequency. So I will say to you that we do need to look at your proposal and consider it; and we have some folks that are in the process of doing that now. So I do not want to give—It would be presumptuous to give you an off-the-cuff remark. But I would raise the spectra of general concern about the overall defined contribution nature and the inability with a defined contribution nature to spread risk over a large population group to equalize benefits in a broader way, to raise entitlement for the relatively lower wage earner versus the higher, to deal with the whole question of disability income when an individual perhaps has not worked a significant amount of time to earn a disability income that would be reasonable and decent for them to live on.

So those are the concerns with which we would approach your proposal.

Senator SYMMS. Well I appreciate that a lot. I might just say to you, that is one of the reasons we crafted this, so that the defined benefit portion of the current Social Security would not be tampered with and would be fully funded so that everyone would be able to get what they anticipate getting now.

It is very difficult when you write a piece of legislation like this to try to get all of the answers. The answer to one part of the bill that I have said publicly that I am not married to is how the second tier defined contribution benefit plan would be set up. We have it set up patterned after the President's family savings plan. But I am certainly not married to that. If the committee in its wisdom decided they would prefer just to have it in a permanent secure investment and not be touched by that person until either they became disabled or reached retirement age, I really would not have any objection to that personally.

Thank you very much, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator.

Senator Pryor, I believe is next on our list.

Senator PRYOR. Mr. Chairman, I just want to make a comment.

Senator MOYNIHAN. Wait. Forgive me, it is Senator Riegle. Forgive me.

Senator RIEGLE. Mr. Chairman, you are kind. I am not going to pose any questions at this point. I know we have others to hear from. But thank you for calling on me.

Senator MOYNIHAN. Excuse me.

Senator Pryor?

Senator PRYOR. Mr. Chairman, I apologize. I just want to make a comment on our distinguished witness's effort to, as she said, talk about some of the micro issues of SSA.

Senator Moynihan has been on the cutting edge of a lot of this for a number of years. One of the fascinating things about this whole debate, Mr. Chairman, is the fact that even though there is a lot of opposition, some of it is relevant to the so-called Moynihan proposal, no one is attacking Senator Moynihan. That is unique.

And usually in emotionally charged debate like this they would have his picture on dart boards. They would be sending out millions of letters saying public enemy number one. This is not happening. The reason it is not happening is because of his extremely high degree of credibility on this issue, and the knowledge of all the members of the House and the Senate, and especially on this committee, of his past record in the area of Social Security.

I would also advise any group or organization who is thinking about chastising him personally for his position that they would receive, I think, only the wrath of the Senate and the House because he is our hero on this point.

Finally, Mr. Chairman, on SSA, I think we are dehumanizing the Social Security Administration. I have stated this on more than one occasion. I think you have brought up the 800 number. We have cut out about 25 or 30 percent of the employees. Those who are remaining, we are trying to turn them into telephone operators.

If you are in Little Rock and you have a question on Social Security you pick up the line and about after the sixth or seventh day you finally get a response. Usually that person that you speak to is either in Albuquerque or Birmingham or Buffalo. And today you can go to the local telephone book and look up the name of the Social Security office and it is not there. You cannot call your local Social Security office any longer.

I have just introduced a bill to make that optional, to give that individual who wants information the opportunity to call the 800 number, but to put that phone number back in the book so that they can talk locally to those people that they know.

Senator MOYNIHAN. Perhaps we can have a hearing on that bill in the context of this oversight.

Senator PRYOR. I want to compliment you, Mr. Chairman.

Senator MOYNIHAN. You who have worked so hard on the Internal Revenue Service and with such success. We want to thank you, sir.

Well then thank you very much. And again, Ms. Ignani, welcome to the Hill.

Ms. IGNANI. Thank you, Senator.

Senator MOYNIHAN. Thank you, Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

[The prepared statement of the AFL-CIO appears in the appendix.]

Senator MOYNIHAN. Now we have a panel consisting of some imminent representatives of the business community. It is to be remembered at all times that half the contributions to Social Security come from employers. That has been the plan for 55 years, that people know the investment and contributions are equal and that they are so recorded.

We have Mr. Frank Mason who is representing the Chamber of Commerce; Michael Roush, representing the National Federation of Independent Business; and Paul Huard, representing the National Association of Manufacturers. I think we will just follow our normal pattern in looking at the listing; and that means you, Mr. Mason, are first.

We welcome you, sir.

STATEMENT OF FRANK MASON, CHAIRMAN OF THE BOARD, MASON CORP., AND FORMER BOARD MEMBER, U.S. CHAMBER OF COMMERCE, TESTIFYING ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, BIRMINGHAM, AL

Mr. MASON. Thank you, sir. Good morning, Mr. Chairman and members of the committee. My name is Frank Mason. I am testifying on behalf of the U.S. Chamber of Commerce. I am a member of the Chamber's Health and Employee Benefits Committee, a former member of the Board of the U.S. Chamber, and Chairman of the Board of the Mason Corporation of Birmingham, a small business located in Birmingham.

The Chamber wishes to thank the committee for the opportunity to present its views on what has become a hotly debated question— and whether it is appropriate at this time to reduce the Social Security taxes.

In 1986 I chaired the Alabama delegation to the White House conference on small business and I worked with a group that looked into the area of payroll taxes. One of our recommendations which emerged as the number 8 priority out of some 60 priorities of the entire conference concerned Social Security. We called for a freeze on the tax rate and the wage base at 1986 levels, and also recommended the exploration of long-range alternatives to the present Social Security system.

The Chamber did endorse our recommendations. As we are all aware, no freeze occurred. FICA taxes have risen twice since then. The Social Security system is taking in more taxes than it needs to pay current benefits, as has been pointed out. The excess taxes, originally defended as a means of building a reserve which can be drawn upon in order to lighten the tax burden on active workers when the huge baby boom generation retires, are instead being used to finance current spending and not incidentally to mask a significant portion of the Federal deficit.

But the day will come when the millions of baby boomers need their Social Security checks. Beyond the taxes collected from their working children, what will the trust fund have to offer?

Figuratively speaking, a stack of Treasury bonds that amounts to a stack of I.O.U.'s. Congress will need cash to redeem those bonds, and will have four choices. They can raise taxes, cut benefits, cut Federal spending or borrow.

Interestingly, these same four choices will present themselves at about the same time if there is no accumulated "surplus." In either case, cash must be raised to provide the benefits. Tomorrow's retirees, workers and indeed the Congress confront essentially the same situation either way. In the meantime, unnecessarily high taxes are burdensome. The burden falls especially heavily on small businesses which generally are more labor intensive and pay lower average wages than large firms.

With the FICA taxable wage base at $51,300, it is likely that virtually every dollar paid out in wages by the small employer carries the automatic surcharge of 7.65 cents. Unlike income taxes, the payroll taxes have no relation to a company's profitability. They must be paid from day one, whether the business is doing well or doing very poorly. Consequently, high payroll taxes constrain not only employment, but the overall financial capacity and competitiveness in the global market.

For small business the employer's contribution to Social Security may constitute the bulk of the contribution he can afford to make to a national retirement protection. However, that portion of tax money spent to finance current spending protects no one. The business owner quite reasonably feels that his dollars would be more properly invested in his operation and his employees, rather than paying the government's current bills.

It should be remembered that Social Security is but one of three legs in the classic three-legged stool of retirement income—the others being the employer-sponsored retirement plans and personal savings. Social Security never was intended to be a full scale retirement plan. While all three legs of the stool appear to be in need of strengthening, and one might cite the increasingly complex and burdensome regulation of retirement plans, the Chamber believes that the personal savings element should be buttressed by the expansion of savings vehicles, such as the IRAs available to workers.

Senator Moynihan, your tax cut proposal has raised a lively debate about its impact on the Federal deficit. The Chamber shares the belief that the need to reduce the deficit is critical. To the extent that surplus receipts permit Congress to defer applying fiscal discipline to the government as a whole, they do the country a disservice.

Hard choices need to be made and they should be addressed now. It may be that our budget process cannot digest a $55 billion tax cut in 1 year; and we are willing to consider a gradual approach, keeping in mind that structuring a framework for continued economic growth is the most crucial step in preparing to meet the funding needs of the next century.

The Chamber urges Congress to reduce the Social Security payroll tax, matched by a reduction in expenditures necessary to meet Gramm-Rudman-Hollings deficit reduction targets, without increasing other taxes. In addition, the Chamber recommends this committee and Congress as a whole be vigilant in controlling the future Social Security benefit increases.

As a final note, let me urge the Congress to join the Chamber in taking a serious look at privatization alternatives to the Social Security system. The Chamber thanks the committee for its attention and particularly wishes to thank you, Mr. Chairman, for focusing public attention on this issue. The Chamber stands ready and willing to work for solutions to the benefit of all concerned.

Thank you very much.

Senator MOYNIHAN. We thank you. That was very clear; very straightforward. I note that you agreed with Chairman Greenspan of the Federal Reserve Board, if we go on doing what we are now doing, which is spending the surplus, then the difference between that and going back to pay-as-you-go as he said, is none, in the real world of economics.

Mr. MASON. Right.

[The prepared statement of Mr. Mason appears in the appendix.]

Senator MOYNIHAN. Mr. Roush, on behalf of the National Federation of Independent Business.

STATEMENT OF MICHAEL ROUSH, ASSISTANT DIRECTOR FOR SENATE, FEDERAL GOVERNMENT RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, DC

Mr. ROUSH. Thank you, Mr. Chairman. My name is Michael Roush and I represent the National Federation of Independent Business, which represents some 550,000 small businesses in this country.

Before I actually begin my statement I would like to introduce into the record a number of documents which I hope the committee will find of some interest. First is my written statement, of course.

Senator MOYNIHAN. That will be placed in the record, as all will be.

Mr. ROUSH. Second, I would like to place into the record a paper that was done by Michael Boskin for NFIB before the 1983 Social Security Amendments, in which he says, among other things, that "one drawback of this system, Social Security, is that while people accumulate future claims against the system, no corresponding wealth accumulation occurs for the system as a whole." And he concludes that paper by saying, "It is time for fundamental refocusing of Social Security to rationalize the benefit structure, roll back and indeed eventually decrease the long-run burden of payroll taxes, and provide not only a strengthened earned entitlement social insurance program, but a more cost effective and sensible transfer payment mechanism."

[The information appears in the appendix.]

Mr. ROUSH. The third document, I would like to introduce, if I may, is a statement which NFIB made to the Advisory Council on Social Security on July 19, 1983 in which we argue that "payroll tax increases cannot always be passed forward to consumers or forced by onto employees by small firms. That is, they must be borne by the small business directly."

[The information appears in the appendix.]

Mr. ROUSH. The fourth statement I would like to put into the record is an article from the February 10, 1990 Economist that argues that "the FICA tax is a bad tax; and that the Social Security system should be on a pay-as-you-go basis within balanced overall budget."

[The information appears in the appendix.]

Senator MOYNIHAN. Indeed, that will be placed in the record too. I note that Dr. Boskin is now Chairman of the President's Council of Economic Advisers. Did you have that in mind?

Mr. ROUSH. Yes, I did.

Mr. Chairman, I am for all records this morning on brevity of my comments. First of all, I would like to say that this hearing on this issue is for NFIB short of like dejavue all over again. We have been screaming in the wilderness to some extent about payroll taxes and how they should be reduced for at least a decade.

Consequently, on behalf of the small business owners that I represent and the people who work for them now and would like to work for them in the future, my statement is simply—cut the payroll tax, cut it now, and cut it deeply. And I will answer any questions. Thank you.

[The prepared statement of Mr. Roush appears in the appendix.]

Senator MOYNIHAN. Well we are breaking records all over the place.

Mr. Huard, you are at a certain disadvantage here. What are you going to do?

Mr. HUARD. Well I doubt that I can beat that.

Senator MOYNIHAN. Do you have a paper that the present Chairman of the Council of Economic Advisers prepared for you 6 years ago or 7 years ago?

Mr. HUARD. No, I cannot match any of that, so I won't try.

Senator MOYNIHAN. Well we welcome you anyway.

STATEMENT OF PAUL R. HUARD, VICE PRESIDENT, TAXATION AND FISCAL POLICY DEPARTMENT, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Mr. HUARD. Thank you, Senator. I am Paul Huard, Vice President of the Taxation and Fiscal Policy Department of the NAM. I certainly appreciate the opportunity to present the Association's views on this matter.

NAM opposes the reduction of Social Security taxes from current levels. As you know the rates currently in effect were adopted in 1983 as part of a bipartisan compromise intended to ensure the adequacy of Social Security retirement benefit financing well into the next century. NAM was a strong supporter of the 1983 Social Security financing reforms and we do not believe those reforms should be dismantled.

You may recall that our then President, Mr. Trowbridge, was a member of the Commission.

Senator MOYNIHAN. Yes, indeed; he surely was.

Mr. HUARD. In our view, the large payroll tax reductions being considered would inevitably lead to one or more of the following results: subsequent reduction of benefits; large increases in the Federal budget deficit; or large increases in other Federal taxes. NAM believes all of the foregoing outcomes are undesirable. Given political realities, benefit reductions seem highly unlikely for the foreseeable future.

I will therefore address the balance of my remarks to the deficit and tax issues. NAM believes that further reductions in the Federal budget deficit, leading eventually to a balanced budget, should rank among our highest national policy priorities. Deficit reduction is essential if we are to bring interest rates down, lessen our dependence on foreign capital and increase net U.S. savings.

In our view, this can best be achieved by gradual restraint in the growth rate of Federal expenditures without tax increases. If, on the other hand, Social Security taxes are reduced in the manner proposed, there will be a significant increase in the size of the Federal deficit in 1991 and later years. Unless offset by spending cuts or increases in other taxes the higher deficits would make the proposed Social Security tax cuts self-defeating. This is because we believe the resulting increases in the deficit would trigger higher interest rates and renewed inflation which would soon wipe out the $3 or $4 weekly increase in most worker's take-home pay.

We do not, however, believe Congress is very likely to tolerate increases in the Federal budget deficit of the magnitude of $55 billion or more annually. For this reason, we believe the likeliest outcome of the proposed reduction in Social Security taxes would be immediate pressure for offsetting increases in other Federal taxes, most notably income taxes.

The history of the past decade clearly suggests to us that when seeking additional tax revenues, the current preference of the Congress is to turn first to U.S. business corporations. NAM believes this is totally unjustified since corporations are already heavily overtaxed relative to individuals, paying Federal corporation income taxes, for example, at effective rates roughly triple the effective rates of individuals.

Further increases in corporate taxation furthermore will only worsen the already difficult situation faced by our members in trying to compete in a global economy where most of our trading partners maintain tax systems that are much more hospitable to their domestic companies.

Finally, we believe retention of the present Social Security tax structure is desirable for another reason. In the past decade, Congress and the Administration have made significant changes in U.S. tax laws on a nearly annual basis. What U.S. taxpayers, and in particular business taxpayers, desperately need at this point is stability in the Federal tax system, enabling them to do rational business planning on a long-term basis.

Dismantling a tax structure that is barely 7 years old, and which when adopted in 1983 was supposed to be good for at least 50 years or more, would further reinforce the perception of many taxpayers that the period of time any major segment of U.S. tax law can be counted on to remain in effect is often measured in months or at best, a few short years.

That concludes my prepared remarks, Senator. I certainly would like to add my congratulations and commendations to those of everybody else and to endorse the remarks of the Senator from Arkansas. While we oppose your bill, we indeed feel that the nation is in your debt for having raised this issue. There are serious problems here dealing with the way the Federal budget is being handled and you certainly are to be congratulated for having brought them into the national public focus.

[The prepared statement of Mr. Huard appears in the appendix.]

Senator MOYNIHAN. We do thank you, Mr. Huard. I count two to one as the vote goes.

I would like to note that Mr. Huard, on behalf of the National Association of Manufacturers, makes a point that this committee is sensitive to, which is that changing the tax code ought to be a deliberative process that does not happen just routinely. And yet it did happen routinely.

The rate schedule we are talking about today on Social Security was put in place in 1977, which is 14 years ago and what happens remains to be seen. The fact is that in the 1980's we were constantly changing the tax system.

Senator Symms, I am sure agrees. There wasn't a year went by that we didn't have a new tax rate for something or other, simply because we were short of revenue.

Senator SYMMS. I used to say we should make all the members of the committee watch that movie Rollerball, Mr. Chairman, so they would see what it is like when they change the rules every week.

Senator MOYNIHAN. Well that is what we did and I think that is a fair and sensitive point. I would, on the other hand, say that there is an issue of a system put in place with one purpose and then being diverted to another.

I mean I think all of you as business representatives—and Mr. Mason is a businessman—ought to be very sensitive to your own pension fund responsibilities. You have pension systems and you are, I am sure, very careful about what you do with that money, are you not, Mr. Mason?

Mr. MASON. Well as a matter of fact, we have had in our company a great deal of concern about the point you make in the changes. I forget now how many thousands of changes have been made in the fairly recent years regarding just the handling of the pension funds and so forth in our own company.

Senator MOYNIHAN. Under ERISA, is that it?

Mr. MASON. Well starting with ERISA and then subsequent. Almost every tax bill includes changes which require a complete redoing of the plan. In our own case, we have had a pension plan and a profit-sharing plan. The profit-sharing plan has provided a much better benefit to the retirees.

Senator MOYNIHAN. Tell that to Senator Symms here.

Mr. MASON. I was interested in Senator Symms' proposal. But in our case, we have recently reached the point where we have elected to discontinue the pension plan and go completely with the profit-sharing. In fact, the big reason is not only the increased cost of maintaining the plan itself but the actual administration cost due to the constant changes that we have had to contend with. So we are in the process of terminating the pension plan—and we were considerably overfunded and elected to allocate those funds to the employees. None of the money comes back into the company.

But we felt that if we allocate those funds to the employee, we could go with a single plan that provided the best benefit, which in our case was the profit-sharing plan.

Senator MOYNIHAN. Senator Symms?

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

Gentlemen, I would just like to ask all of you to have a look and have you Association's take a careful look at my plan and get back to me if you would. I will not ask you to comment on it now.

And then just in passing say that so many people talk about the employer's share of this—and coming from a small business background myself—I recognize that the employers do pay half of it, but don't you all agree with me that basically it is the working people that are paying this because it is allocated out of the expenses of a company as costs of labor to employers and to employees, and it is really the working people that have to pay this 15 percent?

I have heard Senator Dole say many times that in 1983 they did not raise taxes, they had already been raised in 1977. But the Congress just accelerated when they started kicking in those higher payments and overshot the mark basically is what happened.

So I will just yield back the time and thank you all very much.

Mr. ROUSH. Senator, if I could just respond to that question as to who pays this tax?

Senator SYMMS. Yes.

Mr. ROUSH. I think that the economic literature is mixed, although I think that the consensus generally is that the employees bear in the long run almost the entire burden of this tax, that in a shorter run I think that CBO and others agree that there is some passing forward of this incidence, this burden to consumers.

We, however, just to throw our 2 cents into the economic debate—and one of the reasons I introduced some of this material—is that we believe that there is convincing and strong evidence that small business firms, during certain periods in the business cycle, have to bear the burden of this tax directly, entirely, themselves. That they cannot pass it back to employees, nor can they pass it forward to consumers. That is not all the time and in all cases. But in a significant enough part of the business cycle, that is one of our self-interested purposes, actually, of supporting this. I mean, that we believe that we bear the burden of this tax ourselves.

Senator SYMMS. I quite agree with you, that if you are in a competitive market, like in my background, where you are in the produce business, you sell the produce for whatever the market is and you do not dictate it. It is set somewhere else and you cannot just pass forward your costs. But still, there is an allocation there and the working people are bearing this. You know, they are paying for it eventually out of their wages. They could have higher wages is what I am saying without it. They will get part of this in higher wages.

Mr. MASON. If I might comment on that same point, in our case, being familiar with our own operation of our profit sharing plan, if you took the 15 percent and put it into a plan where it could compound and be a deferred payout, I think you would find over a career, an individual would have considerably more available to them—considerably more than in the——

Senator SYMMS. You can see from the chart I have, if you have 7 percent compounded and only had 2 percent of it, or even less than 2 percent, depending on how it would work out, you would end up with that much money. If you had the whole 15 percent, you would have a million dollars.

Mr. MASON. That is right.

Senator SYMMS. But we are not proposing to go that far at this juncture.

But thank you very much, gentleman; and thank you, Mr. Chairman.

Mr. HUARD. I would like to reinforce Mr. Roush's remarks. I have always been troubled by the nearly universal acceptance of the argument that both sides of the FICA tax are paid by the employee.

Senator MOYNIHAN. Yes, that is the literature.

Mr. HUARD. Yes, but we have 9,000 small business members and the feedback that I get is exactly the same as Mr. Roush gets. I think in many cases you are not able to pass this back to the labor force; indeed, the employer is bearing his half of the tax.

Senator MOYNIHAN. That is certainly a credible proposition.

I wonder if I could ask that the responses that you provide on Senator Symms' proposal, if we could have them in time to include them as part of this hearing.

Mr. HUARD. Certainly. We will try to do that.

Mr. ROUSH. Is the record open for 2 weeks?

Senator MOYNIHAN. Sure. Sure. Of course, yes. You will have to consult with your Boards, of course.

Senator SYMMS. And if you have some recommendations of how it could be improved, I would appreciate that also.

Mr. ROUSH. Good.

Senator MOYNIHAN. Gentlemen, thank you very much. We do appreciate it and we learned something here.

[The information appears in the appendix.]

Senator MOYNIHAN. Now we are going to have a panel of persons representing the retired community. All of us hope one day to be in that role. Let's see, first of all, Judith Brown, who is a member of the board of directors of the American Association of Retired Persons; and that most eminent of Washingtonians and Rochestarians, if I may presume to say, the Honorable Arthur S. Flemming, who is Chair of the Save Our Social Security Coalition, who has been so helpful to this committee; Mrs. Martha McSteen, the former Acting Commissioner of Social Security, now president of the National Committee to Preserve Social Security and Medicare; and Mr. Lawrence Smedley, who is executive director of the National Council of Senior Citizens.

Welcome all. I see Mrs. Brown has not been able to be here. So you, sir, are representing the AARP?

Mr. MULVANEY. Yes, sir.

Senator MOYNIHAN. I am sorry, sir, we do not have your name.

Mr. MULVANEY. My name is Ronald Mulvaney.

Senator MOYNIHAN. Good morning and welcome; and you are first.

Mr. MULVANEY. Thank you, Mr. Chairman. Judith Brown was originally scheduled to testify but she was unable to come this morning because of illness.

Senator MOYNIHAN. She is quite a long way off, isn't she? She is from Edina, Minnesota. Give her our best regards.

Mr. MULVANEY. Yes, we will. Thank you, Senator.

STATEMENT OF RON MULVANEY, WISCONSIN AARP VOTE COORDINATOR

Mr. MULVANEY. As I said, my name is Ron Mulvaney, and I am the State coordinator from Wisconsin for AARP Vote, which is the voter education arm of the American Association of Retired Persons.

The Moynihan proposal to return Social Security to pay-as-you-go financing has sparked a debate on the Federal deficit and the future of Social Security. Senator Moynihan has correctly and dramatically defined the problem. His proposal to reduce the growth in Social Security funds reserves underscores that the build up in the reserves is not being properly saved for the baby boom generation's retirement, but instead is masking an increasing portion of the Federal deficit.

AARP has sounded the alarm for the past several years on the use of Social Security to mask the deficit. Unfortunately, the alarm has been muted. Now the proposal to reduce payroll taxes has focused the nation's attention. However, after careful consideration the Association's first preference remains retaining existing Social Security policy to continue to build the reserves for the future generations. This is not fear; this is considered and careful judgment.

But as this debate has dramatically pointed out, continued build up of the reserves must be accompanied by a change in fiscal policy to move the rest of the Federal budget towards balance.

AARP calls upon Congress to enact legislation this year to separate Social Security's financing from the calculation of the Federal deficit.

AARP believes that legislation is necessary for the following reasons: (1) including the trust funds in the deficit figures mask the true extent of the deficit in the rest of the Federal budget; (2) including Social Security in the deficit calculation completely obscures the economic necessity of treating the growing trust funds reserves in a manner that promotes long-term economic growth; (3) Social Security has long-term obligations.

In fact, the program is measured over a 75-year time frame. It is not appropriate to look at Social Security in the context of the 1 to 3-year framework of the Gramm-Rudman-Hollings calculation.

AARP believes that the nation must manage the Social Security program in ways that best assures three goals: (1) strengthening the public confidence in the integrity and safety of the Social Security system, now and in the future, particularly on the part of younger Americans; (2) ensuring higher national savings and investment in order to promote long-term economic growth so that the Social Security benefits promised to today's workers can be honored; and (3) protecting current benefits from year to year fluctuations in the economic cycle.

To do this, the Association believes that the trust fund reserves should continue to build to a level at least equal to 18 to 24 months' worth of outlays. AARP recognizes and shares the frustration of many in Congress on the lack of progress on meaningful deficit reduction. The Association, however, is not prepared to give up on deficit reduction.

In the final analysis there are three choices with respect to the Social Security trust fund build up. First, we can make the reserves economically productive by dealing with the deficit in a responsible way. Second, we can return Social Security to pay- as-you-go financing to limit the accumulation of the reserve. Or third, we can continue current policy, allowing the trust fund build up to mask the deficit.

AARP prefers the first choice—to make the reserves economically productive by dealing with the deficit in a responsible way. If that does not prove successful, then we can consider option two—pay-as-you-go financing. However, the Association rejects the third choice to do nothing.

I would welcome and be happy to answer questions at this time.

[The prepared statement of the AARP appears in the appendix.]

Senator MOYNIHAN. Mr. Mulvaney, we thank you. We are going to hear the whole panel.

Next, of course, the person honored in his own time and legendary in the years to come, in my view, Hon. Arthur S. Flemming. Sir, we welcome you back to the committee.

STATEMENT OF ARTHUR S. FLEMMING, CHAIRMAN, SAVE OUR SECURITY COALITION, WASHINGTON, DC

Mr. FLEMMING. Senator Moynihan, thank you very, very much. I appreciate the opportunity of appearing before you in connection with the proposal that you have pending before this committee.

First of all, I would like to say that all of us are deeply involved in the program, the Social Security program, are deeply indebted to you for the leadership that you have provided us down through the years. I certainly want to say that I know I am representing a great many persons when I say that.

We feel that you have raised a valid and important point about the fiscal imbalance of the Federal Government's operating budget and the fact that the Federal deficit is being masked by including the Social Security reserves when determining the deficit.

Our comments on the proposal follow: First, we feel there should be no immediate cut in the OASDI tax rates. Old-age survivors and disability insurance does not yet have sufficiently large contingency reserves. Most experts believe at a minimum a 1 to 1½-year contingency reserve is necessary to protect the system in times of economic downturns. Currently, the contingency reserve is at three-fourths of a year. A one and a half year's reserve will not be reached until approximately sometime between 1993 and 1995, depending on economic performance.

The Social Security trust funds, we feel, should be removed from the Gramm-Rudman-Hollings deficit calculation. You have a bill pending, along with Senator Heinz, S. 219, which would achieve that particular objective. If the trust funds were removed from the Gramm-Rudman-Hollings calculation, the Social Security trust funds would cease to mask the deficit, thereby encouraging action to reduce the non-Social Security deficit.

However, when the Social Security trust funds are no longer counted in determining the size of the deficit, action should be taken immediately to prevent serious reductions in vital domestic programs by diverting funds for military to nonmilitary purposes, by increasing taxes to provide additional revenues, by revising the Gramm-Rudman-Hollings law or by some combination of these three approaches.

In your bill, of course, you have elected to propose a revision in the Gramm-Rudman-Hollings bill. That is S. 219.

Next, we feel that we should avoid eroding the renewed confidence in the Social Security system of both the beneficiary and the worker populations that has been established as a result of the 1983 Amendments to the Social Security Act. We deeply appreciate the contributions that you made to bring it to the work of the Commission and to the enactment of those Amendments.

We feel a significant reserve should be preserved in the Social Security trust funds in order to avoid in the future sudden decisions either to make major benefit cuts or increase payroll taxes.

However, the specific level of surplus and the payroll taxes necessary to support that level is a subject of legitimate debate and discussion.

I would like to proceed next to the point that is of concern to some of us, and a concern to me personally. Allegations that have been made in the dialogue resulting from the proposal that you have advanced, that the Government is stealing from the trust funds result in serious misunderstandings that contribute to an undermining of confidence in the Social Security system.

The Treasury, as it has been doing since the beginning of Social Security, over 50 years ago, is investing the Social Security reserves in government securities and when it does so is issuing demand notes with the same legal standing as a government bond and is making regular interest payments on these notes. The unsound fiscal policy now being followed by the Federal Government results in the money borrowed from the trust funds being used for current operations, rather than for debt reduction or investment. That means, it is not—as the Chairman of the Federal Reserve so effectively pointed out—an honest to goodness savings program.

A sound fiscal policy would result in the money borrowed from trust funds being used, for example, to help retire the Federal debt. I was interested in Senator Bradley's question along this line. This in turn would mean that the Federal Government's financial burden of redeeming the demand notes in the trust fund would be much easier to meet when the payment of benefits begins to exceed income in approximately 2020.

Listening to the dialogue between you, the Chairman of the committee, and the Chairman of the Federal Reserve, I summarized it in just this way—Social Security as it now stands is a fiscally sound progressive system, considering both the taxes and the benefits, which is being undermined because of our unsound fiscal policy.

Let us substitute sound for unsound fiscal policies and maintain the present Social Security system, a fiscally sound progressive system.

Thank you.

Senator MOYNIHAN. Why can't you ever make up your mind? [Laughter.]

Thank you, Mr. Secretary. That was very clear.

[The prepared statement of Mr. Flemming appears in the appendix.]

Senator MOYNIHAN. Mr. Smedley, you are next, sir.

STATEMENT OF LAWRENCE T. SMEDLEY, EXECUTIVE DIRECTOR, NATIONAL COUNCIL OF SENIOR CITIZENS, WASHINGTON, DC

Mr. SMEDLEY. Mr. Chairman, my name is Lawrence Smedley. I am the Executive Director of the National Council of Senior Citizens. NCSC is a 4.5 million member organization with over 4500 local clubs, area councils and State affiliates throughout the country. Founded in 1961 in the fight for Medicare and Medicaid, we continue our strong interest in seeing that our nation's seniors are able to live their retirement years in dignity and security.

The old-age survivors and disability insurance is an indispensable part of the provision of that security. During the last session of Congress, NCSC, along with Senators Moynihan, Heinz and others, called for the separation of the Social Security trust fund from the Gramm-Rudman-Hollings calculation of the Federal budget deficit, with a commensurate extension of these targets.

We have also long supported an independent Social Security agency in order to insulate the program as much as possible from politics and misuse in the budget process. The continued masking of the Federal budget deficit by the Social Security trust fund surplus presents a danger to the preservation, of and confidence in, Social Security.

The current system creates the illusion that the surplus can be used to pay for general government expenditures; it creates the illusion that Congress and the President are making actual progress in lessening the deficit; and it creates the illusion that a painlessly redeemable surplus exists for the retirement needs of the baby boomers. In a word, the current budget system is dishonest.

For these reasons, the National Council of Senior Citizens applauds you, Senator Moynihan, for initiating a national discussion of the long-term status of the Social Security system. Since the prospects of significant deficit reduction in the near future are not good, consideration must be given to suspending partial prefunding.

However, in the interest of protecting the Social Security system against short-term economic problems, we do believe that a substantial cushion must be maintained. NCSC feels the cushion should be between 125 and 150 percent of 1 year's outgo. In a sense, the existence of this cushion will mean that some degree of deficit masking will continue. We urge the moving of the trust funds out of the Gramm-Rudman-Hollings calculations, even under a return to pay-as-you-go financing.

Once the necessary cushion level is reached and assuming the deficit has not been brought under control, NCSC supports reduction in FICA payroll taxes and placing the Social Security program on a pay-as-you-go basis.

However, we do hold that given the demographic changes that will occur in the next 30 years, some measure of prefunding for the program is both important and justifiable. Important in terms of preserving competence in the system; and justifiable because such funding enhances the prospects for future economic growth which is essential to the long-run soundness of the Social Security system and the economic security of workers and retirees.

In other words, Congress and the President should be put on probation. If they can bring the budget deficit under control by the time a sufficient cushion has been built up, the current FICA tax rate should stay the same. However, if this goal is not achieved, pay-as-you-go financing as proposed by Senator Moynihan is then the sensible course.

Thank you.

[The prepared statement of Mr. Smedley appears in the appendix.]

Senator MOYNIHAN. Thank you.

May I say to our panel, I unavoidably have to be in the back room for a bit and Senator Symms has very generously agreed to chair the panel for a bit. I will return.

Senator SYMMS. Thank you very much, Senator Moynihan. And thank you members of the panel for your statements. I wanted to say that I certainly agree with those of you who have stated that you think we should carry 125 to 150 percent surplus in the account. In my plan it is the only new suggestion on the table that does institutionalize a 150 percent asset ratio to the annual benefits.

I want you all to understand that because if there is any concern that I think that Americans get concerned about is, they do not want someone as the President says, messing around with Social Security. My proposal which would establish a nest egg savings account in addition to the benefits that we now have in Social Security by paying the surplus tax collections to a protected account where Congress cannot touch it is really a new twist on this.

I think that it does have some merit. But I think that it is important that we recognize that the 150 percent in that plan is considered not compromised. I mean I would not want to compromise that particular point. I think that is important that that is protected.

Mrs. McSteen, you have not given your testimony?

Mrs. MCSTEEN. No, not yet.

Senator SYMMS. I apologize.

Mrs. MCSTEEN. That is quite all right.

Senator SYMMS. I apologize. I thought you had testified. I will stop my question for now and then go ahead with your testimony. I apologize. I thought you all four had testified.

STATEMENT OF MARTHA A. McSTEEN, PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE, WASHINGTON, DC

Ms. McSTEEN. Thank you. Mr. Chairman, members of the National Committee welcome the debate on Social Security, its financing and its future. To be sure, Senator Moynihan deserves the praise he has received for focusing national attention on the way the Social Security surplus is being used to disguise the true size of the budget deficit. It is a debate that is long overdue.

In a just-completed poll of National Committee members, they said they believe tax rates should be adjusted and the Social Security system should be returned to a pay-as-you-go method of financing. Our members also believe that Social Security trust funds should not be included in deficit calculations. The trust funds did not create the budget imbalance. They should not be a part of the solution.

Removing Social Security trust funds from the budget calculations is an essential step to maintain the integrity of the Social Security system. Our members overwhelmingly believe that the Social Security surplus should be used exclusively for Social Security benefits. In fact, it is so important that our members indicated they would accept higher deficit or the sacrifices necessary to balance the budget exclusive of Social Security.

As we see it, there are only two ways to prevent the use of trust funds for current government expenses. One way is to balance the budget without the help of trust funds. The other option is to eliminate the unneeded surplus. This approach is a lot like getting rid of the ice cream and donuts before you go on a diet. You remove the temptation and force yourself to make tough decisions.

By removing the surplus and eliminating the temptation, the country would return to a pay-as-you-go financing system under which Social Security was funded for its first five decades.

One point about Social Security is clear. That is, the cost will permanently increase when the baby boom generation begins to retire. Some say a pay-as-you-go plan will be unaffordable. But Social Security experts like Alicia Munnell, of the Federal Reserve Bank of Boston, say the burden will "be completely manageable."

By more than a two-to-one margin, National Committee members polled believe that pay-as-you-go plan makes more sense than the current law. Even with a pay-as-you-go system, a reserve of some fashion will be needed to cushion Social Security against an economic slump. Whatever the size of that reserve, the National Committee believes that it should be accompanied by an automatic rate stabilizer of some fashion, to ensure the stability as well as the soundness of the trust fund.

Such a stabilizer would remove tax increases and decreases from the political process and trigger automatic annual adjustments to the payroll tax rates to keep the reserves at mandated levels. This automatic rate stabilizer that tax rates are as low as possible for workers and employers, and large enough to ensure beneficiaries that the program is financially solid.

Before concluding, Mr. Chairman, I want to mention one other important issue related to Social Security, and that is the need for an independent agency with a strong governing board. The cabinet secretaries who are Social Security trustees are faced with an unresolvable conflict of interest. They must balance the needs of Social Security with the other legitimate needs of the nation, such as reducing the deficit. But in so doing, these decisions may not always be made in the best interests of Social Security.

The trustees must insist on and stand up for what is right for Social Security first and not leave this burden of conscience to members of Congress alone. It is for that reason, Mr. Chairman, that the National Committee urges the Finance Committee to support legislation that would create an independent Social Security agency with a strong governing board.

The National Commission on Social Security Reform deserves our thanks for rescuing Social Security from the brink of bankruptcy back in 1983. But as successful as its work was, the Commission did not systematically examine long-term financing issues or conscientiously recommend a long-term financing strategy.

Well, Mr. Chairman, now is the time to begin the debate about long-term financing issues. Now is the time to come up with necessary strategies. Senator Moynihan has focused national attention on this issue. And we know that you, and other conscientious members of Congress will give it your closest attention.

Thank you.

[The prepared statement of Mrs. McSteen appears in the appendix.]

Senator SYMMS. Thank you very much for your statement. I quite agree with you about the automatic stabilization and we have that built into my plan. I think that is an important facet if we are going to really have a long-term look at this.

I want to thank all of you on the committee and I call your attention to the next witness that will testify. I had mentioned it earlier, and I would love to have the input, not only on my plan, but comments on Stu Sweet and Anne Canfield's proposal that will be made next if you have time to stick around and if you could give us a comment on that. Direct it to the committee and to me specifically. I would appreciate it.

Thank you all very much for your contribution to the committee.

The next witness is Mr. Stu Sweet, vice president of Black, Manfort, Stone and Kelly, and a Social Security economist from Alexandria, VA. Stu Sweet was a former staff member of Capitol Hill, working for Senator Heinz on this committee, as well as, I think, Senator Hawkins.

Ms. Canfield, would you like to join Mr. Sweet at the witness table in case there are any questions come up. Anne Canfield, formerly was a member of my staff, who was instrumental in the Sweet/Canfield plan.

Please go ahead, Mr. Sweet.

STATEMENT OF STUART J. SWEET, VICE PRESIDENT, BLACK, MANAFORT, STONE & KELLY, AND SOCIAL SECURITY ECONOMIST, ALEXANDRIA, VA, ACCOMPANIED BY ANNE CANFIELD

Mr. SWEET. Thank you, Senator.

Mr. Chairman and Members of the committee, thank you very much for allowing me the opportunity to testify here today. It is indeed a great honor. I would like to request that my entire written statement be made a part of the official record.

Senator SYMMS. It shall be, without objection.

[The prepared statement of Mr. Sweet and Ms. Canfield appear in the appendix.]

Mr. SWEET. Before I begin, I wish to recognize my colleague, Anne Canfield, who is equally responsible in every way for the plan we have developed and this written statement as well.

Finally, the remarks made here today are to be attributed to us alone and not to our employers. Furthermore, neither of us has a client interest in this issue. Instead, we believe we have built a better mousetrap and wish to share our discovery.

In preparing this plan we have been guided by four essential principles. They are: (a) OASDI revenues should be dedicated solely for the purpose of paying benefits; (b) the current system of skewing benefits to lower income wage earners is correct and should be maintained; (c) beneficiaries should have a contractual right to their benefits; (d) all beneficiaries, no matter what their income brackets, should have the benefit of professional money management.

Mr. Chairman, as you have so eloquently pointed out, along with Senator Moynihan, the Social Security surplus cannot be spent twice. It can either be invested to provide enhanced retirement benefits or it can be used to reduce the deficit, but not both.

Right now we have chosen option two. However, option one, funding retirement security, is the better choice. It is also the choice that most Americans assume is being done when they see the acronym FICA on their pay stubs. If retirement security is chosen, then two major steps must be taken to make the choice meaningful.

First, Social Security must be taken off budget so that it is insulated from unrelated budget pressures. Second, the Social Security surplus must be professionally managed. The importance of earning attractive rates of return safely through professional management cannot be overstated. One dollar that earns a 2 percent rate of return after inflation will double in real value in 36 years. That same dollar invested at 7 percent will be worth $11 in 36 years.

The same math applies when we are talking about the $2.5 trillion of surplus Social Security contributions that will be collected by 2015. At 2 percent the Social Security Administration says the surplus will grow to $12 trillion. But at 7 percent the surplus will eventually reach $75 trillion. As you may imagine, workers everywhere hope that the investment rate is 7 percent and that they get their share.

We believe this can be done in the following way: Starting on January 1, 1991 workers who chose to do so would have 2 percent of their paychecks sent to mutual funds. At the same time their Social Security taxes will be reduced by 2 percent as well. Thus, the take-home pay of workers is unaffected by this change. To accomplish the transfer into mutual funds, employers will be required to provide all employees with a menu of mutual funds of varied investment aggressiveness for them to chose from. To guarantee safety all funds would have to meet ERISA standards and also be subject to Labor Department and SEC oversight. Workers would then get monthly account statements from their funds.

At retirement, workers will receive two benefit checks instead of one. Their tier one benefit will come from the Social Security Administration; and their two tier benefit will come from their mutual funds investments. For all but higher paid workers the tier one benefit would equal their current law Social Security benefits. Higher paid workers, however, would have a tier one benefit that is worth less than their current law benefits would be. However, their tier two benefits would more than make up the difference.

Our plan offers the following advantages: First, total retirement benefits received by all Americans will rise significantly, but especially for low and moderate income workers who need the help the most. Second, workers will have a more secure overall retirement program and will not have to worry that unrelated budget pressures will force Congress to cut their benefits. Third, ownership of stocks and bonds will be far more widely distributed across all social and economic classes. Fourth, this program will be popular.

A respected polling firm, Market Opinion Research recently asked the following question during the last week of January: "A proposal has been made to give people the choice to divert some of their Social Security taxes they pay into savings plans. Under this proposal the Social Security system will continue to meet its obligations. Would you favor such a plan?" In reply , 68 percent of the American people polled said, yes, they would favor such a proposal; 10 percent had no opinion; but only 22 percent were opposed.

To conclude, Mr. Chairman, real progress towards enhancing retirement security can be made in a popular fashion by (a) placing 2 percent of worker's paychecks in mutual funds made available to them by their employers; (b) guaranteeing all but higher paid workers that their basic Social Security benefits will remain unchanged under this program; and (c) providing all Americans with a second benefit resulting from professional financial management as well from the private sector.

Thank you.

Senator SYMMS. Thank you very much for an excellent statement. I see that you have in your written statement some critiques of the President's proposal. Would you care to comment on that briefly?

Mr. SWEET. Well this may sound extraordinary, but actually the President's plan does not look far enough into the future. His plan says we should use the Social Security surplus to buy down the national debt until the year 2000. Which, indeed, if it actually happened would reduce the national debt held by the public to about $1.7 trillion.

The problem is if we continue this policy, we literally will eliminate the entire national debt by 2005. And yet the Social Security surpluses will continue to roll on. What will then emerge will be a national surplus. I think we ought to address that issue as well. This is an issue that is going to go on literally for decades and I think it is a mistake not to debate it sooner rather than later.

Senator SYMMS. Is your concern about that the fact that then eventually it would end up that the Federal Government would own most of the savings in the country?

Mr. SWEET. If the Federal Government actually controlled a national surplus as large as would be theoretically possible, if we continued the Bush Administration plan until 2015, this would give the Government more control over the U.S. economy than the Politburo has over the Soviet economy.

Senator SYMMS. To go back to your plan as opposed to my plan, how does your plan differ between the Symms plan and the Porter plan and the Canfield-Sweet plan?

Mr. SWEET. Well, Senator, I would first like to commend you for introducing you bill. I know that you have been active in this area for several years. I believe in many ways we are all sitting in the same church, reading from the same Bible, but we are sitting in different pews, and so we have a slightly different view of the proceedings.

There are two major difference between the Symms plan and the Sweet-Canfield plan. Under your proposal it would be possible for taxpayers to take funds out of their mutual fund investments before they reach retirement. Ms. Canfield and I believe that Social Security should remain solely a retirement vehicle and that, although your objectives are laudatory, they should be financed in another fashion.

In addition, we have bit the bullet and proposed a specific method for financing Tier 2 benefits. Specifically, if we are going to take 2 percent of the payroll taxes now going to finance a large increase in future Tier 1 benefits and divert them into mutual fund investments, something has to be done on the benefit side as well so that the overall Social Security system remains sound.

We are proposing that the growth of real benefits to higher paid workers not increase as fast as it would otherwise. Under current law, average real benefits after inflation would more than double over 75 years. We are saying that perhaps higher paid workers who have other retirement vehicles can get by with having their benefits only grow by say 50 percent rather than 250.

Senator SYMMS. So in that respect your plan is closer to the Porter Plan?

Mr. SWEET. Yes, that is correct. We propose a specific solution on how to finance a Tier 2 benefit. Our perspective with the Porter Plan is that it makes the system less progressive. The Porter Plan proposes that everyone's benefits get cut proportionately across the board.

Senator SYMMS. Well first off on your first critique of my plan, I am about to come to the conclusion that I agree with you on the first portion of the first part of the question about whether or not these funds should be available for downpayments on houses, college educations and so forth. I tend to think it might be better and more saleable to the public if it were.

We did that strictly because it dovetailed with the President's family saving plan. But it provided a way to actually get money in the President's family savings plan. But I think that would require a lot of considerable in depth thought by Congress before they step forward with that, to be sure that the money would still be there. In other words, for the retirement.

But I appreciate very much the contribution you both have made to this entire subject. I do think that the point about the Federal Government owning all the debt could be very dangerous to the future of a market economy in the United States. Ultimately, you could end up having to go to the Federal Government to borrow money if this all works out.

I also have said that one of the reasons that I would not want to put in the Moynihan proposal today, the future tax increases, it seems to me it would just be premature, because we do not know what immigration will be. That could have a tremendous impact on where the Social Security funds go. If there is more immigration of workers coming into the country, the Social Security fund may be funded even higher than we anticipate today.

Mr. SWEET. Well, Senator, I agree with that. One thing I would like to suggest the committee consider, in fact, is holding a hearing with the Social Security Actuaries. That may be perhaps considered a dull proceeding. But, if the devil is in the details, it turns out that many of the assumptions the Actuaries make are quite speculative.

Senator SYMMS. Didn't they change by $8 trillion from 1 year to the next?

Mr. SWEET. Senator, I had an occasion to look at the 1983 so-called alternative II-B forecast recently which is widely cited by all analysts. In 1983 they were projecting that the Social Security trust funds would have a combined balance of $20 trillion in 2046. The 1989 report, written 6 years later, has the funds going broke in the year 2046. It is quite an extraordinary change at a time when the economy out performed the alternative II-B assumptions which all agree should strengthen the funds.

So one has to question what was going on with the Actuaries. I really think it is important to look into this issue deeply as well as the immigration issue that you have raised, Senator.

Senator SYMMS. Thank you very much.

Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, sir. We thank Ms. Canfield and Mr. Sweet for being the anchor persons in a very long hearing full of fascinating matters. Do we still have another witness?

Senator SYMMS. Mr. Glover.

Senator MOYNIHAN. First of all, thank you Ms. Canfield and Mr. Sweet. I find it fascinating how much it is we agree on in these things and how many things, like the problem with the Actuaries—I wouldn't want to know what the birthrate and the immigration rate, and so forth, is going to be in the year 2047. I mean, that is a hard call.

Senator SYMMS. I am going to be here to see that.

Senator MOYNIHAN. Indeed you are, and that is why it is important we get it right. At least if we get it wrong, you will let us know.

Thank you both very much.

Mr. SWEET. Thank you, Senators.

Senator MOYNIHAN. And now our final witness this morning. Is it Jere?

Mr. GLOVER. Jere, yes, sir.

Senator MOYNIHAN. Yes, sir.

Mr. Jere Glover, who is the Washington Representative of the National Association for the Self-Employed.

Please go right ahead, Mr. Glover.

STATEMENT OF JERE W. GLOVER, WASHINGTON REPRESENTATIVE, NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED, WASHINGTON, DC

Mr. GLOVER. I am Jere Glover, here on behalf of the National Association for the Self-Employed, one of the largest and fastest growing business organizations in the United States. Founded in 1981, today we have over 200,000 members.

I would like to address some basic misperceptions about the self-employed. Number one, there are a lot more of us than most people think—14 million by the last count, 10.5 million of those working full-time. Secondly, we make a lot less money than most people think. Using the 1982 data which is the most recent available from the Internal Revenue Service, the average self- employed individual, proprietorship, earned less than $10,000.

Senator SYMMS. And there is no debate in the self- employed of who pays the tax.

Mr. GLOVER. No, sir, there is absolutely no debate. The issue of does somebody else pay or does the worker pay, unfortunately, we pay 100 percent. We would like to find somebody else to pay half of it, but we don't.

The average wage that a self-employed individual makes, using again the IRS numbers, comes down to $4.80 per hour if we assume a 40-hour week. So we are not talking about very wealthy people. And often in Congress people say, well let's pass this on to the business community. Be very careful who you pass on burdens like mandatory health insurance and child care and other things, because in the case of the self-employed, we simply do not have enough money to bear those burdens.

That is why the regressive nature of payroll taxes hit our members and the self-employed the hardest. For example, in 1980 the self-employed paid tax was 8.1 percent. Today it is 15.3. If we look at the situation for the maximum self-employed tax, that went from $2,097 in 1980 to $7,484 in 1990. And if we look at the spousal situation where you have husband and wife working in the business together, the situation gets even worse. If we again assume that the spouse makes only the minimum wage of $3.35, then the Social Security tax that has resulted from the 1988 elimination of the spousal deduction is $1,000. That is $1,000 less the business has and less the family has to live on.

So what we have seen is a rather dramatic—a roughly 90 percent increase, plus if it happens to be a family-owned business where both people work, then we see it even hit more heavily. In the case of the better off self-employed, which are paying the maximum, that is a 400 percent increase in just 10 years.

So, obviously, we get very concerned when we see the regressive nature. We also get concerned when we see the rate of increase of the number of proprietorships declining, and we see the rate of earnings for the self-employed declining. In 1983, before this latest round of tax increases came into place, the earnings for the self-employed or sole proprietorships were growing at 18.4 percent. Last year, if we assume inflation, there was no growth at all in the earnings of the self-employed.

So we see a situation that indicates there is a problem. If we look at the amount of penalties that are being assessed from payroll tax deficiencies or late payments, we get even more alarmed—9 million penalties were assessed.

Senator MOYNIHAN. Nine million?

Mr. GLOVER. Nine million. I checked the table four times. Now granted some of those penalties may be repeat offenders where they do not pay three-quarters. But the total number of penalties—and I have the table here for you.

Senator MOYNIHAN. Would you submit that for the record, Mr. Glover? You do not have to drag it out of your briefcase, but see that we get it within the 2 weeks.

Mr. GLOVER. Yes, I will be happy to.

[The information appears in the appendix.]

Mr. GLOVER. $2.5 billion—that is in a release we got from the Internal Revenue Service, as a matter of fact, just yesterday. So it is quite an impressive number.

Senator MOYNIHAN. A depressive number.

Mr. GLOVER. When we consider that the Internal Revenue Service tells us that that is virtually all from the small business and the self-employed, it is quite an alarming number. What it says is, that we have reached a tax burden level on employment taxes where many millions of businesses each year simply are not able to pay it in a timely manner.

In the old days, those penalties were not very severe. So it was a cheap way to finance and borrow money. Today, those penalties are very severe and no business knowingly stiffs employment taxes.

We have seen such a dramatic increase in the past decade, that more and more businesses are not paying it. You do not hear from the self- employed very often. You do not hear from the very small businesses.

Senator MOYNIHAN. No, we do not.

Mr. GLOVER. The reason you do not is we do not have the time. We are too busy just trying to survive and pay the taxes. When it hurts this bad, then the pain really sets in and we have a serious problem.

We thank you very much for your attention to this issue. The spousal Social Security elimination and the rapid increase have really made it difficult for the family-owned business and self-employed and there are 14 million out there to survive.

Thank you for your proposal. We appreciate anything you can do to reduce this burden. Thank you.

Senator MOYNIHAN. Thank you, Mr. Glover.

May I say that you are the second one today who brought off the feat of finishing right in the 5 minutes.

Yes, this is a group from which do not hear often. And more then do we welcome you, because there are a very great many self-employed and they range from the simplest of business activities to individual contractors who do engineering—engineers who do computer work, to actors and to writers, and to musicians. It is a very rich part of our life, and it is not organized almost by definition.

So we thank you for coming in with this. Of course, I will agree with you, but we will see how the whole thing works out.

But again, sir, we appreciate it. You will get us that IRS report. You do not have to dig it out now. But by the next 2 weeks you get it, we will have it part of the record. It ought to be.

Mr. GLOVER. Yes.

[The prepared statement of Mr. Glover appears in the appendix.]

Senator MOYNIHAN. Thank you very much, Mr. Glover. We thank our audience. We thank the staff who very patiently has been through a very long hearing, a very helpful hearing in my view. With that we will conclude, perhaps not the last of the hearings on this matter, but certainly the latest. And we will see whether it is necessary to return to the subject before we commence to work on legislation.

Thank you all.

[Whereupon, the hearing was recessed, to be resumed at the call of the Chair.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF ROBERT E. BALL

Mr. Chairman and members of the Committee: My name is Robert Ball. I was Commissioner of Social Security from 1962 to 1973. Prior to my appointment by President Kennedy, I was a civil servant at the Social Security Administration for some twenty years. Since leaving the government I have continued to write and speak about Social Security and related programs. I was a member of the 1978-79 Advisory Council on Social Security and more recently was a member of the National Commission on Social Security Reform, the Greenspan Commission, whose recommendations were included in the 1983 amendments. I am currently a member of the Quadrennial Advisory Council on Social Security established by statute and appointed by Secretary Sullivan.

DEFINITIONS AND INTRODUCTION

It may be of some use to the Committee as reserve financing and pay-as-you-go are discussed over the period ahead to have in mind some definitions of terms. I believe the following definitions would, in general, be agreed to by those working in the field of Social Security.

Pay-as-you-go (or current cost financing) is a financing method providing annual income to the system close to the annual payout but with a contingency reserve sufficient to carry the system through unexpected periods of poor economic performance. Opinions differ, but for pay-as-you-go most experts favor a contingency reserve at the beginning of the year which is equal to 100 to 150 of the next year's outgo. Since benefits and administrative costs under the system are expected to grow, ordinarily, annual income to the fund should exceed outgo to the extent necessary to keep the reserves at the chosen level.

Full Reserve Financing is a necessary requirement for full safety under private insurance. Since private plans are voluntary it would not be proper to count future income against current liabilities. A full reserve meets the test of liquidation—that is, to be sound the reserve must be sufficient to cover all accrued liabilities without counting on future income. It has never been contemplated that the American social insurance system needed to, or should, meet such a test. The continuation of the government is assumed in the financing plan, and since the coverage is compulsory, the system has been considered in balance if reserves plus estimated future income approximates future estimated obligations.

Partial Reserve Financing is any reserve which goes beyond the requirements of safety as defined for contingency purposes and is short of a full reserve. It is a reserve designed to earn interest income and reduce the size of future contribution rates.

What is the current plan? The plan in present law would gradually move the system to a partial reserve basis. However the funds have not yet reached a level that most experts would consider adequate for a contingency reserve under pay-as-you-go. The reserve is currently 75% of the next year's estimated outgo.

Sometime in the next few years, depending on economic performance and one's definition of adequacy, the trust funds will reach a sufficient contingency level, and under present law the annual surpluses will then begin to build a partial earnings reserve. If one is satisfied with a contingency level for a pay-as-you-go system equal to only a year's outgo that level might well be reached next year if the economy performs well. But the 150% level, which I believe is needed for pay-as-you-go, will not be reached until sometime between 1993 and 1996 the exact date depending on economic performance. Once an adequate contingency reserve is reached, under present law Social Security would move toward partial reserve financing.

The interest on the growing reserves when combined with the present contribution rate of 6.2% of earnings, and the income from the taxation of Social Security benefits of higher income people is estimated to be sufficient to pay all benefits and administrative costs for the next 55 to 60 years. Under present projections, the trust funds would then be exhausted. If we wait until the reserves are used up it would then be necessary to raise the rates to the pay-as-you-go level, which at that time is estimated to be 8.1%. If we were to raise the rates sooner, the increase could be smaller since the reserves would continue to earn interest.

S. 2016 would return the system to pay-as-you-go financing, reducing the old-age, survivors and disability (OASDI) rate from 6.2% to 6.06% for 1990, to 5.1% for 1991–2011, then go to 5.6% for three years (2012–2014) and back to the present rate of 6.2% for five years (2015–2019), to 7% for the next five years (2020–2024), to 7.7% from 2025–2044 and finally to 8.1% for 2045 and later.

PARTIAL RESERVE FINANCING VERSUS PAY-AS-YOU-GO

In my view, there is a case for partial reserve financing of Social Security only if the fund buildup is handled in such a way as to increase the national saving rate and through investment produces a larger pool of goods and services in the future. Since the retirees of the future have to be supported out of the goods and services produced in the future, the only present actions that make it easier to meet their needs are those that improve our capacity to produce. If a buildup of reserves results in a greater surplus in the total accounts of the government (or a lower deficit), 'then the Social Security reserves increase national saving and the capacity to produce goods and services. Or, if somehow the buildup in the reserves were used to provide directly for government investment beyond the level that would occur anyway, then that too would increase future production.

On the other hand, if Treasury borrowing from the reserve merely substitutes for general taxes as a way of paying for the current operating expenses of government, the Social Security buildup does not contribute to economic growth and paying future Social Security claims will be as much of a burden under reserve financing as under pay-as-you-go. They will not be any more of a burden, but the reserve will not have made it any easier.

A Social Security buildup that increases our capacity to produce is possible but not easy to accomplish. We have to exercise enough restraint to finance programs other than Social Security (with the exception of increases in government investment) without relying on borrowing from the trust funds. If, as the Social Security funds lend money to the Treasury (receiving in return bonds and interest earnings) the money is used for current operating expenses, the result is that we have recognized the obligation of the government to pay Social Security benefits in the future, but we have not increased its ability to do so any more than under a pay-as-you-go system. Instead we have substituted borrowing from Social Security for general taxes as a way of meeting the current operating costs of government. This result is undesirable.

Deductions from workers' earnings (with matching contributions by employers) which rise proportionately as earnings rise and with a cap at the point earnings are no longer counted toward benefits seem to me the ideal way to finance a social insurance program. And it is the way we finance OASDI. The contributory nature of the program helps establish an earned right to the benefit and at the same time imposes a discipline on the system; higher benefits require increased contributions.

In the United States this contributory system is progressive. Because of the weighted benefit formula lower-paid workers get more protection in relation to their contributions than higher-paid workers do. Moreover the earned income tax credit relieves the lowest-paid wage earners with children from, in effect, making any Social Security contributions; they get a refund approximately equal to the combined employer/employee Social Security tax. You cannot correctly call a system like that regressive.

On the other hand, separated from the benefits, the Social Security tax alone would be mildly regressive. For most workers the tax is proportional to earnings, but the 7% or so of earners who are above the Social Security maximum pay the same as those at the maximum, and income from capital is not subject to the Social Security tax. This is appropriate for a social insurance program but it would not be a good way to finance the general operating expenses of government.

Therefore, Mr. Chairman, I would argue that partial reserve financing is desirable only if we have the political will to bring the non-Social Security budget into relatively close balance. Then the buildup in the Social Security funds is not borrowed to pay for the current consumption of government but is used to buy the national debt now held in private hands and thus contributes to national savings. If the fund buildup is not handled in this way, it would be better once we reached an adequate contingency level for a pay-as-you-go system to stop the buildup and continue on pay-as-you-go.

Pay-as-you-go is a reasonable enough way to finance Social Security, although there are disadvantages. One is that in return for lower rates now you later have to have higher rates. The more fundamental disadvantage is that the Nation would forego the increase in the future pool of goods and services that reserve accumulation combined with the prudent management of other government finances makes possible. How important this is and how much difference such savings would make in future production is more of an economic question than a Social Security question. The benefits of increased wage growth go well beyond the Social Security system, but there is a Social Security interest. Future Social Security benefit levels may be somewhat better protected to the extent future wage earners have more income; the easier it is to pay for Social Security benefits, the more likely it is that benefit levels will be maintained.

Either pay-as-you-go or partial reserve financing will work for Social Security, but from an overall perspective, the worst outcome would be a policy which built reserves beyond a safe contingency level and used such a buildup merely to finance the current operating expenses of government.

PLANNING FOR PAY-AS-YOU-GO

If a decision were made that the OASDI system should be kept on a pay-as-you-go basis, how can the transition from the tax rates in present law to pay-as-you-go rates best be handled:

1. *The OASDI reserve should be at a fully safe level before OASDI contribution rates are reduced.* Despite all the talk about huge reserves accumulating in the trust funds, the buildup lies mostly in the future. Given the wrenching experience the country went through with two Social Security financial crises—one in the mid-1970's and one in the early 1980's-before making any changes we ought to lean over backwards to provide a contingency reserve with a substantial cushion. I would favor a reserve equal to 150% of the next year's outgo. As stated before, this level will not be reached until sometime between 1993 and 1996 depending on economic performance. In my view it is not desirable to lower rates now because it is estimated that the desired ratio would be reached sometime in the future. The sooner we get to a fully safe level the better. Moreover, we have in the past too often relied on estimates that later turned out to be overly optimistic.

2. *Even if OASDI is but on a pay-as-you-go basis. the overall Social Security contribution rate should not be reduced.* The 1.45% of covered earnings allocated to the hospital insurance program under Medicare out of the overall Social Security contribution rate of 7.65% is clearly inadequate. If the economy performs less well than it has in the recent past, payments from hospital insurance could start to exceed income as early as 1995, with all the bonds held in the hospital insurance fund liquidated by the end of the decade.

If we decide to adopt pay-as-you-go for Social Security, the safe way to do it is to transfer part of the OASDI rate over to Medicare, just as in the past the tax rate has been reallocated between old-age and survivors insurance and disability insurance. Otherwise we will cut the combined rate now with great fanfare and just have to raise it again very soon for Medicare—unless, of course, it. is decided to cut benefits instead. That is always a possibility if programs get close to the financial cliff, as old age and survivors insurance did in 1982. That financing crisis was resolved by benefit cuts in the 1983 amendments along with a speedup in the contribution rates. The best protection for benefit levels in both OASDI and Medicare is adequate financing. A good pay-as-you-go plan, therefore, would be to wait until about 1995, when an adequate contingency reserve is ensured, and then transfer part of the OASDI rate to Medicare.

If instead of getting to pay-as-you-go this way the overall Social Security rate were cut, there are three possible outcomes:

(1) Social Security or Medicare benefits or other public spending might be cut to offset the reductions in income; (2) other taxes might be increased to offset the effect of the cut; or, (3) the deficit in the unified budget might be allowed to increase as a result of the drop in income, or some combination of the three might be possible.

The amounts involved are very large. In 1991 under S.2016 the annual reduction in income is $53.6 billion, and by 1995 the annual reduction is $72.1 billion, by 1998 $86.7 billion. Last week Federal Reserve Board Chairman Greenspan testified that increases in the deficit in the unified budget of such substantial amounts would raise interest rates and require the government to pay more for its borrowing. This would add still further to the deficit.

I assume that alternative three is unacceptable and that the Congress would not propose and the President would not sign an action that so greatly increased the deficit. I assume, instead, if overall Social Security rates were cut—an action I oppose—other taxes would be substituted to make up for both the employer and employee Social Security tax cuts or that some program cuts beyond those already being considered for Gramm/Rudman would be adopted. Obviously these matters need to be considered together. If the overall Social Security rates are cut, what combination of tax increases and program cuts should be adopted at the same time?

Transferring part of the OASDI rate to Medicare later on puts OASDI on a pay-as-you-go basis but does not require tax increases or benefit cuts elsewhere in the budget just to offset an overall Social Security tax cut. Instead tax increases or expenditure cuts would produce real progress on deficit reduction.

Further Consideration of Partial Reserve Financing

It is also possible, though difficult, as stated before, to actually save the Social Security annual surpluses which would develop under present law. You may well not want to give up this option without extensive consideration.

For example, last year's proposal by Senators Moynihan and Heinz is designed to accomplish this purpose and deserves examination, and the Administration has made a proposal in the budget to save the amount of the Social Security buildup.

There are other possibilities for modifying the present long-range financing plan for OASDI that should be considered. Present law provides for a very large accumulation of trust fund investments with tax income estimated to exceed outgo until about 2020. Because of interest earnings the fund continues to build for another 10 years before it will begin to be necessary to sell the bonds held by the funds in order to make full benefit payments. This pattern of a big fund buildup and its later dissipation might be sensible if the cost of financing the retirement of the baby-boom generation were a one-time cost—a rabbit through the Python phenomenon—with lower costs expected later, but such is not the case. The retirement cost of the baby-boom generation establishes a new plateau of cost that is more or less flat thereafter. This is so on the assumption that fertility rates will continue at their present low levels and that mortality rates will continue to improve so that the ratio of those of working age to those of retirement age remains relatively constant. Given these assumptions, a more sensible partial reserve plan than present law might be to keep the current 6.2% rate to 2020, say, and then put in a rate increase to avoid having to cash in the bonds beginning in 2030. If the 6.2% rate were raised to 7.0% in 2020, as provided by S. 2016 for that year, the 7.0% rate would be sufficient to carry the system past 2065, the end of the 75 years over which the estimates are usually made.

You have time to consider all these alternatives and to consider whether for not pay-as-you-go or a partial reserve is better public policy. In my view, nothing should be done to reduce the OASDI buildup until between 1993 and 1996 in any event.

RESPONSES TO QUESTIONS SUBMITTED BY SENATOR DOLE

Question 1. The 1982 Social Security Commission worked not only fix the short-term crisis in Social Security, but to actuarially balance the system over a 75 year period—the very long run. Do you think this is a worthy goal?

Answer 1. Yes, I believe it is important to public confidence in the OASDI program to keep it in approximate actuarial balance over the whole 75 years for which estimates are usually made. It is, of course, of primary importance that the program be closely balanced over the near term. Since the estimates are less accurate the further out they go and since in the very long range there is time for later adjustment in financing, I believe it is permissible to allow somewhat more leeway in the test of actuarial balance for 75 years than for 50, and for 50 as compared to 25.

At present the system shows a surplus for the next 50 years according to the middle range II-B estimates, but a deficit over 75 years, all concentrated 50 to 75 years from now. Like the trustees, I do not consider this a major cause for concern, but I do believe that when the program is next amended it would be desirable to eliminate the long-range deficit.

Question 2. You have indicated that you might support a return to pay-as-you-go financing, but not yet. You're concerned that we first build up a more adequate reserve fund.

Do you think it's reasonable to build and maintain a reserve fund of 100 percent or 150 percent of annual outgo and not do anything to alter our investment policies?

It seems to me that if you agree with the concerns raised by Senator Moynihan, that the reserves are not being saved, we have to face that issue even with pay-as-you-go financing.

Answer 2. My position is that I prefer to continue partial reserve financing for the reasons stated below. However, even if a decision is made to return to pay-as-you-go financing, I believe it would be unwise to do so before the OASDI reserve reaches 150% of the next year's outgo. I realize that this level of reserve is likely to be more than is needed under a pay-as-you-go system, but given the crises of the late 70's and early 80's I would lean over backwards on this point.

Alicia Munnell, Director of Research and Senior Vice President of the Federal Reserve Bank of Boston and a leading Social Security expert, found in a study of this question done in 1984 (Munnell, Alicia H. and Lynn E. Blais, "Do We Want Large Social Security Surpluses?" *New England Economic Review,* September-October 1984, pp. 5–21), that a range from 85 to 145% of the next year's outgo would be a reasonable test of adequacy for a pay-as-you-go contingency reserve.

I see nothing wrong with the present Social Security investment policy. Putting the excess of Social Security income over outgo into treasury bonds that earn the average interest on all longer term debt of the United States seems to me both safe and fair. To the extent there is a problem, it is in the size of the deficit in the current operating budget excluding Social Security. Insofar as borrowing from Social Security trust funds to pay the general operating costs of government substitutes for tax increases or expenditure cuts that would otherwise have taken place, the build-up of the Social Security funds does not contribute to national saving and future productivity and does not make it easier to support the retirees of the future. However, if you believe that in the absence of the Social Security annual surpluses, the budget deficit would be larger than it is, then the Social Security build-up is already contributing to savings.

I believe it is desirable for several reasons to gradually reduce the size of the non-Social Security operating deficit (as distinct from government investment that contributes to future productivity just as private investment does). This deficit is where the problem lies, not in the Social Security build-up or its investment or in the alleged "misuse" of that build-up.

Any tendency for annual Social Security surpluses to inhibit the reduction of the non-Social Security operating deficit through increases in more progressive taxes or cuts in unnecessary expenditures is undesirable. Such a tendency may exist under a pay-as-you-go system with an adequate contingency reserve, although to a lesser extent than under a partial reserve system.

I disagree with the proposal to cut the Social Security tax rate for the following four reasons:

1. Cutting Back on the OASDI Contribution Rate Now Makes It Necessary to Schedule a Large Increase in the Tax Rate Early in the Next Century.

Under a pay-as-you-go approach for OASDI, the present contribution rate of 6.2% of earnings would be cut back to 5.1% of earnings. Then under the Moynihan bill the rate would rise from 5.1% at the end of 2011 to 7.7% at the beginning of 2025, just thirteen years later. This is nearly a 50% increase in a very short period of time.

I am concerned that at the time such a large increase is scheduled, conflict could develop between the workers paying in and those receiving the benefits. Proposals to reduce benefits instead of having such a large tax increase would certainly be considered, particularly since the people receiving benefits would have been paying, on average, at rates considerably below the actuarial value of the benefits. In fact, those coming on the rolls in, say, 2010 would have been paying at only a 5.1% rate for the last twenty years for benefits valued, on average, at about 7% plus matching contributions from their employers. Promised benefit levels would be more secure if workers paid from now on at rates close to the value of the benefits and if large and steep increases in future contribution rates were avoided.

2. *Under Partial Reserve Financing, If the Rest of Government Financing Is Handled Responsibly, the Build-Up in the Reserves Will Contribute to Future Wade Growth.*

If Social Security surpluses result in surpluses in total government accounts (or a lower deficit than would otherwise be the case) then the surpluses result in net additions to the United States savings rate and by increasing investment increase the future productive capacity of the country. Although future Social Security beneficiaries must be supported out of the goods and services produced at approximately the time they are receiving benefits, the burden of their support and the willingness of workers to make the Social Security contributions necessary is affected by the total volume of goods and services available at that time.

Savings are only one determinant of future productive capacity (the skill level of the labor force, for example, is another) and Social Security surpluses are only one part of savings. It is difficult to say how much Social Security surpluses could add to future levels of production, but the contribution could be important. Again, the benefit level that has been promised is more secure if the incomes of contributing workers are increasing so that the cost of Social Security is easier to bear.

3. *If Social Security Taxes Are Cut, It Will Be Even More Difficult to Bring the Overall Federal Deficit into Balance.*

We have not done very well in reducing the total Federal deficit; it will just make it that much harder if income to Social Security is reduced. The desirable goal is to greatly reduce the non-Social Security deficit and then to have at least part of the Social Security surpluses represent surpluses in the total government accounts.

Continuing to run up the size of the debt held in private hands creates a large and unnecessary burden on the Federal tax system. Interest payments from government to the private sector, including persons abroad, is making it difficult to enlarge Federal programs that should be enlarged and to create new programs that are needed. It is true that if Social Security buys back the debt now held in private hands, as would be the case if Social Security surpluses resulted in overall surpluses in the government accounts, interest would have to be paid to the Social Security funds. However, from the standpoint of overall government finance, it will be much easier to meet future Social Security commitments through future Social Security taxes plus interest on reserves if at the same time government does not also have to pay large amounts of interest on debt held privately.

4. *Even If the Congress and the President Were to Agree that the OASDI System Should Be Returned to a Pay-As-You-Go Plan, the overall Social Security Rate Should Not Be Reduced.*

First of all, the overall trust fund size for OASDI is not yet at what most would consider a fully safe level. I think we should lean over backwards to have a major margin of safety even under a pay-as-you-go system, given the devastating financial crises of the mid'70s and the early '80s. Public confidence in the system has not yet completely recovered from these two faith-shaking experiences.

More important than the difference of opinion about the size of the reserve for a pay-as-you-go system in determining whether or not the overall Social Security rate should be reduced, however, is the clear inadequacy of the financing of hospital insurance under Medicare.

Hospital insurance is supported by 1.45% of earnings out of the total current Social Security contribution rate of 7.65%. No further increases for either OASDI or Medicare are scheduled under present law. The latest trustees' report for the hospital insurance program shows that the outgo for the hospital program could exceed income as early as 1995 under relatively pessimistic assumptions and by 1997 under the middle-range estimates. With no hope in the near term of hospital cost increases being reduced below wage growth, it is unwise to cash in the bonds held by the trust fund during the last half of the 1990s and end up with no reserve at all right after the turn of the century. Income to the hospital insurance fund needs to go up in the next five or six years, even under a pay-as-you-go approach. Therefore, should the OASDI system be shifted to a pay-as-you-go plan, which I think is a bad idea, the overall Social Security contribution rate ought not be reduced, but rather a part of the OASDI rate should be shifted to hospital insurance.

A PROPOSAL TO MODIFY PRESENT LAW FINANCING

Although I believe partial reserve financing should be maintained, I favor a change in the present financing plan. Under present law, it is expected that the large build-up in the trust funds extending to about the year 2020 will be followed by a depletion of those trust funds and their exhaustion about the middle of the next century. This build-up and then dissipation might be good policy if the costs arising from the retirement of the baby-boom generation were a one-time phenomenon—a kind of rabbit through the python—but such is not the case. Instead, if we assume continued low levels of fertility and continued improvements in mortality, as seems reasonable, the retirement of the baby-boom generation raises the costs of the system to a new plateau which remains relatively stable into the future. Given these assumptions, the more reasonable course would be to leave the present 6.2% of earnings rate in effect until about 2020 and then raise it to about 7.1%, rates which would carry the system throughout the whole 75 years for which estimates are usually made, and still end up in 2065 with a sizable reserve. Under this plan, it is estimated that for the next 70 years the trust funds would remain at peak levels.

Question 3. Some have suggested that one way to "protect" the trust funds to use private investment instruments rather than treasury securities. What do you think of such a proposal?

Answer 3. I believe it would be unwise to invest Social Security annual surpluses in private investment instruments. On average, over a period of many years, the returns may be somewhat greater from private investments, but such investments are riskier, not only because individual private enterprises may fail but because the timing of investments and their redemption greatly affect returns. Also very fundamentally, investments in equity would put the government in a position where it could influence or control the decisions of private industry, and even bondholders may become involved in decisions to protect their loans.

The practical political problems involved are also daunting. How would the decision-makers deal with pressures to put funds into industries favored by powerful interests or, on the other hand, with pressures to avoid putting funds into industries thought by some to discriminate, for example, against women, minorities or unions? The facts are that the trust funds are well protected by present procedures. The fault lies elsewhere—in the continuing size of the non-Social Security operating deficit.

Question 4. We know Medicare faces a financing crisis in the near future. Would you support a reallocation rather than reduction in the payroll tax to address this impending problem?

Answer 4. As I have stated, I prefer retaining partial reserve financing for OASDI, but if a decision were made, nevertheless, to return to pay-as-you-go, I would certainly think it preferable to reallocate a part of the OASDI tax rate to Medicare rather than to reduce the overall Social Security tax rate. It seems unwise to reduce the overall rate when it is quite clear that the 1.45% allocated to Medicare will soon be insufficient to cover the cost of that part of the program, even on a pay-as-you-go basis.

SUBMITTED BY SENATOR LLOYD BENTSEN

BACKGROUND MATERIAL ON SOCIAL SECURITY

compiled by the

staff of the

Committee on Finance

BRIEF GUIDE TO TABULAR MATERIAL AND CHARTS

Tables and charts are from the 1989 OASDI Trustees' Report, unless otherwise noted.

DETAILED LIST OF TABLES AND CHARTS

TABLE 1

OASDI AND HI TAX RATES, 1966 AND LATER

[In percent]

Calendar years [1]	Employees and employers each			Self-employed		
	OASDI	HI	Total	OASDI	HI	Total
1966	3.85	0.35	4.20	5.80	0.35	6.15
1967	3.90	.50	4.40	5.90	.50	6.40
1968	3.80	.60	4.40	5.80	.60	6.40
1969-70	4.20	.60	4.80	6.30	.60	6.90
1971-72	4.60	.60	5.20	6.90	.60	7.50
1973	4.85	1.00	5.85	7.00	1.00	8.00
1974-77	4.95	.90	5.85	7.00	.90	7.90
1978	5.05	1.00	6.05	7.10	1.00	8.10
1979-80	5.08	1.05	6.13	7.05	1.05	8.10
1981	5.35	1.30	6.65	8.00	1.30	9.30
1982-83	5.40	1.30	6.70	8.05	1.30	9.35
1984 [1]	5.70	1.30	7.00	11.40	2.60	14.00
1985 [1]	5.70	1.35	7.05	11.40	2.70	14.10
1986-87 [1]	5.70	1.45	7.15	11.40	2.90	14.30
1988-89 [1]	6.06	1.45	7.51	12.12	2.90	15.02
1990 and later	6.20	1.45	7.65	12.40	2.90	15.30

TABLE 2

TAXABLE EARNINGS BASES, 1937-90

Calendar Year	Taxable earnings base
1937-50	$ 3,000
1951-54	3,600
1955-58	4,000
1959-65	4,800
1966-67	6,600
1968-71	7,800
1972	9,000
1973	10,800
1974	13,200
1975	14,100
1976	15,300
1977	16,500
1978	17,700
1979	22,900
1980	25,900
1981	29,700
1982	32,400
1983	35,700
1984	37,800
1985	39,600
1986	42,000
1987	43,800
1988	45,000
1989	48,000
1990	51,300

Source: Table compiled by the Congressional Research Service

TABLE 3
CHANGES IN OASDI AND HI TAX RATES ENACTED FROM 1969 THROUGH 1983

Act and effective year	Contribution rate (percent)							
	Employer and employee, each				Self-employed person			
	Total	OASI	DI	HI	Total	OASI	DI	HI
1969 Act:								
1970	4.8	3.65	0.55	0.6	6.9	5.475	0.825	0.6
1971	5.2	4.05	.55	.6	7.5	6.075	.825	.6
1973	5.65	4.45	.55	.65	7.65	6.175	.825	.65
1976	5.7	4.45	.55	.7	7.7	6.175	.825	.7
1980	5.8	4.45	.55	.8	7.8	6.175	.825	.8
1987	5.9	4.45	.55	.9	7.9	6.175	.825	.9
1971 Act:								
1976	5.85	4.6	.55	.7	7.7	6.175	.825	.7
1980	5.95	4.6	.55	.8	7.8	6.175	.825	.8
1987	6.05	4.6	.55	.9	7.9	6.175	.825	.9
1972a Act:								
1973	5.5	4.1	.5	.9	7.8	6.15	.75	.9
1978	5.5	3.95	.55	1.0	7.7	5.875	.825	1.0
1986	5.6	3.95	.55	1.1	7.8	5.875	.825	1.1
1993	5.7	3.95	.55	1.2	7.9	5.875	.825	1.2
2011	6.55	4.65	.7	1.2	8.2	6.085	.915	1.2
1972b Act:								
1973	5.85	4.3	.55	1.0	8.0	6.205	.795	1.0
1978	6.05	4.225	.575	1.25	8.25	6.16	.84	1.25
1981	6.15	4.225	.575	1.35	8.35	6.16	.84	1.35
1986	6.25	4.225	.575	1.45	8.45	6.16	.84	1.45
2011	7.3	5.1	.75	1.45	8.45	6.105	.895	1.45
1973b Act:								
1974	5.85	4.375	.575	.9	7.9	6.185	.815	.9
1978	6.05	4.35	.6	1.1	8.1	6.15	.85	1.1
1981	6.30	4.3	.65	1.35	8.35	6.08	.92	1.35
1986	6.45	4.25	.7	1.5	8.5	6.01	.99	1.5
2011	7.45	5.1	.85	1.5	8.5	6.0	1.0	1.5
1977 Act:								
1978	6.05	4.275	.775	1.0	8.1	6.01	1.09	1.0
1979	6.13	4.33	.75	1.05	8.1	6.01	1.04	1.05
1981	6.65	4.525	.825	1.3	9.3	6.7625	1.2375	1.3
1982	6.7	4.575	.825	1.3	9.35	6.8125	1.2375	1.3
1985	7.05	4.75	.95	1.35	9.9	7.125	1.425	1.35
1986	7.15	4.75	.95	1.45	10.0	7.125	1.425	1.45
1990	7.65	5.1	1.1	1.45	10.75	7.65	1.65	1.45
1980 Act:								
1980	6.13	4.52	.56	1.05	8.1	6.2725	.7775	1.05
1981	6.65	4.7	.65	1.3	9.3	7.025	.975	1.3
1982	6.7	4.575	.825	1.3	9.35	6.8125	1.2375	1.3
1985	7.05	4.75	.95	1.35	9.9	7.125	1.425	1.35
1986	7.15	4.75	.95	1.45	10.0	7.125	1.425	1.45
1990	7.65	5.1	1.1	1.45	10.75	7.65	1.65	1.45
1983 Act:								
1983	6.7	4.775	.625	1.3	9.35	7.1125	.9375	1.3
1984	[1] 7.0	5.2	.5	1.3	[1] 14.0	10.4	1.0	2.6
1985	7.05	5.2	.5	1.35	[1] 14.1	10.4	1.0	2.7
1986	7.15	5.2	.5	1.45	[1] 14.3	10.4	1.0	2.9
1988	7.51	5.53	.53	1.45	[1] 15.02	11.06	1.06	2.9
1990	7.65	5.6	.6	1.45	15.3	11.2	1.2	2.9
2000	7.65	5.49	.71	1.45	15.3	10.98	1.42	2.9

[1] Includes tax credit

Source: *Social Security Bulletin*, Annual Statistical Supplement, 1988.

TABLE 4

MAXIMUM AMOUNT OF OASDI AND HI TAXES FOR EMPLOYEES AND SELF EMPLOYED PEOPLE, 1937-89

Beginning—	Employee				Self-employed person			
	Total	OASI	DI	HI	Total	OASI	DI	HI
Annual:								
1937	$30.00	$30.00	...	...	...	...	...	...
1950	45.00	45.00	...	...	...	...	...	...
1951	54.00	54.00	...	...	$81.00	$81.00	...	...
1954	72.00	72.00	...	...	108.00	108.00	...	...
1955	84.00	84.00	...	...	126.00	126.00	...	...
1957	94.50	84.00	$10.50	...	141.75	126.00	$15.75	...
1959	120.00	108.00	12.00	...	180.00	162.00	18.00	...
1960	144.00	132.00	12.00	...	216.00	198.00	18.00	...
1962	150.00	138.00	12.00	...	225.60	207.60	18.00	...
1963	174.00	162.00	12.00	...	259.20	241.20	18.00	...
1966	277.20	231.00	23.10	$23.10	405.90	348.15	24.65	$23.10
1967	290.40	234.30	23.10	33.00	422.40	354.75	34.65	33.00
1968	343.20	259.35	37.05	46.80	499.20	396.825	55.575	46.80
1969	374.40	290.55	37.05	46.80	538.20	435.825	55.575	46.80
1970	374.40	284.70	42.90	46.80	538.20	427.05	64.35	46.80
1971	405.60	315.90	42.90	46.80	585.00	473.85	64.35	46.80
1972	468.00	364.50	49.50	54.00	675.00	546.75	74.25	54.00
1973	631.80	464.40	59.40	108.00	864.00	670.14	85.86	108.00
1974	772.20	577.50	75.90	118.80	1,042.80	816.42	107.58	118.80
1975	824.85	616.875	81.075	126.90	1,113.90	872.085	114.915	126.90
1976	895.05	669.375	87.975	137.70	1,208.70	946.305	124.695	137.70
1977	965.25	721.875	94.875	148.50	1,303.50	1,020.525	134.475	148.50
1978	1,070.85	756.675	137.175	177.00	1,433.70	1,063.72	192.93	177.00
1979	1,403.77	991.57	171.75	240.45	1,854.90	1,376.29	238.16	240.45
1980	1,587.67	1,170.68	145.04	271.95	2,097.90	1,624.58	201.37	271.95
1981	1,975.05	1,395.90	193.05	386.10	2,762.10	2,086.43	289.57	386.10
1982	2,170.80	1,482.30	267.30	421.20	3,029.40	2,207.25	400.95	421.20
1983	2,391.90	1,704.675	223.125	464.10	3,337.95	2,539.1625	334.6875	464.10
1984 [1]	2,646.00	1,965.60	189.00	491.40	5,292.00	3,931.20	378.00	982.80
1985 [1]	2,791.80	2,059.20	198.00	534.60	5,583.60	4,118.40	396.00	1,069.20
1986 [1]	3,003.00	2,184.00	210.00	609.00	6,006.00	4,368.00	420.00	1,218.00
1987 [1]	3,131.70	2,277.60	219.00	635.10	6,263.40	4,555.20	438.00	1,270.20
1988 [1]	3,379.50	2,488.50	238.50	652.50	6,759.00	4,977.00	477.00	1,305.00
1989 [1]	3,604.80	2,654.40	254.40	696.00	7,209.60	5,308.80	508.80	1,392.00
1990	3,924.45	2,872.80	307.80	743.85	7,848.90	5,745.60	615.60	1,487.70
Cumulative:								
1937-50	435.00	435.00	...	...	...	...	...	...
1951-60	855.00	810.00	45.00	...	1,282.50	1,215.00	67.50	...
1961-70	2,475.60	2,055.90	223.20	196.50	3,623.10	3,091.80	334.80	196.50
1971-80	9,025.04	6,649.35	945.59	1,430.10	12,179.40	9,410.715	1,338.585	1,430.10
1937-76	7,763.10	6,309.45	664.95	788.70	10,395.00	8,632.35	973.95	788.70
1937-77	8,728.35	7,031.325	759.825	937.20	11,698.50	9,652.875	1,108.425	937.20
1937-78	9,799.20	7,788.00	897.00	1,114.20	13,132.20	10,716.645	1,301.355	1,114.20
1937-79	11,202.97	8,779.57	1,068.75	1,354.65	14,987.10	12,092.935	1,539.515	1,354.65
1937-80	12,790.64	9,950.25	1,213.79	1,626.60	17,085.00	13,717.515	1,740.885	1,626.60
1937-81	14,765.69	11,346.15	1,406.84	2,012.70	19,847.10	15,804.945	2,030.455	2,012.70
1937-82	16,936.49	12,828.45	1,674.14	2,433.90	22,876.50	18,011.195	2,431.405	2,433.90
1937-83	19,328.39	14,533.125	1,897.265	2,898.00	26,214.45	20,550.3575	2,766.0925	2,898.00
1937-84 [1]	21,974.39	16,498.725	2,086.265	3,389.40	31,506.45	24,481.5575	3,144.0925	3,880.80
1937-85 [1]	24,766.19	18,557.925	2,284.265	3,924.00	37,090.05	28,599.9575	3,540.0925	4,950.00
1937-86 [1]	27,769.19	20,741.925	2,494.265	4,533.00	43,096.05	32,967.9575	3,960.0925	6,168.00
1937-87 [1]	30,900.89	23,019.525	2,713.265	5,168.10	49,359.45	37,523.1575	4,398.0925	7,438.20
1937-88 [1]	34,280.39	25,508.025	2,951.765	5,820.60	56,118.45	42,500.1575	4,875.0925	8,743.20
1937-89 [1]	37,885.19	28,162.425	3,206.165	6,516.60	63,328.05	47,808.9575	5,383.8925	10,135.20

Foot note for table 4

1/ Includes tax credit under 1983 amendments for employees in 1984 and for self-employed in 1984-1989.

Source: Social Security Bulletin; Annual Statistical Supplement, 1988. (1990 data added by Committee staff)

TABLE 5

ON- AND OFF-BUDGET TOTALS, FY 1990-95
CBO Projections, January 1990

($'s in billions)

	1990	1991	1992	1993	1994	1995
			On-Budget (Excludes Social Security and Postal Service)			
Revenues	779	828	874	924	978	1,037
Outlays	984	1,041	1,095	1,163	1,220	1,283
Deficit	204	212	221	239	242	246
			Off-Budget (Social Security)[a]			
Revenues	288	309	330	352	376	401
Outlays	222	234	244	254	264	273
Surplus	66	74	85	98	112	128
			Total[a]			
Revenues	1,067	1,137	1,204	1,277	1,355	1,438
Outlays	1,205	1,275	1,339	1,418	1,484	1,555
Deficit	138	138	135	141	130	118

SOURCE: Congressional Budget Office.

a. For comparability with the Balanced Budget Act targets, the projections exclude the Postal Service, which is also off-budget.

TABLE 6

COMPARISON OF FINANCIAL IMPACT OF MAJOR FEDERAL TRUST FUND PROGRAMS, 1988
($'s in billions)

Table A shows the "traditional" display of trust fund transactions, with income representing both receipts from the public and "credits from the Government" (i.e., interest, governmental contributions to a program, governmental shares of taxes or pension contributions made as an employer, etc.). Table B shows only the receipts received from the public and payments to the public (i.e., it excludes the credits from the Government to the various trust funds).

TABLE A. Total Income Credited to Trust Funds and Trust Fund Outgo for the Largest Trust Fund Programs, FY 1988

	Income	Outgo	Difference
Social security	$259.1	$220.3	$38.8
Unemployment insurance	27.0	18.6	8.4
Federal employees' retirement	47.0	28.4	18.6
Medicare	103.0	87.7	15.3
Military retirement	33.1	19.0	14.1
Highway	15.3	14.7	.6
All others	6.8	4.7	2.0
Total	491.3	393.5	97.8

TABLE B. Receipts from the Public and Expenditures for the Largest Trust Fund Programs, FY 1988

	Receipts	Expenditures	Difference
Social security	$244.9	$219.3	$25.5
Unemployment insurance	24.4	16.3	8.1
Federal employees' retirement	4.7	28.4	- 23.8
Medicare	59.9	78.9	- 19.0
Military retirement	0	19.0	- 19.0
Highway	14.1	14.7	- 0.6
All other	9.2	11.1	- 1.5
Total	357.1	387.8	- 30.6

Note: Receipts from the public represent social insurance or excise tax receipts. Payments to the public represent expenditures for trust fund programs minus proprietary receipts (such as medicare Part B premiums) and other bookkeeping adjustments.

Source: Table prepared by CRS based on data from OMB, *Special Analysis C, Budget of the United States Government, Fiscal Year 1990.* Jan. 1989.

TABLE 7

OASDI INCOME AND COST RATES, 1950-88 *

(in percent of taxable payroll)

Calendar year	OASI Trust Fund			DI Trust Fund			Total		
	Income rate	Cost rate	Balance	Income rate	Cost rate	Balance	Income rate	Cost rate	Balance
Past experience:									
1950	3.00	1.17	1.83	—	—	—	3.00	1.17	1.83
1955	4.00	3.34	.66	—	—	—	4.00	3.34	.66
1960	5.50	5.59	-.09	0.50	0.30	0.20	6.00	5.89	.11
1965	6.75	7.23	-.48	.50	.70	-.20	7.25	7.93	-.68
1970	7.30	7.32	-.02	1.10	.81	.29	8.40	8.12	.28
1975	8.75	9.29	-.54	1.15	1.36	-.21	9.90	10.65	-.75
1980	9.04	9.36	-.32	1.12	1.38	-.26	10.16	10.74	-.58
1981	9.40	9.97	-.57	1.30	1.39	-.09	10.70	11.36	-.66
1982	9.15	10.59	-1.44	1.65	1.34	.31	10.80	11.94	-1.14
1983	[1]9.91	10.27	-.36	[1]1.33	1.22	.10	[1]11.24	11.50	-.26
1984[2]	10.58	10.08	.50	1.01	1.16	-.14	11.59	11.24	.35
1985[2]	[1]10.72	9.99	.72	[1]1.07	1.14	-.07	[1]11.79	11.13	.66
1986[2]	10.59	9.86	.73	1.01	1.12	-.11	11.60	10.98	.62
1987[2]	10.57	9.63	.94	1.00	1.10	-.10	11.57	10.72	.84
1988[2]	11.22	9.46	1.76	1.06	1.06	([3])	12.28	10.53	1.76

[1]Income rates for 1983, 1985, and 1990 are adjusted to include the lump-sum payments from the general fund of the Treasury (or adjustments to such payments) for the cost of noncontributory wage credits for military service in 1940-56

[2]Figures shown are preliminary.

[3]Income rate differs from cost rate by less than 0.005 percent of taxable payroll.

Note: Totals do not necessarily equal the sums of rounded components.

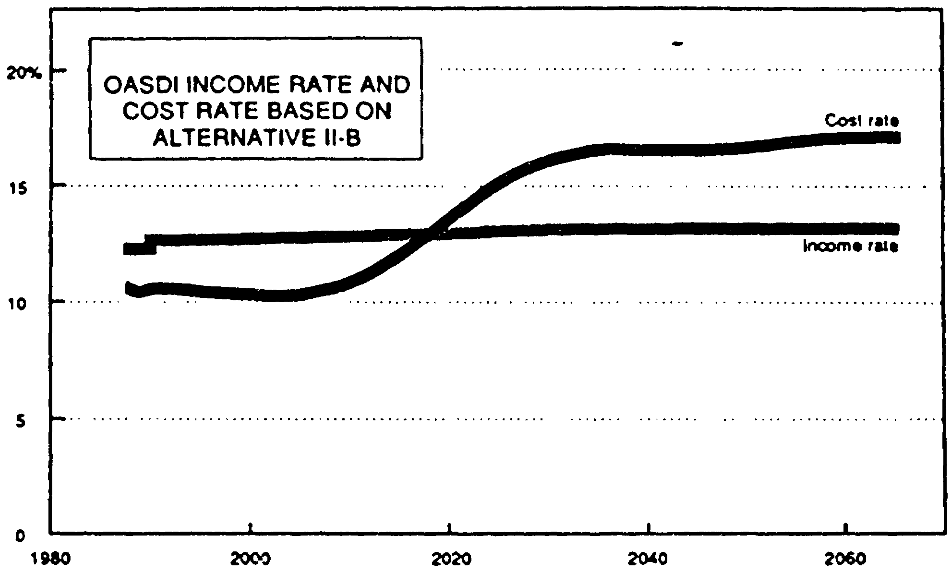
* The income rate is defined as the sum of the OASDI combined employee-employer contribution rate (or the payroll-tax rate) and the rate of income from taxation of benefits. It excludes reimbursements from the general fund of the Treasury for the costs associated with special monthly payments to certain uninsured persons who attained age 72 before 1968 and who have fewer than 3 quarters of coverage, transfers under the interfund borrowing provisions, and net investment income.

The cost rate is the ratio of the cost (or outgo or disbursements) of the program to the taxable payroll. The outgo is defined to include benefit payments, special monthly payments to certain uninsured persons who have 3 or more quarters of coverage (and whose payments are therefore not reimbursable from the general fund of the Treasury), administrative expenses, net transfers from the trust funds to the Railroad Retirement program under the financial interchange provisions, and payments for vocational rehabilitation services for disabled beneficiaries; it excludes special monthly payments to certain uninsured persons whose payments are reimbursable from the general fund of the Treasury, and transfers under the interfund borrowing provisions. For any year, the income rate minus the cost rate is referred to as the "balance" for the year.

CHART 8

PROJECTED OASDI INCOME AND COST RATES, 1989-2065, 1989 trustees' report, intermediate II-B projections *

(in percent of taxable payroll)



* The income rate is defined as the sum of the OASDI combined employee-employer contribution rate (or the payroll-tax rate) and the rate of income from taxation of benefits. It excludes reimbursements from the general fund of the Treasury for the costs associated with special monthly payments to certain uninsured persons who attained age 72 before 1968 and who have fewer than 3 quarters of coverage, transfers under the interfund borrowing provisions, and net investment income.

The cost rate is the ratio of the cost (or outgo or disbursements) of the program to the taxable payroll. The outgo is defined to include benefit payments, special monthly payments to certain uninsured persons who have 3 or more quarters of coverage (and whose payments are therefore not reimbursable from the general fund of the Treasury), administrative expenses, net transfers from the trust funds to the Railroad Retirement program under the financial interchange provisions, and payments for vocational rehabilitation services for disabled beneficiaries; it excludes special monthly payments to certain uninsured persons whose payments are reimbursable from the general fund of the Treasury, and transfers under the interfund borrowing provisions. For any year, the income rate minus the cost rate is referred to as the "balance" for the year.

TABLE 8

PROJECTED OASDI INCOME AND COST RATES, 1989-2065 *
1989 trustees' report

(in percent of taxable payroll)

Calendar year	OASI Income rate	OASI Cost rate	OASI Balance	DI Income rate	DI Cost rate	DI Balance	Total Income rate	Total Cost rate	Total Balance
Alternative I:									
1989	11.23	9.27	1.96	1.07	1.02	0.05	12.30	10.29	2.00
1990	11.38	9.26	2.12	1.21	1.00	.21	12.59	10.28	2.33
1991	11.38	9.14	2.24	1.21	.98	.23	12.59	10.12	2.48
1992	11.38	9.03	2.36	1.21	.96	.25	12.60	9.99	2.61
1993	11.39	8.91	2.48	1.21	.95	.26	12.60	9.88	2.73
1994	11.39	8.79	2.60	1.21	.95	.27	12.60	9.74	2.86
1995	11.38	8.66	2.73	1.21	.94	.27	12.60	9.60	2.99
1996	11.38	8.55	2.83	1.21	.95	.27	12.60	9.50	3.10
1997	11.38	8.45	2.93	1.21	.95	.26	12.59	9.40	3.19
1998	11.38	8.36	3.02	1.21	.96	.25	12.59	9.32	3.27
2000	11.19	8.19	3.00	1.43	.98	.45	12.62	9.17	3.45
2005	11.24	7.85	3.40	1.44	1.08	.36	12.68	8.93	3.76
2010	11.29	8.03	3.26	1.44	1.22	.22	12.73	9.25	3.48
2015	11.35	8.93	2.42	1.45	1.31	.13	12.79	10.24	2.55
2020	11.42	10.17	1.24	1.45	1.35	.09	12.86	11.53	1.34
2025	11.47	11.15	.32	1.45	1.42	.04	12.92	12.56	.36
2030	11.51	11.66	-.15	1.45	1.38	.07	12.96	13.05	-.09
2035	11.52	11.64	-.12	1.45	1.34	.11	12.97	12.98	-.01
2040	11.51	11.25	.26	1.45	1.32	.13	12.96	12.57	.38
2045	11.50	10.88	.61	1.45	1.35	.10	12.95	12.24	.71
2050	11.49	10.72	.77	1.45	1.36	.09	12.94	12.09	.86
2055	11.49	10.67	.82	1.45	1.36	.09	12.95	12.03	.92
2060	11.49	10.61	.88	1.45	1.34	.11	12.94	11.95	.99
2065	11.49	10.52	.97	1.45	1.34	.11	12.94	11.86	1.08
Alternative II-A:									
1989	11.23	9.32	1.91	1.07	1.04	.03	12.30	10.36	1.94
1990	11.39	9.33	2.07	1.21	1.03	.18	12.61	10.36	2.25
1991	11.39	9.32	2.07	1.21	1.02	.19	12.60	10.34	2.25
1992	11.39	9.26	2.13	1.21	1.02	.19	12.60	10.28	2.32
1993	11.39	9.20	2.19	1.21	1.02	.19	12.60	10.22	2.38
1994	11.40	9.13	2.27	1.21	1.03	.18	12.61	10.16	2.45
1995	11.39	9.06	2.34	1.21	1.04	.17	12.60	10.10	2.51
1996	11.39	8.99	2.41	1.21	1.05	.16	12.61	10.04	2.57
1997	11.39	8.94	2.46	1.21	1.07	.14	12.61	10.01	2.60
1998	11.39	8.88	2.51	1.21	1.09	.12	12.61	9.97	2.64
2000	11.21	8.76	2.44	1.44	1.13	0.31	12.64	9.89	2.75
2005	11.27	8.54	2.73	1.44	1.27	.17	12.71	9.82	2.90
2010	11.33	8.83	2.50	1.45	1.47	-.03	12.78	10.30	2.48
2015	11.40	9.91	1.48	1.45	1.61	-.16	12.85	11.52	1.33
2020	11.48	11.44	.04	1.46	1.68	-.23	12.94	13.13	-.19
2025	11.56	12.78	-1.23	1.46	1.78	-.32	13.01	14.56	-1.55
2030	11.61	13.72	-2.11	1.46	1.77	-.31	13.07	15.48	-2.41
2035	11.64	14.07	-2.44	1.46	1.73	-.27	13.10	15.80	-2.71
2040	11.64	14.01	-2.36	1.46	1.74	-.28	13.10	15.75	-2.64
2045	11.65	13.93	-2.28	1.46	1.80	-.34	13.11	15.73	-2.62
2050	11.66	14.07	-2.41	1.46	1.84	-.38	13.12	15.90	-2.78
2055	11.67	14.33	-2.65	1.46	1.84	-.38	13.14	16.17	-3.03
2060	11.69	14.53	-2.84	1.46	1.82	-.36	13.15	16.35	-3.20
2065	11.69	14.61	-2.92	1.46	1.82	-.36	13.16	16.43	-3.28

TABLE 8 (continued)

PROJECTED OASDI INCOME AND COST RATES, 1989-2065 *

1989 trustees' report

(in percent of taxable payroll)

(Continued)

Calendar year	OASI Income rate	OASI Cost rate	OASI Balance	DI Income rate	DI Cost rate	DI Balance	Total Income rate	Total Cost rate	Total Balance
Alternative II-B									
1989	11.23	9.32	1.91	1.07	1.04	.03	12.30	10.36	1.94
1990	11.42	9.48	1.94	1.21	1.05	.17	12.63	10.52	2.11
1991	11.39	9.51	1.88	1.21	1.04	.17	12.60	10.55	2.05
1992	11.39	9.52	1.87	1.21	1.05	.17	12.61	10.57	2.04
1993	11.40	9.50	1.90	1.21	1.05	.16	12.61	10.56	2.05
1994	11.40	9.44	1.96	1.21	1.06	.15	12.61	10.50	2.11
1995	11.40	9.37	2.03	1.21	1.07	.15	12.61	10.44	2.17
1996	11.40	9.31	2.09	1.21	1.08	.13	12.61	10.39	2.22
1997	11.40	9.25	2.15	1.21	1.09	.12	12.61	10.35	2.27
1998	11.40	9.20	2.20	1.21	1.11	.10	12.61	10.31	2.30
2000	11.22	9.12	2.10	1.44	1.15	.29	12.65	10.27	2.38
2005	11.30	8.94	2.35	1.44	1.31	.14	12.74	10.25	2.49
2010	11.36	9.24	2.11	1.45	1.52	-.07	12.81	10.76	2.05
2015	11.43	10.37	1.06	1.45	1.66	-.20	12.88	12.03	.86
2020	11.51	11.97	-.45	1.46	1.73	-.27	12.97	13.70	-.73
2025	11.59	13.39	-1.80	1.46	1.83	-.37	13.06	15.23	-2.17
2030	11.65	14.41	-2.76	1.46	1.82	-.36	13.11	16.23	-3.11
2035	11.66	14.80	-3.14	1.48	1.80	-.32	13.14	16.61	-3.47
2040	11.69	14.79	-3.10	1.46	1.79	-.33	13.15	16.58	-3.43
2045	11.69	14.71	-3.02	1.46	1.86	-.39	13.15	16.56	-3.41
2050	11.70	14.84	-3.15	1.46	1.89	-.43	13.16	16.74	-3.58
2055	11.71	15.11	-3.39	1.46	1.89	-.43	13.18	17.00	-3.82
2060	11.73	15.32	-3.59	1.46	1.87	-.41	13.19	17.19	-4.00
2065	11.73	15.42	-3.69	1.46	1.87	-.41	13.20	17.29	-4.10
Alternative III									
1989	11.23	9.56	1.68	1.07	1.09	-.02	12.30	10.65	1.65
1990	11.44	9.96	1.48	1.22	1.13	.08	12.65	11.09	1.56
1991	11.40	10.05	1.35	1.21	1.15	.07	12.61	11.20	1.41
1992	11.41	10.19	1.22	1.21	1.18	.04	12.62	11.37	1.26
1993	11.42	10.56	.86	1.21	1.25	-.03	12.64	11.81	.83
1994	11.42	10.51	.92	1.22	1.27	-.05	12.64	11.78	.86
1995	11.42	10.48	.94	1.22	1.30	-.09	12.64	11.79	.85
1996	11.42	10.44	.98	1.22	1.34	-.13	12.64	11.78	.86
1997	11.43	10.41	1.02	1.22	1.39	-.17	12.64	11.80	.85
1998	11.43	10.39	1.04	1.22	1.44	-.22	12.64	11.83	.82
2000	11.25	10.33	.92	1.44	1.48	-.04	12.69	11.81	.88
2005	11.34	10.18	1.17	1.45	1.64	-.19	12.79	11.82	.97
2010	11.42	10.51	.91	1.46	1.90	-.44	12.87	12.41	.46
2015	11.50	11.82	-.33	1.46	2.11	-.64	12.96	13.93	-.97
2020	11.60	13.78	-2.18	1.47	2.23	-.76	13.07	16.02	-2.94
2025	11.71	15.73	-4.03	1.47	2.39	-.92	13.18	18.12	-4.94
2030	11.80	17.42	-5.62	1.47	2.41	-.93	13.28	19.83	-6.55
2035	11.86	18.56	-6.69	1.48	2.41	-.93	13.34	20.96	-7.62
2040	11.90	19.22	-7.32	1.48	2.47	-.99	13.38	21.69	-8.31
2045	11.94	19.86	-7.92	1.48	2.61	-1.13	13.42	22.47	-9.05
2050	11.99	20.80	-8.81	1.48	2.70	-1.21	13.47	23.49	-10.02
2055	12.05	21.91	-9.87	1.48	2.71	-1.23	13.53	24.63	-11.10
2060	12.10	22.90	-10.80	1.48	2.67	-1.19	13.58	25.57	-11.99
2065	12.13	23.62	-11.49	1.48	2.67	-1.19	13.62	26.29	-12.67

Note: Totals do not necessarily equal the sums of rounded components.

* The income rate is defined as the sum of the OASDI combined employee-employer contribution rate (or the payroll-tax rate) and the rate of income from taxation of benefits. It excludes reimbursements from the general fund of the Treasury for the costs associated with special monthly payments to certain uninsured persons who attained age 72 before 1968 and who have fewer than 3 quarters of coverage, transfers under the interfund borrowing provisions, and net investment income.

The cost rate is the ratio of the cost (or outgo or disbursements) of the program to the taxable payroll. The outgo is defined to include benefit payments, special monthly payments to certain uninsured persons who have 3 or more quarters of coverage (and whose payments are therefore not reimbursable from the general fund of the Treasury), administrative expenses, net transfers from the trust funds to the Railroad Retirement program under the financial interchange provisions, and payments for vocational rehabilitation services for disabled beneficiaries; it excludes special monthly payments to certain uninsured persons whose payments are reimbursable from the general fund of the Treasury, and transfers under the interfund borrowing provisions. For any year, the income rate minus the cost rate is referred to as the "balance" for the year.

TABLE 9

PROJECTED OASDI INCOME AND COST RATES, 1989-2065, IN 25-YEAR SEGMENTS *

1989 trustees' report

(in percent of taxable payroll)

Calendar year	OASI Income rate	OASI Cost rate	OASI Balance	DI Income rate	DI Cost rate	DI Balance	Total Income rate	Total Cost rate	Total Balance
Alternative I									
25-year subperiods:[1]									
1989-2013	11.30	8.41	2.89	1.33	1.06	0.27	12.63	9.47	3.17
2014-2038	11.45	10.80	.65	1.45	1.37	.08	12.90	12.17	.73
2039-2063	11.49	10.82	.66	1.45	1.35	.10	12.94	12.17	.76
Valuation ranges:[2]									
25 years 1989-2013	11.53	8.41	3.12	1.34	1.06	.29	12.87	9.47	3.40
50 years 1989-2038	11.49	9.53	1.96	1.39	1.20	.19	12.88	10.73	2.15
75 years 1989-2063	11.49	9.91	1.58	1.41	1.25	.16	12.90	11.16	1.74
Alternative II-A									
25-year subperiods:[1]									
1989-2013	11.32	8.95	2.37	1.33	1.20	.12	12.65	10.16	2.50
2014-2038	11.53	12.50	-.97	1.46	1.72	-.27	12.99	14.23	-1.24
2039-2063	11.65	14.21	-2.56	1.46	1.81	-.35	13.11	16.03	-2.91
Valuation ranges:[2]									
25 years 1989-2013	11.55	8.95	2.60	1.34	1.20	.14	12.90	10.16	2.74
50 years 1989-2038	11.54	10.56	.98	1.39	1.44	-.04	12.94	12.00	.94
75 years 1989-2063	11.57	11.54	.03	1.41	1.54	-.13	12.98	13.08	-.10
Alternative II-B									
25-year subperiods:[1]									
1989-2013	11.34	9.29	2.05	1.33	1.23	.09	12.67	10.52	2.14
2014-2038	11.57	13.13	-1.56	1.46	1.77	-.32	13.03	14.91	-1.88
2039-2063	11.69	15.00	-3.31	1.46	1.87	-.41	13.15	16.87	-3.72
Valuation ranges:[2]									
25 years 1989-2013	11.57	9.29	2.28	1.34	1.23	.11	12.91	10.52	2.39
50 years 1989-2038	11.57	11.04	.52	1.40	1.48	-.09	12.96	12.52	.44
75 years 1989-2063	11.60	12.13	-.53	1.41	1.58	-.17	13.02	13.72	-.70
Alternative III									
25-year subperiods:[1]									
1989-2013	11.37	10.36	1.01	1.33	1.51	-.18	12.70	11.87	.83
2014-2038	11.68	15.63	-3.94	1.47	2.32	-.85	13.15	17.95	-4.79
2039-2063	11.98	21.04	-9.06	1.48	2.64	-1.16	13.46	23.68	-10.22
Valuation ranges:[2]									
25 years 1989-2013	11.63	10.36	1.27	1.34	1.51	-.18	12.97	11.87	1.10
50 years 1989-2038	11.65	12.67	-1.02	1.40	1.86	-.47	13.05	14.54	-1.48
75 years 1989-2063	11.73	14.73	-2.99	1.42	2.06	-.64	13.15	16.78	-3.63

[1] Income rates do not include beginning trust fund balances.

[2] Income rates do include beginning trust fund balances.

Note: Totals do not necessarily equal the sums of rounded components.

* The income rate is defined as the sum of the OASDI combined employee-employer contribution rate (or the payroll-tax rate) and the rate of income from taxation of benefits. It excludes reimbursements from the general fund of the Treasury for the costs associated with special monthly payments to certain uninsured persons who attained age 72 before 1968 and who have fewer than 3 quarters of coverage, transfers under the interfund borrowing provisions, and net investment income.

The cost rate is the ratio of the cost (or outgo or disbursements) of the program to the taxable payroll. The outgo is defined to include benefit payments, special monthly payments to certain uninsured persons who have 3 or more quarters of coverage (and whose payments are therefore not reimbursable from the general fund of the Treasury), administrative expenses, net transfers from the trust funds to the Railroad Retirement program under the financial interchange provisions, and payments for vocational rehabilitation services for disabled beneficiaries; it excludes special monthly payments to certain uninsured persons whose payments are reimbursable from the general fund of the Treasury, and transfers under the interfund borrowing provisions. For any year, the income rate minus the cost rate is referred to as the "balance" for the year.

TABLE 10 A

PROJECTED OASDI AND HI INCOME AND COST RATES, 1989-2060 * 1989 trustees' report

(in percent of taxable payroll)

	OASDI			HI			TOTAL		
Calendar year	Income rate	Cost rate	Balance	Income rate	Cost rate	Balance	Income rate	Cost rate	Balance
Alternative I									
1989	12.30	10.29	2.00	2.90	2.51	0.39	15.20	12.80	2.40
1990	12.59	10.26	2.33	2.90	2.59	31	15.49	12.85	2.64
1991	12.59	10.12	2.48	2.90	2.62	28	15.49	12.74	2.75
1992	12.60	9.99	2.61	2.90	2.67	23	15.50	12.66	2.84
1993	12.60	9.86	2.73	2.90	2.71	19	15.50	12.57	2.93
1994	12.60	9.74	2.86	2.90	2.74	16	15.50	12.48	3.02
1995	12.60	9.60	2.99	2.90	2.77	13	15.50	12.37	3.12
1996	12.60	9.50	3.10	2.90	2.80	10	15.50	12.30	3.20
1997	12.59	9.40	3.19	2.90	2.82	08	15.49	12.23	3.27
1998	12.59	9.32	3.27	2.90	2.84	06	15.49	12.17	3.33
2000	12.62	9.17	3.45	2.90	2.88	02	15.52	12.06	3.47
2005	12.68	8.93	3.76	2.90	2.89	01	15.58	11.82	3.76
2010	12.73	9.25	3.48	2.90	2.92	- 02	15.63	12.17	3.47
2015	12.79	10.24	2.55	2.90	2.92	- 02	15.69	13.16	2.53
2020	12.86	11.53	1.34	2.90	3.02	- 11	15.76	14.54	1.22
2025	12.92	12.56	36	2.90	3.19	- 29	15.82	15.75	07
2030	12.96	13.05	- 09	2.90	3.35	- 45	15.86	16.40	- 54
2035	12.97	12.98	- 01	2.90	3.47	- 57	15.87	16.44	- 58
2040	12.96	12.57	38	2.90	3.55	- 65	15.86	16.13	- 27
2045	12.95	12.24	71	2.90	3.60	- 70	15.85	15.84	01
2050	12.94	12.09	86	2.90	3.64	- 74	15.84	15.72	12
2055	12.95	12.03	92	2.90	3.67	- 77	15.85	15.70	14
2060	12.94	11.95	99	2.90	3.72	- 82	15.84	15.68	17
Alternative II-A									
1989	12.30	10.36	1.94	2.90	2.52	38	15.20	12.89	2.31
1990	12.61	10.36	2.25	2.90	2.64	26	15.51	13.00	2.51
1991	12.60	10.34	2.25	2.90	2.71	19	15.50	13.05	2.44
1992	12.60	10.28	2.32	2.90	2.79	11	15.50	13.07	2.43
1993	12.60	10.22	2.38	2.90	2.87	03	15.50	13.10	2.41
1994	12.61	10.16	2.45	2.90	2.96	- 06	15.51	13.12	2.39
1995	12.60	10.10	2.51	2.90	3.04	- 14	15.50	13.14	2.37
1996	12.61	10.04	2.57	2.90	3.12	- 22	15.51	13.16	2.34
1997	12.61	10.01	2.60	2.90	3.20	- 30	15.51	13.20	2.30
1998	12.61	9.97	2.64	2.90	3.27	- 37	15.51	13.24	2.26
2000	12.64	9.89	2.75	2.90	3.42	- 52	15.54	13.31	2.23
2005	12.71	9.82	2.90	2.90	3.70	- 80	15.61	13.52	2.10
2010	12.78	10.30	2.48	2.90	4.05	-1.15	15.68	14.35	1.33
2015	12.85	11.52	1.33	2.90	4.42	-1.52	15.75	15.94	- 19
2020	12.94	13.13	- 19	2.90	4.96	-2.06	15.84	18.09	-2.26
2025	13.01	14.56	-1.55	2.90	5.60	-2.70	15.91	20.16	-4.25
2030	13.07	15.48	-2.41	2.90	6.15	-3.25	15.97	21.64	-5.67
2035	13.10	15.80	-2.71	2.90	6.52	-3.62	16.00	22.32	-6.33
2040	13.10	15.75	-2.64	2.90	6.71	-3.81	16.00	22.45	-6.45
2045	13.11	15.73	-2.62	2.90	6.80	-3.90	16.01	22.53	-6.52
2050	13.12	15.90	-2.78	2.90	6.87	-3.97	16.02	22.78	-6.76
2055	13.14	16.17	-3.03	2.90	6.95	-4.05	16.04	23.12	-7.08
2060	13.15	16.35	-3.20	2.90	7.04	-4.14	16.05	23.38	-7.33

* See note on Table 9 for definition of income and cost rates.

TABLE 10 A

PROJECTED OASDI AND HI INCOME AND COST RATES, 1989-2060 *
1989 trustees' report

(in percent of taxable payroll)

(continued)

Calendar year	OASDI Income rate	OASDI Cost rate	OASDI Balance	HI[2] Income rate	HI[2] Cost rate	HI[2] Balance	TOTAL[3] Income rate	TOTAL[3] Cost rate	TOTAL[3] Balance
Alternative II B									
1989	12 30	10 36	1 94	2 90	2 53	37	15 20	12 89	2 31
1990	12 63	10 52	2 11	2 90	2 66	24	15 53	13 19	2 35
1991	12 60	10 55	2 05	2 90	2 74	16	15 50	13 29	2 21
1992	12 61	10 57	2 04	2 90	2 84	06	15 51	13 41	2 10
1993	12 61	10 56	2 05	2 90	2 93	- 03	15 51	13 49	2 02
1994	12 61	10 50	2 11	2 90	3 02	- 12	15 51	13 52	1 99
1995	12 61	10 44	2 17	2 90	3 11	- 21	15 51	13 55	1 97
1996	12 61	10 39	2 22	2 90	3 20	- 30	15 51	13 59	1 92
1997	12 61	10 35	2 27	2 90	3 28	- 38	15 51	13 63	1 88
1998	12 61	10 31	2 30	2 90	3 30	- 40	15 51	13 67	1 84
2000	12 65	10 27	2 38	2 90	3 54	- 64	15 55	13 81	1 74
2005	12 74	10 25	2 49	2 90	3 87	- 97	15 64	14 12	1 52
2010	12 81	10 76	2 05	2 90	4 27	-1 37	15 71	15 03	68
2015	12 88	12 03	86	2 90	4 69	-1 78	15 78	16 71	- 93
2020	12 97	13 70	- 73	2 90	5 26	-2 36	15 87	18 96	-3 09
2025	13 06	15 23	-2 17	2 90	5 93	-3 03	15 96	21 16	-5 20
2030	13 11	16 23	-3 11	2 90	6 50	-3 60	16 01	22 73	-6 72
2035	13 14	16 61	-3 47	2 90	6 87	-3 97	16 04	23 48	-7 44
2040	13 15	16 58	-3 43	2 90	7 06	-4 16	16 05	23 64	-7 59
2045	13 15	16 56	-3 41	2 90	7 15	-4 25	16 05	23 72	-7 66
2050	13 16	16 74	-3 58	2 90	7 22	-4 32	16 06	23 96	-7 90
2055	13 18	17 00	-3 82	2 90	7 30	-4 40	16 08	24 31	-8 23
2060	13 19	17 19	-4 00	2 90	7 40	-4 50	16 09	24 59	-8 50
Alternative III									
1989	12 30	10 65	1 65	2 90	2 59	31	15 20	13 24	1 97
1990	12 65	11 09	1 56	2 90	2 79	11	15 55	13 88	1 67
1991	12 61	11 20	1 41	2 90	2 91	- 01	15 51	14 11	1 40
1992	12 62	11 37	1 26	2 90	3 05	- 15	15 52	14 42	1 11
1993	12 64	11 81	83	2 90	3 24	- 34	15 54	15 05	49
1994	12 64	11 78	86	2 90	3 38	- 48	15 54	15 16	38
1995	12 64	11 79	85	2 90	3 55	- 65	15 54	15 34	20
1996	12 64	11 79	86	2 90	3 71	- 81	15 54	15 50	05
1997	12 64	11 80	85	2 90	3 87	- 97	15 54	15 67	- 13
1998	12 64	11 83	82	2 90	4 04	-1 14	15 54	15 87	- 32
2000	12 69	11 81	88	2 90	4 40	-1 50	15 59	16 21	- 62
2005	12 79	11 82	97	2 90	5 29	-2 39	15 69	17 11	-1 41
2010	12 87	12 41	46	2 90	6 40	-3 50	15 77	18 81	-3 03
2015	12 96	13 93	- 97	2 90	7 72	-4 82	15 86	21 64	-5 78
2020	13 07	16 02	-2 94	2 90	9 42	-6 52	15 97	25 44	-9 47
2025	13 18	18 12	-4 94	2 90	11 30	-8 40	16 08	29 42	-13 34
2030	13 28	19 83	-6 55	2 90	12 92	-10 02	16 18	32 75	-16 57
2035	13 34	20 96	-7 62	2 90	13 95	-11 05	16 24	34 91	-18 67
2040	13 38	21 69	-8 31	2 90	14 37	-11 47	16 28	36 06	-19 78
2045	13 42	22 47	-9 05	2 90	14 56	-11 66	16 32	37 02	-20 70
2050	13 47	23 49	-10 02	2 90	14 70	-11 80	16 37	38 19	-21 82
2055	13 53	24 63	-11 10	2 90	14 86	-11 96	16 43	39 49	-23 06
2060	13 58	25 57	-11 99	2 90	15 05	-12 15	16 48	40 62	-24 14

[1] Cost rates for HI exclude amounts required for trust fund maintenance

[2] The taxable payroll for HI is somewhat larger than the taxable payroll for OASDI, because HI covers all Federal civilian employees, including those hired before 1984, all State and local goverment employees hired after April 1 1986, and railroad employees This difference is relatively small and does not significantly affect the comparisons

[3] Effects of the Medicare Catastrophic Coverage Act of 1988 are not reflected

Note Totals do not necessarily equal the sums of rounded components

* See note on Table 9 for definition of income and cost rates.

TABLE 10 B

PROJECTED OASDI AND HI INCOME AND COST RATES, 1989-2060 *
Summarized by 25-year periods

1989 trustees' report

(in percent of taxable payroll)

Calendar year	OASDI			HI[1,2]			TOTAL[3]		
	Income rate	Cost rate	Balance	Income rate	Cost rate	Balance	Income rate	Cost rate	Balance
Alternative I:									
25-year subperiods[4]:									
1989-2013	12.63	9.47	3.17	2.90	2.82	0.09	15.54	12.28	3.25
2014-2038	12.90	12.17	.73	2.90	3.21	-.30	15.80	15.38	.43
2039-2063	12.94	12.17	.76	2.90	3.64	-.74	15.84	15.82	.02
Valuation ranges[5]:									
25 years: 1989-2013	12.87	9.47	3.40	3.05	2.82	.23	15.92	12.28	3.63
50 years: 1989-2038	12.88	10.73	2.15	2.98	3.00	-.02	15.86	13.73	2.13
75 years: 1989-2063	12.90	11.16	1.74	2.96	3.19	-.23	15.86	14.35	1.51
Alternative II-A:									
25-year subperiods[4]:									
1989-2013	12.65	10.16	2.50	2.90	3.40	-.50	15.56	13.56	2.00
2014-2038	12.99	14.23	-1.24	2.90	5.58	-2.68	15.89	19.80	-3.91
2039-2063	13.11	16.03	-2.91	2.90	6.88	-3.98	16.02	22.91	-6.89
Valuation ranges[5]:									
25 years: 1989-2013	12.90	10.16	2.74	3.05	3.40	-.35	15.95	13.56	2.39
50 years: 1989-2038	12.94	12.00	.94	2.99	4.39	-1.41	15.92	16.39	-.47
75 years: 1989-2063	12.98	13.08	-.10	2.96	5.06	-2.10	15.95	18.14	-2.20
Alternative II-B:									
25-year subperiods[4]:									
1989-2013	12.67	10.52	2.14	2.91	3.53	-.62	15.57	14.05	1.52
2014-2038	13.03	14.91	-1.88	2.90	5.91	-3.00	15.93	20.81	-4.88
2039-2063	13.15	16.87	-3.72	2.90	7.24	-4.33	16.06	24.11	-8.05
Valuation ranges[5]:									
25 years: 1989-2013	12.91	10.52	2.39	3.06	3.53	-.47	15.97	14.05	1.92
50 years: 1989-2038	12.96	12.52	.44	2.99	4.61	-1.63	15.95	17.14	-1.19
75 years: 1989-2063	13.02	13.72	-.70	2.96	5.34	-2.37	15.98	19.06	-3.08
Alternative III:									
25-year subperiods[4]:									
1989-2013	12.70	11.87	.83	2.91	4.54	-1.63	15.61	16.41	-.80
2014-2038	13.15	17.95	-4.79	2.90	11.16	-8.26	16.06	29.11	-13.05
2039-2063	13.46	23.68	-10.22	2.90	14.72	-11.82	16.37	38.40	-22.03
Valuation ranges[5]:									
25 years: 1989-2013	12.97	11.87	1.10	3.07	4.54	-1.47	16.04	16.41	-.36
50 years: 1989-2038	13.05	14.54	-1.48	3.00	7.44	-4.45	16.05	21.98	-5.93
75 years: 1989-2063	13.15	16.78	-3.63	2.98	9.23	-6.26	16.13	26.01	-9.89

[1] Cost rates for HI exclude amounts required for trust fund maintenace.

[2] The taxable payroll for HI is somewhat larger than the taxable payroll for OASDI, because HI covers all Federal civilian employees, including those hired before 1984, all State and local government employees hired after April 1, 1986, and railroad employees. This difference is relatively small and does not significantly affect the comparisons.

[3] Effects of the Medicare Catastrophic Coverage Act of 1988 are not reflected.

[4] Income rates do not include beginning trust fund balances.

[5] Income rates include beginning trust fund balances.

Note: Totals do not necessarily equal the sums of rounded components.

* See note on Table 9 for definition of income and cost rates.

TABLE 11

PROJECTED OASDI FINANCIAL OPERATIONS, 1989-2065
1989 trustees' report

(Constant dollars in billions)

Calendar year	Income excluding interest	Interest income	Total income	Outgo	Assets at end of year
Alternative I:					
1989	$282.3	$13.0	$295.3	$235.2	$169.9
1990	296.6	18.3	314.8	242.1	237.8
1991	307.2	23.7	330.9	247.8	314.4
1992	318.1	29.0	347.1	253.1	400.7
1993	329.2	34.1	363.3	256.5	498.6
1994	340.6	38.9	379.5	263.9	602.2
1995	351.6	43.2	394.8	268.7	718.5
1996	362.5	47.5	410.0	273.7	836.7
1997	372.8	52.3	425.1	279.0	980.4
1998	383.7	57.8	441.6	284.6	1,108.4
2000	409.2	70.6	479.8	290.0	1,410.9
2005	479.5	109.7	589.2	338.1	2,350.3
2010	551.9	166.6	718.6	401.7	3,536.4
2015	626.5	230.2	856.7	502.5	4,846.7
2020	707.2	293.1	1,000.3	634.9	6,131.4
2025	798.2	351.9	1,150.1	777.5	7,329.0
2030	905.1	408.6	1,313.7	913.0	8,498.7
2035	1,030.0	471.3	1,501.3	1,032.8	9,802.6
2040	1,171.3	549.8	1,721.0	1,138.6	11,450.4
2045	1,331.2	650.9	1,982.1	1,260.5	13,570.8
2050	1,514.5	776.9	2,291.4	1,416.8	16,201.9
2055	1,726.8	929.1	2,655.9	1,807.3	19,376.7
2060	1,971.4	1,112.0	3,083.5	1,824.1	23,191.2
2065	2,250.2	1,332.6	3,582.8	2,088.2	27,780.2
Alternative II-A:					
1989	281.1	13.0	294.1	235.7	168.1
1990	293.3	18.1	311.3	241.4	232.1
1991	301.6	23.4	325.0	248.4	301.4
1992	310.3	28.4	338.7	254.1	377.2
1993	318.8	33.2	352.0	258.4	458.9
1994	327.5	37.7	365.2	264.6	546.2
1995	335.9	41.9	377.8	268.8	638.2
1996	344.5	46.1	390.5	274.9	735.3
1997	352.8	50.5	403.3	280.7	836.4
1998	361.5	55.3	416.8	286.8	942.2
2000	381.2	65.2	446.4	290.0	1,170.1
2005	433.6	93.9	527.5	335.6	1,830.1
2010	484.9	134.5	619.4	391.8	2,598.6
2015	533.0	174.1	707.1	479.0	3,330.6
2020	580.9	203.5	784.4	580.7	3,850.3
2025	631.2	217.5	848.6	707.8	4,094.0
2030	687.1	215.6	902.7	815.7	4,036.3
2035	749.1	201.9	951.1	905.9	3,785.5
2040	814.8	181.4	996.2	981.2	3,372.7
2045	884.1	155.3	1,039.4	1,083.2	2,874.6
2050	958.7	120.2	1,078.9	1,164.6	2,198.4
2055	1,040.6	71.0	1,111.6	1,283.5	1,250.9
2060	(*)	(*)	(*)	(*)	(*)
Alternative II-B:					
1989	281.2	13.1	294.2	235.7	168.3
1990	290.3	18.1	308.4	242.3	227.2
1991	294.8	23.3	318.1	247.7	287.9
1992	300.5	28.2	328.7	252.8	351.8
1993	307.5	33.1	340.6	258.3	420.0
1994	315.1	37.8	352.9	263.2	493.5
1995	322.6	42.2	364.8	267.8	571.5
1996	330.1	46.4	376.5	272.6	653.4
1997	337.2	50.6	387.8	277.5	738.6
1998	344.7	54.9	399.5	282.6	827.1
2000	$359.9	$62.9	$422.9	$293.1	$1,012.9
2005	401.1	84.8	485.9	323.6	1,522.3
2010	440.1	117.1	557.2	370.7	2,083.1
2015	474.6	145.4	620.0	444.2	2,558.5
2020	507.4	160.7	668.1	537.2	2,798.3
2025	540.9	158.2	699.0	632.3	2,727.5
2030	577.5	138.0	715.6	716.4	2,355.2
2035	617.5	104.4	721.9	782.3	1,757.7
2040	658.7	62.3	721.0	832.4	1,019.2
2045	700.8	13.2	714.0	884.8	158.5
2046	(*)	(*)	(*)	(*)	(*)
Alternative III:					
1989	274.8	12.8	287.7	236.5	161.0
1990	275.5	16.8	292.3	241.8	202.5
1991	276.0	20.8	296.8	246.2	240.8
1992	278.7	24.7	303.4	251.9	278.1
1993	277.5	28.0	305.4	260.0	310.3
1994	282.5	30.6	313.1	264.4	343.5
1995	288.0	32.8	320.7	269.6	378.3
1996	293.6	34.6	328.3	274.8	413.8
1997	298.9	36.1	335.0	279.8	449.3
1998	303.8	37.5	341.3	285.1	484.0
2000	313.5	39.7	353.2	292.7	554.9
2005	338.8	44.0	382.7	314.0	729.9
2010	361.0	54.1	415.1	349.1	889.3
2015	377.2	55.9	433.1	406.6	898.7
2020	389.8	40.5	430.3	479.0	823.3
2025	(*)	(*)	(*)	(*)	(*)

[*]The combined OASI and DI Trust Funds are estimated to become exhausted during this year

TABLE 12

PROJECTED OASDI FINANCIAL OPERATIONS, 1989-2065
1989 trustees' report

(Current dollars in billions)

Calendar year	Income excluding interest	Interest income	Total income	Outgo	Assets at end of year
Alternative I					
1989	$282.3	$13.0	$295.3	$235.2	$169.9
1990	305.6	18.8	324.4	249.5	244.8
1991	325.5	25.1	350.6	262.3	333.1
1992	345.5	31.5	376.9	274.9	435.1
1993	365.7	37.9	403.5	287.1	551.6
1994	386.1	44.1	430.2	299.1	682.7
1995	406.6	50.0	456.6	310.7	828.8
1996	427.6	56.0	483.5	322.9	989.3
1997	448.5	62.9	511.5	335.6	1,165.1
1998	470.9	71.0	541.9	349.3	1,357.7
2000	$522.4	$90.1	$612.6	$380.4	$1,801.3
2005	675.9	154.6	830.5	478.7	3,313.0
2010	858.9	259.2	1,118.1	625.2	5,503.8
2015	1,076.5	395.5	1,472.0	863.4	8,328.0
2020	1,341.6	556.1	1,897.7	1,204.4	11,632.1
2025	1,671.9	737.0	2,408.9	1,628.5	15,351.3
2030	2,093.1	945.0	3,038.2	2,111.5	19,649.5
2035	2,629.9	1,203.4	3,833.3	2,636.5	25,028.9
2040	3,301.9	1,549.8	4,851.7	3,210.3	32,279.1
2045	4,143.3	2,025.9	6,169.3	3,923.3	42,237.7
2050	5,204.6	2,669.7	7,874.3	4,868.7	55,878.4
2055	6,551.5	3,525.2	10,076.8	6,098.1	73,516.8
2060	8,258.3	4,658.3	12,916.5	7,641.0	97,146.8
2065	10,407.0	6,163.4	16,570.[illegible]	9,556.2	128,541.9
Alternative II-A					
1989	281.1	13.0	294.1	235.7	168.1
1990	304.2	18.7	322.9	250.4	240.7
1991	322.8	25.0	347.8	265.9	322.6
1992	342.1	31.3	373.4	280.1	415.9
1993	362.1	37.6	399.8	294.6	521.1
1994	383.1	44.1	427.1	309.5	638.8
1995	404.6	50.5	455.1	325.0	768.9
1996	427.4	57.2	484.6	341.1	912.3
1997	450.8	64.6	515.4	358.8	1,069.0
1998	475.9	72.7	548.7	377.3	1,240.3
2000	532.4	91.1	623.4	417.8	1,834.1
2005	702.1	152.0	854.1	543.3	2,963.0
2010	910.1	252.5	1,162.5	735.4	4,877.2
2015	1,159.7	378.8	1,538.5	1,042.3	7,246.8
2020	1,465.2	513.3	1,978.5	1,490.1	9,734.4
2025	1,845.6	635.9	2,481.5	2,069.7	11,971.2
2030	2,329.2	730.9	3,060.1	2,765.0	13,682.3
2035	2,943.9	793.5	3,737.4	3,560.0	14,797.2
2040	3,711.9	826.2	4,538.1	4,470.1	15,364.9
2045	4,669.1	820.2	5,489.2	5,615.1	15,181.4
2050	5,869.3	736.1	6,605.3	7,129.9	13,465.8
2055	7,385.7	503.6	7,889.3	9,109.4	6,878.6
2060	[1]	[1]	[1]	[1]	[1]
Alternative II-B					
1989	281.2	13.1	294.2	235.7	168.3
1990	303.3	18.9	322.2	253.2	237.3
1991	321.8	25.4	347.2	270.3	314.2
1992	342.2	32.2	374.4	287.9	400.7
1993	364.8	39.2	404.1	306.4	498.4
1994	389.0	46.7	435.6	324.8	609.1
1995	414.1	54.2	468.3	343.8	733.6
1996	440.7	62.0	502.6	363.9	872.3
1997	468.2	70.2	538.4	385.2	1,025.5
1998	497.7	79.2	576.9	408.1	1,194.3
2000	562.1	98.3	660.4	457.7	1,581.8
2005	762.0	161.2	923.2	614.9	2,892.5
2010	1,017.4	270.8	1,288.2	857.0	4,815.6
2015	1,334.8	408.9	1,743.7	1,249.4	7,196.1
2020	1,736.4	549.8	2,286.2	1,838.4	9,575.6
2025	2,251.8	658.6	2,910.3	2,632.6	11,355.6
2030	2,925.4	699.3	3,624.7	3,629.0	11,929.8
2035	3,805.5	643.7	4,449.1	4,821.1	10,832.4
2040	4,938.5	467.2	5,405.7	6,241.6	7,841.8
2045	6,393.3	120.4	6,513.7	8,071.6	1,446.1
2046	[1]	[1]	[1]	[1]	[1]
Alternative III					
1989	274.8	12.8	287.7	238.5	161.0
1990	291.6	17.8	309.3	256.0	214.3
1991	310.9	23.4	334.3	277.4	271.3
1992	333.7	29.5	363.2	301.6	332.9
1993	348.8	35.1	383.9	326.8	390.0
1994	$373.8	$40.4	$414.3	$349.9	$454.4
1995	400.1	45.5	445.8	374.5	525.5
1996	428.6	50.4	479.0	400.9	603.6
1997	457.7	55.4	513.1	428.6	688.1
1998	488.5	60.3	548.8	458.6	778.4
2000	555.9	70.3	626.2	518.0	983.8
2005	766.6	99.5	866.1	710.6	1,651.7
2010	1,042.5	156.4	1,198.9	1,008.2	2,568.5
2015	1,390.4	205.9	1,596.4	1,498.8	3,312.5
2020	1,833.6	190.8	2,024.4	2,253.3	2,932.1
2025	[1]	[1]	[1]	[1]	[1]

[1] The combined OASI and DI Trust Funds are estimated to become exhausted during the year

TABLE 13

PROJECTED OASDI TRUST FUND CONTINGENCY RATIOS, 1983-2060
1983 trustees' report

(Balance at beginning of year as % of outgo during the year)

Calendar year	Alternative I			Alternative II-A			Alternative II-B			Alternative III		
	OASI	DI	Total	OASI	DI	Total	OASI	DI	Total	OASI	DI	Total
1983	15	15	15	15	15	15	15	15	15	15	15	15
1984	21	38	22	20	38	22	20	38	22	19	37	21
1985	22	35	23	21	33	22	20	32	21	17	29	18
1986	26	35	27	24	31	25	22	29	23	18	25	19
1987	28	40	29	25	32	25	23	28	23	21	24	21
1988	37	50	38	26	36	27	23	30	24	18	24	19
1989	53	94	57	39	48	40	28	38	29	26	30	27
1990	73	113	77	51	84	54	35	69	38	34	56	38
1991	99	152	104	69	109	72	47	89	51	42	70	45
1992	126	188	131	88	135	92	59	111	64	48	83	51
1993	162	237	169	110	165	115	75	136	80	56	97	60
1994	201	287	209	135	195	140	91	161	98	64	111	68
1995	244	340	253	161	226	168	110	185	117	73	124	78
1996	290	394	300	191	258	197	130	213	137	83	136	88
1997	340	450	350	222	291	229	152	240	160	93	149	98
1998	393	495	402	256	317	262	175	262	183	105	158	110
1999	448	535	457	291	340	296	200	280	206	118	164	123
2000	506	574	513	329	360	332	227	297	234	132	169	136
2001	564	631	571	366	397	370	253	329	261	145	187	148
2002	624	683	630	405	429	408	281	357	289	158	202	163
2003	685	725	689	445	454	446	309	379	317	172	212	177
2004	746	761	748	485	475	484	338	396	345	187	218	190
2005	807	792	805	525	491	521	367	409	372	201	220	203
2006	867	819	861	565	503	557	397	419	399	215	220	218
2007	925	842	915	603	512	591	425	425	425	229	217	227
2010	1,079	897	1,055	704	526	580	501	431	491	260	193	251
2015	1,227	983	1,195	792	532	757	563	421	544	263	127	245
2020	1,288	1,088	1,262	800	535	767	556	405	538	204	38	184
2025	1,316	1,216	1,305	766	544	741	507	390	494	99	([1])	81
2030	1,363	1,400	1,366	723	577	708	442	393	437	([1])	([1])	([1])
2035	1,448	1,542	1,458	684	595	675	372	388	374	([1])	([1])	([1])
2040	1,594	1,652	1,601	662	596	655	308	369	314	([1])	([1])	([1])
2045	1,761	1,743	1,759	642	587	636	245	339	255	([1])	([1])	([1])
2050	1,913	1,853	1,906	615	585	611	178	311	192	([1])	([1])	([1])
2055	2,050	1,965	2,040	580	585	580	106	284	125	([1])	([1])	([1])
2060	2,193	2,086	2,180	544	590	549	31	260	54	([1])	([1])	([1])
Trust fund is projected to be first exhausted in	([2])	([2])	([2])	([2])	([2])	([2])	([2])	([2])	([2])	2028	2021	2027

[1] The fund is projected to be exhausted and not to recover before the end of the projection period.

[2] The fund is not projected to be exhausted within the projection period.

Note. The definitions of alternatives I, II-A, II-B, and III, and trust fund ratio are presented in the text. The OASDI ratios shown after the year a given fund is projected to be exhausted are theoretical and are shown for informational purposes only.

CHART 14

PROJECTED OASDI TRUST FUND CONTINGENCY RATIOS, 1988-2065
1989 trustees' report, intermediate II-B projections

(Balance at beginning of year as % of outgo during the year)

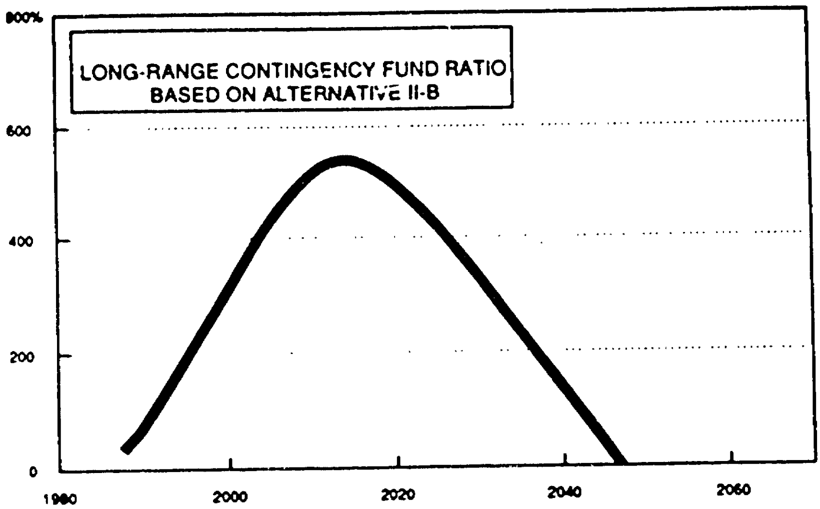


TABLE 14

PROJECTED OASDI TRUST FUND CONTINGENCY RATIOS, 1988-2065
1989 trustees' report

(Balance at beginning of year as % of outgo during the year)

Calendar year	Alternative I			Alternative II-A			Alternative II-B			Alternative III		
	OASI	DI	Total	OASI	DI	Total	OASI	DI	Total	OASI	DI	Total
1989	59	39	57	59	38	57	59	38	57	59	37	57
1990	82	47	79	82	44	78	81	43	77	77	37	73
1991	108	69	104	105	62	101	102	60	98	92	43	87
1992	136	96	132	131	82	126	124	76	120	106	48	100
1993	167	124	163	157	101	152	146	93	141	118	50	111
1994	200	154	196	186	120	179	170	108	164	130	48	121
1995	236	185	231	215	138	207	195	123	188	142	43	131
1996	274	214	268	246	155	236	221	137	212	154	36	140
1997	314	242	307	277	168	265	247	149	237	167	27	150
1998	354	268	345	308	180	294	274	159	262	179	14	159
2000	438	315	425	373	198	353	330	173	312	206	(1)	178
2005	655	477	633	533	276	499	459	240	431	262	(1)	220
2010	855	544	813	674	271	616	571	225	522	309	(1)	245
2015	952	587	905	727	229	657	605	172	546	303	(1)	222
2020	957	627	918	696	171	629	563	102	505	234	(1)	147
2025	937	643	904	632	93	566	485	13	428	121	(1)	32
2030	920	684	895	554	(1)	491	390	(1)	336	(1)	(1)	(1)
2035	931	753	912	479	(1)	418	291	(1)	239	(1)	(1)	(1)
2040	980	818	963	413	(1)	349	195	(1)	143	(1)	(1)	(1)
2045	1,050	857	1,028	348	(1)	280	98	(1)	44	(1)	(1)	(1)
2050	1,116	898	1,091	276	(1)	203	(1)	(1)	(1)	(1)	(1)	(1)
2055	1,175	948	1,150	194	(1)	118	(1)	(1)	(1)	(1)	(1)	(1)
2060	1,237	1,008	1,212	104	(1)	25	(1)	(1)	(1)	(1)	(1)	(1)
2065	1,309	1,061	1,281	7	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Trust fund is estimated to be exhausted in	(2)	(2)	(2)	2065	2029	2060	2049	2025	2046	2029	1998	2025

[1] The fund is estimated to be exhausted in the year shown in the last line of the table.

[2] The fund is not estimated to be exhausted within the projection period.

TABLE 15

PROJECTED OASDI PAYROLL TAXES & INCOME FROM TAXING BENEFITS, 1989-2063
1989 trustees' report

(in percent of taxable payroll)

Calendar year	OASI Payroll tax	OASI Taxation of benefits	OASI Total	DI Payroll tax	DI Taxation of benefits	DI Total	Total Payroll tax	Total Taxation of benefits	Total Total
Alternative I:									
25 years: 1989-2013	11.07	0.23	11.30	1.31	0.02	1.33	12.38	0.25	12.63
50 years: 1989-2038	11.02	.35	11.37	1.36	.02	1.38	12.39	.37	12.76
75 years: 1989-2063	11.01	.40	11.41	1.38	.02	1.40	12.39	.42	12.81
Alternative II-A:									
25 years: 1989-2013	11.07	.25	11.32	1.31	.02	1.33	12.38	.27	12.65
50 years: 1989-2038	11.02	.39	11.42	1.36	.03	1.39	12.38	.42	12.80
75 years: 1989-2063	11.01	.47	11.48	1.38	.03	1.41	12.39	.50	12.89
Alternative II-B:									
25 years: 1989-2013	11.07	.27	11.34	1.31	.02	1.33	12.38	.29	12.67
50 years: 1989-2038	11.02	.42	11.44	1.36	.03	1.39	12.38	.45	12.83
75 years: 1989-2063	11.01	.50	11.51	1.38	.03	1.41	12.38	.54	12.92
Alternative III:									
25 years: 1989-2013	11.07	.30	11.37	1.30	.02	1.33	12.37	.33	12.70
50 years: 1989-2038	11.02	.49	11.51	1.35	.04	1.39	12.38	.52	12.90
75 years: 1989-2063	11.01	.62	11.63	1.37	.04	1.41	12.38	.66	13.04

TABLE 16

PROJECTED OASDI AND HI SHARES OF GNP, 1989-2063
1989 trustees' report

Calendar year	Percentage of GNP: OASDI Income excluding interest	OASDI Outgo	OASDI Balance	HI [1] Income excluding interest	HI [1] Outgo	HI [1] Balance	TOTAL [1] Income excluding interest	TOTAL [1] Outgo	TOTAL [1] Balance	GNP in dollars
Alternative I										
1989	5.39	4.49	0.90	1.32	1.14	0.18	6.71	5.63	1.08	$5,234
1990	5.47	4.47	1.00	1.32	1.18	.14	6.79	5.64	1.14	5,584
1991	5.47	4.41	1.06	1.32	1.19	.13	6.79	5.61	1.19	5,946
1992	5.48	4.36	1.12	1.32	1.21	.11	6.80	5.58	1.23	6,301
1993	5.49	4.31	1.18	1.32	1.23	.09	6.82	5.55	1.27	6,657
1994	5.50	4.26	1.24	1.32	1.25	.07	6.83	5.52	1.31	7,015
1995	5.51	4.21	1.30	1.33	1.27	.06	6.83	5.47	1.36	7,384
1996	5.51	4.16	1.35	1.33	1.28	.05	6.84	5.44	1.39	7,758
1997	5.51	4.12	1.39	1.33	1.29	.03	6.83	5.41	1.42	8,146
1998	5.51	4.09	1.42	1.33	1.30	.03	6.83	5.39	1.45	8,548
2000	5.53	4.03	1.50	1.33	1.32	.01	[illegible]	5.35	1.51	9,445
2005	5.58	3.93	1.64	1.34	1.33	.00	[illegible]	5.27	1.65	12,114
2010	5.61	4.09	1.53	1.34	1.35	-.01	6.96	5.44	1.52	15,298
2015	5.65	4.53	1.12	1.34	1.35	-.01	6.99	5.88	1.11	19,059
2020	5.68	5.10	.58	1.34	1.39	-.05	7.02	6.49	.53	23,621
2025	5.71	5.56	.15	1.34	1.47	-.13	7.05	7.03	.02	29,302
2030	5.72	5.77	-.05	1.34	1.55	-.21	7.06	7.32	-.26	36,587
2035	5.72	5.74	-.01	1.34	1.60	-.26	7.07	7.34	-.28	45,943
2040	5.72	5.56	.16	1.34	1.64	-.30	7.06	7.20	-.14	57,729
2045	5.71	5.41	.30	1.34	1.66	-.32	7.06	7.08	-.02	72,501
2050	5.71	5.34	.37	1.34	1.68	-.34	7.05	7.03	.03	91,093
2055	5.71	5.32	.40	1.34	1.70	-.36	7.05	7.02	.04	114,663
2060	5.71	5.29	.43	1.34	1.72	-.38	7.05	7.01	.05	144,539
Summarized rates [1]										
25-year 1989-2013	5.65	4.16	1.49	1.40	1.29	.11	7.05	5.45	1.60	---
50-year 1989-2038	5.68	4.73	.95	1.37	1.38	-.01	7.05	6.11	.94	---
75-year 1989-2063	5.69	4.92	.77	1.36	1.47	-.11	7.05	6.39	.66	---
Alternative II-A										
1989	5.40	4.53	.87	1.32	1.15	.17	6.72	5.68	1.04	5,204
1990	5.48	4.51	.97	1.32	1.20	.12	6.79	5.71	1.09	5,555
1991	5.48	4.51	.97	1.32	1.23	.09	6.80	5.74	1.05	5,894
1992	5.48	4.49	.99	1.32	1.27	.05	6.80	5.76	1.04	6,238
1993	5.49	4.46	1.02	1.32	1.31	.01	6.81	5.77	1.04	6,601
1994	5.49	4.43	1.05	1.32	1.35	-.03	6.81	5.78	1.03	6,982
1995	5.48	4.41	1.08	1.32	1.38	-.06	6.80	5.79	1.02	7,378
1996	5.49	4.38	1.11	1.32	1.42	-.10	6.80	5.80	1.01	7,793
1997	5.48	4.36	1.12	1.32	1.45	-.13	6.79	5.81	.98	8,232
1998	5.48	4.34	1.13	1.32	1.49	-.17	6.79	5.83	.97	8,669
2000	5.50	4.31	1.18	1.32	1.55	-.24	6.81	5.86	.95	9,887
2005	5.52	4.27	1.25	1.32	1.68	-.37	6.84	5.96	.88	12,711
2010	5.54	4.47	1.06	1.32	1.84	-.52	6.85	6.31	.54	16,435
2015	5.55	4.99	.56	1.31	2.00	-.69	6.86	6.98	-.12	20,900
2020	5.56	5.65	-.09	1.30	2.23	-.93	6.86	7.89	-1.02	26,353
2025	5.57	6.24	-.68	[illegible]	2.51	-1.21	6.86	8.75	-1.88	33,155
2030	5.56	6.60	-1.04	1.29	2.74	-1.45	6.86	9.35	-2.49	41,865
2035	5.55	6.71	-1.16	1.29	2.89	-1.60	6.83	9.60	-2.77	53,060
2040	5.52	6.65	-1.13	1.28	2.96	-1.68	6.80	9.61	-2.81	67,197
2045	5.50	6.61	-1.11	1.27	2.93	-1.71	6.77	9.60	-2.83	84,905
2050	5.48	6.65	-1.18	1.27	3.00	-1.74	6.75	9.66	-2.91	107,143
2055	5.46	6.73	-1.27	1.26	3.02	-1.76	6.72	9.75	-3.03	135,306
2060	5.44	6.77	-1.34	1.26	3.04	-1.79	6.69	9.82	-3.13	171,113
Summarized rates [1]										
25-year 1989-2013	5.62	4.42	1.19	1.39	1.55	-.16	7.00	5.97	1.03	---
50-year 1989-2038	5.59	5.19	.40	1.35	1.98	-.63	6.94	7.17	-.23	---
75-year 1989-2063	5.56	5.60	-.04	1.33	2.26	-.94	6.89	7.87	-.98	---

TABLE 16 (continued)

PROJECTED OASDI AND HI SHARES OF GNP, 1989-2063
1989 trustees' report

(continued)

Calendar year	OASDI[1] Income excluding interest	OASDI[1] Outgo	OASDI[1] Balance	HI[1] Income excluding interest	HI[1] Outgo	HI[1] Balance	TOTAL[1] Income excluding interest	TOTAL[1] Outgo	TOTAL[1] Balance	GNP in dollars
	Percentage of GNP									
Alternative II-B										
1989	5.41	4.53	0.87	1.32	1.15	0.17	6.73	5.69	1.04	$5,200
1990	5.49	4.58	.91	1.32	1.21	.11	6.80	5.79	1.02	5,530
1991	5.47	4.59	.88	1.32	1.25	.07	6.79	5.84	.95	5,884
1992	5.48	4.60	.87	1.32	1.29	.03	6.78	5.88	.89	6,264
1993	5.46	4.58	.87	1.31	1.33	-.01	6.77	5.91	.86	6,684
1994	5.46	4.56	.90	1.31	1.37	-.06	6.77	5.93	.85	7,123
1995	5.46	4.53	.93	1.31	1.41	-.09	6.77	5.94	.83	7,581
1996	5.46	4.51	.95	1.31	1.45	-.13	6.78	5.96	.82	8,066
1997	5.46	4.49	.97	1.31	1.48	-.17	6.77	5.97	.79	8,581
1998	5.45	4.47	.98	1.31	1.52	-.21	6.77	5.99	.77	9,124
2000	5.46	4.45	1.01	1.31	1.60	-.29	6.77	6.04	.73	10,281
2005	5.47	4.41	1.06	1.30	1.74	-.44	6.77	6.15	.62	13,836
2010	5.46	4.60	.86	1.30	1.91	-.61	6.75	6.50	.25	18,640
2015	5.45	5.10	.35	1.28	2.07	-.79	6.73	7.17	-.44	24,515
2020	5.43	5.75	-.32	1.27	2.31	-1.04	6.70	8.06	-1.35	31,871
2025	5.41	6.33	-.92	1.26	2.57	-1.32	6.67	8.90	-2.23	41,596
2030	5.39	6.68	-1.30	1.25	2.80	-1.55	6.63	9.48	-2.84	54,316
2035	5.35	6.77	-1.43	1.23	2.93	-1.69	6.58	9.70	-3.12	71,185
2040	5.30	6.69	-1.40	1.22	2.98	-1.75	6.52	9.67	-3.15	93,233
2045	5.25	6.63	-1.38	1.21	2.99	-1.78	6.46	9.61	-3.15	121,832
2050	5.20	6.63	-1.43	1.20	2.99	-1.79	6.40	9.62	-3.22	158,985
2055	5.16	6.67	-1.51	1.19	2.99	-1.80	6.35	9.66	-3.32	207,639
2060	5.11	6.68	-1.57	1.18	3.00	-1.82	6.29	9.68	-3.39	271,546
Summarized rates:[1]										
25-year 1989-2013	5.58	4.54	1.03	1.38	1.59	-.21	6.95	6.13	.82	---
50-year 1989-2038	5.50	5.31	.19	1.32	2.04	-.72	6.82	7.35	-.53	---
75-year 1989-2063	5.41	5.71	-.29	1.29	2.32	-1.03	6.70	8.02	-1.32	---
Alternative III										
1989	5.43	4.67	.76	1.33	1.18	.14	6.75	5.85	.90	5,086
1990	5.44	4.78	.66	1.30	1.25	.05	6.75	6.03	.72	5,358
1991	5.38	4.80	.58	1.30	1.30	-.01	6.68	6.10	.58	5,778
1992	5.40	4.88	.52	1.30	1.37	-.07	6.70	6.25	.45	6,178
1993	5.42	5.08	.34	1.30	1.45	-.15	6.72	6.53	.19	6,435
1994	5.38	5.03	.34	1.29	1.51	-.22	6.67	6.54	.13	6,954
1995	5.37	5.03	.34	1.29	1.58	-.29	6.66	6.61	.08	7,444
1996	5.38	5.04	.35	1.29	1.65	-.36	6.67	6.68	-.01	7,980
1997	5.39	5.05	.34	1.29	1.73	-.43	6.68	6.77	-.09	8,494
1998	5.39	5.06	.33	1.29	1.80	-.51	6.68	6.86	-.18	9,057
2000	5.40	5.04	.36	1.29	1.96	-.67	6.69	7.00	-.31	10,295
2005	5.39	4.99	.39	1.28	2.33	-1.05	6.67	7.33	-.66	14,229
2010	5.36	5.18	.18	1.27	2.79	-1.53	6.62	7.97	-1.35	18,456
2015	5.33	5.74	-.42	1.25	3.32	-2.07	6.57	9.06	-2.49	26,108
2020	5.30	6.51	-1.21	1.23	3.99	-2.77	6.52	10.50	-3.98	34,629
2025	5.28	7.26	-1.98	1.21	4.72	-3.51	6.48	11.98	-5.50	45,680
2030	5.23	7.83	-2.60	1.19	5.32	-4.13	6.42	13.15	-6.73	60,256
2035	5.18	8.16	-2.98	1.18	5.66	-4.48	6.35	13.82	-7.46	79,579
2040	5.12	8.32	-3.20	1.16	5.75	-4.59	6.28	14.07	-7.79	104,781
2045	5.06	8.49	-3.43	1.14	5.74	-4.60	6.20	14.24	-8.03	137,306
2050	5.01	8.76	-3.75	1.13	5.72	-4.59	6.13	14.47	-8.34	179,180
2055	4.96	9.05	-4.09	1.11	5.70	-4.59	6.07	14.74	-8.67	233,552
2060	4.90	9.26	-4.36	1.10	5.69	-4.58	6.00	14.95	-8.95	304,882
Summarized rates:[1]										
25-year 1989-2013	5.51	5.04	.47	1.36	2.01	-.65	6.58	7.06	-.18	---
50-year 1989-2038	5.40	6.01	-.61	1.29	3.21	-1.92	6.69	9.23	-2.53	---
75-year 1989-2063	5.30	6.76	-1.46	1.25	3.88	-2.63	6.55	10.64	-4.09	---

[1] Effects of the Medicare Catastrophic Coverage Act of 1988 are not reflected in this table.

TABLE 17

PROJECTED OASDI BENEFIT AMOUNTS & REPLACEMENT RATES, 1989-2065
1989 trustees' report, intermediate II-B projections

(Benefits as a % of pre-retirement earnings)

Calendar year	CURRENT DOLLARS Low[1]	CURRENT DOLLARS Average	CURRENT DOLLARS Maximum[2]	CONSTANT DOLLARS Low[1]	CONSTANT DOLLARS Average	CONSTANT DOLLARS Maximum[2]	PERCENT OF EARNINGS Low[1]	PERCENT OF EARNINGS Average	PERCENT OF EARNINGS Maximum[2]
Age-65 retirement									
1989	5,016	8,022	10,795	5,016	8,022	10,795	57.5	41.4	24.0
1990	5,256	8,657	11,712	5,031	8,286	11,210	56.8	42.2	24.4
1995	6,690	11,051	15,352	5,212	8,609	11,959	55.8	41.5	24.6
2000	8,663	14,309	20,628	5,547	9,162	13,208	55.8	41.5	25.4
2005	10,840	17,903	26,758	5,705	9,422	14,082	53.9	40.1	25.4
2010	13,550	22,382	34,440	5,861	9,682	14,896	52.1	38.7	25.2
2015	17,542	28,980	45,450	6,237	10,304	16,159	52.1	38.7	25.7
2020	22,439	37,068	58,388	6,557	10,832	17,063	51.4	38.2	25.5
2025	27,306	45,102	71,089	6,559	10,833	17,075	48.3	35.8	24.0
2030	35,354	58,398	92,070	6,980	11,528	18,176	48.3	35.8	24.0
2035	45,768	75,593	119,149	7,427	12,266	19,334	48.3	35.8	24.0
2040	59,254	97,867	154,278	7,903	13,052	20,576	48.3	35.9	24.0
2045	76,720	126,710	199,748	8,410	13,890	21,896	48.4	35.9	24.0
2050	99,320	164,038	258,601	8,949	14,780	23,300	48.4	35.9	24.0
2055	128,578	212,365	334,780	9,522	15,727	24,791	48.4	35.8	24.0
2060	166,468	274,938	433,358	10,132	16,735	26,378	48.4	35.9	24.0
2065	215,504	355,940	560,874	10,781	17,807	28,065	48.4	35.9	24.0

[1] Earnings equal to 45 percent of average.

[2] Earnings equal to the SSA contribution and benefit base.

TABLE 18

FINANCIAL OPERATIONS OF OASDI TRUST FUNDS, 1960-88

[In millions]

Fiscal year[1]	Income: Total	Income: Net contributions[2]	Income: Income from taxation of benefits	Income: Payments from the general fund of the Treasury[3]	Income: Net interest[4]	Disbursements: Total	Disbursements: Benefit payments[5]	Disbursements: Administrative expenses	Disbursements: Transfers to Railroad Retirement program	Interfund borrowing transfers[6]	Net increase in funds	Funds at end of period
Past experience												
1960	$11,394	$10,830	—	—	$564	$11,606	$10,798	$234	$574	—	-$212	$22,996
1965	17,681	17,032	—	—	648	17,456	16,618	379	459	—	224	22,187
1970	36,127	34,096	—	$458	1,572	30,275	29,063	623	589	—	5,851	37,720
1975	66,677	63,374	—	499	2,804	64,658	62,547	1,101	1,010	—	2,018	48,138
1980	117,427	114,413	—	675	2,339	118,548	115,624	1,494	1,430	—	-1,121	32,246
1981	134,565	131,606	—	670	2,289	139,584	136,267	1,703	1,614	—	-5,019	27,228
1982	148,027	145,113	—	843	2,072	155,963	152,097	2,046	1,820	—	-7,936	19,290
1983	170,280	155,163	—	7,391	7,725	170,058	165,569	2,210	2,279	$12,437	12,660	31,950
1984	178,461	172,946	$2,275	125	3,114	178,199	173,603	2,170	2,426	—	262	32,212
1985	197,865	192,181	3,368	105	2,211	188,504	183,959	2,192	2,353	-1,824	7,538	39,750
1986	215,461	205,146	3,558	3,310	3,447	198,730	193,869	2,209	2,653	-10,613	6,117	45,867
1987	226,893	218,878	3,307	69	4,638	207,323	202,430	2,279	2,614	—	19,570	65,437
1988	258,090	248,145	3,390	55	6,500	219,290	213,907	2,532	2,851	—	38,800	104,237

[1]Under the Congressional Budget Act of 1974 (Public Law 93-344), fiscal years 1977 and later consist of the 12 months ending on September 30 of each year. The act further provides that the calendar quarter July-September 1976 is a period of transition from fiscal year 1976, which ended on June 30, 1976, to fiscal year 1977, which began on October 1, 1976.

[2]Beginning in 1983, includes government contributions on deemed wage credits for military service in 1957 and later. The amount shown for 1983 includes, in addition to the annual contributions on 1983 wage credits, a net amount of $5,790 million representing (1) retroactive contributions on deemed wage credits for military service in 1957-82, less (2) all reimbursements received prior to 1983 for the costs of such credits. An adjustment to these amounts totaling $528 million was transferred to the trust funds from the general fund of the Treasury in 1984.

[3]Includes payments (1) in 1947-52 and in 1967 and later, for costs of noncontributory wage credits for military service performed before 1957, (2) in 1972-83, for costs of deemed wage credits for military service performed after 1956, and (3) in 1969 and later, for costs of benefits to certain uninsured persons who attained age 72 before 1968.

[4]Net interest includes net profits or losses on marketable investments. Beginning in 1967, administrative expenses are charged currently to the trust funds on an estimated basis, with a final adjustment, including interest, made in the following fiscal year. The amounts of these interest adjustments are included in net interest. For years prior to 1967, a description of the method of accounting for administrative expenses is contained in the 1970 Annual Report. Beginning in 1983, these figures reflect payments from a borrowing trust fund to a lending trust fund for interest on amounts owed under the interfund borrowing provisions. Also, beginning in 1983, interest paid from the trust funds to the general fund of the Treasury on advance tax transfers is reflected. The amount shown for 1983 includes $7,337 million in interest on (1) retroactive government contributions on deemed wage credits for military service in 1957-82, and (2) unnegotiated benefit checks issued before 1983. The amount shown for 1984 includes an interest adjustment of $1,901 million on government contributions on deemed wage credits for military service in 1957-83. The amounts shown for 1985 and 1986 include interest adjustments of $91.3 million and $11.5 million, respectively, on unnegotiated checks issued before April 1985.

[5]Beginning in 1967, includes payments for vocational rehabilitation services furnished to disabled persons receiving benefits because of their disabilities. Beginning in 1983, amounts are reduced by amount of reimbursement for unnegotiated benefit checks. The amount shown for 1983 is reduced by $336 million for all unnegotiated checks issued before 1983; reductions in subsequent years are relatively small.

[6]Positive figure represents amounts lent to the OASI Trust Fund from the HI Trust Fund. Negative figures represent amounts repaid from the OASI Trust Fund to the HI Trust Fund.

TABLE 19

Estimated operations of the OASI, DI, and HI Trust Funds under present law on the basis of the 1983 Trustees Report alternative II-B assumptions, calendar years 1982-92

(Amounts in billions)

Calendar year	Income					Outgo					Interfund borrowing transfers 1/		
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	HI
1982	$125.2	$22.7	$147.9	$38.0	$185.9	$142.1	$18.0	$160.1	$36.1	$196.3	$17.5	-$5.1	-$12.4
1983	151.4	20.9	172.2	44.7	216.9	151.6	17.9	169.5	41.2	210.7	---	---	---
1984	163.9	17.1	180.9	45.6	226.5	162.3	18.0	180.3	46.6	226.8	-.5	---	.5
1985	180.4	18.3	198.7	51.3	250.0	175.2	18.6	193.8	52.3	246.1	---	---	---
1986	194.9	19.6	214.5	58.4	273.0	190.2	19.6	209.9	58.0	267.9	-1.1	---	1.1
1987	210.2	21.0	231.2	62.5	293.7	204.6	20.6	225.2	64.1	289.2	-2.4	---	2.4
1988	239.7	23.8	263.4	66.0	329.5	219.2	21.7	240.8	71.0	311.8	-8.4	---	8.4
1989	259.5	25.5	285.1	70.0	355.0	233.6	22.9	256.5	78.4	334.8	-5.1	5.1	---
1990	283.1	30.7	313.8	73.9	387.7	248.4	24.3	272.7	86.6	359.3	---	---	---
1991	305.2	33.4	338.6	77.8	416.4	263.9	25.9	289.8	95.1	384.9	---	---	---
1992	329.5	36.1	365.6	81.8	447.4	280.0	27.7	307.7	104.5	412.1	---	---	---

Calendar year	Net increase in funds					Funds at end of year					Assets at beginning of year as a percentage of outgo during year 2/				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1982	$0.6	-$0.4	$0.2	-$10.6	-$10.3	$22.1	$2.7	$24.8	$8.2	$32.9	15%	17%	15%	52%	22%
1983	-.3	3.0	2.7	3.5	6.3	21.8	5.7	27.5	11.7	39.2	15	15	15	20	16
1984	1.0	-.9	.1	-.5	-.4	22.8	4.8	27.6	11.2	38.9	20	38	22	25	23
1985	5.2	-.4	4.9	-1.0	3.9	28.1	4.4	32.5	10.2	42.7	20	32	21	21	21
1986	3.6	(3/)	3.6	1.5	5.1	31.7	4.4	36.1	11.8	47.9	22	29	23	18	22
1987	3.2	.4	3.6	.8	4.5	34.9	4.8	39.7	12.6	52.3	23	28	23	18	22
1988	12.1	2.1	14.2	3.5	17.7	46.9	6.9	53.9	16.1	70.0	23	30	24	18	23
1989	20.9	7.7	28.6	-8.4	20.2	67.8	14.6	82.4	7.8	90.2	28	38	29	21	27
1990	34.8	6.3	41.1	-12.6	28.5	102.6	21.0	123.5	-4.9	118.7	35	69	38	9	31
1991	41.4	7.4	48.8	-17.3	31.5	143.9	28.4	172.3	-22.2	150.1	47	89	51	-5	37
1992	49.5	8.4	57.9	-22.7	35.2	193.5	36.8	230.2	-44.9	185.4	59	111	64	-21	42

1/ Positive figures represent amounts borrowed by the trust fund or recoveries of prior loans to other trust funds; negative figures represent amounts loaned by the trust fund or repayments of prior loans from other trust funds.

2/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for January.

3/ Between $0 and -$50 million.

Note: The estimated operations for HI and for OASDI and HI combined in 1990 and later are theoretical because the HI Trust Fund would be depleted in that year under this set of assumptions.

Social Security Administration
Office of the Actuary
June 24, 1983

TABLE 20

Estimated operations of the OASI, DI, and HI Trust Funds under present law on the basis of the 1983 Trustees Report alternative III assumptions, calendar years 1982-92

(Amounts in billions)

Calendar year	Income					Outgo					Interfund borrowing transfers 1/		
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	HI
1982	$125.2	$22.7	$147.9	$38.0	$185.9	$142.1	$18.0	$160.1	$36.1	$196.3	$17.5	-$5.1	-$12.4
1983	150.3	20.7	171.0	44.4	215.4	151.7	17.9	169.6	41.2	210.8	---	---	---
1984	159.6	16.7	176.3	44.5	220.8	162.5	18.0	180.5	46.8	227.4	---	---	---
1985	177.5	18.0	195.5	50.5	246.0	174.5	18.6	193.2	54.1	247.2	---	---	---
1986	195.2	19.6	214.8	58.2	273.0	187.3	19.5	206.8	61.9	268.7	---	---	---
1987	213.5	21.3	234.8	62.6	297.5	206.3	21.1	227.4	70.5	297.9	-12.4	---	12.4
1988	246.5	24.4	270.9	66.5	337.4	224.4	22.7	247.0	80.4	327.4	---	---	---
1989	269.5	26.4	295.9	70.2	366.2	242.6	24.4	267.0	91.2	358.1	-5.1	5.1	---
1990	296.3	32.0	328.3	73.7	402.0	261.2	26.4	287.6	103.3	390.9	---	---	---
1991	321.4	35.0	356.4	76.7	433.1	295.3	29.4	324.6	116.3	441.0	---	---	---
1992	347.2	37.9	385.1	79.5	464.6	316.2	31.8	348.0	130.7	478.7	---	---	---

Calendar year	Net increase in funds					Funds at end of year					Assets at beginning of year as a percentage of outgo during year 2/				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1982	$0.6	-$0.4	$0.2	-$10.6	-$10.3	$22.1	$2.7	$24.8	$8.2	$32.9	15%	17%	15%	52%	22%
1983	-1.4	2.8	1.4	3.2	4.6	20.6	5.5	26.2	11.4	37.6	15	15	15	20	16
1934	-2.9	-1.4	-4.3	-2.3	-6.6	17.7	4.2	21.9	9.1	31.0	19	37	21	24	22
1985	3.0	-.7	2.3	-3.6	-1.3	20.7	3.5	24.2	5.5	29.7	17	29	18	17	18
1986	7.9	.1	8.0	-3.7	4.3	28.6	3.6	32.2	1.8	34.0	18	25	19	9	17
1987	-5.2	.2	-5.0	4.5	-.5	23.4	3.8	27.2	6.3	33.6	21	24	21	3	17
1988	22.2	1.7	23.9	-13.9	10.0	45.5	5.5	51.1	-7.5	43.5	18	24	19	8	16
1989	21.9	7.1	29.0	-20.9	8.0	67.4	12.6	80.0	-28.5	51.6	26	30	27	-8	18
1990	35.2	5.6	40.7	-29.6	11.1	102.6	18.2	120.8	-58.1	62.7	34	56	36	-28	19
1991	26.2	5.6	31.8	-39.7	-7.9	128.7	23.8	152.6	-97.7	54.8	42	70	45	-50	20
1992	31.0	6.1	37.1	-51.2	-14.0	159.7	30.0	189.7	-148.9	40.8	48	83	51	-75	17

1/ Positive figures represent amounts borrowed by the trust fund or recoveries of prior loans to other trust funds; negative figures represent amounts loaned by the trust fund or repayments of prior loans from other trust funds.

2/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for January.

Note: The estimated operations for HI and for OASDI and HI combined in 1988 and later are theoretical because the HI Trust Fund would be depleted in that year under this set of assumptions.

Social Security Administration
Office of the Actuary
June 24, 1983

Table 21.--Estimated operations of the OASI and DI Trust Funds under present law on the basis of the alternative II-B assumptions from the 1989 Trustees Report, fiscal years 1988-98

(Amounts in billions)

Fiscal year	Income			Outgo		
	OASI	DI	OASDI	OASI	DI	OASDI
1988	$235.7	$22.4	$258.1	$197.0	$22.3	$219.3
1989	262.4	24.7	287.1	208.9	23.3	232.2
1990	284.2	28.7	312.8	223.9	24.8	248.7
1991	308.6	31.8	340.4	239.9	26.3	266.2
1992	330.9	34.0	365.0	255.5	28.0	283.5
1993	359.2	36.9	396.1	271.8	30.1	301.8
1994	387.7	39.7	427.4	288.1	32.2	320.3
1995	416.4	42.6	458.9	304.6	34.5	339.1
1996	447.4	45.6	493.0	321.9	37.1	359.0
1997	479.4	48.7	528.1	340.0	39.9	379.9
1998	513.8	52.0	565.8	359.2	43.2	402.4

Fiscal year	Net increase in funds			Funds at end of year			Assets at beginning of year as a percentage of outgo during year1/		
	OASI	DI	OASDI	OASI	DI	OASDI	OASI	DI	OASDI
1988	$38.7	$0.1	$38.8	$97.0	$7.3	$104.2	37%	39%	37%
1989	53.5	1.4	54.9	150.5	8.7	159.2	54	38	53
1990	60.2	3.9	64.1	210.7	12.5	223.3	75	42	72
1991	68.6	5.6	74.2	279.4	18.1	297.5	96	55	92
1992	75.4	6.0	81.4	354.8	24.1	378.9	117	72	113
1993	87.5	6.8	94.3	442.3	30.9	473.2	139	88	134
1994	99.6	7.5	107.1	541.9	38.4	580.3	161	104	156
1995	111.8	8.0	119.8	653.7	46.5	700.1	186	119	179
1996	125.5	8.5	134.1	779.2	55.0	834.2	211	133	203
1997	139.4	8.8	148.2	918.6	63.8	982.5	237	145	228
1998	154.6	8.9	163.5	1073.2	72.7	1145.9	264	155	252

1/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for October.

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Table 22.--Estimated operations of the OASI and DI Trust Funds under present law on the basis of the alternative III assumptions from the 1989 Trustees Report, fiscal years 1988-98

(Amounts in billions)

Fiscal year	Income			Outgo		
	OASI	DI	OASDI	OASI	DI	OASDI
1988	$235.7	$22.4	$258.1	$197.0	$22.3	$219.3
1989	258.5	24.3	282.8	209.0	23.7	232.7
1990	273.3	27.5	300.7	225.4	25.7	251.0
1991	297.3	30.5	327.8	244.4	27.8	272.2
1992	322.4	32.8	355.1	265.1	30.5	295.5
1993	342.7	34.5	377.3	286.9	33.6	320.6
1994	370.0	36.9	406.9	307.3	36.9	344.2
1995	398.4	39.4	437.8	327.9	40.5	368.4
1996	428.3	41.9	470.2	349.7	44.6	394.3
1997	460.0	44.3	504.3	372.5	49.2	421.7
1998	492.8	46.7	539.6	396.7	54.4	451.1

Fiscal year	Net increase in funds			Funds at end of year			Assets at beginning of year as a percentage of outgo during year1/		
	OASI	DI	OASDI	OASI	DI	OASDI	OASI	DI	OASDI
1988	$38.7	$0.1	$38.8	$97.0	$7.3	$104.2	37%	39%	37%
1989	49.5	.6	50.1	146.4	7.9	154.3	54	37	53
1990	47.9	1.8	49.7	194.4	9.7	204.1	72	37	69
1991	52.9	2.7	55.6	247.3	12.4	259.7	87	42	82
1992	57.3	2.3	59.6	304.6	14.7	319.3	101	47	95
1993	55.8	.9	56.7	360.4	15.6	376.0	113	50	107
1994	62.7	(2/)	62.7	423.1	15.6	438.7	124	49	116
1995	70.5	-1.1	69.4	493.6	14.5	508.1	136	45	126
1996	78.6	-2.7	75.9	572.2	11.8	584.0	148	38	136
1997	87.5	-4.9	82.6	659.7	6.9	666.7	161	30	145
1998	96.2	-7.7	88.5	755.9	-.7	755.1	173	18	155

1/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for October.

2/ DI income and outgo differ in this year by less than $50 million.

Note: The estimated operations for DI, and for OASI and DI combined, in 1998 and later are theoretical because the DI Trust Fund would be depleted in that year.

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Table 23.--Estimated operations of the OASI, DI, and HI Trust Funds under present law on the basis of the President's Fiscal Year 1991 Budget assumptions, fiscal years 1988-95

(Amounts in billions)

Fiscal year	Income					Outgo				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1988	$235.7	$22.4	$258.1	$68.0	$326.1	$197.0	$22.3	$219.3	$52.7	$272.0
1989	260.5	24.5	284.9	75.1	360.1	209.1	23.4	232.5	58.2	290.7
1990	281.7	28.5	310.2	80.4	390.6	223.5	24.8	248.3	63.6	311.9
1991	310.3	32.2	342.5	86.9	429.4	238.4	26.3	264.7	66.6	331.3
1992	335.8	34.7	370.4	93.9	464.4	252.9	28.0	280.9	74.1	355.0
1993	366.0	37.8	403.8	101.6	505.5	267.9	29.9	297.7	80.8	378.6
1994	394.8	40.7	435.5	108.9	544.4	282.8	31.9	314.7	88.1	402.8
1995	421.4	43.4	464.8	115.3	580.1	297.6	34.0	331.6	95.7	427.3

Fiscal year	Net increase in funds					Funds at end of year					Assets at beginning of year as a percentage of outgo during year1/				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1988	$38.7	$0.1	$38.8	$15.3	$54.1	$97.0	$7.3	$104.2	$65.9	$170.1	37%	39%	37%	96%	49%
1989	51.4	1.1	52.4	16.9	69.3	148.3	8.4	156.7	82.8	239.4	54	38	53	113	65
1990	58.2	3.7	61.9	16.8	78.7	206.5	12.1	218.6	99.6	318.1	74	40	71	130	83
1991	71.9	5.8	77.8	20.3	98.1	278.4	17.9	296.3	119.9	416.2	94	53	90	149	102
1992	82.8	6.7	89.5	19.8	109.3	361.2	24.6	385.8	139.7	525.5	118	72	113	162	123
1993	98.1	7.9	106.1	20.8	126.9	459.4	32.5	491.9	160.5	652.4	143	90	138	173	145
1994	112.0	8.9	120.8	20.8	141.6	571.3	41.4	612.7	181.3	794.0	171	110	165	182	168
1995	123.8	9.4	133.2	19.6	152.8	695.1	50.8	745.9	200.9	946.8	200	129	193	189	192

1/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year, plus the respective OASI and DI advance tax transfers for October.

Social Security Administration
Office of the Actuary
January 11, 1990

TABLE 24

CURRENT LAW PROJECTIONS OF THE OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUND OUTLAYS, INCOMES, AND BALANCES UNDER CBO'S BASELINE SET OF ECONOMIC ASSUMPTIONS
(By fiscal year, in billions of dollars)

FISCAL YEARS	1989	1990	1991	1992	1993	1994	1995
				OASI			
TOTAL OUTLAYS	210.1	224.8	240.2	255.5	271.6	287.9	305.0
INCOME a/	261.5	286.8	309.3	334.6	362.2	392.0	423.4
YEAR-END-BALANCE	148.3	210.3	279.3	358.4	449.0	553.0	671.4
START OF YEAR BALANCE AS PERCENT OF OUTLAYS b/	54	74	96	117	140	164	190
				DI			
TOTAL OUTLAYS	23.5	24.9	26.5	28.1	29.9	31.8	33.8
INCOME a/	24.6	29.0	31.9	34.5	37.2	40.2	43.4
YEAR-END-BALANCE	8.4	12.4	17.9	24.2	31.5	40.0	49.6
START OF YEAR BALANCE AS PERCENT OF OUTLAYS b/	38	42	55	72	90	108	127
				OASI AND DI			
TOTAL OUTLAYS	233.6	249.7	266.8	283.7	301.5	319.7	338.8
INCOME a/	286.1	315.8	341.2	369.1	399.4	432.2	466.8
YEAR-END-BALANCE	156.7	222.7	297.2	382.6	480.6	593.0	721.0
START OF YEAR BALANCE AS PERCENT OF OUTLAYS b/	53	71	92	114	136	159	184

SOURCE: Congressional Budget Office estimates based on January 1990 baseline assumptions.

a/ Income to the trust funds is budget authority, and includes payroll tax receipts, interest on investments, and certain general fund transfers.

b/ Start of year balances are computed as the balances at the end of the previous year plus the advanced tax transfers on October 1.

TABLE 25

ECONOMIC ASSUMPTIONS, 1960-2065
1989 trustees' report

	Average annual percentage increase in—					
Calendar year	Real GNP[1]	Average annual wage in covered employment	Consumer Price Index[2]	Real-wage differential[3] (percent)	Average annual interest rate[4] (percent)	Average annual unemployment rate[5] (percent)
Past experience:						
1960-64	3.9	3.4	1.3	2.1	3.7	5.7
1965-69	4.4	5.4	3.4	2.0	5.2	3.8
1970-74	2.4	6.3	6.1	.1	6.7	5.4
1975	-1.3	6.7	9.2	-2.5	7.4	8.5
1976	4.9	8.7	5.7	3.0	7.1	7.7
1977	4.7	7.3	6.5	.8	7.1	7.1
1978	5.3	9.7	7.6	2.1	8.2	6.1
1979	2.5	9.8	11.4	-1.6	9.1	5.8
1980	-.2	8.7	13.5	-4.7	11.0	7.1
1981	1.9	9.9	10.3	-.4	13.3	7.6
1982	-2.5	6.5	6.0	.5	12.8	9.7
1983	3.6	[6]4.8	3.0	[6]1.8	11.0	9.6
1984	6.8	[6]6.5	3.4	[6]3.0	12.4	7.5
1985	3.4	[6]4.4	3.5	[6].8	10.8	7.2
1986	2.8	[6]4.1	1.6	[6]2.5	8.0	7.0
1987	3.4	[6]5.8	3.6	[6]2.2	8.4	6.2
Alternative I:						
1988	3.9	6.4	4.0	2.4	8.8	5.5
1989	3.7	6.4	3.8	2.6	9.3	5.2
1990	3.6	5.5	3.0	2.4	8.7	5.0
1991	3.6	5.4	2.8	2.5	7.8	5.0
1992	3.4	5.0	2.5	2.5	6.9	4.9
1993	3.3	4.7	2.3	2.5	6.2	4.9
1994	3.2	4.4	2.1	2.3	5.5	4.8
1995	3.2	4.1	2.0	2.1	4.9	4.7
1996	3.0	4.0	2.0	2.0	4.7	4.7
1997	2.9	4.1	2.0	2.1	4.9	4.7
1998	2.9	4.1	2.0	2.1	5.0	4.7
2000	3.1	4.3	2.0	2.2	5.0	5.0
2010 & later[7]	2.6	4.2	2.0	2.2	5.0	5.0
Alternative II-A:						
1988	3.9	6.4	4.0	2.4	8.8	5.3
1989	3.2	6.0	3.9	2.1	9.3	5.2
1990	3.2	5.5	3.7	1.8	9.0	5.1
1991	3.1	5.1	3.2	1.9	8.2	5.1
1992	2.9	5.0	3.0	2.0	7.5	5.1
1993	2.8	5.0	3.0	2.0	6.7	5.2
1994	2.7	4.9	3.0	1.9	6.2	5.2
1995	2.6	4.7	3.0	1.7	5.8	5.2
1996	2.6	4.7	3.0	1.7	5.6	5.2
1997	2.6	4.8	3.0	1.8	5.6	5.2
1998	2.5	4.7	3.0	1.7	5.6	5.2
2000	2.6	4.8	3.0	1.7	5.5	5.5
2010 & later[7]	2.1	4.7	3.0	1.7	5.5	5.5
Alternative II-B:						
1988	3.8	6.4	4.0	2.4	8.8	5.5
1989	2.6	6.2	4.8	1.4	9.5	5.4
1990	2.6	5.3	4.5	.8	9.4	5.5
1991	2.6	5.5	4.5	1.0	9.1	5.5
1992	2.5	5.6	4.3	1.2	8.6	5.5
1993	2.5	5.8	4.2	1.6	8.0	5.5
1994	2.4	5.6	4.0	1.6	7.4	5.5
1995	2.3	5.5	4.0	1.5	6.9	5.5
1996	2.3	5.5	4.0	1.5	6.6	5.6
1997	2.3	5.6	4.0	1.8	6.4	5.6
1998	2.2	5.4	4.0	1.4	6.2	5.8
2000	2.2	5.4	4.0	1.3	6.0	6.0
2010 & later[7]	1.8	5.3	4.0	1.3	6.0	6.0
Alternative III:						
1988	3.8	5.2	4.0	1.2	8.8	5.5
1989	-.6	4.7	5.4	-.8	9.7	5.9
1990	.9	5.4	5.8	-.4	10.1	6.7
1991	2.4	6.4	6.4	([8])	10.5	6.4
1992	1.2	5.8	6.3	-.5	10.3	6.2
1993	-.7	4.8	5.0	-.3	9.6	7.2
1994	2.7	6.8	5.3	1.5	8.8	6.9
1995	1.9	5.9	5.0	.9	7.9	6.7
1996	1.8	5.9	5.0	.9	7.5	6.6
1997	1.6	6.0	5.0	1.0	7.2	6.5
1998	1.6	5.8	5.0	.8	6.8	6.5
2000	1.7	5.9	5.0	.8	6.5	7.0
2010 & later[7]	1.2	5.8	5.0	.8	6.5	7.0

[1]The real GNP (gross national product) is the value of total output of goods and services, expressed in 1982 dollars.

[2]The Consumer Price Index is the average of the 12 monthly values of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).

[3]The real-wage differential is the difference between the percentage increases, before rounding, in (1) the average annual wage in covered employment, and (2) the average annual Consumer Price Index.

[4]The average annual interest rate is the average of the nominal interest rates, which, in practice, are compounded semiannually, for special public-debt obligations issuable to the trust funds in each of the 12 months of the year.

[5]Through 1998, the rates shown are crude civilian unemployment rates. After 1998, the rates are total rates (including military personnel), adjusted by age and sex based on the estimated total labor force on July 1, 1988.

[6]Preliminary.

[7]This value is for 2010. The annual percentage increase in real GNP is assumed to continue to change after 2010 for each alternative to reflect the dependence of labor force growth on the size and age-sex distribution of the population. The increases for 2065 are 2.7, 1.8, 1.5, and 0.5 percent for alternatives I, II-A, II-B, and III, respectively.

[8]This value is between 0.05 percent and -0.05 percent.

TABLE 26

ECONOMIC ASSUMPTIONS, 1989-2065
1989 trustees' report

(GNP & taxable payroll in billions)

Calendar year	Adjusted CPI[1]	SSA average wage index[1]	Taxable payroll[a]	Gross national product	Compound interest-rate factor[a]
Alternative I:					
1989	100 00	$20,703	$2,284	$5,234	1 0000
1990	103 04	21,807	2,431	5,584	1 0865
1991	105 94	22,933	2,593	5,946	1 1752
1992	108 60	24,030	2,752	6,301	1 2582
1993	111 07	25,125	2,911	6,657	1 3373
1994	113 37	26,174	3,072	7,015	1 4120
1995	115 64	27,207	3,236	7,384	1.4816
1996	117 95	28,246	3,400	7,758	1 5527
1997	120 31	29,342	3,569	8,146	1.6291
1998	122.71	30,475	3,746	8,548	1.7114
2000	127 87	33,088	4,148	9,445	1.8890
2005	140 96	40,646	5,341	12,114	2.4178
2010	155 63	49,929	6,759	15,298	3 0946
2015	171 83	61,332	8,431	19,059	3 9609
2020	189 71	75,341	10,449	23,621	5 0697
2025	209 46	92,548	12,961	29,302	6 4889
2030	231 26	113,686	16,182	36,587	8 3053
2035	255 33	139,651	20,319	45,943	10 6302
2040	281 90	171,547	25,531	57,729	13 6060
2045	311 25	210,728	32,063	72,501	17 4147
2050	343 64	258,858	40,284	91,093	22 2897
2055	379 41	317,980	50,707	114,663	28 5293
2060	418 90	390,605	63 918	144,539	36 5156
2065	462 49	479,818	80,562	182,179	46.7375
Alternative II-A:					
1989	100 00	20,480	2,275	5,204	1 0000
1990	103 72	21,585	2,417	5,555	1 0916
1991	107 03	22,650	2,571	5,894	1 1831
1992	110 25	23,739	2 724	6,238	1.2730
1993	113 56	24,888	2 881	6,601	1 3594
1994	116 96	26,057	3,046	6,982	1 4455
1995	120 47	27,242	3,219	7,378	1.5304
1996	124 08	28,460	3,398	7,793	1.6177
1997	127.81	29,756	3,585	8,232	1 7100
1998	131.64	31,080	3,784	8,689	1 8076
2000	139 66	34,070	4,222	9,687	2 0147
2005	161 90	42 866	5,535	12,711	2 6425
2010	187.69	53,932	7,139	16,435	3 4660
2015	217 58	67,854	9,046	20,900	4 5460
2020	252 23	85,371	11,351	26,353	5 9626
2025	292 41	107,410	14,212	33 155	7 8206
2030	338 98	135,138	17,858	41,865	10 2576
2035	392 97	170,024	22,524	53,060	13 4541
2040	455 56	213,916	28,389	67,197	17 6465
2045	528 12	269,139	35,697	84,905	23 1454
2050	612 24	338,618	44,830	107,143	30 3577
2055	709 75	426,033	56,342	135,306	39 8178
2060	822 80	536,015	70,910	171,113	52 2252
2065	953.85	674,389	89,272	216,458	68.4992
Alternative II-B.					
1989	100 00	20,522	2,274	5 200	1 0000
1990	104 48	21,583	2,405	5,530	1 0965
1991	109 16	22,717	2,563	5,884	1.1989
1992	113.89	23,933	2,724	6,264	1.3037
1993	118.65	25,275	2,903	6,684	1 4102
1994	123 43	26,645	3,093	7,123	1.5167
1995	128 37	28,066	3,294	7,581	1.3225
1996	133 50	29,554	3,502	8,066	1.7305
1997	138 84	31,144	3,723	8,581	1 8424
1998	144.39	32,777	3,957	9,124	1.9582
2000	156.17	36,343	4,455	10,291	2 2035
2005	190.01	47,051	6,000	13,936	2 9600
2010	231.18	60,913	7,965	18,640	3 8761
2015	281.28	78,859	10,389	24,515	5 3410
2020	342.20	102,092	13,419	31,971	7.1744
2025	416 34	132,170	17,291	41,596	9 6373
2030	506 54	171,110	22,362	54,316	12.9456

TABLE 26 (continued)

ECONOMIC ASSUMPTIONS, 1989-2065
1989 trustees' report

(GNP & taxable payroll in billions)

(Continued)

Calendar year	Adjusted CPI[1]	SSA average wage index[2]	Taxable payroll[3]	Gross national product	Compound interest-rate factor[4]
Alternative II-B (Cont.)					
2035	616.28	$221.522	$29.026	$71.185	17.3896
2040	749.80	286.787	37.653	93.233	23.3592
2045	912.24	371.280	48.732	121.832	31.3780
2050	1,109.89	480.665	62.985	158.965	42.1496
2055	1,350.34	622.278	81.474	207.639	56.6188
2060	1,642.90	805.613	105.533	271.546	76.0551
2065	1,998.84	1,042.962	136.739	355.237	102.1635
Alternative III					
1989	100.00	20.028	2.220	5.066	1.0000
1990	105.84	21.073	2.307	5.358	1.1030
1991	112.65	22.355	2.476	5.779	1.2217
1992	119.73	23.615	2.653	6.178	1.3513
1993	125.68	24.685	2.768	6.435	1.4842
1994	132.31	26.281	2.970	6.954	1.6172
1995	138.92	27.762	3.176	7.444	1.7473
1996	145.87	29.339	3.401	7.960	1.8813
1997	153.16	31.022	3.633	8.494	2.0186
1998	150.82	32.760	3.877	9.057	2.1584
2000	177.30	36.670	4.395	10.295	2.4516
2005	226.29	48.611	6.013	14.229	3.3708
2010	288.81	64.442	8.124	19.456	4.6345
2015	368.60	85.427	10.761	26.108	6.3721
2020	470.44	113.246	14.068	34.628	8.7611
2025	600.41	150.125	18.293	45.680	12.0458
2030	766.29	199.012	23.785	60.256	16.5619
2035	978.01	263.820	30.965	79.579	22.7713
2040	1,248.21	349.733	40.189	104.781	31.3087
2045	1,593.07	463.623	51.914	137.306	43.0468
2050	2,033.21	614.601	66.780	179.180	59.1858
2055	2,594.94	814.745	85.804	233.552	81.3757
2060	3,311.88	1,080.066	110.415	304.882	111.8848
2065	4,226.89	1,431.787	142.168	398.234	153.8324

[1]The CPI used to adjust OASDI benefits is the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), as defined by the Bureau of Labor Statistics, Department of Labor. The values shown are adjusted by dividing the average of the 12 monthly values of the CPI by the analogous value for 1989, and multiplying the result by 100, thereby initializing the CPI at 100 for 1989.

[2]The "SSA average wage index" is defined in section 215(i)(1)(G) of the Social Security Act; it is used in the calculations of initial benefits and the automatic adjustment of the contribution and benefit base and other wage-indexed program amounts.

[3]Taxable payroll consists of total earnings subject to OASDI contribution rates, adjusted to include deemed wages based on military service and to reflect the lower effective contribution rates (compared to the combined employee-employer rate) which apply to multiple-employer "excess wages."

[4]The compound-interest-rate factor is based on the average of the assumed annual interest rates for special public-debt obligations issuable to the trust funds in the 12 months of the year, under each alternative.

TABLE 27

DEMOGRAPHIC ASSUMPTIONS, 1940-2065
1989 trustees' report

Calendar year	Total fertility rate[1]	Age-sex-adjusted death rate[2] (per 100,000)	Life expectancy[3]: At birth, Male	At birth, Female	At age 65, Male	At age 65, Female
Past experience:						
1940	2.23	1,532.8	61.4	65.7	11.9	13.4
1945	2.42	1,366.4	62.9	68.4	12.6	14.4
1950	3.03	1,225.3	65.6	71.1	12.8	15.1
1955	3.50	1,134.2	66.7	72.8	13.1	15.6
1960	3.61	1,128.6	66.7	73.2	12.9	15.9
1965	2.88	1,103.6	66.8	73.8	12.9	16.3
1970	2.43	1,041.8	67.1	74.9	13.1	17.1
1975	1.77	934.0	68.7	76.6	13.7	18.0
1976	1.74	923.2	69.1	76.8	13.7	18.1
1977	1.80	898.0	69.4	77.2	13.9	18.3
1978	1.76	892.4	69.6	77.3	13.9	18.3
1979	1.82	864.2	70.0	77.7	14.2	18.6
1980	1.85	878.0	69.9	77.5	14.0	18.4
1981	1.83	853.4	70.4	77.9	14.2	18.6
1982	1.83	827.8	70.8	78.2	14.5	18.8
1983	1.81	835.0	70.9	78.1	14.3	18.6
1984	1.80	828.2	71.1	78.2	14.4	18.7
1985	1.84	830.0	71.1	78.2	14.4	18.6
1986	1.84	821.8	71.2	78.3	14.5	18.7
1987	1.88	808.5	71.5	78.4	14.9	18.7
1988[4]	1.91	801.1	71.6	78.6	14.9	18.8
Alternative I:						
1989	1.92	797.8	71.7	78.6	14.9	18.8
1990	1.93	794.3	71.8	78.7	15.0	18.8
1995	1.99	773.9	72.4	78.9	15.0	18.9
2000	2.05	760.9	72.8	79.1	15.0	18.9
2005	2.11	749.8	73.0	79.3	15.1	18.9
2010	2.17	739.5	73.2	79.5	15.2	19.0
2015	2.20	729.9	73.4	79.6	15.3	19.1
2020	2.20	720.7	73.5	79.7	15.3	19.2
2025	2.20	711.7	73.7	79.9	15.4	19.3
2030	2.20	703.0	73.8	80.0	15.5	19.4
2035	2.20	694.4	74.0	80.2	15.6	19.5
2040	2.20	686.1	74.1	80.3	15.7	19.6
2045	2.20	678.0	74.3	80.4	15.8	19.7
2050	2.20	670.2	74.4	80.6	15.9	19.8
2055	2.20	662.5	74.6	80.7	15.9	19.9
2060	2.20	655.1	74.7	80.9	16.0	20.0
2065	2.20	647.8	74.9	81.0	16.1	20.1
Alternatives II-A and II-B:						
1989	1.91	801.9	71.7	78.7	15.0	18.9
1990	1.91	794.5	71.8	78.9	15.1	19.0
1995	1.91	756.3	72.1	79.5	15.4	19.3
2000	1.91	725.1	72.7	80.1	15.6	19.6
2005	1.91	694.5	73.5	80.5	15.8	19.8
2010	1.90	673.2	74.1	80.8	16.0	20.1
2015	1.90	656.6	74.4	81.1	16.2	20.3
2020	1.90	641.1	74.6	81.4	16.4	20.5
2025	1.90	626.3	74.9	81.7	16.6	20.7
2030	1.90	611.9	75.2	82.0	16.8	20.9
2035	1.90	598.1	75.5	82.3	16.9	21.1
2040	1.90	584.8	75.7	82.6	17.1	21.4
2045	1.90	571.9	76.0	82.8	17.3	21.6
2050	1.90	559.5	76.3	83.1	17.5	21.8
2055	1.90	547.5	76.5	83.4	17.7	22.0
2060	1.90	536.0	76.8	83.6	17.8	22.2
2065	1.90	524.8	77.0	83.9	18.0	22.4
Alternative III:						
1989	1.90	806.9	71.8	78.8	15.1	19.0
1990	1.88	796.3	71.9	79.1	15.2	19.1
1995	1.82	754.6	72.3	80.1	15.8	19.8
2000	1.75	735.9	72.0	80.7	16.2	20.4
2005	1.69	682.6	73.2	81.4	16.6	20.8
2010	1.63	623.2	75.0	82.3	17.0	21.2
2015	1.60	587.6	76.0	82.9	17.4	21.6
2020	1.60	561.8	76.5	83.4	17.8	22.0
2025	1.60	539.2	77.0	84.0	18.2	22.5
2030	1.60	517.8	77.4	84.5	18.6	22.9
2035	1.60	497.3	77.9	85.0	18.9	23.3
2040	1.60	477.6	78.4	85.5	19.3	23.7
2045	1.60	458.7	78.8	86.0	19.7	24.1
2050	1.60	440.7	79.3	86.5	20.1	24.5
2055	1.60	423.5	79.8	87.1	20.5	24.9
2060	1.60	407.2	80.3	87.6	20.9	25.4
2065	1.60	391.7	80.8	88.1	21.3	25.8

[1]The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birthrates by age observed in, or assumed for, the selected year, and if she were to survive the entire child-bearing period. The ultimate total fertility rate is assumed to be reached in 2013.

[2]The age-sex-adjusted death rate is the crude rate that would occur in the enumerated total population as of April 1, 1980, if that population were to experience the death rates by age and sex observed in, or assumed for, the selected year.

[3]The life expectancy for any year is the average number of years of life remaining for a person if that person were to experience the death rates by age observed in, or assumed for, the selected year.

[4]Estimated

CHART 28

PROJECTED WORKERS PER OASDI BENEFICIARY, 1988-2065
1989 trustees' report

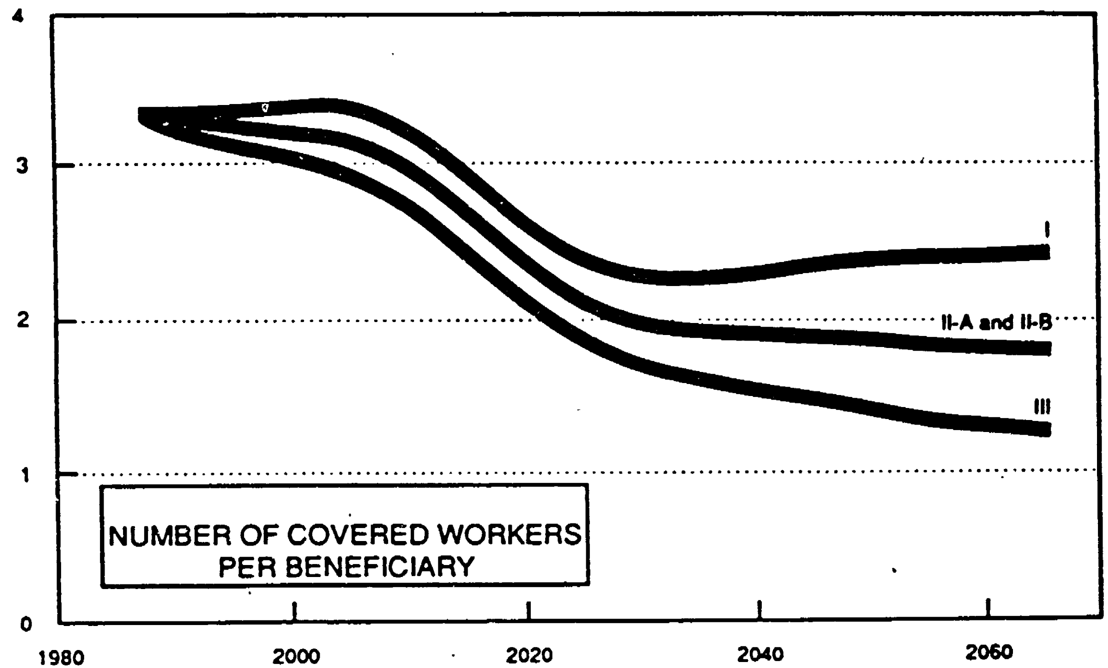

TABLE 28

PROJECTED WORKERS PER OASDI BENEFICIARY, 1988-2065
1989 trustees' report

Calendar year	Covered workers[1] (in thousands)	Beneficiaries[2] (in thousands) OASI	DI	Total	Covered workers per OASDI beneficiary	Beneficiaries per 100 covered workers
Past experience						
1945	46,930	1,106	—	1,106	42.4	2
1950	48,280	2,930	—	2,930	16.5	6
1955	65,200	7,563	—	7,563	8.6	12
1960	72,530	13,740	522	14,262	5.1	20
1965	80,680	18,509	1,648	20,157	4.0	25
1970	93,090	22,618	2,568	25,186	3.7	27
1975	100,200	26,998	4,125	31,123	3.2	31
1980	112,212	30,385	4,734	35,119	3.2	31
1985	[3]119,853	32,776	3,874	36,650	3.3	[3]31
1986	[3]122,700	33,349	3,972	37,321	3.3	[3]30
1987	[3]124,900	33,917	4,034	37,952	3.3	[3]30
1988	[3]128,000	34,343	4,077	38,421	3.3	[3]30
Alternative I.						
1989	129,910	34,788	4,112	38,901	3.3	30
1990	131,565	35,438	4,125	39,563	3.3	30
1995	138,987	37,332	4,266	41,598	3.3	30
2000	145,795	38,396	4,794	43,189	3.4	30
2005	152,450	39,537	5,414	44,951	3.4	29
2010	156,955	42,306	6,130	48,436	3.2	31
2015	159,321	47,620	6,551	54,172	2.9	34
2020	160,747	54,348	6,783	61,130	2.6	38
2025	162,331	60,582	7,152	67,734	2.4	42
2030	165,004	65,192	7,151	72,343	2.3	44
2035	168,673	67,447	7,099	74,546	2.3	44
2040	172,536	67,531	7,192	74,724	2.3	43
2045	176,397	67,393	7,506	74,899	2.4	42
2050	180,424	67,944	7,753	75,696	2.4	42
2055	184,683	69,143	7,937	77,081	2.4	42
2060	189,723	70,500	8,086	78,586	2.4	41
2065	194,668	71,822	8,306	80,128	2.4	41
Alternative II-A.						
1989	129,772	34,791	4,121	38,913	3.3	30
1990	131,281	35,452	4,166	39,618	3.3	30
1995	137,521	37,536	4,538	42,074	3.3	31
2000	143,377	38,947	5,270	44,217	3.2	31
2005	149,002	40,467	6,104	46,571	3.2	31
2010	152,593	43,551	7,034	50,585	3.0	33
2015	153,595	49,190	7,601	56,791	2.7	37
2020	153,168	56,275	7,892	64,167	2.4	42
2025	152,396	62,876	8,300	71,175	2.1	47
2030	152,183	67,958	8,250	76,209	2.0	50
2035	152,539	70,725	8,136	78,861	1.9	52
2040	152,776	71,281	8,177	79,458	1.9	52
2045	152,664	71,494	8,451	79,945	1.9	52
2050	152,355	72,272	8,602	80,874	1.9	53
2055	152,162	73,472	8,621	82,093	1.9	54
2060	152,183	74,475	8,552	83,027	1.8	55
2065	152,248	75,096	8,567	83,663	1.8	55
Alternative II-B:						
1989	129,538	34,791	4,121	38,913	3.3	30
1990	130,708	35,452	4,166	39,618	3.3	30
1995	136,765	37,536	4,538	42,074	3.3	31
2000	142,124	38,944	5,268	44,212	3.2	31
2005	147,400	40,462	6,099	46,560	3.2	32
2010	150,989	43,542	7,024	50,566	3.0	33
2015	151,997	49,176	7,586	56,762	2.7	37
2020	151,591	56,255	7,873	64,129	2.4	42
2025	150,826	62,849	8,277	71,127	2.1	47
2030	150,613	67,925	8,225	76,151	2.0	51
2035	150,950	70,684	8,110	78,794	1.9	52
2040	151,192	71,232	8,149	79,381	1.9	53
2045	151,088	71,438	8,422	79,860	1.9	53
2050	150,776	72,208	8,572	80,780	1.9	54
2055	150,592	73,400	8,592	81,992	1.8	54
2060	150,606	74,396	8,523	82,920	1.8	55
2065	150,672	75,018	8,537	83,553	1.8	55
Alternative III.						
1989	129,049	34,794	4,147	38,941	3.3	30
1990	128,276	35,465	4,244	39,710	3.2	31
1995	133,604	37,726	5,029	42,756	3.1	32
2000	138,702	39,445	5,899	45,344	3.1	33
2005	142,672	41,329	7,018	48,347	3.0	34
2010	145,190	44,741	8,207	52,948	2.7	36
2015	144,906	50,763	8,930	59,693	2.4	41
2020	142,821	58,322	9,265	67,587	2.1	47
2025	140,001	65,458	9,705	75,163	1.9	54
2030	137,233	71,275	9,589	80,864	1.7	59
2035	134,680	74,911	9,409	84,320	1.6	63
2040	131,775	76,402	9,394	85,796	1.5	65
2045	128,318	77,486	9,623	87,109	1.5	68
2050	124,434	79,021	9,638	88,659	1.4	71
2055	120,526	80,702	9,420	90,123	1.3	75
2060	116,916	81,741	9,040	90,781	1.3	78
2065	113,482	81,923	8,777	90,700	1.3	80

[1] Workers who pay OASDI taxes at some time during the year

[2] Beneficiaries with monthly benefits in current-payment status as of June 30

[3] Preliminary

Table 29. -- Social Security Tax Rates Under Present Law and Under the Moynihan and Sasser Proposals

Year	Present Law					Moynihan Bill					Sasser Proposal		
	OASI	DI	OASDI	HI	OASDHI	OASI	DI	OASDI	HI	OASDHI	OASDI	HI	OASDHI
1989	5.53	0.53	6.06	1.45	7.51	5.53	0.53	6.06	1.45	7.51	6.06	1.45	7.51
1990	5.60	0.60	6.20	1.45	7.65	5.48	0.58	6.06	1.45	7.51	6.20	1.45	7.65
1991	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	5.73	1.45	7.18
1992	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	5.55	1.45	7.00
1993	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	5.20	1.45	6.65
1994	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	5.00	1.45	6.45
1995	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	4.85	1.45	6.30
1996	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	4.65	1.45	6.10
1997	5.60	0.60	6.20	1.45	7.65	4.52	0.58	5.10	1.45	6.55	4.55	1.45	6.00
2000	5.49	0.71	6.20	1.45	7.65	4.43	0.67	5.10	1.45	6.55	(rates after 1997 not specified)		
2012	5.49	0.71	6.20	1.45	7.65	4.80	0.80	5.60	1.45	7.05			
2015	5.49	0.71	6.20	1.45	7.65	5.38	0.82	6.20	1.45	7.65			
2020	5.49	0.71	6.20	1.45	7.65	6.15	0.85	7.00	1.45	8.45			
2025	5.49	0.71	6.20	1.45	7.65	6.82	0.88	7.70	1.45	9.15			
2045	5.49	0.71	6.20	1.45	7.65	7.19	0.91	8.10	1.45	9.55			

Sources: Internal Revenue Code, S. 2016, materials from office of Senator Sasser

Table 30. -- Annual Employee Tax Payments Under Alternative Proposals

	Year	Tax in dollars		
		Present Law	Moynihan bill	Sasser proposal
$30,000 earner:	1990	2295	2253	2295
	1991	2295	1965	2154
	1995	2295	1965	1890
	2000	2295	1965	*
	2025	2295	2745	*
	2045	2295	2865	*
$50,000 earner:	1990	3825	3755	3825
	1991	3825	3275	3590
	1995	3825	3275	3150
	2000	3825	3275	*
	2025	3825	4575	*
	2045	3825	4775	*

* Sasser proposal does not indicate rates in effect after 1997

Source: Computed on basis of rates shown in Table 29.

Table 31.--Estimated operations of the OASI and DI Trust Funds under a proposal by Senator Moynihan to lower OASDI tax rates 1/, on the basis of the alternative II-B assumptions from the 1989 Trustees Report, calendar years 1988-98

(Amounts in billions)

Calendar year	Income			Outgo		
	OASI	DI	OASDI	OASI	DI	OASDI
1988	$240.8	$22.7	$263.5	$200.0	$22.5	$222.5
1989	269.1	25.2	294.3	212.0	23.7	235.7
1990	286.5	29.1	315.5	228.0	25.2	253.2
1991	259.1	31.2	290.4	243.7	26.7	270.4
1992	272.6	33.5	306.1	259.6	28.5	288.1
1993	290.2	36.1	326.3	276.1	30.6	306.7
1994	308.8	38.7	347.5	292.3	32.8	325.1
1995	328.0	41.5	369.5	308.9	35.1	344.1
1996	348.3	44.3	392.7	326.4	37.8	364.2
1997	369.5	47.3	416.7	344.8	40.7	385.5
1998	392.2	50.3	442.5	364.3	44.0	408.3

Calendar year	Net increase in funds			Funds at end of year			Assets at beginning of year as a percentage of outgo during year 2/		
	OASI	DI	OASDI	OASI	DI	OASDI	OASI	DI	OASDI
1988	$40.7	$0.2	$41.0	$102.9	$6.9	$109.8	41%	38%	41%
1989	57.1	1.5	58.6	160.0	8.3	168.3	59	38	57
1990	58.5	3.9	62.4	218.5	12.2	230.7	81	43	77
1991	15.5	4.6	20.0	233.9	16.8	250.7	98	56	94
1992	13.0	5.0	18.0	246.9	21.8	268.7	99	69	96
1993	14.1	5.5	19.6	261.0	27.3	288.3	98	81	96
1994	16.4	5.9	22.4	277.5	33.2	310.7	98	93	97
1995	19.1	6.3	25.4	296.6	39.5	336.1	98	104	99
1996	21.9	6.6	28.5	318.5	46.1	364.6	100	114	101
1997	24.7	6.6	31.2	343.2	52.6	395.8	101	123	103
1998	27.8	6.3	34.2	371.0	59.0	430.0	103	129	106

1/ OASDI employee and employer tax rates would revert to 6.06 percent for 1990. For 1991-2014, the OASDI employee and employer tax rate would equal 5.1 percent.

2/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for January.

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Table 32.--Estimated operations of the OASI and DI Trust Funds under a proposal by Senator Moynihan to lower OASDI tax rates 1/, on the basis of the alternative III assumptions from the 1989 Trustees Report, calendar years 1988-98

(Amounts in billions)

Calendar year	Income OASI	Income DI	Income OASDI	Outgo OASI	Outgo DI	Outgo OASDI
1988	$240.8	$22.7	$263.5	$200.0	$22.5	$222.5
1989	263.1	24.6	287.7	212.2	24.2	236.5
1990	275.1	27.8	302.9	229.8	26.1	256.0
1991	249.3	29.8	279.1	249.0	28.4	277.4
1992	263.3	32.0	295.4	270.5	31.2	301.8
1993	273.2	33.4	306.6	292.6	34.5	327.1
1994	289.6	35.6	325.2	312.4	37.7	350.1
1995	306.4	37.8	344.2	333.3	41.4	374.7
1996	324.4	40.1	364.5	355.4	45.7	401.1
1997	342.7	42.2	384.9	378.4	50.4	428.8
1998	361.5	44.5	405.9	403.0	55.8	458.8

Calendar year	Net increase in funds OASI	Net increase in funds DI	Net increase in funds OASDI	Funds at end of year OASI	Funds at end of year DI	Funds at end of year OASDI	Assets at beginning of year as a percentage of outgo during year 2/ OASI	DI	OASDI
1988	$40.7	$0.2	$41.0	$102.9	$6.9	$109.8	41%	38%	41%
1989	50.9	.3	51.2	153.6	7.2	161.0	59	37	57
1990	45.3	1.6	46.9	199.1	8.8	207.9	77	36	73
1991	.3	1.4	1.7	199.4	10.2	209.6	88	40	83
1992	-7.2	.8	-6.4	192.2	11.1	203.2	82	42	77
1993	-19.4	-1.0	-20.4	172.8	10.0	182.8	73	40	70
1994	-22.8	-2.1	-24.9	150.0	7.9	157.9	63	35	60
1995	-26.9	-3.6	-30.5	123.1	4.3	127.4	53	27	50
1996	-31.0	-5.6	-36.6	92.1	-1.3	90.7	42	17	39
1997	-35.8	-8.2	-43.9	56.3	-9.5	46.8	32	5	29
1998	-41.5	-11.3	-52.9	14.8	-20.8	-6.1	22	-10	18

1/ OASDI employee and employer tax rates would revert to 6.06 percent for 1990. For 1991-2014, the OASDI employee and employer tax rate would equal 5.1 percent.

2/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for January.

Note: The estimated operations for DI, and for OASI and DI combined, in 1996 and later are theoretical because the DI Trust Fund would be depleted in that year.

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Table 33.--Estimated operations of the OASI and DI Trust Funds under a proposal by Senator Sasser to lower OASDI tax rates 1/, on the basis of the alternative II-B assumptions from the 1989 Trustees Report, calendar years 1988-98

(Amounts in billions)

Calendar year	Income OASI	Income DI	Income OASDI	Outgo OASI	Outgo DI	Outgo OASDI
1988	$240.8	$22.7	$263.5	$200.0	$22.5	$222.5
1989	269.1	25.2	294.3	212.0	23.7	235.7
1990	292.2	30.0	322.2	228.0	25.2	253.2
1991	291.0	32.4	323.4	243.7	26.7	270.3
1992	301.0	34.9	335.8	259.5	28.5	288.0
1993	301.9	37.6	339.5	276.0	30.6	306.6
1994	309.7	39.2	348.9	292.3	32.8	325.0
1995	320.1	40.0	360.1	308.9	35.1	344.1
1996	324.7	42.5	367.1	326.5	37.8	364.2
1997	334.0	45.2	379.2	344.9	40.7	385.6
1998	351.3	48.0	399.3	364.5	44.0	408.5

Calendar year	Net increase in funds OASI	Net increase in funds DI	Net increase in funds OASDI	Funds at end of year OASI	Funds at end of year DI	Funds at end of year OASDI	Assets at beginning of year as a percentage of outgo during year 2/ OASI	DI	OASDI
1988	$40.7	$0.2	$41.0	$102.9	$6.9	$109.8	41%	38%	41%
1989	57.1	1.5	58.6	160.0	8.3	168.3	59	38	57
1990	64.2	4.8	69.0	224.2	13.2	237.4	81	43	77
1991	47.3	5.7	53.0	271.5	18.9	290.4	102	60	98
1992	41.5	6.4	47.9	313.0	25.3	338.3	114	76	110
1993	26.0	7.0	32.9	338.9	32.3	371.2	122	93	119
1994	17.4	6.4	23.8	356.3	38.7	395.0	124	108	123
1995	11.2	4.8	16.0	367.5	43.5	411.0	124	119	123
1996	-1.8	4.7	2.9	365.7	48.3	414.0	120	124	121
1997	-10.8	4.5	-6.4	354.8	52.7	407.6	114	127	115
1998	-13.1	4.0	-9.2	341.7	56.7	398.4	105	129	108

1/ OASDI employee and employer tax rates would be lowered starting in 1991. See accompanying memorandum for the proposed OASDI tax rate schedule.

2/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for January.

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January 29, 1990

NOTE: 1998 projections assume continuation of 1997 tax rates.

Table 34.--Estimated operations of the OASI and DI Trust Funds under a proposal by Senator Sasser to lower OASDI tax rates 1/, on the basis of the alternative III assumptions from the 1989 Trustees Report, calendar years 1988-98

(Amounts in billions)

Calendar year	Income			Outgo		
	OASI	DI	OASDI	OASI	DI	OASDI
1988	$240.8	$22.7	$263.5	$200.0	$22.5	$222.5
1989	263.1	24.6	287.7	212.2	24.2	236.5
1990	280.6	28.7	309.3	229.8	26.1	256.0
1991	280.2	30.9	311.1	249.0	28.4	277.4
1992	291.7	33.4	325.1	270.4	31.2	301.7
1993	285.7	34.9	320.6	292.5	34.5	327.0
1994	291.9	36.2	328.1	312.3	37.7	350.1
1995	300.3	36.5	336.8	333.3	41.4	374.7
1996	302.7	38.3	341.1	355.5	45.7	401.2
1997	308.7	40.2	348.9	378.5	50.4	428.9
1998	320.9	42.1	363.0	403.1	55.8	458.9

	Net increase in funds			Funds at end of year			Assets at beginning of year as a percentage of outgo during year 2/		
	OASI	DI	OASDI	OASI	DI	OASDI	OASI	DI	OASDI
1988	$40.7	$0.2	$41.0	$102.9	$6.9	$109.8	41%	38%	41%
1989	50.9	.3	51.2	153.8	7.2	161.0	59	37	57
1990	50.8	2.6	53.3	204.6	9.7	214.4	77	37	73
1991	31.2	2.6	33.8	235.8	12.3	248.1	91	43	86
1992	21.2	2.1	23.4	257.1	14.5	271.5	96	48	91
1993	-6.8	.5	-6.3	250.3	14.9	265.2	96	50	91
1994	-20.4	-1.5	-21.9	229.9	13.4	243.3	88	48	83
1995	-32.9	-5.0	-37.9	196.9	8.5	205.4	76	40	72
1996	-52.7	-7.4	-60.1	144.2	1.1	145.3	62	26	58
1997	-69.8	-10.3	-80.0	74.4	-9.2	65.2	45	9	41
1998	-82.2	-13.7	-95.9	-7.8	-22.9	-30.7	25	-10	21

1/ OASDI employee and employer tax rates would be lowered starting in 1991. See accompanying memorandum for the proposed OASDI tax rate schedule.
2/ Assets at beginning of year are defined for the OASI and DI Trust Funds as assets at end of prior year plus the respective OASI and DI advance tax transfers for January.

Note: The estimated operations for DI, and for OASI and DI combined, in 1997 and later are theoretical because the DI Trust Fund would be depleted in that year.

Social Security Administration
Office of the Actuary
January 29, 1990

NOTE: 1998 Projections assume continuation of 1997 tax rates.

PREPARED STATEMENT OF CHARLES A. BOWSHER

Mr. Chairman and Members of the Committee: I am pleased to be here today to discuss our views on Senator Moynihan's proposal to return Social Security to a pay-as-you-go basis. This proposal forces the Congress and the American people to face squarely the budget deficit problem and to deal with the blue smoke and mirrors that have characterized our budget process for several years now. I would like to commend you, Mr. Chairman, for promptly scheduling these hearings, which provide an appropriate forum for airing these issues.

Last year, Senator Moynihan asked us to review the current Social Security financing plan. In our report [1] to him and later in this statement, I present our views on the potentially desirable economic effects of accumulating reserves as well as the implications of the current financing plan for Federal budget policy.

I am pleased that a public debate has begun on these important issues. The caliber of the debate is important—it must be grounded in fact, not fiction. And, it must involve honest discourse. We have difficult financing decisions to make and serious fiscal problems to solve. We need to disclose fully the real status of our current fiscal affairs to make informed judgments. We must face the facts.

Senator Moynihan is correct in focusing attention on the extent to which Social Security reserves have masked the general fund deficit. I believe, in fact, that the luxury of these reserves has provided a convenient excuse for avoiding the tough choices needed to cut the general fund deficit. This discouraging story is told in table 1, which is attached to my statement.

The actual 1989 general fund deficit [2] was $275 billion—$8 billion larger than this deficit in 1985, the year before Gramm-Rudman-Hollings took effect. Despite the intended pressures of Gramm-Rudman-Hollings, we have failed to reduce the underlying deficit in government operations.

The value of the Senator's proposal is that it compels us to focus on numbers like these. Unfortunately, however, attention has been diverted by suggestions that his proposal would lead to cuts in Social Security benefits. This assertion is not correct. The Senator merely proposes to return Social Security to pay-as-you-go; which is how it has operated over most of the last half century.

The administration proposes to deal with the masking of the general fund deficit by creating the Social Security Integrity and Debt Reduction Fund. But, this proposal doesn't even start until fiscal year 1993 and is then phased in over 3 years. Even if the administration's budget forecast is correct, however, this delay will add over $1 trillion in new debt, raising our total debt to about $4 trillion—four times the debt at the beginning of the 1980s.

Moreover, I fear that the administration has not presented a plan that deals forthrightly with the fundamental fiscal imbalance. The Congressional Budget Office projections included in table 1 may represent a more accurate forecast of where our current policies will take us. They indicate that if we continue on our current path, the general fund deficit will actually grow to $303 billion by 1995. In these CBO projections, the national debt rises by over $1.5 trillion, and gross interest payments soar to $334 billion by 1995. At that level, interest could well be the largest item in the Federal budget, having surpassed defense and Social Security. In the mid-1970s, interest was only about $30 billion.

ACCUMULATING SOCIAL SECURITY RESERVES—AN OPPORTUNITY TO INCREASE LONG-TERM ECONOMIC GROWTH

As you know, under the current financing plan for the Social Security cash benefits programs, trust fund revenues are substantially greater than needed to meet current benefit payments. This situation is likely to continue for about the next 40 years. Over that period, the balance in the Social Security trust fund could increase from a little more than $160 billion today to something like $12 trillion in 2030.

Last year, Senator Moynihan asked us to review this financing plan and to report our views about it, focusing particularly on the implications of the plan for Federal budget policy and the long-run health of the economy. We gave him our analysis just about 1 year ago.

In our report, we noted that the baby boom generation will begin retiring in about 2010 and that, beginning then, the burden of supporting this nation's aged would increase significantly. Whereas today some 3.3 workers support each Social Security beneficiary, by 2030 each beneficiary will be supported by only 2 workers.

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[1] *Social Security: The Trust Fund Accumulation, the Economy, and the Federal Budget* (GAO/HRD-89-44, Jan. 19, 1989).

[2] Technically known as the Federal funds deficit.

The impact of this higher burden on the welfare of tomorrow's workers depends largely on the behavior of our economy between now and then. If our economy does not grow, or grows only very little, higher future burdens can be borne by tomorrow's workers only if they are willing to accept a lower standard of living than today's workers enjoy. In contrast, if we adopt policies today that help our economy experience steady and sustained growth over the next several decades, future workers can bear the heavier burden and still experience rising living standards.

We reported that increasing our national savings rate may be the single most important step we can take if we want to promote sustained and steady growth in future living standards. And we emphasized that the single most important step we can take today to increase national savings is to deal with our Federal budget deficit.

If we were able finally to balance the Federal budget, our savings rate would be significantly higher than it has been in recent years, but it would still remain low in comparison to the savings rates of many of our international competitors. In this regard, the scheduled buildup of large Social Security reserves provides us with a unique opportunity to further increase our savings rate and reduce the gap between us and our competitors. But we can take advantage of this opportunity only if we manage the rest of our budget intelligently.

In particular, the surpluses in the Social Security account will help us deal with future burdens only if they represent net additions to savings. These surpluses will not help us deal with the future if they serve merely as an excuse to avoid making other budget deficit reductions.

In our report to Senator Moynihan, we concluded that the scheduled Social Security surpluses represented an appropriate fiscal policy for the 1990s, *as long as they represented a new source of national savings.* We cautioned against accumulating these large Social Security reserves, however, if they merely represented an excuse for inattention to the deficit problems elsewhere in our Federal budget.

THE ILLUSION OF CURRENT BUDGET POLICY

We share Senator Moynihan's concern that under the current Gramm-Rudman-Hollings process, the growing Social Security surpluses are serving more as a substitute for other deficit reduction actions than as a net addition to national savings. Under Gramm-Rudman-Hollings, deficit reduction is focused on the total deficit. As you know, that measure represents the combination of the Social Security surplus and the deficit in the rest of the budget. In fact, in the fiscal year just ended, the reported total deficit of $152 billion represented the combination of a deficit of $275 billion in the general fund, offset by surpluses of $52 billion in Social Security and $71 billion in all the other trust funds.

By helping us to meet the Gramm-Rudman-Hollings targets, rising Social Security surpluses are allowing us to avoid the steps necessary to make substantial progress in dealing with the general fund deficit. Virtually all of the progress we appear to have made in dealing with our budget deficit can be traced to increasing surpluses in Social Security—and, to a lesser extent, in other trust fund accounts.

Last year we proposed restructuring the Federal budget accounts to depict more clearly the various important fiscal relationships within the budget. Specifically, we recommended maintaining the unified budget concept but separating the unified budget into six constituent parts: into general, trust, and enterprise funds, with each of these subdivided to distinguish between operating and capital activities.[3] Such a change would provide full disclosure of the government's financial operations while retaining the discipline of presenting the combined effect of all government activities on the Treasury's cash financing needs. The government's financial results for fiscal year 1988 are presented using this format in table 2 at the end of my statement.

From a budget disclosure standpoint, the six-part budget would highlight the extent to which deficit reduction activities deal with the deficit in the general fund. As we proposed to the National Economic Commission, for example, the Gramm-Rudman-Hollings targets could then be revised to focus on both the pace at which the budget is to be balanced and the extent to which the proper balance is stuck between current consumption and capital investment. This should help us make the tough choices necessary to bring the general fund deficit under control.

We are pleased that the Office of Management and Budget acknowledges the merit of an alternative budget presentation such as this. While not the official pres-

[3] *Managing the Cost of Government: Proposals for Reforming Federal Budgeting Practices* (GAO/AFMD-90-1, Oct. 1989).

entation, this year's budget submission shows how the fiscal year 1991 budget estimates look when displayed in our six-part format.

ENDING THE ILLUSION

As long as the rising Social Security surplus allows us to avoid dealing with the general fund deficit, we are not taking full advantage of the potential to add to national savings. If we do not use the accumulating Social Security reserves to increase our national savings rate, we will be in no better position to meet our obligations to future retirees than we would be if we had remained under pay-as-you-go financing and were forced to reduce the general fund deficit through other means.

The current Social Security financing plan requires workers to pay a higher payroll tax than would be necessary under a pay-as-you-go system. They are left with the impression that this tax is being used to build reserves to help pay for their future benefits. We urge the Congress to take the steps necessary to ensure that this reserve accumulation has real economic meaning.

If such steps are not taken, we are using this revenue to finance other general fund expenditures—expenditures that we seem to be unwilling to ask taxpayers to pay for explicitly. In this case, the growing reserve is merely an illusion.

We must end this illusion. We must restore honesty to the budget debate. We must deal forthrightly with our fiscal imbalances. We must face the facts.

As I noted earlier, the CBO baseline projects an increase of $1.5 trillion in our national debt by 1995. Simply returning to pay-as-you-go involves potential revenue losses of about $60 billion a year. We would be very concerned if such a change were made in the absence of additional and offsetting spending reductions or revenue increases. Without these additional actions, we could add another $300 billion to this growing debt burden, running the total up close to $5 trillion.

Unless the deficit problem is solved, it will hamstring the government's ability to achieve vital policy goals; it will make it very difficult to begin addressing the nation's unmet needs; and it could sap our long-run economic vitality.

To solve our fiscal imbalance, our political leadership needs to negotiate a multiyear, politically sustainable budget strategy. We hope that Senator Moynihan's proposal will provide the catalyst to compel action.

This concludes my statement, Mr. Chairman. I would be happy to answer any questions you might have.

ATTACHMENT

Table 1.—MASKING THE FEDERAL DEFICITS WITH TRUST FUNDS

Billions of Dollars	Actual FY 1985	Actual FY 1986	Actual FY 1989	Estimate FY 1990	Estimate FY 1991	Estimate FY 1993	Estimate FY 1995
Revenues	734	769	991	1,067	1,137	1,277	1,438
Outlays	946	990	1,143	1,205	1,275	1,418	1,555
Total Deficit	−212	−221	−152	−138	−138	−141	−118
Federal Funds Deficit	−267	−283	−275	−270	−273	−297	−303
Trust Fund Surpluses:							
Social Security	9	17	52	66	74	98	128
Other Trust Funds	45	45	71	66	62	59	57
Subtotal, Trust Fund Surpluses	54	62	123	132	136	157	185
Total Deficit	−212	−221	−152	−138	−138 --	141 −	118

Source: FY 1985 and 1986—OMB's Special Analysis for FY 1987 and 1988; FY 1989—OMB's Budget for FY 1991; Other Years—CBO's Economic and Budget Outlook, January 1990.

Note: Totals may not add due to rounding.

ATTACHMENT

Table 2.—FISCAL YEAR 1988 BUDGET RESULTS RESTRUCTURED ACCORDING TO GAO PROPOSAL

[Dollars in billions]

	Total	General	Trust	Enterprise
Operating surplus/deficit(−)	−131	−248	124	−7
Capital financing requirements	−24	−23	2	−3
Unified budget financing requirements	−155	−271	126	−10

Note: With the exception of the $155 billion total, the amounts are approximations.

United States General Accounting Office

GAO

A Presentation by
Charles A. Bowsher
Comptroller General of
the United States

November 1989

The Deficit Crisis: Beyond the Numbers

The Deficit Crisis: Beyond the Numbers

To understand the deficit crisis facing the United States, it helps to start by recounting a little history to put into perspective the situation in which we find ourselves today.

As we prepare to enter the last decade of the 20th century, we can look back on an often turbulent past. Since 1900, we have fought four wars, endured the Great Depression, and suffered through several recessions. Yet, as recently as the mid-1970s, the financial health of the federal government was in pretty good shape. We had a public debt of about $500 billion, 25 percent of which was owed to federal trust funds and only 12 percent of which was owed to foreigners. Our international trade was in reasonable balance, and the yearly budget deficit was, in retrospect, a minor economic distraction.

Since the late 1970s, however, the situation has deteriorated dramatically. The trade surpluses of the past have evaporated, and today we continue to run massive trade deficits at close to record levels. Meanwhile, the national debt has soared to nearly $3 trillion. Projections indicate that our national debt will likely hit $4 trillion by the end of fiscal year 1993.

How, Americans ask, can the debt be going up so far and so fast? The federal deficit is supposed to be decreasing. The Gramm-Rudman-Hollings deficit reduction plan promised to set us on a course toward a balanced budget by 1993. The official figures show it is working: the deficit was reported at $155 billion in 1988 and is supposed to shrink to $100 billion in fiscal year 1990, which has just begun.

Furthermore, to enforce discipline, the Gramm-Rudman process requires automatic spending cuts—known as a sequester—whenever the Congress fails to meet the deficit reduction targets. In fact, a sequester of $16 billion was ordered just last month when the Congress failed to meet the 1990 budget target of $100 billion. If the Congress and the President ultimately meet the target and then rescind the automatic cuts, isn't that proof that the deficit is coming down? The answer is no.

The Official Figures Mask the Real Deficit Story

The sad truth is that the official numbers do not tell the real deficit story; the reality is worse—much worse:

- First, the official numbers for this year and beyond have been badly distorted by a combination of rosy economic forecasts and accounting sleight-of-hand. Some of these gimmicks, such as moving paydays from one year to another or taking credit in 1990 for the fact that people failed to cash their food stamps as much as 25 years ago, have become so blatant as to defy belief.

- Second, the official numbers mask the problem's size by merging the operations of federal trust funds with expenditures for the rest of the government. The decision to increase the payroll tax a few years ago is now generating Social Security trust fund surpluses of $54 billion a year, and they will soon reach more than $100 billion a year. These surpluses were supposed to be real savings to finance investments to support the retirement of the baby boom generation in the next century. In addition to Social Security surpluses, we're now running another $67 billion of surpluses in other federal trust funds. All of these surpluses are being spent today to run the rest of the government. If you exclude the surpluses in the trust funds, it is obvious that we haven't begun to deal with the deficit in the government's general operations. Measure the deficit without benefit of trust fund surpluses and you will find the deficit was above $250 billion in 1988 and grew to more than $280 billion in fiscal 1989—about the same deficit that existed in 1986 when we began the Gramm-Rudman-Hollings deficit reduction process.
- Third, the official numbers ignore huge costs, such as those needed to cover the deposit insurance in the thrift industry—a staggering $257 billion over the next 30 years—or to prop up the ailing Farm Credit System. We've pretended that the money borrowed to deal with these problems is

not part of the budget or of the public debt.

- Fourth, the official numbers ignore the huge burden we face from years of neglect in such areas as cleaning up and modernizing the nation's nuclear weapons complex—possibly as much as $150 billion. Similarly, the official numbers largely ignore the costs we face for such massive programs as cleaning up environmental contamination on military bases, rebuilding the nation's air traffic control system, upgrading computer systems to make Social Security payments or collect taxes, and repairing or rebuilding the nation's physical infrastructure.
- Fifth, the official numbers ignore the enormous imbalance between the money that will be available to operate our defense establishment and the weapons systems that the military services now have in the pipeline or on the drawing boards.

None of these facts is a secret. The press has been reporting them in an increasingly strident tone as reporters have begun to understand the ramifications of what is involved. Meanwhile, foreign bankers, on whose good will we are more and more dependent for the money to finance our budget and trade deficits, are beginning to talk about us in terms previously reserved for third-world debtors.

None of this saga was supposed to happen. In the early 1980s, President

Reagan and the supply-siders promised that we could and would grow our way out of the deficit. Instead, we have gone deeper and deeper into debt.

In the mid-1980s, the proponents of Gramm-Rudman-Hollings promised that their statutory targets for the deficit would force the political leadership to make the "hard choices." Instead, Gramm-Rudman only intensified the search for gimmicks and phony savings to meet the Gramm-Rudman targets.

Tragically, however, the fiscal side of the deficit debate tells only a part of the story. Although the press and the American public are beginning to understand that the numbers do not add up, there remains little comprehension of other problems that we are beginning to suffer as a result of our refusal to face the true ramifications of the deficit crisis.

That is why it is instructive to look beyond the numbers of the deficit saga.

The Budget Deficit Restricts Flexibility

The deficit is greatly diminishing the flexibility of those who are elected or appointed to govern the nation. Because there are so few financial resources, both the President and Members of Congress are forced to spend much of their time arguing over how to divide up a shrinking pie rather than focusing on the long-range needs of the American public.

The first place this lack of flexibility manifests itself is in the difficulty lawmakers have in finding the money to pay for new initiatives. During the campaign, President Bush said that he wanted to be an "education President." Yet, in his first budget submission, he could find little room for added federal spending on schools and training. Thanks to the deficit, the money is not there.

Lack of flexibility also affects our competitive position in the world and thus our trade deficit. In a global economy, the United States must be able to respond rapidly to changing conditions and to maintain investment in such things as research and development. When financial resources are tight, maintaining, let alone increasing, such expenditures beomes difficult.

The deficit also has affected interest rates, which in turn have affected the value of the dollar. As the United States is forced to borrow more from foreign lenders, it must offer rates that will attract foreign capital. This hinders the flexibility of policymakers seeking to hold the value of the dollar at a low enough rate to keep imports relatively expensive and thus promote exports, which is essential if we're going to reduce the record trade deficits of the past several years.

On issues as diverse as responding to such tragedies as hurricane Hugo or the San Francisco earthquake, providing long-term nursing care for senior citizens, fighting the war on drugs, dealing with global warming, and meeting new challenges facing our military services, Americans look to the federal government for answers—and for resources. Yet the budget deficit increasingly restricts policymakers' flexibility to respond or it forces them to respond only by cutting essential programs in other areas.

The bottom line is that lack of flexibility caused by limited resources is a problem that affects, one way or another, all Americans. Lack of flexibility affects the education of our children, our response to environmental challenges, and our ability to deal with such corrosive problems as drugs in our cities and housing for the poor and homeless. It hinders the ability of American industry to compete in world markets. In short, lack of flexibility threatens to paralyze our ability to meet the myriad challenges of a changing and complex world.

Budget Plans Do Not Reflect Urgent Unmet Needs

Earlier, I mentioned that the deficit has prevented us from facing up to the costs for such needs as rebuilding our deteriorating nuclear weapons complex or modernizing the air traffic control system and the nation's run-down infrastructure.

Sadly, I think, few Americans truly understand the magnitude of these costs. Only now are many Americans awakening to the magnitude of what it will cost just to make good on the government's promises to depositors at insolvent savings and loan associations. Our latest estimates are that we will spend $257 billion over the next three decades. Of that amount, $139 billion will be directly borne by the taxpayers. That amounts to more than $2,100 for every family in America.

We at GAO also calculate that it could cost as much as $150 billion to clean up, modernize, and rebuild the nation's nuclear weapons complex, which has been shut down because of environmental and safety concerns. Few Americans, I suspect, are aware that we have stopped building nuclear weapons because this complex has been allowed to deteriorate. Unless we find the resources, this has major implications for our national security.

To take another case, increasing numbers of Americans are flying each year. This has major implications for our air traffic control system, which is badly in need of modernization. For example, the Federal Aviation Administration (FAA) continues to use radar equipment that relies upon vacuum tubes. The FAA is now 6 years into its modernization program, which was originally estimated to cost $12 billion.

We now estimate the cost at $25 billion over the next decade—and that may be conservative.

As if that were not bad enough, the Department of Transportation estimates that it will cost $50 billion to repair or replace the nation's 240,000 deficient bridges and a staggering $300 billion or more over the next decade to maintain highways in their 1983 condition. Although these costs are shared with state and local governments, the federal government has traditionally provided a large share of the money. The San Francisco earthquake offers a very graphic example of the need to upgrade highways and other infrastructure systems.

The list goes on—$20 billion to repair the deteriorating stock of public housing, $2 billion just to eliminate a backlog of deferred maintenance of our national parks, about $5 billion to build needed prisons, and $14 billion to clean up hazardous waste dumps at military installations.

The key point is that few of these unmet needs are reflected in any budget planning document. We are pretending they do not exist—just as we pretended for years that there was no crisis in the nation's nuclear weapons plants. But these are real needs, and there are real costs associated with each that we will have to face. Furthermore, the costs of attending to them will grow, not diminish, with each passing year.

But more ominous, I think, are the blinders we wear to avoid facing another set of growing costs—the need to invest in the central operations of government.

Investment in Government Operations Cannot Be Postponed

In agency after agency, computer systems are aging and will require billions of dollars in new investment. I've already mentioned the FAA, but it is not alone. The Internal Revenue Service, the Social Security Administration, the Department of Veterans Affairs, the military services, and the General Services Administration all will have to spend billions of dollars to upgrade aging computer facilities, some of them so old they cannot long be maintained in a functional state.

But investment in the central functions of government means more than buying new computer systems, as important as they are. It also involves people. Throughout the federal government, poor pay and obsolete personnel systems have created conditions that are making it impossible to recruit capable people to government service and to retain them. This has been documented in our own studies at GAO, as well as in studies by such private groups as the National Commission on the Public Service, headed by former Federal Reserve Chairman Paul Volcker.

Beyond the numbers, failure to invest in systems and in people to manage the functions of government undercuts our ability to offer the American people the one thing they have every right to expect—a government that works well in providing services. Because government operations affect our dealing with other nations in such areas as trade, diplomacy, law enforcement, and defense, this failure has adverse international ramifications. Finally, because governmental operations are linked with the smooth functioning of the private sector, the nation's business community is inevitably affected when we fail to invest adequately in the central operations of government.

Social Security Surpluses Were Meant to Be Invested

One of the least appealing aspects of the deficit crisis is the emphasis it forces us to place on short-term expediency at the expense of the long-range economic well-being of the nation. By concentrating on immediate pressures to meet yearly budget targets through whatever means are at hand, we are in danger of short-changing the future.

In purely economic terms, the deficit is destroying our ability to promote the savings that are necessary to future growth and prosperity. Nowhere is this more evident than in the misguided use of Social Security trust fund surpluses to pay for day-to-day operating expenses rather than investing those surpluses as a true reserve of savings to pay retirement benefits when the current baby boom generation begins retiring about 2010.

The situation with respect to Social Security bears examination because few Americans are aware of how we are presently using payroll taxes to offset the deficit.

In 1983, when the Congress approved legislation to rescue Social Security from a precipitous drop in reserves, the nation moved away from traditional pay-as-you-go financing and toward the accumulation of substantial reserves over the coming generation. The idea was to accumulate—or save—the reserves necessary to help pay retirement benefits for the baby boom generation. The new law recognized that the United States is entering a period of fundamental demographic change: there will be fewer workers to support a rising percentage of retired Americans. By accumulating savings of huge reserves (estimated at $12 trillion by the year 2020), we can substantially ease the burden of these retirement benefits on the next generation of workers.

As these surpluses accumulate, they are loaned to the Treasury in the form of special issue U.S. Treasury securities. If the rest of the budget is in deficit, as is now the case, the Treasury uses the Social Security money it has borrowed to cover current operations in the rest of the government. This means, of course, that the Treasury has to borrow less from the public than would otherwise be required.

This pattern of using Social Security surpluses to cover other government operations has far-reaching implications. As I have already mentioned, it masks the true size of the deficit in government operations. For purposes of meeting Gramm-Rudman-Hollings targets, only the "unified" budget totals are counted. This leads to the misperception that we are solving the budget deficit when, in reality, we are not.

By using these surpluses to finance regular government operations, we are squandering a special opportunity to increase national savings, which could lead to higher productivity and more rapid economic growth.

Such an opportunity, however, would be present only if the operating budget were balanced, or close to it. If that were the case, Social Security and the other trust fund surpluses could be used to begin retiring the national debt. This, in turn, would free money now loaned by the public to the Treasury to be used for investment in the private sector to build new plants, to create new jobs, and to improve the economic well-being of the nation as a whole. Such investment would improve worker productivity, thus giving rise to faster economic growth. It would also reverse our present growing dependence on foreign capital and would have a salutary effect on the trade deficit.

One need only look at Japan to understand how important a high rate of national savings is to overall economic prosperity. The American savings rate has been among the lowest in the industrialized world for several decades. In the 1980s, we have made the situation even worse because the government has been forced to borrow so heavily to finance the deficit, thus draining away the funds that could have been invested in new factories and other income-producing assets.

Because we are not taking advantage of this opportunity to save and invest the Social Security surplus, a fundamental question arises: What happens when we need the money 20 or 30 years from now to pay for retirement benefits? The answer is that we must then either drastically raise taxes to meet benefits or dramatically curtail benefits. These are hardly appealing choices, especially since they can be avoided by dealing now with the totality of the deficit crisis.

The use of Social Security reserves to mask the deficit is a prime example of how the deficit is endangering the economic future of the nation.

A Future Saddled With Debt Threatens Future Generations

More difficult to measure, but equally important, are the human costs of failing to deal with the deficit while it is still a manageable problem. The history of the United States has always been one of generational improvement: We've always worked and saved to provide a better life for our children and grandchildren. The deficit, however, is reversing that trend. By borrowing so heavily from the future, we are forcing our children to eventually pay our bills on a scale never seen in the past.

If we continue this trend, how will our children find the resources to meet the challenges their generation will face? How will they pay the higher costs of education, medical care, and environmental protection? How will they be able to afford the investment in homes, factories, and technology their generation will require?

The answer is that if we do not deal with the deficit, future generations will find it more difficult to face the challenges they will encounter. Already, increasing amounts of money must be allocated each year to pay interest on the national debt. In 1975, interest on the public debt was about $33 billion, of which about $8 billion was paid on borrowings from the various trust funds. By 1980, total interest costs had more than doubled, to $75 billion, including $12 billion on money borrowed from the trust funds. In the 1980s, interest costs ballooned to the point that, in 1988, they totaled $214 billion, including more than $40 billion paid to the trust funds. This trend is irreversible unless we get the general fund deficit under control.

Servicing the national debt represents one of the largest transfers of wealth in American history. It is money that flows from American workers (who pay most of the taxes) to institutional investors and wealthy individuals who purchase Treasury securities. Increasingly, many of these institutions and individuals are foreign, attracted by the premium rates we must pay to finance the debt. In 1988, for example, it is estimated that more than $27 billion of the interest cost, almost 13 percent of the total, was paid to foreign owners of Treasury securities.

Money spent to service the debt is money that comes off the top, and the share of the budget that is tied up in interest costs has risen dramatically. In 1975, interest on the public debt was 13 percent of total general fund outlays. By 1980, that had risen to 17 percent, and by 1988, it had reached an astonishing 26 percent of the general fund budget. This money cannot be used to hire air traffic controllers, to fight the war on drugs, to pay for modern weapons, to improve health care for Americans, or to buy any of the other goods and services the government must purchase each year.

A future saddled with debt is a future few Americans want for our country. Yet, it is a future we are inevitably creating for our children and their children because we continue to refuse to face up to the severity of the deficit problem.

Conclusion

The irony is that the deficit is a solvable problem. It will require a bipartisan approach agreed upon by key leaders in the Congress and by the President. To avoid damaging the economy, such an approach must be implemented over a number of years. But within such a framework, it seems to me that these two ingredients are essential:

- First, we must spend what money we have more wisely. There are programs that could be eliminated or run more efficiently at less cost. Cutting programs is never easy. Shutting down old and obsolete military bases is a prime example. It took a special commission and a carefully crafted legislative strategy to close or partially dismantle just a few installations earlier this year. But making these tough choices is essential to control the deficit.

Spending money more wisely also involves demanding greater accountability. The new scandal at the Department of Housing and Urban Development stems from poor or nonexistent internal controls, as did last year's procurement scandal at the Pentagon. Improved standards of accountability will not only help protect taxpayers from fraud and abuse, they will allow resources to be allocated more efficiently.

- Second, we will probably need to raise taxes. By now we should have learned an old lesson: There is no free lunch. It costs money—a lot of money—to run the government Americans want and to provide the services Americans demand. We cannot starve our government of tax revenue, as we have done for the past 8 years, without paying a steep and growing price in the future.

In the final analysis, we must learn to think of the deficit as more than a dispute over numbers. The numbers are real, but it's what they represent—the economic security and well-being of the American people—that is truly important.

If we continue to deprive ourselves of flexibility, if we pretend unmet needs do not exist and continue to postpone needed investment in government operations, and if we continue to sacrifice the future for the pleasures of the present, the price we will pay will almost certainly far exceed the minor inconveniences we need to accept now, in this generation, to deal with the consequences of our extravagance.

RESPONSES TO QUESTIONS FROM SENATOR DOLE

Question 1. In your statement, you argue that the luxury of the reserves have provided a convenient excuse for avoiding tough choices. What tough choice would you make if the Moynihan plan was implemented and the deficit increased by an estimated $55 billion.

Answer. As I have said frequently, we delude ourselves if we think there are any easy solutions to putting our economic house in order. I envision a difficult bipartisan negotiating process to work out a combination of spending cuts and tax increases—the tough policy choices needed to solve our Federal budget problems. On the spending side, I have noted hard choices regarding defense and entitlement programs that will likely generate controversial and contentious debate. And, I have pointed out that the deficit has cut into our ability to deal with increasing demands to meet unmet needs. Equally tough choices need to be made on the revenue side. Specifically, we need to decide when and how to increase revenues. I believe the sooner we admit the revenue base must be restored to bring our budget into approximate balance, the better.

Question 2. GAO seems to take a position of supporting an overall budget surplus (yet you oppose the president's plan because it takes too long to phase in.) How quickly would you propose moving to a surplus?

Do you think this is politically realistic?

Answer. As I testified, the Social Security Integrity and Debt Reduction Fund would not be implemented until 1993. In its fiscal year 1991 budget, the administration briefly described the concept of the fund but provided little detail regarding how the 3-year implementation would actually proceed. We believe that the economic consequences of inaction for 3 additional years can only exacerbate the grave problems now facing the American public.

PREPARED STATEMENT OF RICHARD DARMAN

Chairman Bentsen, Ranking Republican Senator Packwood, and distinguished members of the Senate Finance Committee, it is a pleasure to appear before you. You asked that I be prepared to respond to questions concerning:

—Senator Moynihan's recent proposal to cut Social Security Trust Fund receipts by $55 billion in fiscal year 1991 and by substantially more thereafter; and

—the Administration's proposal to protect the integrity of the Social Security Trust Fund, while reducing publicly-held Federal debt—thus assuring that future Social Security benefits can be fully paid without placing an undue burden on future workers or on America's capacity to finance its obligations.

I know that members of the Committee will recall rising at the State of the Union address when the President said:

> "To every American out there on Social Security, to every American supporting that system today, and to everyone counting on it when they retire: We made a promise to you—and we are going to keep it. We rescued the system in 1983—and it's sound again. Our budget fully funds today's benefits—and it assures that future benefits will be funded as well. *The last thing we need to do is mess around with Social Security.*" [standing ovation]

The President's statement—and the overwhelmingly favorable reaction to it—underline our mutual commitment to protect the structure of benefits and receipts enacted in 1983 and known as the "bipartisan Social Security compromise." Many of the members of this Committee played important roles in the development of that historic compromise. Indeed, Senator Moynihan himself played a leading role. He participated as a key member of the core negotiating group—a matter about which he has spoken and written with justifiable pride.

I, too, was a member of that core negotiating group. I continue 'to feel privileged to have had an opportunity to participate in what has been widely viewed as one of the more favorable examples of our political system rising to meet its responsibilities.

The 1983 compromise, and the related work of the bipartisan National Commission on Social Security Reform, recognized the need to move away from what had been intended to be a "current cost financing" system. The compromise, the Commission Report, and the '83 Act consciously, specifically, and explicitly moved away from the near-bankrupt "pay-as-you-go" system, and moved toward a system with much higher reserves for the 1990s and the early part of the twenty-first century.

This shift to build up higher reserves was adopted for two basic reasons that are as relevant today as they were in 1983:

—For the short term, lower levels of reserves made the Old Age and Survivors Trust Fund vulnerable to the possibility of economic downturn. (NOTE: Even now, the OASI Trust Fund has reserves that are less than sufficient to cover a full year's costs.)

—For the longer term, the disparity between the large "baby boom" generation and the smaller succeeding generation necessitated the normalization of the Social Security tax burden across generations—or else a "current cost" tax burden on future workers might be perceived to be prohibitively high, thus threatening the ability to pay the expected retirement benefits of the baby boom generation (today's workers). (NOTE: Since 1983, neither the demographic nor political facts have changed in a way that should dictate a different conclusion. If Social Security reserves are not built up for today's workers, there would be more than sufficient reason to question whether their expected benefits would, in fact, be paid.)

The practical reality is that a proposal to switch back to the current cost financing system that was rejected in 1983 could have one or both of the following undesirable effects:

- It could threaten a return to the days of short-term Trust Fund financing crises.
- It could (and likely would) jeopardize the retirement benefits of today's workers.

Unfortunately, Senator Moynihan's recent proposal runs not only these risks; it also risks creating fiscal policy havoc. It would either abandon budget discipline altogether; or it would require offsetting deficit-reduction measures amounting to $55 billion in FY '91 and more thereafter. Since additional spending reduction of this magnitude is not contemplated, it would seem to suggest a major offsetting tax increase (such as that proposed by Senator Hollings). But this, of course, would hurt the very workers Senator Moynihan's proposal is ostensibly intended to help. Indeed, it would hurt them doubly:

—first, by jeopardizing their future retirement benefits; and

—second, by taking back in new taxes what it pretended to give in the way of a tax cut.

For all these reasons, it is understandable that not only the Administration and many distinguished members of Congress, but also the American Association of Retired Persons have concluded that:

> "[T]he first preference remains retaining existing Social Security policy to continue to build the reserves for future generations." (AARP—February 2, 1990)

For its part, the Administration is unwilling to give up on the 1983 bipartisan Social Security rescue and compromise; unwilling to give up on funding the retirement benefits of the baby boom generation; and unwilling to give up on the effort to restore fiscal discipline. Accordingly, we must respectfully reject the recent proposal of Senator Moynihan. We would urge, instead, a return to consideration of the type of approach with which Senator Moynihan was previously associated (as late as 1989) when he argued for a combination of a build-up in trust fund reserves (as in the '83 Act), a reduction in the non-Social Security deficit, and renewed emphasis on savings and investment.

We do not mean to suggest that there is not a problem to be dealt with. We mean only to suggest that Senator Moynihan's latest proposal seems to give up on the problem—just when the political system is preparing to deal with it.

It is important to be clear about what the problem is and is not.

—Our problem, at the moment, is not an excess of revenues relative to spending. (That would seem to be the "problem" that Senator Moynihan's recent proposal—would address.)

—Nor is our problem "thievery" or "embezzlement"—if those terms are intended in any way to suggest something illegal or something of which the Congress was not fully aware. Social Security taxes are being collected in accordance with the law. Social Security reserves are being built up in accordance with the law. The reserves are held in the form of Treasury securities backed by the full faith and credit of the U.S. government as required by law. Social Security is treated as "off-budget," as required by law—except with respect to calculations for Gramm-Rudman-Hollings, which include Social Security as specifically decided and required by law.

The problem is a derivative of this set of existing *legal requirements*. It is simply this: By including the intended Social Security operating surplus in the Gramm-Rudman-Hollings deficit calculations—as required by law—the full magnitude of the non-Social Security deficit is masked. To the extent that this, in turn, causes the non-Social Security deficit to be higher than it might otherwise be, Federal debt held by the public is also correspondingly higher. And to the extent that publicly-held Federal debt continues to rise, it threatens to leave an undue burden for the future—when the intentionally rising Social Security Trust Fund obligations (the reserves) will have to be redeemed.

Our proposal to establish a Social Security Integrity and Debt Reduction Fund is intended to address this problem. It would:

—allow reserves in the Social Security Trust Fund to be built up exactly as under current law (and as in the 1983 compromise);

—require the non-Social Security budget to be balanced (after an orderly phase-in)

—extend the G-R-H law beyond 1993, requiring a balanced G-R-H budget in 1993 and permanent balance thereafter; and

—allocate the equivalent of the annual Social Security operating surplus to a Debt Reduction Fund—requiring that this transaction be charged as outlays in G-R-H deficit calculations; and requiring that an equivalent amount of publicly-held Federal debt be retired in the process (after a phase-in period that would be complete in fiscal year 1994).

This approach effectively leaves Social Security subject to the G-R-H discipline, while it adjusts the G-R-H deficit calculations to remove the masking effect of the annual Social Security operating surplus. Among its useful-practical consequences would be the following:

• The Social Security Trust Fund would be protected and would not be a victim of raids on the reserves, which would build up exactly as under present law for the protection of future retirees.

• The national debt held by the public would be reduced by substantial amounts each year, with favorable effects on interest rates, investment and the future capacity to fund Social Security obligations.

• The total G-R-H budget each year would be balanced without using Social Security operating surpluses. There would be no G-R-H "surplus" to create a temptation for additional spending.

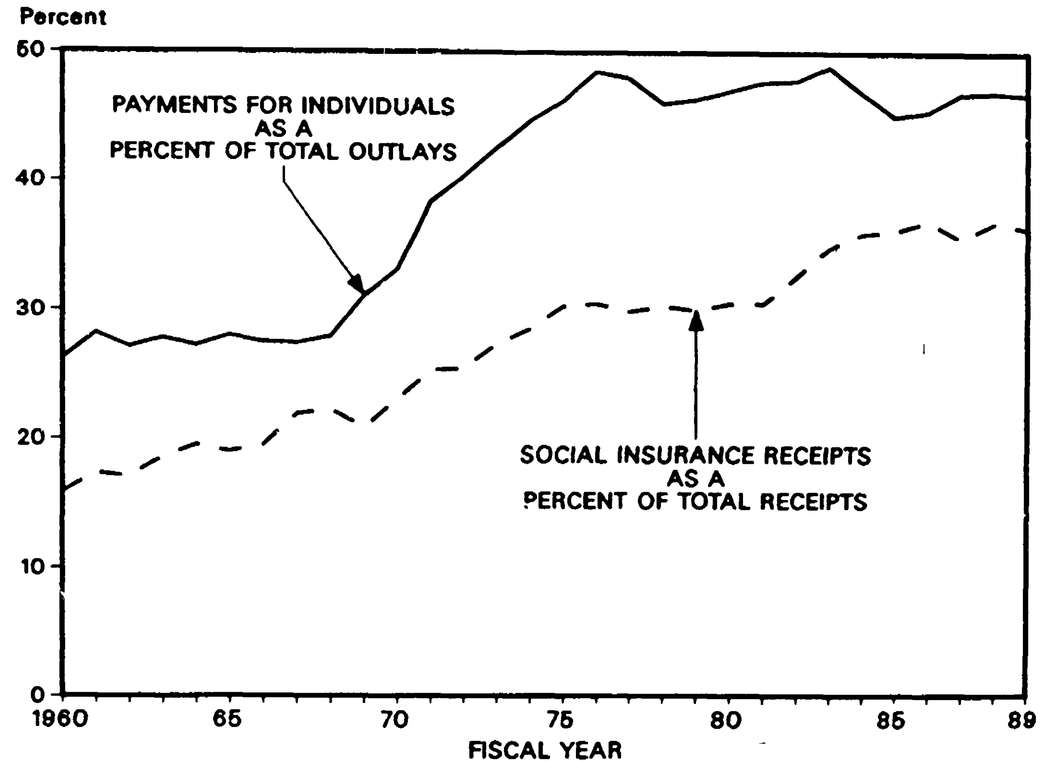
We are aware of several other possible changes in accounting and budgeting systems that are being considered by various Senators. Some of these could have the same favorable effects as the Administration's proposal, although they may be structured somewhat differently. We are not wedded inflexibly to our own proposal, and are happy to work with any and all Senators who might advance a responsible way to correct the deficit-masking problem that inheres in current law.

We believe that this can and should be done without giving up on the obligations of the 1983 Social Security compromise. Indeed, we believe that by correcting the accounting and budgeting systems in a manner that accomplishes what we recommend, generations of the future will be better able to honor the Social Security commitments that we have made.

Thank you very much, Mr. Chairman, for the opportunity to introduce the Administration's position. I look forward to responding to questions.

Attachment.

PAYMENTS FOR INDIVIDUALS AS A PERCENT OF TOTAL OUTLAYS, SOCIAL INSURANCE RECEIPTS AS A PERCENT OF TOTAL RECEIPTS



PROGRESSIVITY: AN ANALYSIS OF THE WAYS AND MEANS/CONGRESSIONAL BUDGET OFFICE STUDY

[Prepared by the staffs of the Council of Economic Advisers and the Office of Management and Budget, February 1990]

INTRODUCTION

Using tables prepared by the Congressional Budget Office (CBO), thestaff of the House Ways and Means Committee has prepared a backgroundpaper arguing that the U.S. tax system became significantly more regressiveduring the 198os. According to this study, the essential source of the reducedprogressivity was increases in payroll taxes for social insurance.

The study has many shortcomings that lead one to doubt the basicconclusion. There are methodological flaws in the construction of the tables, and even more in the interpretation of the tables by the Committee staff. The study is too narrowly focused. It concentrates on changes in effective tax rates despite the fact that their own tables show that *the share of taxes paid by higher income taxpayers rose in the 1980s while the share paid by lower income taxpayers fell.* Most importantly, it fails to integrate Federal transfer payments with Federal taxes. A complete analysis of how the Government affects income distribution must consider the entire set of tax and transfer programs. Any such analysis reveals that the full set of Federal Government taxes and transfers is highly progressive and has remained so even as increased incomes for retired Americans have moved Social Security recipients higher on the income scale.

METHODOLOGICAL PROBLEMS WITH THE WAYS AND MEANS STUDY

Base Year Choice

The first problem is that the base year chosen for comparison by the Ways and Means staff, 1980, is a poor choice. Largely as a result of inflation induced bracket creep, 1980 had unusually high effective income tax rates, particularly on middle and high income individuals. During the late 1970s, high inflation overwhelmed the practice of legislating periodic inflation corrections to the tax code. The result was increased tax rates for most taxpayers. From 1977 to 1981, the average marginal tax rate faced by individuals rose from 28.1 percent to 32.5 percent (using shares of adjusted gross income as weights). Reflecting this bracket creep, average income taxes also rose. In fiscal year 1980, individual income taxes were 9.1 percent of GNP compared with 8.2 percent on average for fiscal years 1971 through 1979.

These increases in tax rates did not represent deliberate policy changes. Indeed, these factors were a major impetus for the tax reforms of the 1980s. Income tax rates were lowered in 1981 and inflation-indexed beginning in 1985 precisely' to offset this bracket creep. In the 1986 Tax Reform Act, the standard deduction and personal exemption were increased and 4.3 million low income taxpayers were removed from the tax rolls.

Mixing Fact with Projection

A second problem with the study is the mix of actual data with projections concerning the future path of effective tax rates. The 1990 figures cited in the Ways and Means tables are based on a forecast. Like most economic forecasts, these are subject to uncertainty. This forecast, however, is especially problematic. To produce the forecast, CBO *estimated* the effects of the dramatic Tax Reform Act of 1986. There are, as yet, *no* data that reflect full implementation of tax reform, so the forecast reflects a judgment of how the reform will work out.

Correctly measuring the impact of the 1986 reform is particularly important for judging the progressivity of the tax system. The reform made the tax system more progressive by removing 4.3 million taxpayers from the tax rolls, expanding the alternative minimum tax, and increasing the corporate tax burden. The latter falls more heavily on upper income groups. The Ways and Means tables show a shift towards more progressivity between 1985 and 1990, but given the uncertainties, the shift could be larger or smaller than anticipated in the tables.

It would be far preferable simply to restrict the analysis to actual data. If it is desired to show how tax burdens have changed over a 10-year interval, it would be better to compare 1977 with 1987—the most recent year with complete data—than 1980 with projected 1990.

Importance of Endpoints

The tables in the Ways and Means study show how sensitive comparisons are to the choice of endpoints. Table 1 demonstrates that between 1977 and 1980, as also between 1985 and 1990, taxes became more progressive.

Table 1.—PERCENTAGE POINT CHANGES IN EFFECTIVE TAX RATES FOR ALL FAMILIES BETWEEN SELECTED YEARS

Quintile	Actual 1977-1980	Projected 1980-1990	Projected 1985-1990
Lowest	−1.1	1/3	−0.9
Second	0.1	1.0	0.6
Third	0.4	0.3	1.0
Fourth	1.1	−0.5	0.8
Highest	0.2	−1.5	1.8

Source: Ways and Means (1990)

Identifying the Rich

Another difficulty is that the highest income quintile is hardly "super rich"—it begins at a family income of just $50,400. A finer breakdown of the upper income category would be needed to identify the taxes paid by those who might be thought of as truly wealthy.

Quintile	1988 Family income
1st	0 to $10,370
2nd	$10,370 to $20,530
3rd	$20,530 to $32,580
4th	$32,580 to $50,400
5th	above $50,400

Source: CBO (1987).

Incidence Assumptions

In order to measure income and taxes paid, CBO must make assumptions about the "incidence" of each tax and, in effect, allocate the taxes paid to families' incomes. The most important incidence assumption in the study is that *all* payroll taxes are paid by workers. This assumption is the root source of much of the alleged change in progressivity. It is controversial. The Social Security payroll tax is divided evenly between employees and employers, with each paying one-half of the tax. CBO assumes that the employer half is borne by employees in the form of lower wages. The employer component could instead b0 borne by the businesses paying the tax—or capital more generally-or passed on to consumers via higher prices. *CBO itself* estimates that for any reasonable change in the incidence assumption, the effective tax rate for higher income families would be raised. If the Social Security payroll tax were more progressive than shown in the tables, then the increase in payroll taxes since 1977 would have contributed a much smaller reduction in the progressivity of the tax system.

A second incidence issue concerns the corporation income tax. The Ways and Means study allocates corporate income taxes equally to labor earnings and capital income. Although much-debated, there is no firm consensus on the incidence of the corporate income tax. Many people believe that the tax is almost exclusively borne by shareholders of corporations, or by owners of capital more generally. The use of this more standard assumption would lead to increased progressivity of the tax system.

Percents of Percents

Another set of methodological issues concerns the presentation of the results in the Ways and Means study. Computing percent changes in effective tax rates (that are already expressed in percentage terms) places undue significance on small changes. For example, the effective excise tax rate for the top 5 percent of the population is shown to have *decreased* 11.7 percent from 1980 to 1990, even though it was reported as 0.4 percent in 00th years. The reported 11.7 percent decrease is highly misleading. In fact, the effective tax rate must have changed by only *hundredths of a percentage point.*

In addition, these questionable methods are used selectively. In the *same* table, the effective individual income tax rate for the lowest quintile falls from -0.4 to -1.5. Using the same questionable methodology, this is a decrease of 275 percent. Instead of reporting this number, the Ways and Means staff states, "since the denominator for this calculation is very close to zero, this figure is meaningless." They fail to note that the denominator for the calculated decline in the effective excise tax rate is just as close to zero.

A more conventional approach would simply compare *percentage point* changes in effective tax rates (as in Table 1 of this report).

A Flawed Income Measure

Flaws in the measure of income used by CBO likely lead to an understatement of the progressivity of the tax system each year (the effect on the estimated change in progressivity between two years is uncertain). First, the CBO measure does not include non-cash income, thus excluding such important government transfers as Medicare, Medicaid, Food Stamps, and public housing and employer-provided non-wage compensation such as health and life insurance. Non-cash government transfers are heavily progressive. Neglecting them leads to an understatement of low incomes, an overstatement of effective tax rates for lower incomes, and biases the results against progressivity.

In addition, the CBO measure of cash income excludes losses due to partnerships and rentals—ostensibly to eliminate tax-induced paper losses, but some real economic losses are excluded as well—leading to overstated higher incomes where these losses are concentrated. Further, the cash income measure includes an imputed value for *realized* capital gains that suffers from two problems. First, although realized capital gains are part of the tax base, they bear little relation to the change in the value of assets, but rather reflect a change in the composition of assets. A better way to measure income for this purpose would be to allocate both corporate income taxes (as CBO does) and retained corporate profits to households directly. Further, CBO imputes realizations as a fixed share of national income, apparently to mitigate tax-induced bunching of realizations. For the years in the tables, however, realizations varied greatly as a share of national income without any changes in the tax treatment of capital gains from the previous year. In these ways, the CBO cash income likely overstates high incomes, understating the effective tax rate, and again biases down the measured progressivity.

ALTERNATIVE WAYS OF VIEWING PROGRESSIVITY

Effective tax rates are difficult to measure correctly and are not the only way or the best way to evaluate the fairness of the tax system. Indeed, one of the main goals of the 1981 tax changes was to lower inefficiently high marginal tax rates that were costing the Government revenue by encouraging high income taxpayers to shelter their incomes to avoid taxes.

Share of Taxes Paid

Another way to look at fairness is to examine how much of the overall tax burden is carried by the different income classes. By this measure, the tax system has become more progressive. Other tables in the Ways and Means study show that the *share* of taxes paid by the highest income quintile of the population is projected to rise between 1980 and 1990 for *every* tax studied: individual income taxes, corporation income taxes, social insurance taxes, and excise taxes. The share of total Federal taxes paid by the highest income quintile rose by 2.4 percentage points, while their share of social insurance taxes rose by 2.5 percentage points (see Tables 2 and 3).

For other taxpayers, the share of taxes is projected to fall for nearly every other quintile and tax studied. The *sole* exception is the share of excise taxes paid by the lowest income quintile, which is projected to rise by a slight 0.3 percentage points, an increase of roughly $5 in 1990.

International Comparisons

The attention devoted to payroll taxes in the U.S. tax structure may leave the impression that payroll taxes are unusually high in the United States. In fact, the United States relies far less on payroll and sales taxes to finance Government programs than do other large industrialized nations except Japan (see Table 4). If the

United States were to collect taxes in the same manner as most of these other countries, the distribution of income would probably become less equal.

Table 2.—SHARE OF TAXES PAID BY ALL FAMILIES

[In percent]

	Actual 1980	Projected 1990
Lowest 20 percent	1.6	1.6
Second 20 percent	7.0	6.6
Third 20 percent	13.4	12.6
Fourth 20 percent	22.2	21.0
Highest 20 percent	55.7	58.0
Total	100.0	100.0

Table 3.—SHARE OF SOCIAL INSURANCE TAXES PAID BY ALL FAMILIES

[In percent]

	Actual 1980	Projected 1990
Lowest 20 percent	3.4	3.3
Second 20 percent	11.5	10.8
Third 20 percent	18.8	17.9
Fourth 20 percent	27.2	26.5
Highest 20 percent	38.9	41.4
Total	100.0	100.0

Source: Ways and Means (1990)

Table 4.—SHARE OF TOTAL TAX REVENUE RAISED

[In percent]

	Personal, corporate, and property taxes	Social Security contributions, sales, and payroll taxes
Japan	58.2	41.5
U.S.	54.5	45.5
U.K.	50.9	49.5
Italy	39.4	60.7
W. Germany	37.2	62.7
France	22.6	74.2

Source: H. Aaron, Wall Street Journal, February 14, 1990.

LOOKING AT THE WHOLE PICTURE: TAXES AND TRANSFERS

The Ways and Means study not only has significant flaws in design and execution, it is by nature incomplete. Its myopic focus on the tax system ignores the highly progressive nature of the Government's tax and transfer system taken as a whole.

Progressivity of Social Security

When the overall structure of payroll taxes *and* benefits is examined, Social Security is found to be one of the most progressive of Government programs. Chart 1 shows the highly progressive nature of Social Security when payroll taxes are netted against Social Security benefits. (The chart shows taxes and benefits by income group, not taxes and benefits for individual families.) At any point in time, lower income groups receive much more back in benefits than they pay out, while the reverse is true at the upper end of the spectrum.

For individuals, as opposed to income groups, Social Security is also progressive because low-income individuals receive proportionally more Social Security benefits relative to their contributions than do high-income beneficiaries. Also, historically Social Security has provided benefits that have permitted older generations to share in the growth of real incomes occurring after their retirement, producing a progressive impact across generations.

Growth of Government Transfers

The role of Government transfers extends far beyond Social Security. Substantial growth in the size of Government transfer payments continued during the 1980s, raising living standards of low-income families. As shown in Chart 2, the real value of Federal transfer payments—both total and means-tested—rose 28 percent between 1980 and 1989.

Overall Progressivity of Taxes and Transfers

The Federal tax and transfer system is highly progressive. The total effect of taxes and transfers in 1987 was to reduce overall income inequality substantially, as measured by the most commonly used index of income concentration. For the lowest quintile, taxes and transfers increased their share of total cash and noncash income by 3.7 percentage points, from 1.0 percent to 4.7 percent (Table 5). For the top quintile, taxes and transfers reduced their income share by 6.6 percentage points. While income and payroll taxes reduce income inequality, Government transfers have produced the bulk of the reduction in income inequality, again measured using the most common index of income inequality.

While it would be useful to compare 1987 with earlier years to gauge how the tax and transfer system has affected the income distribution over time, data are not published in a comparable form for all noncash transfers in years prior to 1986. Even if it were possible to extend the comparisons, year-to-year variations in the measured progressivity of the tax and transfer system should be viewed with caution. These changes are not necessarily the result of changes in policy, but also reflect the influences of recessions, changing family structures, inflation, and other factors. In general, in recent years, changes in the distributional effect of the Federal Government tax and transfer system have been negligible compared with the large, progressive nature of the basic system itself.

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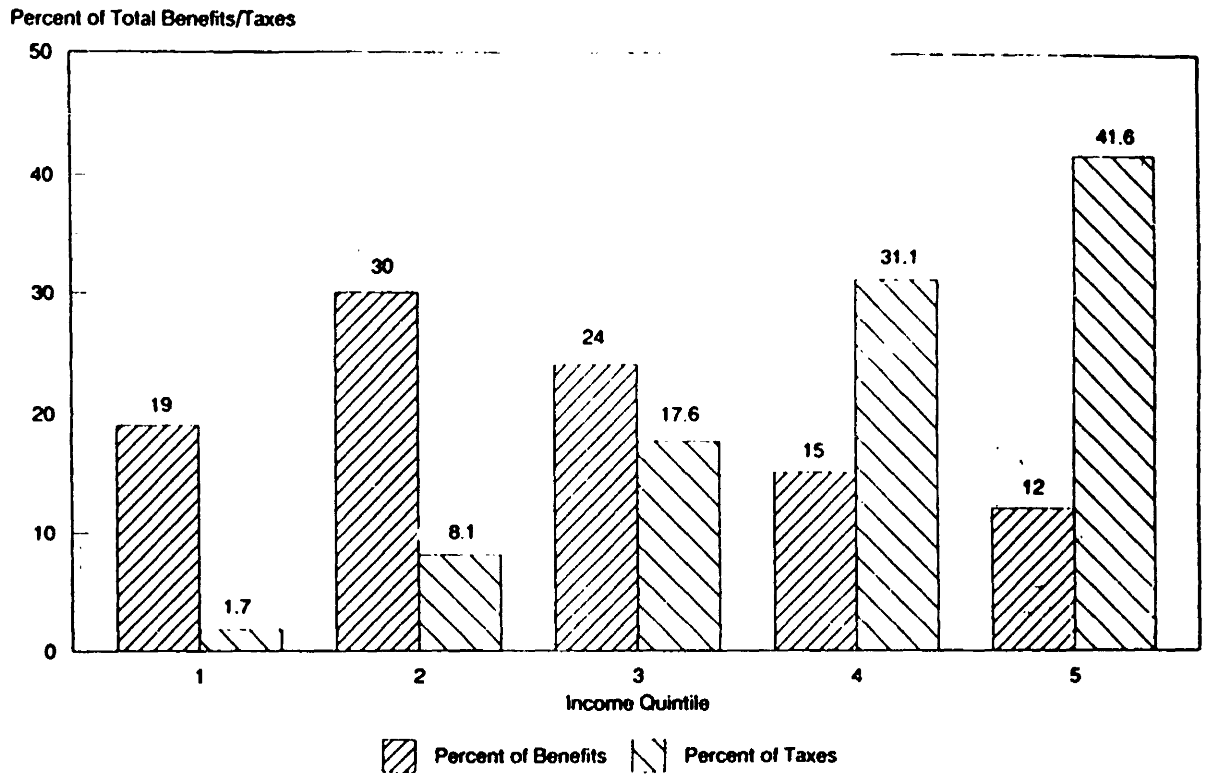
Congressional Budget Office, *The Changing Distribution of Federal Taxes: A Closer Look at 1980,* July 1988.

CHART 1

Share of Social Security Benefits Received and Taxes Paid by Income Quintile
1987

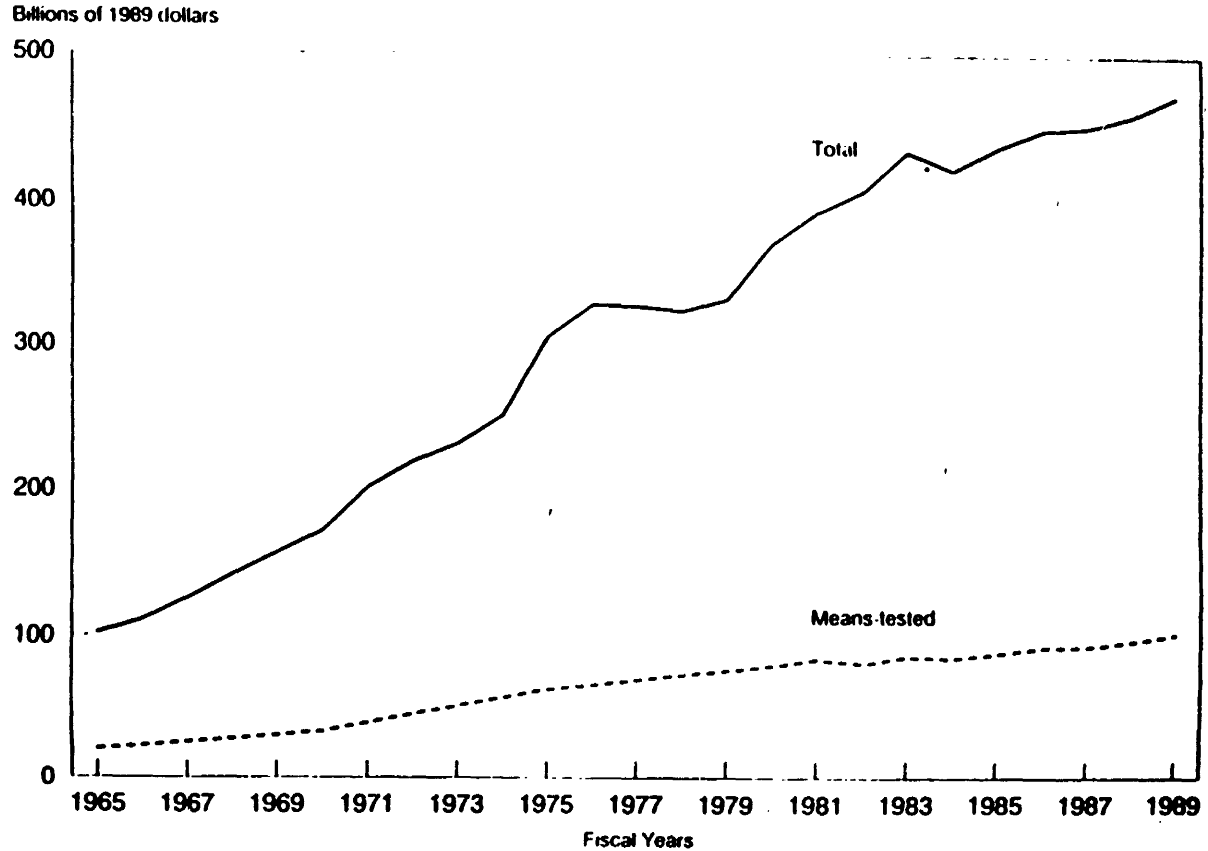


Source: Social Security Administration

Notes: (1) Quintiles are based on Census money income and are not directly comparable to CBO quintiles .
(2) Benefits and taxes are shown for quintiles and do not necessarily represent payments and receipts for each family.

CHART 2

Real Federal Transfer Payments



Source: Office of Management and Budget

Table 5

Income Distribution Before and After Taxes and Transfers 1987

Income Quintile[a]	(1) Income Excluding Transfers[b]	(2) Income After Taxes[c]	(3) After-Tax Income plus Transfers[d]	(4) Net Impact[e]
	-------- percent		---------	percentage points
1	1.0	1.2	4.7	3.7
2	7.6	8.5	10.6	3.0
3	15.2	15.8	16.1	0.9
4	24.3	24.8	23.2	-1.1
5	52.0	48.5	45.4	-6.6

[a]Quintiles of households, defined using income definition in each column.
[b]Money income plus capital gains and health insurance, less government transfers.
[c]Income as in b, less Federal and state income taxes and employee social security payroll taxes.
[d]Income as in c, plus cash and non-cash government transfers.
[e]Net impact of taxes and transfers on the share of after-tax income; column (3) minus column (1).

Source: Bureau of the Census (1989)

Prepared Statement of Senator Bob Dole

[February 5, 1990]

INTRODUCTION

Mr. Chairman: Let me begin by thanking you for scheduling this hearing so quickly. There seems to be some real interest here: Senator Moynihan certainly got our attention by shouting "Social Security" in a crowded Congress.

I've had the honor of working with the distinguished Senator from New York on Social Security when we served together on President Reagan's blue ribbon Social Security Commission. In fact, one of the proudest moments in my Senate career took place in 1983, when Senator Moynihan and I helped get the rescue operation back on track.

It took weeks and months and plenty of guts to fix Social Security. But we did it; we rescued the system. One irony is, today, some people are accusing us of "over-rescuing" it! It's true, those of us who served on the Social Security Commission never anticipated that the trust fund reserves would grow so large, but the economy has grown faster than we'd ever dreamed possible.

OUR INVESTMENT IN THE FUTURE

Despite our current embarrassment of riches, one of the biggest problems we face is a lack of confidence in the system. We have to assure our senior citizens that the program will continue to be there for them, as well as convince young workers that something will be left when they retire.

Senator Moynihan, himself, has suggested that the members of the Greenspan commission actually planned a build-up in reserves to increase confidence in the system. In a speech to the national academy of social insurance last year, Senator Moynihan explained the Greenspan commission wanted to "build a reserve in the trust funds that people could see and believe in." Now, it seems that the reserves have themselves become the issue.

No one denies that as long as the rest of the budget is in deficit, the surpluses help finance non-Social Security spending. Although this was not the intention of the bipartisan Social Security rescue effort, the answer should not be simply to cut the payroll tax, or cut benefits, or raise other taxes. Those answers bring with them some serious questions.

PRESENT RESERVES ARE NOT ADEQUATE

First, "What is a safe level of Social Security reserves for a pay-as-you-go plan?" Although Senator Moynihan has acknowledged the reserve is not yet at a safe level, he himself can not pin down exactly what a safe level is. Frankly, I don't know the correct answer either.

As we learned when we played this numbers game in 1983, the adequacy of the reserves depends heavily on the behavior of the economy as a whole. Alls well into the near term under intermediate assumptions, but under the so-called pessimistic assumptions, OASDI would be insolvent in 1998. I note this only to underscore what you know better than—actuarial calculations may be a science—but it's an imperfect science.

I, for one, don't want to face the prospect of having to cut benefits because of a miscalculation.

IS THE MOYNIHAN PLAN A STEALTH TAX INCREASE?

Second, we must squarely face the question, "What happens after a social security tax cut?" Let's face it: the bottom line is the Moynihan plan will eliminate $55 billion from the Federal balance sheet. How are we going to make that up? Both Henry Aaron and Charles Schultze have argued, correctly in my view, that simply cutting payroll taxes would only serve to worsen the budget deficit and further reduce the nation's already low savings rate.

MEDICARE IS UNDERFUNDED

While the Social Security trust fund may be in good shape, the Medicare trust fund is scheduled to go broke around the year 2002. Any Social Security reform plan must acknowledge Medicare's endangered future, as well as the fact that the aging of the population is placing a great many additional demands on the program—not the least of which is the need for a long-term care program. While I'm not arguing for an interfund transfer or a reallocation of the tax, those possibilities would certainly' be considered by any group seriously considering social security reform.

ALTERNATIVES TO MOYNIHAN

As I noted earlier, it seems to me that in addition to the problem of what to do with the surplus, we also face the problem of convincing the American people that the social security system is secure. Maintaining any kind of support for the continuation of a trust fund surplus will be next to impossible if people are not convinced that Social Security will be there when they retire.

I expect there will be alternatives to Senator Moynihan's proposal coming along in bunches soon. The President has already announced a plan that would fence off the Social Security surplus to prevent it from being used for deficit reduction.

On another tack, Senator Symms proposes gradually funneling FICA taxes into a Social Security family savings plan. It is a radical alternative, but one which he argues guarantees a much-needed increase in our nation's savings rate.

Of course, the easiest approach would simply be to develop new Gramm-Rudman-Hollings targets that exclude the Social Security trust fund after we balance the budget in 1993. I have been told Senator Heinz, Senator Domenici, Senator Rudman, and Senator Gramm are working on exactly such a plan. I look forward to seeing what they come up with.

CONCLUSION

While I'm not dismissing any one option until I've had a chance to examine them all, I do reject out-of-hand the notion that we can simply add $55 billion to the deficit. Moreover, I want to emphasize that I am not prepared to simply throw out the 1983 Social Security agreement.

President bush laid down a huge marker in his state of the union address when he said, "The last thing we need to do is mess around with Social Security." I agree. This Senator isn't ready to "mess around" with Social Security. And I happen to believe 38 million Social Security recipients don't want us "messing" with it either.

I look forward to hearing from our distinguished witnesses and having the opportunity to examine the Moynihan proposal in depth. Let's look at the surplus issue and let's do it together.

PREPARED STATEMENT OF SENATOR DOLE

[February 8, 1990]

SOCIAL SECURITY TAX CUT

I would like to again thank Senator Bentsen for holding these hearings so quickly. "What to do with the Social Security trust fund surplus?" is clearly the question of the hour. Although the Congressmen in this room may support approaches, one thing we all agree on is the need to protect beneficiaries—now and in the future.

Since we are fortunate today to have with us some of the best economists in the country, would like to ask them to address exactly this issue—how can we best protect beneficiaries. Should the surplus be diverted into private investment? Or is the president's plan to protect Social Security by running a budget surplus a better route?

Although we wrestled with many of these technical questions during the 1983 Social Security reform debate, they are still with us. That's testimony to how complicated this issue really is. Congress needs your help.

PREPARED STATEMENT OF ARTHUR FLEMMING

I. INTRODUCTION

A. I appreciate appearing before the Senate Finance Committee to discuss, in behalf of the Save Our Security Coalition, the proposal made by Senator Moynihan. (S. 2016)

B. The AFL–CIO, which is a member of our coalition issued its own public statement and is presenting testimony to this Committee. The same approach has been taken by the United Automobile Workers, the American Association of Retired Persons, and the National Council of Senior Citizens. The American Foundation for the Blind does not concur in the views expressed in this statement.

C. Senator Moynihan has raised a valid and important point about the fiscal imbalance in the Federal Government's operating budget and the fact that the true

Federal deficit is being masked by including the Social Security reserves when determining the deficit. Our comments on the proposal follow:

II. BODY

A. There should be *no* immediate cut in the OASDI tax rates:

1. Old-Age, Survivors and Disability Insurance does not yet have sufficiently large contingency reserves.
2. Most experts believe, at a minimum, a 1 to 1½ year contingency reserve is necessary to protect the system in times of economic downturns.
3. Currently the contingency reserve is at three-fourths of a year. A 1½ year's reserve will not be reached until approximately sometime between 1993 and 1995 depending on economic performance.

B. The Social Security trust funds should be removed from the Gramm-Rudman-Hollings deficit calculation. (S. 219)

1. If the trust funds were removed from the Gramm-Rudman-Hollings calculation, the Social Security trust funds would cease to "mask" the deficit, thereby, encouraging action to reduce the non-Social Security deficit.
2. When the Social Security Trust funds are no longer counted in determining the size of the deficit action should be taken immediately to prevent serious reductions in vital domestic programs by diverting funds from military to non-military purposes, by increasing taxes to provide additional revenues, by revising the Gramm-Rudman-Hollings law or by some combination of these three approaches.

C. We should avoid eroding the renewed confidence in the Social Security System of both the beneficiary and the worker populations that has been established as a result of the 1983 amendments to the Social Security Act.

1. A significant reserve should be preserved in the Social Security trust funds in order to avoid in the future sudden decisions either to make major benefit cuts or increase payroll taxes.
2. However, the specific level of surplus and the payroll taxes necessary to support that level is a subject of legitimate debate and discussion.

D. If the goal of the Moynihan proposal is tax relief for middle-low-income workers, consideration should be given to ways to accomplish that goal which will not erode confidence in the Social Security System. (For example, expansion of the earned-income-tax-credit.)

1. It should also be recognized that the Moynihan plan provides for reducing taxes for employers—an action which would not provide any relief for middle and low-income workers.
2. In addition the Moynihan plan lowers the Social Security tax rates but does not have a plan to increase taxes in order to offset the additional deficit created by this cut.
3. The Moynihan plan, by removing large amounts of revenue from the operating budget and not replacing them, could in the short-run, result in a sequester of funds under Gramm-Rudman-Hollings that would negatively affect vital domestic spending programs.

E. Allegations that have been made in the dialogue resulting from the Moynihan proposal that the Government is "stealing" from the trust funds result in serious misunderstandings that contribute to an undermining of confidence in the Social Security System.

1. The Treasury, as it has been doing since the beginning of Social Security over 50 years ago, is investing the Social Security reserves in government securities and when it does so is issuing demand notes with the same legal standing as a government bond and is making regular interest payments on these notes.
2. The unsound fiscal policy now being followed by the Federal Government results in the money borrowed from the trust funds being used for current operations rather than for debt reduction or investment.
3. A sound fiscal policy would result in the money borrowed from trust funds being used, for example, to help retire the Federal debt. This, in turn, would mean that the Federal Government's financial burden of redeeming the demand notes in the trust funds would be much easier to meet when the payment of benefits begins to exceed income in approximately 2020.

III. CONCLUSION

A. No major change should be made in the method of financing our Social Security System until the Congress has had the opportunity of deciding how a national health plan can and should be financed.

B. Hopefully, as a result of the work of the Pepper Commission, the Congress will have the opportunity of confronting this issue in a short period of time.

PREPARED STATEMENT OF JERE W. GLOVER

Mr. Chairman and Members of the Committee: Thank you for the opportunity to present our views on S. 2016 and related legislation.

My name is Jere Glover and I appear before you today on behalf of the fourteen million self-employed Americans and the 200,000 members of the National Association for the Self-Employed.

The vast majority of our members are family-owned businesses. They span the entire spectrum of industries, including services, retail, construction, manufacturing and even farming. Many are home-based businesses. Over 90 percent of our members have fewer than 5 employees.

Mr. Chairman, at the 1980 White House Conference on Small Business, delegates voted the issue of the impact of Social Security on their businesses as number 17 on the list of the 60 most vital issues.

At the 1986 White House Conference on Small Business the same issue was voted the eighth most important of 60 issues.

If such a conference was held today, I believe the issue would be ranked as one of the top issues. I make that statement, Mr. Chairman, with conviction, having been Counsel to the 1980 Conference and a delegate to the 1986 Conference.

Your hearings on this subject are most timely.

In order to better understand our position on this legislation, it is important to understand some facts about what it means to be self-employed.

In 1982, the latest year for which data are available, there were 13 million sole proprietorships that filed business tax returns with the Internal Revenue Service. While these firms had receipts of $490 billion, they had an average net income of less than $10,000. In fact, over half of these businesses had total sales of less than $10,000.[1] Presuming only a 40 hour work week, the owner made $4.80 per hour!

It is important to understand therefore, that any tax that is regressive, such as the Social Security tax, is very, very significant to these individuals. Reducing their bottom line by $300-600 can be critical to the firm's survival:

Although our discussion is focused on businesses at the lower end of the earnings spectrum, those with greater earnings are also adversely affected since the maximum taxable earnings base has doubled in the past decade. Those individuals have seen their Social Security taxes increase from $2,097 to $7,848, a four-fold increase.

Secondly, self-employed businesses whose Social Security tax rate was 8 percent just 10 years ago, now must pay 15.3 percent—an increase of 90 percent in the last decade!

Thirdly, Mr. Chairman, since the spousal exemption was eliminated in 1988, self-employed, family-owned businesses in which the spouse often is critical to success, have had their Social Security payments doubled. The latest increase raised the rates for these firms to as much as 30.6 percent of the firm's net income. Two years ago when the spousal Social Security tax took effect, a spouse who earned only the then minimum wage of $3.35 an hour for a 40-hour work week added $1,050 of new taxes to the business costs and diminished the family and business income accordingly.

With all of these facts in mind, it is clear why we wholeheartedly support your efforts to reduce payroll taxes.

Only last week I received a call from a self-employed businessman who reminded us that many localities, including New York City, where he is located, impose a separate tax on the self-employed. During our conversation he said, "The self-employed are fast becoming an endangered species."

Recent economic indicators from the Council of Economic Advisors tend to support his contention.

Mr. Chairman, today there are fewer new businesses starting, and those that do earn less money. These changes have occurred at a time when these businesses' payroll taxes increased by 90 percent in 10 years.

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[1] SOI Bulletin 8, No. 4 (Spring 1989): 105, 116.

Since emerging from the 1981-82 recession, we have witnessed a steady decline in the year to year increase in self-employed non-farm earnings.

In 1983, net earnings of proprietorships increased at a yearly rate of 18.2 percent. By contrast, in 1989, sole proprietorship earnings increased by only 5.5 percent, almost all of which is directly attributable to inflation.

Since there was an increase of 450,000 in the total number of businesses, earnings per proprietorship actually decreased.[2]

It begs the question, Mr. Chairman, is there a correlation between the increase in payroll taxes and the decline in proprietorship profits and the decline in the rate of new business starts?

Every time we add a new burden on business, whether it be increased minimum wages, mandated health benefits, parental leave or increased government regulation of any kind, it impacts disproportionately on the self-employed.

A Social Security tax reduction of 2 percent over the next two years or 4 percent in the case of family-owned businesses in which the spouse is employed full time, could have several salutary effects.

It could increase the self-employed firm's profitability.

It could provide funds many self-employed firms lack to provide themselves or their employees with fringe benefits such as health insurance.

It could allow self-employed firms to pass on to customers a portion of added profits in the form of lower prices and thus become more competitive.

It could strengthen and improve self-employed firms' productivity.

I would like to paraphrase a political adage coined many years ago by one of your distinguished colleagues: "Don't tax you and don't tax me. Tax the man behind the tree."

In this case, Mr. Chairman, the self-employed have been behind the tree for too long. We are often too busy just surviving and staying in business to let Washington know how legislation impacts us. We don't usually scream. Only when the pain is too great do you hear from us.

We are fully aware of the complexities of this issue and certainly do not take them lightly. The self-employed accept our fair share of responsibility in helping eliminate the continuing and unacceptable budget deficit that is sapping our national strength.

But I submit to you that the self-employed share little if any responsibility for creating and exacerbating the deficit and should not, therefore, bear-what most surely is a disproportionate, and in our view unreasonable, share of the burden of trying to eliminate it.

Lessening that burden by reducing the payroll tax can do more than any-thing else to make the fourteen million self-employed businesses in this nation more profitable, more productive, more competitive and more capable of making a greater contribution to the difficult task of reducing the deficit and restoring the integrity and stability of our Federal finances.

It is not often that small business and the AFL-CIO stand side by side on legislation. Maybe it should happen more often. We both represent hard working people who make too little money and pay too much taxes. The regressive nature of payroll taxes hits both of us hard.

We thank the Committee for your interest in small business and we thank Chairman Moynihan for his concerns about the impact that Social Security taxes are having on the working people of America.

NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED COMPARISON SOCIAL SECURITY TAXES FOR THE SELF-EMPLOYED 1980–1990

Years	Maximum taxable earnings	Self-employment tax	Maximum self-employment tax
1980	$25,900	8.1%	$2,097.90
1981	29,700	9.3	2,762.10
1982	32,400	9.35	3,029.40
1983	35,700	9.35	3,337.95
1984	37,800	11.3	4,271.40
1985	39,600	11.8	4,672.80
1986	42,000	12.3	5,166.00

[2] Lichtenstein, "Measuring Self.-Employed," SBA

NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED COMPARISON SOCIAL SECURITY TAXES FOR THE SELF-EMPLOYED 1980–1990—Continued

Years	Maximum taxable earnings	Self-employment tax	Maximum self-employment tax
1987	43,800	12.3	5,387.40
1988	45,000	13.02	5,859.00
1989	48,000	13.02	6,249.60
1990	51,300	15.3	[1] 7,848.90

[1] Partially deductible.

DRAFT

Table 14—Civil Penalties Assessed and Abated
(Dollars in thousands)

	Assessments		Abatements		Net penalties	
	Number	Amount	Number	Amount	Number	Amount
Total, all civil penalties	29 907,698	11 790,294	3,686,525	4,682,075	26 221,173	7 107 219
Individual Total	16,634,639	3,846,872	1,137,124	494 717	15 497 506	2,361,155
Delinquency	1 790 258	806 218	199 439	200 886	1 590 819	605 332
Estimated tax	4 191 647	737 604	151 142	69 756	4 040 505	667 842
Failure to pay	8 288 842	600 838	605 748	58 547	7 683 094	541 291
Bad check	238 514	6 878	11 808	1 385	226 706	5 493
Fraud	10 257	174 908	733	39 089	9 524	135 320
Negligence	1 902 542	505 084	59 993	72 137	1 842 549	432 927
Other[1]	112 570	214 267	18 263	51 917	94 307	162 350
Corporation Total[2]	837 418	998,636	202,148	668,218	635,261	333 418
Delinquency	162 273	289,264	39 004	245,860	123 269	43 404
Estimated tax	283,727	348,178	44 604	205,311	239 123	142 867
Failure to pay	380 474	246,786	117 968	203,019	262 506	43 [illegible]
Bad check	3 078	159	223	82	2 856	[illegible]
Fraud	468	45 887	22	723	446	45 164
Negligence	6 087	34 218	248	7 225	5 838	26 993
Other	1 303	34 164	80	2,998	1 223	31 166
Employment Total[3]	11,368,898	4,798 718	1,996,643	1,711,267	9,372,255	2,680,451
Delinquency	2 615 324	894 480	394 549	324 681	2 220 775	569 [illegible]
Failure to pay	4 961 830	420 267	869 664	134 824	4 091 966	285 343
Federal tax deposits	3 667 162	2 844 729	717 995	1 250.114	2 949 167	1 594 615
Bad check	113,078	4 671	2,599	191	110 479	4 480
Fraud	561	2 351	52	172	509	2 [illegible]
Other	2,941	3 040	784	1 175	2 157	1 365
Excise Total[4]	486,867	183 644	128,296	132,751	348 462	50 893
Delinquency	147 123	52 948	24 384	33 698	122 739	19 250
Daily delinquency	40 107	50 571	29 420	43 715	10 687	6 356
Failure to pay	234 173	23 577	61 540	14 038	172 633	9 539
Federal tax deposits	39 004	47,004	10 327	34 541	28 677	12 463
Bad check	4,069	96	207	0	3 862	38
Fraud	770	5 824	196	8 638	574	[illegible]
Other	1 411	3 624	131	113	1 280	3 [illegible]
Estate and Gift Total	15,418	90,882	7,563	72,448	7,857	18,283
Delinquency	6 332	56 012	2 541	46 296	3 791	[illegible]
Failure to pay	8,564	30 364	4 856	24 436	3 708	5 928
Bad check	251	334	53	267	198	67
Fraud	3	506	2	562	1	34
Negligence	47	497	9	208	38	289
Other	213	2 999	92	680	121	2 319
All Other Total[5]	414,763	541,848	156,109	320,244	258,654	221,601
Delinquency	217,910	482 580	96 727	264 376	121 183	218 204
Failure to pay	132,289	12 430	44 534	7,315	87 755	[illegible]
Bad check	2,433	83	179	18	2 254	65
Negligence	258	350	37	233	221	[illegible]
Missing information	13,159	22 665	10 180	33 432	2 979	110 567
Other	48,714	23 537	7 452	14,870	41 262	8 667
Non-return[6]	178,132	2,088,777	89,742	1,298,429	188,390	1,373,348

Note: With the exception of estimated tax, assessments and abatements can apply to any tax year.
Detail may not add to totals due to rounding.
[1] Includes taxpayer identification number, failure to report tips, miscellaneous and false withholding.
[2] Includes Forms 1120, 990C and 990T.
[3] Includes Forms 940, 941, 942, 943 and CT-1.
[4] Includes Forms 1041A, 5227, 990PF, 990, 4720, 4638, 2290, 11C, 720 and 730.
[5] Includes Forms 1041, 1065 and individual retirement accounts.
[6] Includes penalties assessable under the Tax Equity and Fiscal Responsibility Act of 1982 and Tax Reform Acts of 1984 and 1986.

Prepared Statement of Alan Greenspan

Mr. Chairman, I am pleased to be here today to discuss the government's role in providing retirement security to present and future generations—an issue that has moved to the forefront of the policy debate. Senator Moynihan has introduced legislation to cut payroll taxes and return social security to a pay-as-you-go basis, and others would like to move its finances fully off-budget.

In large part, such proposals arise out of frustration with the slow pace of deficit reduction, and they have helped to dramatize the seriousness of the current budget situation. But I am concerned that they will ultimately be counterproductive and hamper the efforts needed to meet our longer-term fiscal responsibilities. And, as I hope to make clear, they will increase the difficulty of providing for the needs of an aging population in a way that is equitable across generations. I shall address in particular how the social security system can contribute to those objectives; this issue was a main focus of the National. Commission on Social Security Reform in the early 1980s. I shall also touch on the relationship of social security to the rest of the budget and its role in the setting of overall budget goals.

I have testified often before committees of the Congress about the corrosive effects that sustained large budget deficits have on the economy and about the way our economic prospects in coming years will hinge on our ability to increase national saving and investment. One factor that argues for running sizable budget surpluses by later this decade is the need to set aside resources to meet the retirement needs of todays working population. Although the share of the total population that is in the labor force has risen steadily over the past few decades, that percentage will shrink considerably after the turn of the century as members of the so-called "baby boom" generation begin to retire. Barring a sharp upturn in the birth rate, a large influx of immigrants, or a significant increase in the age of retirement, growth of the labor force will slow appreciably.

The demographics are compelling. In 1960, there were twenty beneficiaries for every one hundred workers contributing to social security; currently there are thirty. The Social Security Administration—under intermediate economic and demographic assumptions—expects that number to approach fifty by about the year 2025 and to remain at that level at least through the middle of the 21st century.

Assuming their living standards keep pace with those of the working population, the elderly will of necessity consume a growing proportion of total output in the future. They will finance their consumption out of private and public pensions and by drawing down their own assets. Nonetheless, the goods and services they buy can only come from the output of then-active workers. The allocation of production to meet the needs of retirees necessarily will cut into what is available for consumption by the rest of the population and for investment in new equipment and structures.

We can do little to change the demographic forces. We can, however, take actions now that will help to lift the size of future output above that implied by the current pace of capital formation and the trend in productivity. Such actions will improve the likelihood that future workers can maintain their living standards while satisfying the retirement expectations of current workers. Your decisions will also influence how much of the burden of its retirement the baby boom cohort will shoulder for itself and how much will fall on its children. Indeed, this is one of the few instances in which policymakers have had the luxury of being able to foresee a problem that a thoughtful policy response might ameliorate. Thus far, I believe, the plan for social security, given the conflicting political pressures, has been reasonable.

One element in the strategy is the accumulation of sizable balances in the social security trust funds over the next few decades. As you know, before the Social Security Amendments of 1977, the system operated, in effect, on a pay-as-you-go basis. The 1977 Amendments set in motion an accumulation of trust fund assets that can be drawn down as required to meet the retirement needs of today's workers. This shift toward a funded system was given careful further consideration by the National Commission on Social Security Reform in the early 1980s.

The deliberations of the commission identified several complex issues. They included difficult questions of equity within and across generations and assessments of the effects social security has on incentives to work and save. We recognized, too, the political riskiness of accumulating large surpluses. On the whole, however, we concluded that each cohort of workers and their employers should make contributions into a fund that, with interest, at least approached the actuarial value of the benefits the workers will eventually receive. Notably, this requirement forces today's workers—including the baby boomers—to pay more in payroll taxes than is needed to cover the benefits of the relatively small group of current beneficiaries, so that sizable surpluses build up in the trust funds. In essence, the commission reaffirmed the intent of the 1977 Amendments; our recommendations were largely accepted by the Congress and hence shaped the legislation of 1983. The current structure of social security may not be appropriate in all circumstances. But, at present, it is still the best; option.

One reason to build surpluses in the trust funds is to set aside saving, and thus to divert part of the nation's current production away from consumption—both private and public. Assuming, of course, that the surpluses are not offset by reductions in the saving of households and businesses or by larger dissaving, i.e. deficits, elsewhere in the Federal budget, they should boost investment and thus foster the growth of the nation's capital stock. And with more capital per worker than would otherwise be in place, productive capacity will be greater, and we will be better able to fulfill our promises to the retirees, while maintaining the standard of living of future workers.

The relationships among saving, the aggregate capital stock, and labor productivity are complex and difficult to pin down quantitatively, in part because productivity depends not only on the amount of physical capital but on factors such as the education and skill level of the work force and the rate of technological progress. Nonetheless, I have little doubt that a larger, more modern capital stock will improve labor productivity and hence overall real income levels in coming years.

Building surpluses in the trust funds also contributes to fairness across generations. Given the demographics, the generation after the baby boomers will have to shoulder a fairly heavy burden to meet the retirement claims of their parents. This burden can be ameliorated only if current workers save enough during their working years to fund, in effect, their own retirement. Saving today will not reduce the share of GNP that will be transferred to retirees tomorrow; however, current saving directed toward capital formation will help to ensure that overall incomes in the future will be large enough to provide benefits to retirees without denting the standards of living of their children too deeply, if at all. The current social security system, when used properly, has such a focus and affords an opportunity for today's workers to lighten the burden on the workers of the next generation.

Pay-as-you-go financing does not have that focus. Rather, each year, workers and employers contribute only enough to cover the cost of providing benefits to current recipients and to maintain a contingency reserve sufficient to carry the system through periods of poor economic performance. Thus, returning to pay-as-you-go now would confer a significant windfall on the baby boomers who, in effect, would benefit doubly from the size of their age cohort. Given their numbers, each would make a disproportionately small contribution during his or her working years to the retirement of their elders. Yet in retirement, each would expect to receive full benefits, which could come only at a disproportionately high cost to their children. At that time, pressures may well emerge to stretch out benefits by, for example, increasing the retirement age to reflect rising life expectancies.

Linking an individual's benefits to his or her contributions has generally been considered equitable and desirable. Under the present system, the current generation of workers and the next will face the same OASDI tax rate of 12.4 percent, summing the employee and the employer shares. Assuming that benefits evolve according to existing laws—and that social security revenues are set aside, rather than used to lower other taxes or raise other outlays—the system moves in the direction of actuarial soundness; it confers no windfall gains or unforeseen losses on any particular generation. Accordingly, it offers some assurance to current and future workers that the government will keep its promises.

Senator Moynihan's proposal cuts the OASDI tax rate to 10.2 percent of covered wages in the 1990s. However, as his bill makes clear, with pay-as-you-go, rates will have to rise sharply once the baby boomers begin to retire; the proposed rate for the years 2025 through 2044, for example, is 15.4 percent. Support for the system may well erode when the next generation is asked to take on a tax bill that their parents were unwilling—or too short-sighted—to assume during their own working years.

The choice of financing mechanism can also influence the mix of Federal taxes. Indeed, the increase in the share of payroll taxes in total revenues—and the regressiveness of these taxes—is frequently cited as a reason to return to pay-as-you-go financing. However, looking at just the tax side presents an overly narrow view of the relationship between social security and the distribution of income in the United States. When considered from the perspective of an individual's lifetime—and when the formula for benefits as well as contributions is taken into account—social security clearly appears progressive.

The numbers are striking. Consider individuals who retire this year at age 65 after working forty years. All anticipate receiving a benefits annuity that equals or exceeds in present value terms the sum of lifetime social security contributions plus accumulated interest. The return for low-income workers, however, is especially great. In fact, the average minimum-wage worker can expect benefits that—relative to contributions—are roughly 1½ to two times as large as those received by persons with above-average earnings.

In any event, although the current system assigns them a leading role in providing retirement incomes in coming decades, the trust funds are only part of the story. In reality, the social security reserves are merely a bookkeeping entry within the Federal sector. Ultimately, their size matters only to the extent that they lead to smaller overall Federal budget deficits—or larger total surpluses—and thus to higher national saving than would otherwise be the case.

At present, the contribution of the trust funds to national saving is greatly diluted by the large deficits in the rest of the budget. As long as the non-social security deficits remain sizable, Senator Moynihan and others are correct in pointing out that we are doing little to solve the future retirement problem. If, however, actions are taken to bring the rest of the budget into balance, the trust funds will no longer be financing current government consumption, but will. translate dollar-for-dollar into national saving.

Where in the total unified budget the saving takes place—in social security or elsewhere—is of secondary importance. What matters in terms of reaching our longer-term growth objective is the government's net contribution to national saving. The important policy issue in the current context, therefore, is whether any of the major proposals regarding social security will help to achieve that goal. For example, is the Federal Government more likely to shift toward a position of positive net saving if social security is returned to pay-as-you-go financing? Given the large revenue loss implied by the plan, I think not.

Another proposal is to move the social security system fully "off-budget," so that the trust funds would be excluded from the official summary budget figures and from the setting of deficit targets. Unlike Senator Moynihan's plan, a switch in budget accounting systems in isolation would not change the government's contribution to national saving and thus would have no direct effect on the economy. But the proposal raises other concerns.

First, splitting off social security—or any other program—would highlight a distinction that has little macroeconomic or analytical significance. Regardless of which numbers are reported, government saving or dissaving would continue to be well-approximated by the surplus or deficit in the total Federal budget as currently defined in the National Income and Product Accounts, a close variant of the total unified budget.

Moreover, the way budget numbers are presented can influence public perceptions of important fiscal issues and thus—for good or ill—shape the debate among policymakers. As a consequence, methods of accounting and presentation can play a role in determining the size of the overall deficit or surplus. In particular, I fear that adopting a system that draws attention to the surpluses in the trust funds might foster the illusion that we already are putting enough money aside to meet future obligations. Furthermore, it would tend to remove social security from the broader fiscal policy debate.

In large part, my concerns are grounded in the analytical issues discussed earlier. But they are compounded by a technical factor that affects the interpretation of the commonly cited statistics on the social security trust funds. For example, the Congressional Budget Office projects that the annual surplus in the OASDI trust funds will increase from $66 billion in fiscal 1990 to $128 billion in fiscal 1995. But, as CBO points out, fully half of the difference between those two figures is accounted for by the interest received on the trust funds' holdings of government debt, which is forecast to grow from $16 billion to $50 billion over that period. The latter figure represents nearly 0.7 percent of the GNP projected by CBO for that year. Moreover, in their report for 1989, the Social Security Board of Trustees projects that ratio to rise to 1.3 percent of GNP by the year 2030. Such intragovernmental interest payments are both an inflow to the trust funds and an outlay from the general funds and wash out when the accounts are consolidated. But, because they result in an overstatement of both the saving taking place in the trust funds and the dissaving elsewhere, they can contribute to a significant misreading of saving trends when either part of the budget is considered in isolation.

The figures over longer time horizons are even more dramatic, magnified by the wonders of compound interest; but the story is much the same. For example, the Social Security Trustees project that net inflows to the trust funds—apart from interest—will remain at their current level of about 1 percent of GNP over the next twenty years, then turn sharply negative once the baby boomers retire in force.

However, because of the surging interest payments, trust fund assets will continue to grow for a time, reaching a peak of about $12 trillion around the year 2030. Excluding interest payments, those assets will rise to only about $3 trillion around the year 2020 before turning down. Thus, the peak trust balance in 2030 will essentially represent interest receipts that are offset elsewhere in the Federal accounts. While the contribution of social security to national saving is sizable—over both the medium and the long term—it is clearly much smaller than the conventional calculations suggest.

More generally, I fear that moving away from the unified budget concept will impede the achievement of the sizable deficit reductions that the nation so sorely needs. The arguments are well-known. Many of them center on social security itself and on the inevitable pressures that would develop to expand benefits or cut payroll taxes if the system were not subject to the discipline of an overall deficit constraint. In the absence of offsetting changes elsewhere in the budget, such actions would reduce national saving and over time worsen the burden on the generation after the baby boom.

Moreover, responsible budgeting requires a comprehensive framework for setting priorities and assessing competing claims on national resources. That function currently is filled by the unified budget process. If deficit targets were to be set exclusive of social security, they could be met—at least in part—by moving related programs into the social security account or by shifting other trust funds off the books. Such actions would shrink the on-budget deficit but would not reduce Federal demands on private saving or on credit markets.

Most important, we must not allow the choice of a budget accounting system to divert attention from the pressing need for meaningful deficit reduction. In other words, the Congress must take actions to set the Federal government's claim on saving—however the budget deficit is measured—firmly on a downward track. Making a serious commitment to eliminating the unified deficit within the foreseeable future is an essential first step, and meeting that commitment will be a formidable challenge. But it is just a first step. If households and businesses continue to save relatively little, then the Federal Government should compensate by moving its budget in the direction of greater surplus.

Let me reiterate that the source of our fundamental budget problem is the persistence of enormous deficits at a time when demographic trends call for increases in private and government saving. Undoing a social security system that is the result of many years of careful consideration and compromise, in my judgment, will not address our fundamental policy needs. Indeed, it could be counterproductive.

Prepared Statement of Senator John Heinz

Mr. Chairman. The subject of this hearing is quite simply this: Is the Congress going to start telling the American people the whole truth—or is the Congress going to continue to engage in repeated annual acts of budget deficit deception by spending the Social Security reserves to mask the real size of the deficit. Pat Moynihan calls this thievery. I call it embezzlement. He and I have sung a duet on this subject, and I thank you, Mr. Chairman, for orchestrating this forum and providing a captive audience.

In any case, it is time for Congress to stop the Social Security skullduggery that Congress started and which Congress continues. Congress' practice of embezzling the future security of America's retirees is both deplorable and irresponsible. But to stop it, we don't need to put anyone in jail—all we need to do is tell the American people the truth.

Why is it so hard to get Congress to face up to the problem and stop it? Because the now standard of practice of deficit deception has been legislated by the Congress and condoned by the Congress, and the Congressional leadership does not want to admit that Congress bears the responsibility for this scandal.

Chart 1 shows the true deficit story. This black line represents what we tell the American public is happening to the deficit. But the truth—once we subtract the Social Security reserves shown by the green line—is totally different. In the year 2000, while we pretend the budget is balanced, the government will actually be in the red to the tune of $208 billion.

This is why I offered the amendment to take Social Security off-budget totally in 1983; why I held up "the Senate for two weeks to try again in 1985, and brought this issue up in this Committee repeatedly last year. To no avail. That's why I insisted that the Senate vote on the issue when the Debt Ceiling bill was on the floor last November. And what happened? The Senate leadership was so embarrassed by telling the whole truth and nothing but the truth, that the Senate leadership tried to confuse the issue by accusing us of trying to bring the government to a halt. But now the secret is out. And, like democracy in Eastern Europe, truth in Social Security budgeting is an idea which cannot; be denied.

Mr. Chairman, I am grateful to get this issue on the right track, but I am concerned that S. 2016—the Moynihan proposal—will wreck the entire train. The Moynihan proposal, will, in my opinion, derail years of efforts to ensure that the Social Security system remains sound, secure and on a strong foundation. I have three specific comments.

My first point, to put it plainly, is that the Moynihan proposal will almost certainly bankrupt the Social Security system in short order. This is not only my own conclusion, it is clear from the charts and tables provided by the Finance Committee staff. Based on an entirely plausible set of economic assumptions, Table 32 shows that the Moynihan proposal would create annual and rapidly growing shortfalls in the entire Old Age and Survivors program beginning in 1992 and will literally completely bankrupt the Social Security system by 1998. In short, those who support the Moynihan plan are proposing a clear and present danger to the safety and soundness of Social Security and both its present and future beneficiaries.

Some will say that the next more optimistic set of assumptions, II B, should be the basis for any analysis. Let's look at those II B assumptions first before we accept them. They are:

- Inflation of exactly 4 percent every year for ten years, even if we know energy prices will be going up and the purchasing power of the dollar, down;
- An entire decade without a recession or even an economic slowdown;
- Unemployment that never rises above 5-1/2 percent; and
- Wages that are increasing 30 percent faster than prices forever in the face of more and tougher foreign competition from EC92 and Eastern Europe—who are we kidding?

Mr. Chairman, these assumptions describe a world we might all *dream* about living in. But, unless you believe in the Easter Bunny, there is little chance that they describe the world we *will* live in. In the real world, the Moynihan plan is nothing less than a sugar-coated poison pill for Social. Security, the equivalent of the Medieval practice of purging the patient of disease by bleeding him to death, and the Finance Committee's own numbers prove it.

My second concern is that the Senator's tax break for working Americans actually cuts a hole in their wallets. It's a matter of simple arithmetic. Unless we are willing to increase the national debt by $55 billion next year—then what we subtract from general revenues through a payroll tax cut, we have to make up by either massive spending cuts or hiking taxes.

The second chart I have illustrates this point. Remember, employers and workers pay an equal amount into Social Security each month. So half of the $55 billion in payroll tax cuts—$27.5 billion—will go into the wallet of individuals, and half into that of employers. In fact, this the biggest business tax cut in history. And the question I want to ask is: if we have to raise taxes to make up any of the difference, is it the business beneficiary of this liberal corporate largess who will pay most of the increase, or will it be the wage earner and consumer?

Let's look at the likely strategies to recoup that money—such as Senator Hollings' 5 percent Value Added Tax (VAT) A national sales tax will shift a disproportionate burden to individuals at the cash register. Conservatively 90 percent—or $49.5 billion—of dollars generated by a VAT tax will be paid by individuals—$1.50 in new taxes for every $1 in tax cuts.

Or take another alternative to make up the revenue loss: increasing the gasoline tax. Here again, 80 percent ($44 billion) of the total tax would be paid out of the pockets of individuals, while 20 percent ($11 billion) would come from industry.

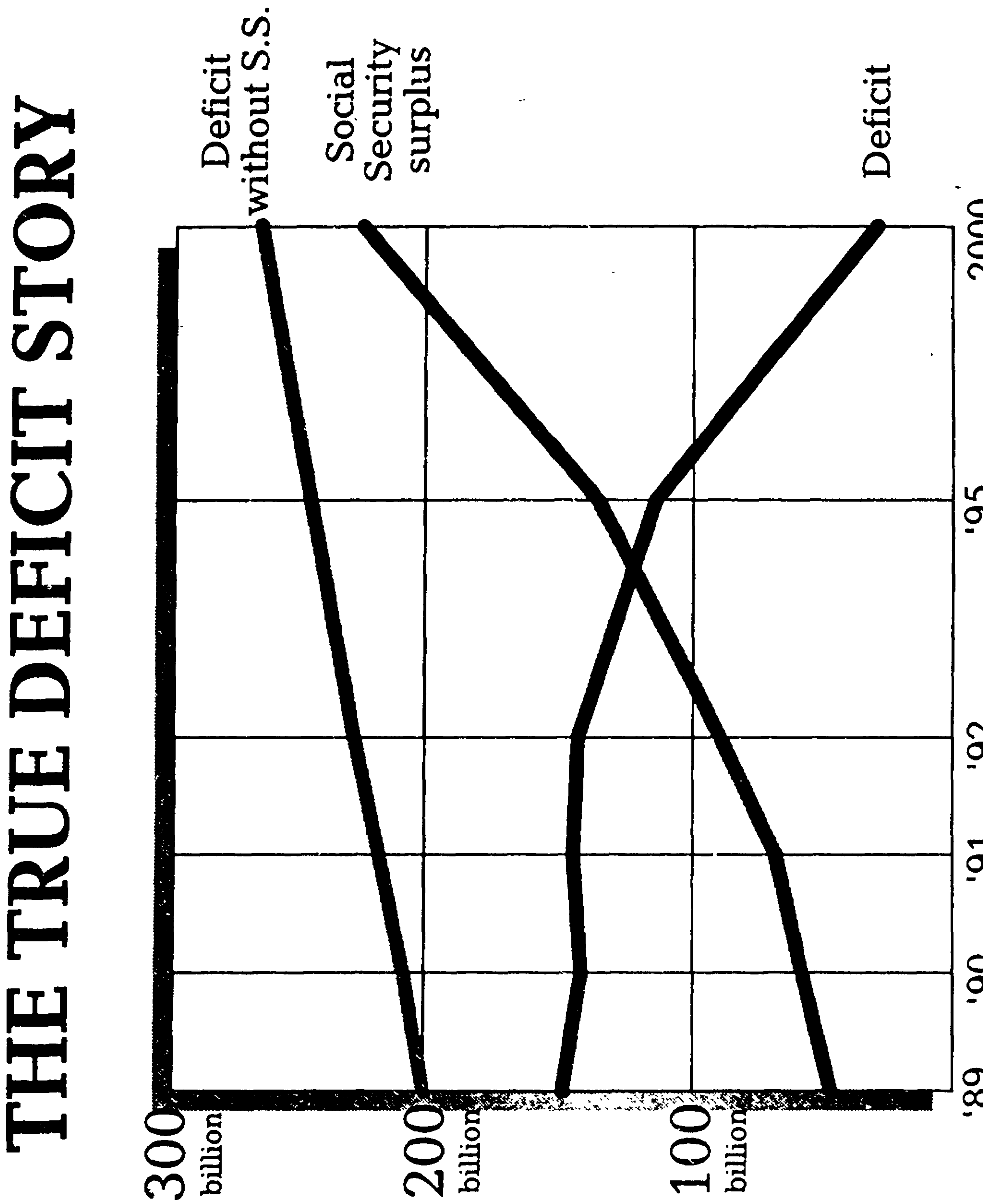
Let's look at exactly what this means for a typical worker's pocketbook. As the next chart illustrates, a worker earning $24,000 a year will take home $240 more a year from the Moynihan proposal. But that same worker will pay out $360 a year in added sales taxes or $401 a year in the way of increased gas taxes. What might sound good to workers when they hear the term "payroll tax cut" will be, in fact, a tax increase. what goes in one pocket will come out the other much faster.

The reason workers will lose, of course, is that exactly one-half of the $55 billion Moynihan tax cut goes not to workers, but to business because business pays a Social Security contribution equal to that of every worker.

And that brings me to my third point. I've said that the Moynihan plan proposes the biggest business tax break in history—a minimum of $150 billion over five years for every type of business from McDonalds to General Motors. It marks the first time we would knowingly shift a massive amount of tax burden off of business and onto the shoulders of wage earners and consumers. The Moynihan plan is tax reform thrown into reverse.

Mr. Chairman, we should reject the Moynihan plan because its sugar coating hides a twin toxic menace: poison that w.ill bankrupt Social Security and burden the many to the benefit of the few.

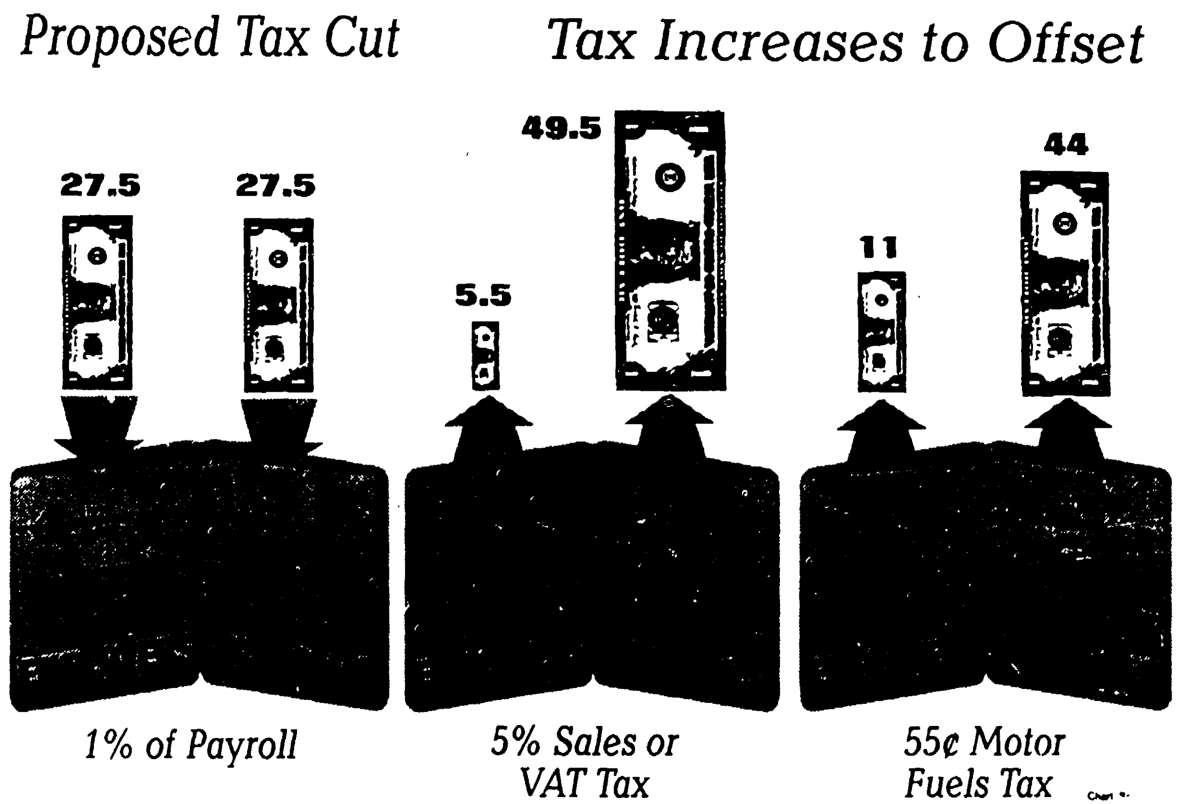
The best way to achieve a solution to this problem is to remove the Social Security Old Age Survivors and Disability Income Trust funds (OASDI) from the GRH deficit reduction calculations just as quickly as we can.



HOW CONSUMERS/WORKERS LOSE

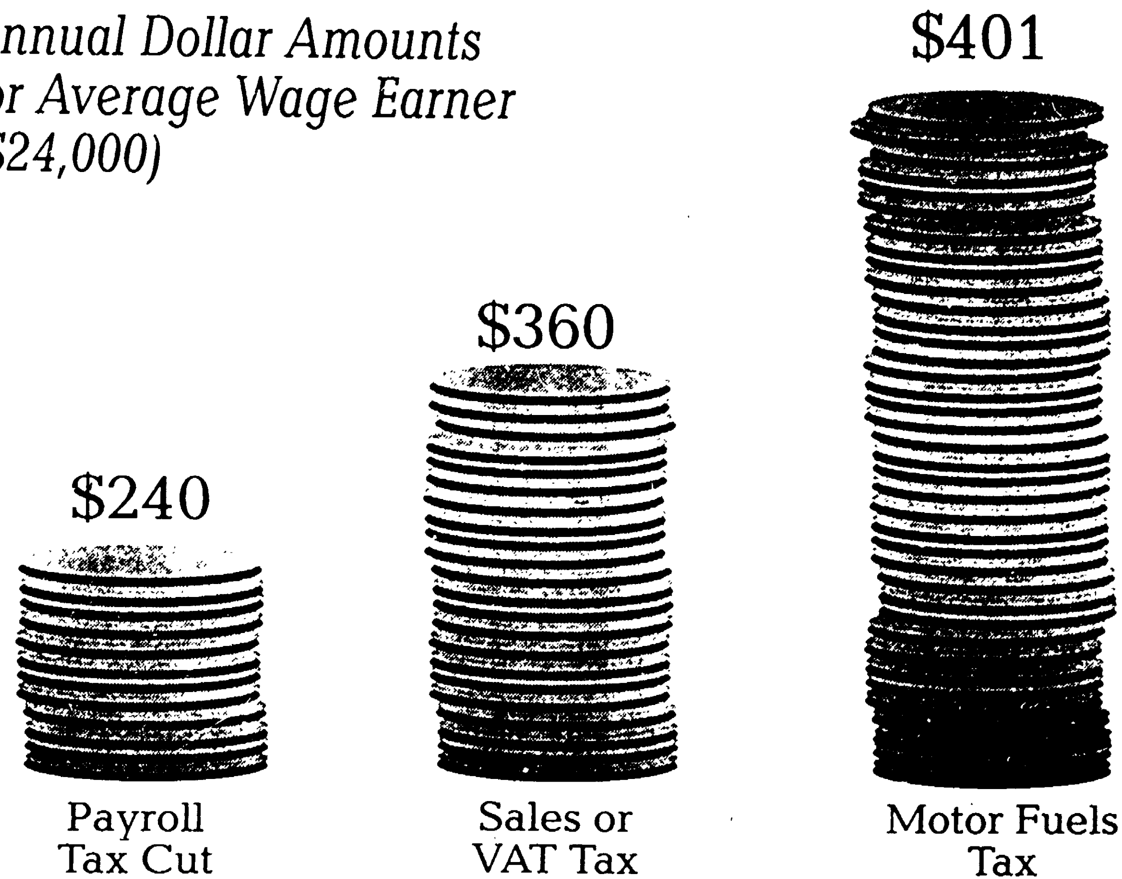
With pay-as-you-go

(Dollars in Billions)



HOW MUCH DO CONSUMERS/WORKERS LOSE?

Annual Dollar Amounts
for Average Wage Earner
($24,000)



PREPARED STATEMENT OF PAUL R. HUARD

I am Paul R. Huard, Vice President of the Taxation and Fiscal Policy Department of the National Association of Manufacturers. I appreciate the opportunity to present to the Committee on Finance the Association's views on proposals to roll back recent increases in Social Security payroll taxes. The main proposal under consideration is a bill introduced by Senator Moynihan, which would reduce Social Security payroll taxes by about $7 billion this year and by $55 billion or more in each subsequent year. Unless otherwise noted, my comments today will be directed at Senator Moynihan's proposal.

NAM opposes the reduction of Social Security taxes from current levels. As you know, the rates currently in effect were adopted in 1983 as part of a bipartisan compromise intended to ensure the adequacy of Social Security retirement benefit financing well into the next century. Among the effects specifically contemplated in the 1983 plan was that, for at least several decades, Social Security tax receipts would exceed the amounts needed for current benefit payments. This imbalance would permit the accumulation of surpluses which would ultimately be drawn down to pay benefits when the so-called "baby boom" generation begins to retire early in the next century.

NAM was a strong supporter of the 1983 Social Security financing reforms and we do not believe those reforms should be dismantled. In our view, the large payroll tax reductions being considered would inevitably lead to one or more of the following results:

(1) subsequent reduction of Social Security benefits;
(2) large increases in the Federal budget deficit; or
(3) large increases in other Federal taxes.

NAM believes all of the foregoing outcomes are undesirable. Given political realities, a benefit reduction seems highly unlikely for the foreseeable future. I will therefore address the balance of my remarks to the deficit and tax issues.

NAM believes that further reductions in the Federal budget deficit, leading eventually to a balanced budget, should rank among our highest national policy priorities. Deficit reduction is essential if we are to bring interest rates down, lessen our dependence on foreign capital and increase net U.S. Savings. In our view, this can best be achieved by gradual restraint in the growth rate of Federal expenditures, without tax increases. If, however, Social Security taxes are reduced in the manner proposed, there will be a significant increase in the size of the Federal deficit in 1901 and later years. Unless offset by spending cuts or increases in other taxes, the higher deficits would make the proposed Social Security tax cuts self-defeating. This is because we believe the resulting increases in the deficit would trigger higher interest rates and renewed inflation which would soon wipe out the $3 or $4 weekly increase in most workers' take-home pay.

We do not, however, believe Congress is very likely to tolerate increases in the Federal budget deficit of the magnitude of $55 billion or more annually. For this reason, we believe the likeliest outcome of the proposed reduction in Social Security taxes would be immediate pressure for offsetting increases in other Federal taxes, most notably income taxes.

The history of the past decade clearly suggests to us that, when seeking additional tax revenues, the current preference of Congress is to turn first to U.S. business corporations. NAM believes this is completely unjustified, since corporations are already heavily overtaxed relative to individuals, paying Federal corporate income taxes, for example, at an effective rate which is roughly triple the effective rate paid by individuals. Further increases in corporate taxation will only worsen the already difficult situation faced by our members in trying to compete in a global economy where most of our trading partners maintain tax systems that are much more hospitable to their domestic companies.

Finally, we believe retention of the present Social Security tax structure is desirable for another reason. In the past decade, Congress and the Administration have made significant changes in U.S. tax laws on a nearly annual basis. What U.S. taxpayers, in particular business taxpayers, desperately need at this point is stability in the Federal tax system, enabling them to do rational business planning on a long-term basis. Dismantling a tax structure that is barely seven years old, and which when adopted in 1983 was supposed to be good for at least fifty years, would further reinforce the perception of many taxpayers that the period of time any major segment of U.S. tax law can be counted on to remain in effect is often measured in months, or at best a few short years.

This concludes the Association's prepared remarks. I would be pleased to address any specific questions any members of the Committee may have.

PREPARED STATEMENT OF GARY HUFBAUER

SUMMARY

Mr. Chairman, seldom does a bill so dramatically alter the political landscape that it promises to correct a major malfunction in our nation's public finances. The proposal sponsored by Senator Moynihan, S. 2016, is one of those rare bills.

My statement can be summarized as follows. There are four good arguments for a pay-as-you-go approach to Social Security financing. There are two strong arguments for a save-the-surplus approach to Social Security financing. There is only one argument—and it is a bad argument—for the present bogus approach to Social Security financing.

In graphic terms, my thesis is summarized in Figure I. Pay-as-you-go would be good public policy; save-the-surplus would be good public policy; bogus funding is bad public policy. Unfortunately, the United States has long wallowed in the trough of bad policy. Senator Moynihan's bill would move our nation out of that trough.

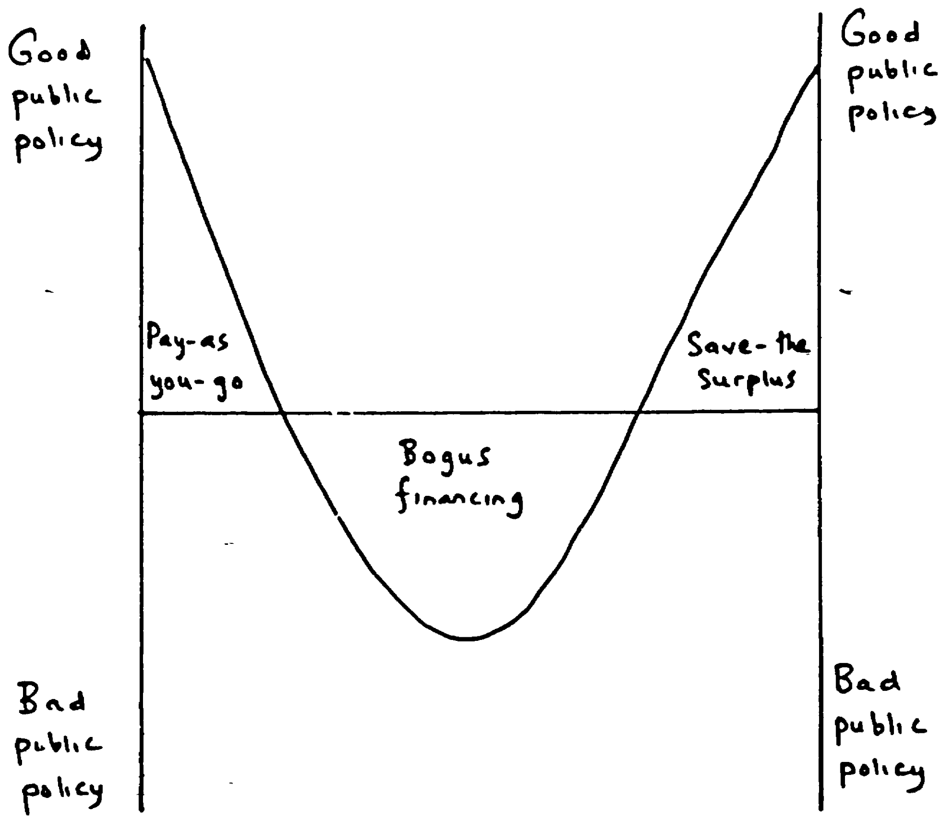


Figure 1

ARGUMENTS FOR PAY-AS-YOU-GO

By pay-as-you-go, I mean a system in which current Social Security receipts match current benefits, with a cushion of one to two years reserves. In this system, today's workers pay for the benefits received by retired and disabled workers. Senator Moynihan's bill would return Social Security to a pay-as-you-go system. There are four good arguments for pay-as-you-go.

1. *Labor Supply.* Social Security is essentially financed by a tax on labor. Half the tax is paid by the employee and half is paid by the employer; but since the total amount of tax (12.4% is directly proportional to the amount of wages (up to roughly the first $51,000 of wages) it all represents a tax on labor services. A tax on labor

reduces the number of people employed, and it reduces the working hours of those who are employed. No one knows how much productive output and employment is lost on account of this tax, but it is; substantial.

One scholar of the social security system, Michael J. Boskin (now Chairman of the Council of Economic Advisors) has summarized his research in these words: [1]

> The empirical results are striking: we estimate (quite precisely) substantial own and cross price elasticities for Current and future consumption and labor supply . . . We also strongly reject the hypothesis that social security had no effect on factor supply.

In plain language, Boskin believes that Social Security taxes reduce employment in the American economy. Moreover, according to Boskin, the U.S. tax system, including Social Security, is especially harsh on female labor participation.[2]

Since a return to pay-as-you-go would entail lower tax rates, the detrimental impact on the nation's labor supply and employment would be correspondingly lessened. Perhaps a million new jobs would be created.

2. *Tax Fairness.* Based on casual observation, my guess is that the United States operates the most regressive tax system of the major industrial nations. The Senate Finance Committee might well ask the Joint Committee on Taxation or the Congressional Research Service to contrast the progressivity of the U.S. tax system with the systems of its principal industrial competitors Japan, Germany, France, Italy, United Kingdom, and Canada—to ascertain the present situation, tax-by-tax. Certainly in none of the other countries can top executives and entertainers earn millions of dollars of annual compensation and pay tax at rates of only 30 to 35 percent.

A major factor in the regressive quality of the United States tax (structure is the large role played by Social Security taxes, which now account for some 36 percent of total Federal receipts. Tax fairness argues that this percentage should be reduced. Pay-as-you-go means lower Social Security taxes here-and-now, thereby contributing to tax fairness.

3. *Moral Hazard.* Judging from the experience of the late 1980s, and projections into the early 1990s, a departure from pay-as-you-go confronts the Federal Government with an almost irresistible moral hazard to finance its operating deficit through the Social Security surplus. Correspondingly, the Social Security surplus yields no net addition to national savings. Instead, discipline is removed both on the tax side and the spending side of the Federal ledger.

4. *Danaer of Back Door Industrial Policy.* The final argument for pay-as-you-go is that its converse, save-the-surplus, would create such an enormous financial surplus that all outstanding Treasury debt would soon be acquired by the trustees of the Social Security system. The Administration and Congress would then be tempted to embark on various types of misguided industrial policies as a way of investing the surplus. The outcome would be a sharp deterioration in the social productivity of the nation's capital stock. This argument has been forth with special vigor by Paul Craig Roberts.[3]

To me, the answer to these concerns is straightforward. In the first place, under the most optimistic save-the-surplus scenario, the Social Security surplus could be entirely absorbed by buying existing Treasury debt obligations until the year 2005. In the meantime, the following steps can be taken:

- Create a Social Security Trust Board, with comparable independence and stature as the Federal Reserve Board. Ensure that the appointees are men and women of proven talent in managing pension funds, mutual funds, and the like.
- Enable the Board to diversify gradually the holdings of the trust fund away from Treasury securities into non-voting corporate stocks, bonds, and other financial instruments.

There is no call whatsoever to "privatize" Social Security. "Privitization" is simply code language for slashing the Social Security benefits of low income Americans.

ARGUMENTS FOR SAVE-THE-SURPLUS

By save-the-surplus, I mean the accumulation of the financial surplus that results from the present Social Security tax rates 6.2 percent each on employer and employee from 1990 on—and no offsetting operating deficits in the Federal budget. Under a save-the-surplus approach, accumulations in the Social Security trust fund would contribute to national savings. There are two strong arguments for save-the-surplus.

1. *Social Security Diminishes Personal Savings.* The first argument is that each household, contemplating the prospect of its future Social Security benefits, tends to save less for its future retirement and disability needs than it otherwise would. This

would not be a national problem if greater public savings (in the Social Security trust fund) were accumulated to offset smaller private savings. But it is a problem when the Social Security surplus is consumed by Federal operating deficits. In that case, total national savings are depressed by the existence of the Social Security system.

There has been considerable debate on the magnitude of the adverse impact that Social Security exerts on private savings. The debate has been summarized by Michael J. Boskin: [4]

> . . . my interpretation of the econometric evidence to date is as follows: There is modest proof that social security has had a direct effect in depressing private savings; the evidence, however, is far from conclusive . . . A good working hypotheses would place the substitution between 25 and 50 cents per dollar [of "social security wealth," i.e. the present value of expected future Social Security benefits to which the working population is entitled].

In other words, Boskin thinks that households may reduce their own savings effort so that their retirement "nest egg" is reduced by as much as 50 cents for every dollar they expect to receive from Social Security.

2. *Low National Savings Rate.* Quite apart from whatever impact that Social Security exerts on national savings, it is clear that the U.S. savings record is dismally low compared to our industrial competitors. On a year-to-year basis, there is a strong link between the national savings rate and the current account deficit in our balance of payments. Thus, a higher national savings rate would go far to reduce the external deficit.

Over a period of years, the national savings rate is a key determinant of national capital formation. In turn, capital formation critically shapes national productivity and competitiveness. The slipping American position in the ranks of industrial nations can thus be traced directly to our low national savings rate.

With this in mind, serious government action to boost the national savings rate would be most welcome. A save-the-surplus approach to Social Security would be just such a measure.

On balance, the arguments for save-the-surplus strike me as more persuasive than the arguments for pay-as-you-go. That reflects my perception that U.S. competitiveness in the international arena is our number one economic problem. But it is quite impossible to save the surplus without decisive Presidential leadership.

Presidential leadership means cutting the operating deficit now, not after 1993. The Administration's Social Security Integrity and Debt Reduction Fund is, at best, a fancy prescription with a preposterous name for procrastination. A cut in the operating budget requires hard actions today, not bookkeeping promises tomorrow. If, for example, the Administration proposed a surtax on families earning more than say, $200,000, to take effect automatically if the Federal Government incurred operating deficits after 1993, then the Administration's counter-proposal to S. 2016, might; be taken seriously. But the Administration seems singularly disinterested in sponsoring policies that would convincingly save the surplus. Faced with this reality, a return to pay-as-you-go is the best possible outcome in the current political climate.

To be sure, according to the Congressional Budget Office, S. 2016, would increase the unified budget deficit—that is, the operating deficit plus trust funds—by the following amounts

[Billions of dollars]

1990	1991	1992	1993	1994	1995
$4.5	$39.7	$57.5	$65.8	$74.6	$83.9

Precisely this sort of fiscal shock seems necessary to alter the Administration's complacent attitude toward our nation's public finances.

ARGUMENT FOR BOGUS FINANCING

The present system of Social Security financing can be rightly called bogus financing. While the tax rate of 12.4% is supposed to generate very large surpluses over the next several decades, the Administration's spend-as-you-go approach to the Federal budget threatens to consume the entire amount. There will be no net addition to the nation's capital stock. National savings will remain low. The surpluses will exist on paper only, not in the reality of the American economy. There is, of course, only one argument for bogus financing: it is the least difficult way, in political terms, to meet the Gramm-Rudman-Hollings targets. It is the easiest way to postpone serious consideration of tax fairness and national competitiveness. It is classic muddling through. This argument is unworthy of the United States.

ENDNOTES

1. Michael J. Boskin, "Taxation, Social Security and Aggregate Factor Supply in the United States" in *Accumulation et Repartition des Patrimones*, Paris, 1982, pp. 185–188.
2. Michael J. Boskin, "The Effects of Government Expenditure and Taxes on Female Labor," *American Economic Review*, vol. 74, no. 2, 1974.
3. Paul Craig Roberts, "That's How It's Done In Other Countries," *Wall Street Journal*, February 1, 1990, p. A8.
4. Michael J. Boskin. *Too Many Promises: The Uncertain Future of Social Security* Twentieth Century Fund Report, Dow-Jones-Irwin: Homewood, Illinois, 1986. For earlier views in a similar vein see Michael J. Boskin and Marc Robinson, "Social Security and Private Saving: Analytical Issues, Econometric Evidence, and Policy Implications," Joint Economic Committee, Congress of the United States, *Special Study of Economic Change, vol. 8, Social Security and Pensions: Programs of Equity and Security*. Washington, D.C., December 4, 1980.

PREPARED STATEMENT OF CALVIN P. JOHNSON

Mr. Chairman, members of the Committee, I am pleased to have the opportunity to share with you the AFL-CIO's views on financing Social Security.

This hearing is timely, because once again events have called into question the long-term health of the system. However, unlike the dire situation in the early 1980s, when the contingency reserve plunged to a dangerously low level of only 8 weeks of benefits; at present, concern centers around the program taking in too much money and having its surpluses used to substitute for general taxes in meeting the Federal government's current operating expenses. This situation does nothing to increase national savings and improve investment to help us meet the needs of future retirees. Moreover, it continues to mask deficits that have been exacerbated by unwise spending and revenue policies.

Once again, it is time for Congress to take steps necessary to prevent a crisis of confidence in the system. We believe that you should seriously consider Senator Moynihan's proposal to reduce the Social Security payroll tax, returning to pay-as-you-go financing, provided two conditions are met: (1) Protections must be added to ensure that an adequate threshold of assets is maintained in the system before any changes in financing are made; and (2) Measures must be taken to avert massive cuts in Federal programs, once the trust fund's surplus revenues are removed from the deficit calculations under the Gramm-Rudman-Hollings law.

I would like to explain our rationale for this position.

SOCIAL SECURITY AS A SAFETY NET FOR FAMILIES

At present, 39 million senior citizens, surviving spouses and dependent children receive Social Security benefits each month, making it a true safety net for American families. While 92 percent of the elderly receive benefits, retired workers comprise slightly less than two-thirds of the beneficiary population. Spouses and children account for 30 percent of beneficiaries, and the disabled account for 7 percent.

In 1987, Social Security was the major source of income (at least 50 percent) for 61 percent of beneficiaries. Social Security provided almost all of the income (90 percent) for 25 percent of beneficiaries and, for 14 percent of beneficiaries, Social Security is the only source of income.

THE 1983 SOCIAL SECURITY COMPROMISE

Prior to 1970, there were enough reserves in the Social Security trust fund to finance a year's worth of benefits. By 1976 reserves had dipped to 57 percent. By 1982, reserves had fallen to a dangerously low level of 15 percent. This precipitated a major crisis of confidence in the system and lead to the bipartisan compromise legislation that moved the system to partial reserve financing, sufficient to pay benefits over the next 55 to 60 years. At the end of that period, under present projections, the trust funds would be exhausted.

While the action taken to put Social Security back on firm financial footing was prudent at the time, it is time to evaluate whether the current financing method is adequate for the long-term. In their 1983 report, the members of the Commission on Social Security Reform made it clear that they favored a fund buildup that would increase the national savings rate and, through investment, produce a larger pool of goods and services in the future. Unfortunately, this has not happened; nor is it likely to happen in the near term, because the Social Security surpluses are being use to offset the deficit in non-Social Security programs.

In our view, we should not continue to rob Peter to pay Paul by borrowing from Social Security to cover the Federal government's operating expenses. While we strongly believe that the current system is appropriate for financing a social insurance program, it is a totally inappropriate mechanism for financing other Federal responsibilities.

THE RELATIONSHIP BETWEEN SOCIAL SECURITY AND THE BUDGET

The AFL-CIO is very concerned that the growing OASDI reserves do not represent true government savings, as anticipated by the National Commission on Social Security Reform. Instead, these surpluses are being loaned to the Treasury to meet current obligations in non-Social Security programs.

While the Treasury still must repay what it borrows from the trust fund, this practice of offsetting deficits does nothing to encourage the investment necessary to expand our future economy. In addition, by masking the true size of the deficit, this only forestalls serious efforts to confront the deficit problem.

On the other hand, removing Social Security surpluses from deficit calculations without addressing the underlying budget issues could produce higher interest rates and/or crippling cuts in essential Federal programs.

IS THE SOCIAL SECURITY SYSTEM REGRESSIVE?

Within recent months two key issues about the nature of the Social Security system have surfaced: (1) whether the tax on earnings is an appropriate method of financing the social security program, (2) whether the social security tax is appropriate to finance the Federal government's non-social security expenses.

Since Social Security's benefits formula provides higher replacement of earnings for lower paid workers than for higher paid workers and, in addition, the earned income tax credit provides targeted relief to poor working families, we believe that the financing system is a fair one.

On the second issue, at present, 7 percent of the population has income which exceeds Social Security's maximum level of taxable earnings. Moreover, capital is not taxed for Social Security purposes nor is income from capital. Therefore, while Social Security is a progressive social insurance program, compared to general taxes, it is a regressive way to finance government operating expenses.

From 1980 to 1988, Social Security as a percent of total Federal tax levies, rose by 23 percent. By contrast during the same period personal income tax and corporate tax receipts declined by 6 percent and 23 percent, respectively.

IS THE SOCIAL SECURITY PROGRAM ADEQUATELY SERVING BENEFICIARIES

The AFL-CIO is very concerned about whether or not the Social Security Administration (SSA) has the staff resources necessary to properly administer all of its programs. Concerns have surfaced in many quarters about the quality of services now being provided. At present, SSA is working with a staff that has been reduced by almost 30 percent over a 5 year period. This downsizing has lead to serious problems in a number of key areas, including the following:

- posting of earnings
- beneficiary appeals
- disability applications
- service provided by field offices
- employee moral

Funds for the administration of Social Security come from the Social Security trust funds. Congress must take steps immediately to assure that enough money is being allocated to obtain the staff necessary to provide high quality services to beneficiaries.

As part of the process of protecting Social Security, we would recommend establishing a separate Social Security agency administered by an independent board.

CONCLUSION AND RECOMMENDATIONS

The Federation would like to offer a six point plan for your consideration.

1. Continue the present financing system until the Social Security trust fund surplus reaches 125–150 percent.
2. Once this cushion is reached, reduce the payroll tax to a level that would return to a pay-as-you-go financing system with the 125–150 percent contingency reserve.
3. Remove the Social Security trust fund surplus from deficit calculations under the Gramm-Rudman-Hollings legislation.
4. Lengthen the time period over which deficit reduction would occur or raise revenue by making the income tax system more progressive.
5. Create a separate Social Security agency administered by an independent three person board.
6. Provide a level of staffing necessary to assure that beneficiaries receive high quality services.

Congress will need to move with deliberate speed to protect the integrity of the Social Security system. The nation has a fiduciary duty and philosophical commitment to the program. Our citizens deserve nothing less than a sound financing system, which uses assets for Social Security and Social Security alone.

PREPARED STATEMENT OF SENATOR ROBERT W. KASTEN, JR.

Mr. Chairman and Members of the Committee, I thank you for this opportunity to present my legislation to cut the payroll tax on working men and women, preserve the integrity of the Social Security program and restore honesty to the Federal budget process.

Two years ago, then-Representative Jack Kemp and I proposed payroll tax cuts as part of an omnibus jobs-and-economic/growth package called the "Plant Opening" bill. We were right back then. The tax increases were not needed.

The case today is even more compelling:

The working men and women of America need a tax cut.

A tax cut would help the economy and create new jobs.

And—after all—we're only using excess payroll tax receipts to mask the true dimensions of the budget deficit.

The Social Security tax is now imposing a larger burden on the average taxpayer than the Federal income tax. A full 74 percent of all taxpayers pay more in combined payroll taxes than they do in income taxes. The impact on America's family budget has been devastating:

- *From 1955 to 1988, the tax burden on Americans rose twice as fast as their income (see Chart I).*
- In 1955, a median-income family of four paid Federal taxes at the rate of *9 percent* per year.
- In 1970, they paid 16 percent. *In 1988, they paid 24 percent.*

The chief culprit in this 35-year-long tax hike has been the payroll tax, which has skyrocketed from 4 percent in 1955 to 15.3 percent today—a nearly 400 percent increase (see Chart 2).

Today, the maximum Social Security tax for working families is a whopping $3,180.

Some have argued that today's tax system is somehow more regressive because of the Reagan-Kemp-Roth tax cuts in 1981 and the bipartisan tax reforms in 1986. But the exact opposite is true: The top 5 percent of American taxpayers paid a greater share of Federal income taxes during the 1980s than in the past, and middle- and lower-income Americans paid a lesser share. (see Chart 3)

The Reagan tax cuts resulted in *income tax savings* of $2,656 in 1988 for the median income two-earner family of four (see Table 1). The 1986 tax reforms removed 5 million low-income workers from the income tax rolls—and that's why the payroll tax now accounts for such a disproportionate share of the tax burden borne by these Americans.

While we've made great progress in cutting the *income tax burden* on middle-income Americans since 1980, some of those savings have been *eroded* by the simultaneous 22 percent increase in the *payroll tax burden*. In effect, we have given with one hand and taken away with the other.

The American family is still overtaxed. Washington continues to take a big slice out of the American worker's paycheck—leaving a thin slice for his family to *buy* *that first home, pay for decent child care, and save for the future.* We're widening the gap between what Americans earn and what the government lets them keep—*and that's unacceptable.*

America's retirees have children and grandchildren who are now raising families, paying mortgages and saving for retirement security as they did when they were young. *The difference is that today's tax burden has made it harder for their children and their grandchildren to make ends meet.*

That's why I believe that millions of America's senior citizens will support a payroll tax cut for their children, despite the opposition of the 38-member legislative council of the American Association of Retired Persons (AARP).

The economic argument for cutting this tax is compelling. These payroll tax hikes hurt businesses and workers by increasing labor costs and reducing take-home pay. Because of international competition, American businesses are forced to reduce the number of workers they employ. And this tax is especially burdensome on America's small business men and women, many of whom are self-employed and have to pay both portions of the FICA tax.

And—as usually happens when bad economic policy is enacted—the chief victims are those at the bottom of the economic ladder. In addition to reducing low-skilled, entry-level job opportunities, the payroll tax hikes reduce work incentives.

One of the reasons welfare recipients have been discouraged from taking entry-level jobs is the high Federal tax on their first dollar of earnings. It may not make economic sense for a welfare mother with four children to take that entry-level job paying $15,000 when the government takes away $2,600 in taxes (including the employer's share of the FICA tax). We need to make entry-level jobs more attractive to welfare recipients.

According to a recent study by the Institute for Research on the Economics of Taxation (IRET), the Social Security tax hikes of 1988 and 1990 will increase the tax burden on working Americans by $500 billion over the next 15 years—costing the economy an estimated 500,000 jobs and reducing GNP and capital stock by $100 billion. *By contrast, IRET estimates that every dollar of reduction in Social Security taxes would expand economic output by 68 cents.*

In short, the tax increase will have a negative effect on economic growth.

So I agree in principle with the payroll tax cut approach Senator Moynihan has proposed. I think nonetheless that there is substantial room for improvement in his proposal. I recently introduced a payroll tax cut bill, S. 2052, the *Social Security Integrity and Tax Reduction Act of 1990.*

My bill would reduce the 1990 Social Security tax on both employers and employees from 6.2 percent to 5.9 percent, and further reduce the rate to 5.6 percent in 1991 and 5.3 percent in 1992.

The result is an annual tax cut of up to $519 per worker in 1992 (see table 2).

Allowing Americans to keep more of their hard-earned money would give the economy a shot in the arm and boost private savings and investment. *IRET estimates that by the year 2000 my tax cut plan would:*

—add between 450,000 and 920,000 new jobs;
—raise GNP by almost $300 billion; and
—increase the capital stock by $180 billion.

A tax reduction to 5.3 percent tax rate provides a reserve "cushion" in the trust fund to protect benefits in the event of an economic downturn. The Social Security Administration estimates that, under my bill, the OASDI reserves would rise to 102 percent (one year's benefits) in 1992, 123 percent in 1996, and 150 percent in 2000 (see table 3).

It's also time we leveled with the American people about the true size of the Federal budget deficit. *Using the Social Security tax surplus to cover the general government deficit is dishonest and irresponsible.* My bill takes Social Security out of the budget, extends the Gramm-Rudman process in the out-years so that we can achieve a *balanced operating budget* by 1997.

Mr. Chairman, this is a plan that can unite all Americans Republicans and Democrats, young and old, business and labor. Cutting the payroll tax is supported by groups across the political spectrum, from liberal groups like the Institute for Policy Studies and the Progressive Policy Institute to conservative groups like the Heritage Foundation, Citizens for a Sound Economy and the American Conservative Union.

Business groups such as the National Federation of Independent Businesses and the U.S. Chamber of Commerce have endorsed a cut in the payroll tax. And the AFL–CIO supports a payroll tax cut that maintains 125 percent to 150 percent of OASDI reserves; takes Social Security out of the budget; and adjusts Gramm-Rudman to lengthen the time period over which deficit reduction should occur—all of which my bill would do. I am hopeful that the AFL-CIO and other labor union groups will endorse my bill.

Mr. Chairman, numerous objections have been raised to the concept of cutting payroll taxes. These objections have varying degrees of merit. Some are *false;* others contain *a grain of truth;* and still others are *very serious* indeed.

The loudest objection—that a payroll tax cut would reduce benefits to retirees—is simply false. In fact, some are trying to turn this into an issue of generational warfare, turning our young people against our senior citizens and vice versa.

Make no mistake: *With or without this tax cut, Social Security will be solvent for at least three decades*—according to Social Security Administration projections. A payroll tax cut should be viewed as an opportunity to unite the generations behind the common goals of tax reduction and economic growth.

I believe we have a compact between generations, but that compact does not provide for tax increases in the name of Social Security which only serve to mask the Federal deficit.

A more serious objection is that the payroll tax cut will result in a sizable increase in the deficit, completely throwing off the Gramm-Rudman deficit reduction process and leading to higher interest rates.

I'd like to put this deficit issue in perspective. The Congressional Budget Office projects that in Fiscal Year 1992, the deficit will be only 2.15 percent of GNP. When finally phased in, my tax cut plan would increase the FY 1992 deficit by $39 billion, or 0.62 percent of GNP—resulting in a deficit that is 2.77 percent of GNP. As recently as 1983, the deficit was more than twice that high—or 6.3 percent of GNP. While it's clear that we have to do more to bring the deficit down, we are in fact making some progress.

To be sure, payroll tax cuts lose revenue—but the resulting increase in the deficit will be at least partially offset by the dynamic impact on the economy from increased economic activity, lower labor costs, and greater competitiveness.

Mr. Chairman, in 1983 Social Security was broke and Congress acted in a bipartisan manner to fix it.

The goal of the 1983 amendments was to solve the immediate financial crisis—and to preserve the Trust Fund's actuarial balance. But as Senator Bentsen pointed out the other day, there was little if any Congressional debate on the merits of pay-as-you-go vs. partial funding to achieve this actuarial balance. Let me quote from a new Congressional Research Service report:

> "An examination of the record of the committee proceedings leading up to the 1983 amendments, and the earlier deliberations of the National Commission on Social Security Reform will show only passing references to the possibility of future surpluses. *No record exists showing that Congress seriously considered building a fund or how such a fund would actually save resources.*"

At that time, no one expected the surplus to rise this quickly. The 1983 House Ways and Means Committee projected that reserves would rise to 38 percent in 1990 under II-B projections. But today the reserves have grown twice as fast as expected—rising to 75 percent. It is misleading to assert that the current surpluses were debated, agreed to, and fully anticipated by Congress. They were not.

Defenders of the 1983 Social Security reforms have also argued that the growing tax surplus should be used to retire the Federal debt; they think this would increase national savings and economic growth—thus ensuring a healthy Social Security system and reducing the tax burden on tomorrow's workers. But a $3.2 trillion tax burden—and that's how much the excess payroll tax will take from workers over the next three decades—will have the opposite effect: It will reduce GNP growth, reduce private savings, and lead to distorted economic decisionmaking.

Economist John Cogan reports that throughout history large Social Security surpluses have always been spent—not saved. In 1939, Congress abandoned the policy of building large reserves in response to mounting public criticism that the funds were being used to finance other government spending.

The only way to truly increase national savings and economic growth is to reduce the overall government burden on the economy. That means holding the line on Federal spending until the Federal debt stops increasing and actually begins to decline as a percentage of our Gross National Product.

We need a three-pronged approach to spur savings, investment and economic growth. First, we have to reduce the capital gains tax, which unlike a payroll tax cut would actually increase revenues to the Federal Treasury while also sparking economic growth. Second, we also need to encourage private savings through tax incentives such as the President's Family Savings Act and IRAs. And third, we must cut the payroll tax for working families so that they will have extra money to save. The President's Savings and Economic Growth Act will be complete with a pro-growth cut in the payroll tax.

The bottom line is this: *The central choices about the nation's economic future must be restored to the American family.* That ought to be the goal of any intelligent and far-sighted economic policy.

To summarize, let's cut the payroll tax—to boost the income of the average American. Let's take Social Security off budget—to protect benefits for America's retirees. And let's mandate a balanced budget by 1997—to restore fiscal responsibility to the Federal government.

We have a historic opportunity to strike a blow for today's middle- and lower-income Americans, and for tomorrow's retirees as well.

I look forward to building a *bipartisan* coalition to cut the payroll tax.

Thank you.

Middle-Class Tax Burden

Percentage increase from 1955, in current dollars:

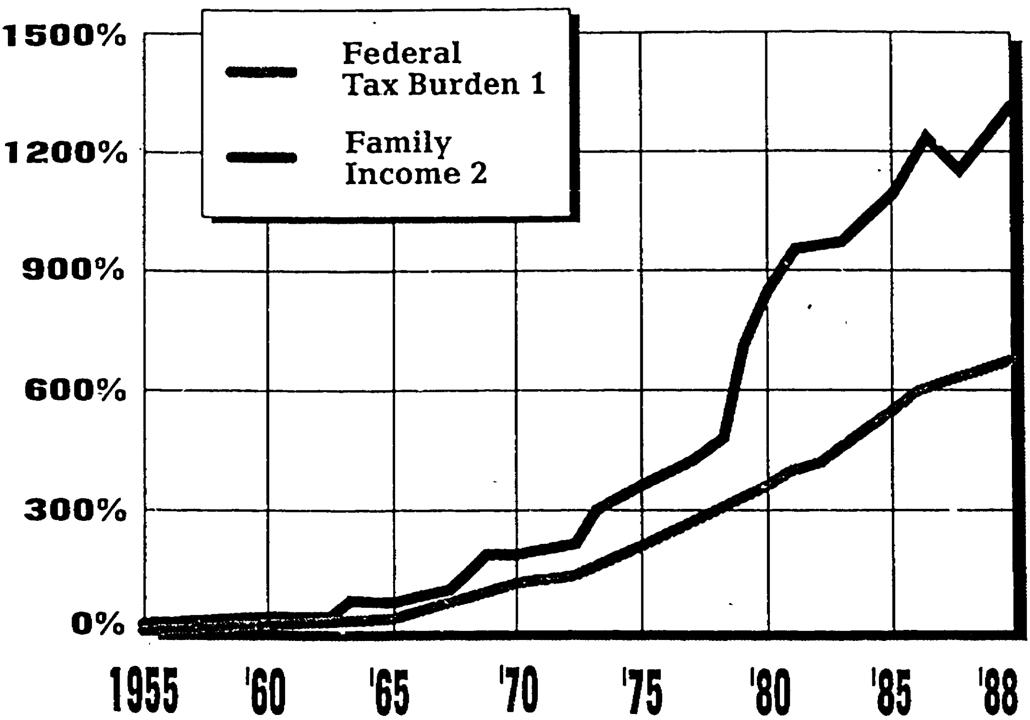


CHART 1

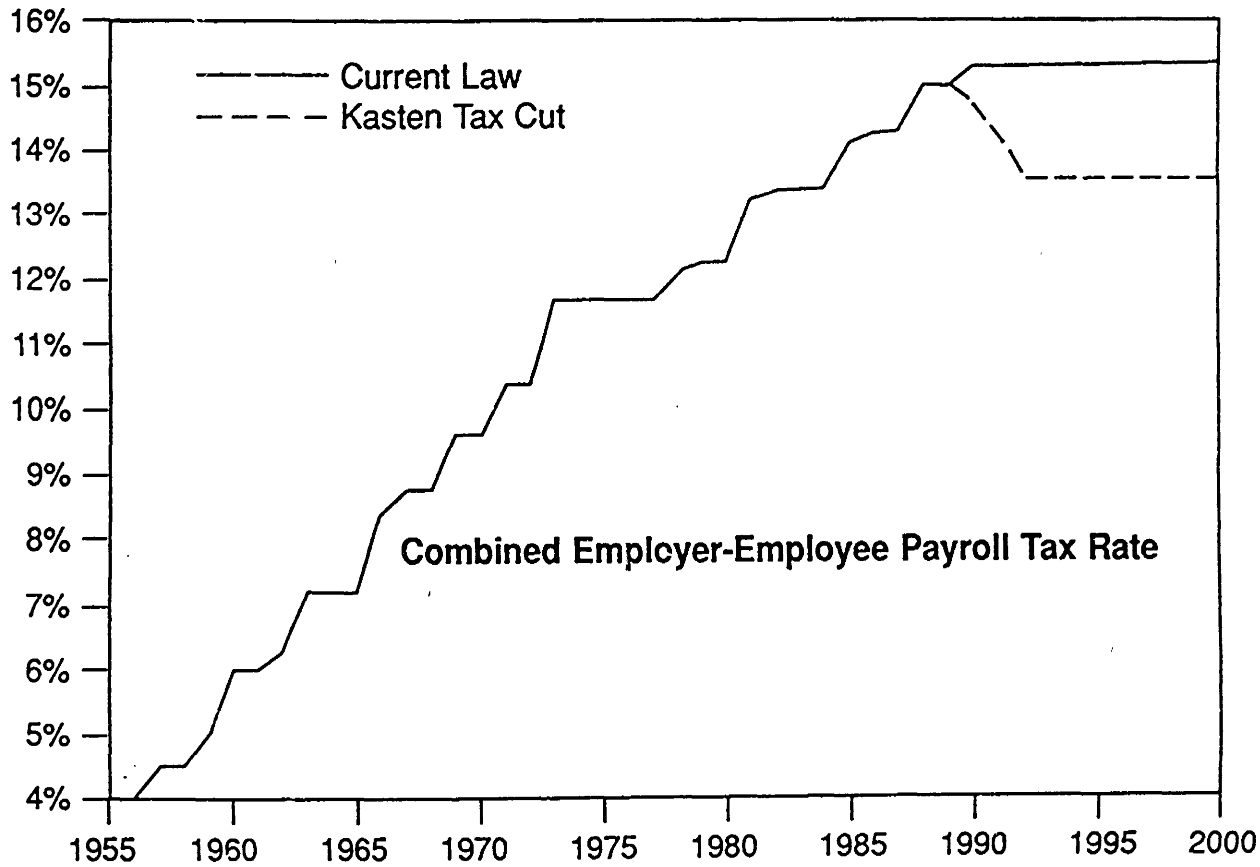
1 Income tax plus Social Security tax

2 Median income earned by one spouse for a four-person family. Figures for 1987-88 are estimated

Source: Office of Tax Analysis, Dept. of Treasury
Chart: Senate Republican Conference

CHART 2

SOCIAL SECURITY PAYROLL TAX RATE, 1955 - 2000



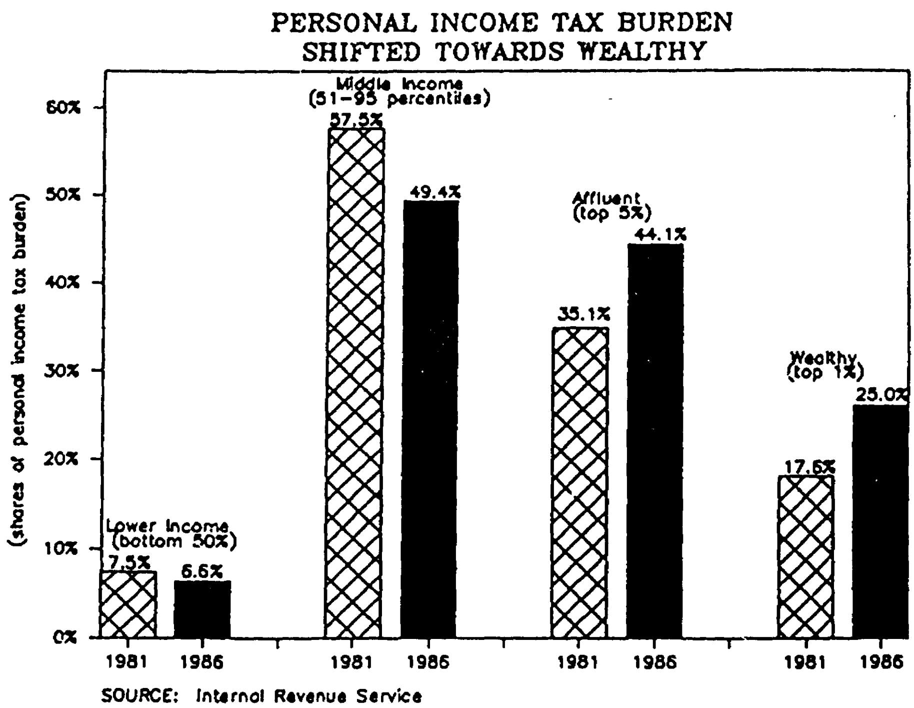

PERSONAL INCOME TAX BURDEN
SHIFTED TOWARDS WEALTHY
(shares of personal income tax burden)
60%
50%
40%
30%
20%
10%
0%
Lower Income (bottom 50%)
7.5%
6.6%
Middle Income (51–95 percentiles)
57.5%
49.4%
Affluent (top 5%)
35.1%
44.1%
Wealthy (top 1%)
17.6%
25.0%
1981
1986
1981
1986
1981
1986
1981
1986
SOURCE: Internal Revenue Service

CHART 3

TABLE 1

TABLE 2-1.—*Income Tax Reductions: Current Law Versus 1980 Law, Median Income One-Earner and Two-Earner Families of Four*

Year	Median income one-earner family of four				Median income two-earner family of four			
	Income	Taxes under		Reductions under current law[1]	Income	Taxes under		Reductions under current law[1]
		Current tax law[1]	1980 tax law			Current tax law[1]	1980 tax law	
1980	$20,429	$2,081	$2,081	$0	$25,669	$2,227	$2,227	$0
1981	21,690	2,266	2,295	29	27,803	2,605	2,648	43
1982	22,777	2,217	2,487	270	29,316	2,333	2,970	637
1983	23,885	2,183	2,691	508	30,581	2,150	3,236	1,086
1984	25,561	2,295	3,003	708	32,549	2,313	3,670	1,357
1985	25,849	2,284	3,087	803	34,469	2,541	4,129	1,588
1986	28,388	2,591	3,574	983	35,336	2,598	4,353	1,755
1987	29,654	2,389	3,840	1,451	38,022	2,456	5,009	2,553
1988[2]	30,863	2,626	4,106	1,480	39,572	2,737	5,393	2,656

[1] "Current tax law" refers to the law in effect in year shown.
[2] Estimated.
Sources: Department of Labor (median income data) and Office of Management and Budget.

Potential Family Savings under the Kasten Plan

[In dollars]

1990	154
1991	326
1992	519
1993	551
1994	586
1995	618

Source: Social Security Administration.

TABLE 2

OASDI Reserves under the Kasten Plan (II-B)

[In percent]

1990	77
1991	92
1992	102
1993	106
1994	111
1995	117
1996	123
1997	130
1998	137
1999	143
2000	150
2005	181
2010	199
2015	174
2020	109

OASDI Reserves under the Kasten Plan (II-B)

[In billions of dollars]

1990	223
1991	257
1992	293
1993	333
1994	373
1995	417
1996	468
1997	520
1998	580
1999	644
2000	715
2005	1,163
2010	1,749
2100	2,100
2020	1,464

Source: Social Security Administration.

TABLE 3

TABLE 4.—ESTIMATED OPERATIONS OF THE OASI, DI, AND HI TRUST FUNDS UNDER H.R. 1900 AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS, ON THE BASIS OF THE 1983 ALTERNATIVE II–B ASSUMPTIONS, CALENDAR YEARS 1982–92

[Amounts in billions]

Calendar year	Income					Outgo				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1982	$142.7	$17.6	$160.3	$25.6	$185.9	$142.1	$18.0	$160.1	$36.2	$196.3
1983	150.7	21.0	171.7	44.6	216.4	151.6	17.7	169.4	41.1	210.5
1984	164.4	17.2	181.5	45.7	227.3	162.6	17.9	180.5	46.8	227.3
1985	183.6	18.6	202.2	52.2	254.4	178.6	18.9	197.5	53.0	250.4
1986	198.3	20.2	218.5	62.7	281.2	196.3	20.1	216.4	59.9	276.3
1987	214.8	22.0	236.7	69.6	306.4	213.2	21.3	234.5	67.4	301.9
1988	248.8	23.8	272.7	75.2	347.9	230.8	22.7	253.5	75.9	329.4
1989	273.3	30.8	304.1	74.4	378.5	248.6	24.2	272.9	85.4	358.3
1990	303.5	32.7	336.2	78.7	414.9	266.7	26.0	292.6	95.1	387.7
1991	328.5	35.8	364.3	83.0	447.3	284.4	27.8	312.2	104.9	417.1
1992	354.6	38.8	393.4	87.0	480.5	301.7	29.8	331.6	116.0	447.6

Calendar year	Net increase in funds					Funds at end of year					Assets at beginning of year as a percentage of outgo during year [1]				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1982	$0.6	−$0.4	$0.2	−$10.6	−$10.3	$22.1	$2.7	$24.8	$8.2	$32.9	15	17	15	52	22
1983	−.9	3.3	2.4	3.5	5.9	21.2	6.0	27.2	11.7	38.8	15	15	15	20	16
1984	1.8	−.8	1.0	−1.1	−.1	23.0	5.2	28.2	10.6	38.8	20	40	22	25	23
1985	5.0	−.2	4.7	−.7	4.0	27.9	5.0	32.9	9.8	42.8	20	34	21	20	21
1986	2.0	.2	2.2	2.8	5.0	30.0	5.1	35.1	12.6	47.7	22	32	22	16	21
1987	1.6	.7	2.2	2.2	4.4	31.5	5.8	37.3	14.8	52.2	21	31	22	19	21
1988	18.0	1.1	19.1	−.7	18.4	49.5	6.9	56.5	14.1	70.6	21	33	22	20	22
1989	24.6	6.6	31.2	−11.0	20.2	74.2	13.5	87.7	3.1	90.8	28	36	29	17	26
1990	36.8	6.7	43.5	−16.3	27.2	111.0	20.2	131.2	−13.2	118.0	36	61	38	3	30
1991	44.1	8.0	52.1	−21.9	30.2	155.1	28.2	183.3	−35.2	148.2	47	82	50	−13	34
1992	52.9	9.0	61.9	−29.0	32.9	208.0	37.2	245.2	−64.2	181.0	60	103	64	−30	39

[1] Assets at beginning of year include OASDI advance tax transfers.

Notes. 1. It is assumed that the lump-sum reimbursement for military service wage credits and unnegotiated checks would be received by July 1, 1983.

2. Income and end-of-year asset figures reflect transfers of assets among the OASI, DI, and HI Trust Funds under the interfund borrowing authority provided by P.L. 97–123. These estimates assume that of the $12.4 billion borrowed by OASI from HI in 1982, $2.5 billion would be repaid in 1986, $4.5 billion in 1987, and $5.4 billion in 1988. The $5.1 billion borrowed by OASI from DI in 1982 is assumed to be repaid in 1989.

3. Under H.R. 1900, and based on this set of assumptions, the HI Trust Fund would be depleted in 1990. Subsequent HI operations as shown above are theoretical.

TABLE 4

PREPARED STATEMENT OF GWENDOLYN S. KING

Mr. Chairman and members of the Committee: I am pleased to be here today to discuss Social Security financing and the continued long-term health of the program. On Thursday, Mr. Darman and other experts will be addressing the questions you raised in announcing these hearings concerning the economic aspects of the trust fund buildup and the effects of budget deficits.

There has been intense public discussion in recent weeks on the Social Security trust funds, payroll taxes, and related issues. The quality of this discussion will be enhanced by the participation of a well-informed public.

I believe the public needs to be fully aware of the current health of Social Security and its reserves. Social Security's current and future beneficiaries also need to know the full implications for the program that are inherent in current legislative proposals.

The Bush administration and the Congress share a solemn commitment to protect and preserve Social Security. We want to assure its continued solvency. We are devoted to protecting the long-term integrity of the Social Security system. We want to build even greater public confidence in the system. We each seek to uphold a program that has served millions of Americans well for over five decades.

EFFECT OF 1983 AMENDMENTS ON SOCIAL SECURITY FINANCING

As we discuss these issues, I think it is important to keep in mind the history of Social Security financing during the last decade, a chapter,, I might add, written by most of you on this Committee. Just 7 years ago, Social Security trust fund reserves were nearly exhausted, and the program stood on the brink of defaulting on its commitments. Retirees feared their benefit payments would be disrupted and many workers, especially younger workers, lost confidence that they would receive Social Security benefits when they reached retirement.

Public opinion polls taken at that time reveal that public confidence in the program was seriously eroded, to the extent that only one-third of the public expressed confidence in the system at the beginning of the 1980's. Since the financing crisis was resolved in 1983, public confidence in the program, which depends in large measure on the public's perceptions about the soundness of Social Security financing, is on the rise.

This remarkable turnaround is attributable in large measure to the courageous action of the bipartisan national commission on Social Security reform, on which, I should note, four members of this Committee—Senators Dole, Armstrong, Heinz, and Moynihan—served. Their recommendations laid the foundation for the 1983 Social Security amendments, which have brought us to where we are today.

Today, Social Security is financially sound. Trust fund reserves will increase by about $68 billion this year and are projected to grow consistently over the next four decades. Reserves are expected to surpass $1.5 trillion by the turn of the century and to reach nearly $12 trillion at their peak, around 2030.

Last month, Social Security marked its 50th anniversary of paying benefits, on time and in the right amount, to those who depend on them. The program that issued Ms. Ida Mae Fuller the very first benefit check 50 years ago now serves nearly 40 million Americans each month. We can be proud of the role Social Security continues to play in the lives of so many people, especially America's most vulnerable citizens. Much of the credit for the program's achievements belongs to you, your colleagues, and your predecessors.

CONCERNS ABOUT MISLEADING INFORMATION

The scheduled buildup of Social Security trust fund reserves has a specific purpose—to help finance Social Security benefit payments to today's workers when they reach retirement.

In our pursuit of the best policies to achieve that objective, however, I would offer one word of caution. We must be careful to conduct our discussions in a way that promotes the best interests of the Social Security program. An unfortunate byproduct of the current discussions is the spread of a good deal of misleading information about Social Security. I am especially concerned about statements describing trust fund investments as worthless IOUs which future generations might not honor and distorted discussions about the regressivity of the Social Security tax. These arguments are wrapped in half-truths and both cause unnecessary and unjustified concerns in the public psyche.

With respect to trust fund investment policy, as you know, section 201 of the Social Security act requires that the trust funds be invested only in obligations issued or guaranteed by the united states government. As such, these investments are backed by the full faith and credit of the united states, the same guarantee that stands behind the savings bonds and treasury bills and notes held by millions of Americans.

The law restricts trust fund investments to government obligations, because they are simply the safest form of investment. Understandably, safety is the foremost consideration in investing the assets of the nation's primary means for providing economic security against the loss of earnings that occurs when workers retire, become disabled, or die.

Those who fan the flames of public uncertainty about the Social Security system by claiming that earned benefits will not be available when our workers retire are performing a terrible disservice to the public.

Discussions about the regressivity of the Social Security payroll tax present a distorted picture in that they tend to ignore the fact that Social Security is a social insurance program and progressivity is built into the program's benefit structure. As you know, the program provides low earners with considerably higher benefits in relation to preretirement earnings than it does for high earners. For workers retiring today, Social Security benefits replace about 57 percent of a low-income worker's earnings, about 42 percent for middle-income workers, and about 24 percent for high earners. Often disregarded, too, are the benefits the program provides to family members of retired, disabled, or deceased workers.

My point, Mr. Chairman, is that Social Security is not just a regressive tax, as some value added or general sales taxes are, but is part of a total social insurance program, one portion of which should not be viewed in isolation from the rest.

I raise these issues because I am convinced that the way we pursue our discussions about Social Security financing and related issues is every bit as important as the issues themselves. It would be regrettable if, in our efforts to promote responsible public debate about the policies that will be in the best interests of those served by the Social Security program, we permitted the debate to be framed in ways that unintentionally undermined confidence in the system.

CONTINUE TRUST FUND BUILDUP

Getting back to the central issues before you today, Mr. Chairman, as Commissioner of Social Security, I think it is vitally important to carefully consider the consequences of abandoning the buildup in trust fund reserves. To reverse course now and abandon the buildup could:

- expose workers and retirees once again to the uncertainties and anxieties that prevailed less than a decade ago.
- erase the strides we have made in restoring public confidence in Social Security.
- repudiate the widely held principle that the Social Security program should be changed only to serve Social Security, not Federal budget, objectives.
- impose a heavier burden on future workers for supporting baby booms retirees.
- signal to the American people that its leadership had lost hope of reducing non-social security budget deficits so that trust fund reserves could truly be saved.

I might mention that a recent *Wall Street Journal*/NBC news poll found that 53 percent of registered voters oppose rolling back Social Security tax rates. Also, in a recent poll of registered voters taken by the *Boston Globe*, 72 percent of the respondents said Social Security taxes should not be cut.

The administration has advanced an approach that preserves the integrity of the Social Security trust funds. The President's budget for FY 1991 includes such a proposal, the "Social Security Integrity and Debt Reduction Act of 1990." Under the administration's proposal:

- Social Security trust fund reserves will continue to increase along the current path; the proposal does not modify Social Security financing in any way, and prevents Social Security receipts from being spent for any other purpose.
- Non-Social Security budget deficits will be gradually reduced to zero and balanced budgets will be required thereafter.
- Growing trust fund reserves will reduce the publicly held national debt, add to national savings, contribute to capital formation, and raise economic growth. The resulting additional output will be available to raise U.S. living standards and meet Social Security commitments to the "baby booms" generation.

I understand that Mr. Darman will discuss this proposal in detail when he appears before you later this week.

CONCLUSION

In concluding, Mr. Chairman, let me say again that I welcome the opportunity to participate in this discussion. I know that the members of this committee and the administration share the same concerns about the need to reduce the budget deficit. This issue is clearly the major economic issue facing the Nation. But as Commissioner of Social Security, I have a unique responsibility. I need to ensure that, to the extent the larger debate incorporates discussion of the Social Security program, such discussion edifies, and does not confuse, the public and that it does not undermine the confidence that the American people have in the Social Security system. When people of good will and noble intentions discuss these issues, at least three positive developments will result. One, there will be a better understanding of Social Security among those who participate in it. Second, we will achieve stronger, more effective protection for the Social Security trust fund. Those monies, after all, are more than mere dollars. They represent America's future financial security. And, finally, the 63,000 dedicated and caring employees of the Social Security Administration will be even more resolute in their determination to make the program even more effective, now and in the years ahead. Our workforce has a goal, to assure that Social Security will work as well for today's working men and women and their children as it did for their parents and grandparents.

That concludes my statement, Mr. Chairman. I will be happy to answer any questions the committee may have.

Attachment.

THE FINANCING QUESTION FIFTY YEARS AGO

In May 1938, Mary Dewson, one of the original members of the Social Security Board (1937–1938), addressed the State Convention of Affiliated Young Democrats meeting in New York City. Her speech entitled, "Fifty Years Progress Toward Social Security," reviewed the previous fifty years of social legislation and the financial basis of the newly established Social Security system.

Fifty years later, her remarks on investment policy of Social Security funds are prophetic and certainly instructive in the context of the current debate on financing the Social Security system. After describing the benefit and contribution principles of the Social Security system, Miss Dewson describes the financing provisions:

> "These facts about old-age insurance are pretty generally understood today and there can be no question that the nation as a whole stands firmly behind this program. In fact, it is significant that the only serious current criticisms are concerned only with the financial provisions of the present law. *These criticisms aim most of their fire at the fact that the Treasury is directed to invest old-age insurance funds in U.S. Government obligations. This line of reasoning implies that it would be safer to hide the currency under a mattress or to bury it in an old iron pot.* If this strange idea were actually followed, there might then be some point in the contention that Social Security taxes take money out of circulation. It is true, of course, that if this law had not been in operation, the Government would have sold more bonds on the open market; and that, instead of doing so, it has now issued obligations to the credit of the old-age reserve. But the only effect of this procedure is to make millions of individual workers holders of Government obligations which would otherwise have been bought up by large investors. *To call the government obligations purchased for the old-age reserve account mere I.O.U.'s gets nowhere. The same thing could be said—and would be just as meaningless—about every bank deposit, every insurance policy, every private security investment in existence.* Yet the people who cry "wolf" loudest about old-age insurance are the very ones who profess the greatest confidence in private business. *Moreover, if investment in government obligations is as unsound as critics of the reserve contend, why do banks, insurance companies and other large corporations invest in United States Treasury bonds? Actually, of course, business concerns but their money into government obligations because they know these are the safest investment they can make. The government obligations bought for the old-age reserve are every whit as safe.*
>
> "Admittedly, the present reserve system is not the only conceivable method of financing old-age insurance. The alternative most frequently proposed suggests that Congress each year appropriate only so much money as would be needed to finance the benefits currently payable. This would, it is true, make it possible to finance benefits with relatively small contributions

during the early years, while most covered workers are still under the benefit age. But a generation hence annual benefit payments will be much larger than the amount collected annually under the tax rates now provided by the act. What would happen then is anybody's guess. *It may be pertinent, however, to point out that similar 'current-cost' schemes had long ago been tried and found wanting by the early private fraternal societies.* Their initial assessments were, to be sure, low; but as the members became older and the number of claims to be paid increased, both costs and premiums mounted. In the few societies that continued without reserves, the policyholders who were unfortunate enough to live longest—and who had therefore also made the largest contributions—in the end lost both their investment and all hope of protection. *Regardless of what we call it and how we work it, sound financing of old-age insurance must recognize certain facts: First, it is no more true to assume that obligations do not exist until the moment comes to pay them than it would be to assume that an apple does not exist until it falls from the tree. Second, the tests of sound insurance are acceptance of responsibility for accruing obligations, and assurance that they can and will be met when due.*"

PREPARED STATEMENT OF FRANK MASON

Good morning, Mr. Chairman and members of the Committee. My name is Frank Mason, and I am testifying on behalf of the U.S. Chamber of Commerce. I am a member of the Chamber's Health and Employee Benefits Committee, a former member of its Board of Directors, and Chairman of the Board of the Mason Corporation in Birmingham, Alabama. With me is Lisa Sprague, the Chamber's manager of employee benefits policy.

The Chamber wishes to thank the Committee for the opportunity to present its views on what has become a hotly debated question throughout the land: whether it is appropriate at this time to reduce Social Security taxes.

BACKGROUND

In 1983, the President's bipartisan National Commission on Social Security Reform recommended and Congress adopted a number of changes in the funding and operation of the Social Security system. Among these provisions was a schedule of payroll tax increases for both employers and employees. At that time, the Chamber commended the Commission for its diligent efforts in clarifying and offering a proposal to solve the urgent financing problems then facing the system. At the same time, however, the Chamber cautioned Congress against over reliance on payroll taxes as a solution to ongoing financial problems.

In 1986, I led the Alabama delegation to the White House Conference on Small Business and I chaired a group that looked at the area of payroll taxes. One of our recommendations, which emerged as the number 8 priority of the entire conference, concerned Social Security. We called for a freeze on the tax rate and the wage base at 1986 levels and suggested further reductions in the tax rate as well as the exploration of long-range alternatives to the present Social Security system, which places an undue and inequitable financial burden on businesses and their employees. The Chamber endorsed this recommendation

As we all are aware, no freeze occurred. Social Security (FICA) taxes have risen twice since then. From 1980 to 1990, the basic payroll-tax rate rose from 6.13 percent to 7.65 percent, an increase of 25 percent. Over the same period, the taxable wage base expanded from $25,900 to $51,300. Combined, the two factors are responsible for more than doubling (from $1,588 to $3,924) the maximum tax paid by employees and matched by businesses. The maximum tax paid by a self-employed individual rose from $2,098 in 1980 to $7,849 in 1990.

The result of this escalation is that the Social Security system is now taking in more in taxes than it needs to pay for current benefits. The excess of taxes over benefits for 1989 was approximately $52 billion; this disparity widens until about 2030, when cumulative surpluses are projected to reach nearly $12 trillion.

THE QUESTION OF A "RESERVE"

One of the goals of the 1983 reforms was to move the Social Security system from its traditional "pay-as-you-go" mode to a "partially-funded" basis. The reformers structured tax increases to create a surplus in the trust funds, which was presented as a reserve which could be drawn upon in order to lighten the tax burden on active workers when the huge baby-boom generation retires.

In intuitive terms, this makes sense. We have all been taught to save for a rainy day. In practical terms, however, it emerges that we are doing nothing of the kind. The much-discussed Social Security surplus exists only on paper. Excess taxes collected are exchanged for special-issue Treasury bonds, redeemable at a later date. The Treasury bonds establish rights for the Social Security program to draw on government resources in the future, but they do not cause real capital to be accumulated. In the interim, the Treasury takes the cash, which is used to finance current spending and—not incidentally—mask a significant portion of the Federal deficit.

But the day will come when millions of baby-boomers need their Social Security checks. Beyond the taxes collected from their working children, what will the trust fund have to offer? Figuratively speaking, a stack of Treasury bonds that amounts to a stack of IOUs. The cash for which the bonds were issued is long since spent, yet the bonds must be redeemed. One might draw the analogy of a father saving for his child's college education. Each Monday he puts $50 in a cookie jar, and each Wednesday he takes the cash out to spend on something else, depositing an IOU in its place. When the child reaches college age, the father still needs real money. In the case of Social Security, Congress will be forced to raise the necessary cash somehow and will have four choices: raise taxes, reduce benefits, cut Federal spending, or borrow. Interestingly, these same four choices will present themselves, at about the same time, if there is no accumulated "surplus." Whether it is a question of playing benefits directly, or redeeming bonds in order to pay benefits, cash must be raised before checks can be cut. Tomorrow's retirees, tomorrow's workers, and indeed tomorrow's Congress will confront essentially the same situation either way. Consequently, if we look strictly at the Social Security system, the interim device of Treasury bonds could be skipped altogether.

The Chamber of course recognizes that the Social Security trust fund cannot be considered as an isolated entity. The pay-as-you-go and partially-funded approaches have very different impacts on the workers and businesses of today and on the thorny question of the Federal deficit.

IMPACT ON BUSINESS

The Chamber's 1989 Employee Benefits survey found that employer FICA taxes account for 18.6 percent of all benefit dollars spent. This figure is based on a sample of businesses of all sizes. For small business, which frequently cannot afford to sponsor pension and welfare benefit plans, the proportion of available benefit dollars consumed by FICA taxes is much higher.

The FICA tax burden falls heavily on small business for a number of reasons. Small businesses generally are more labor-intensive than larger firms, and their average wages are lower. With a FICA taxable wage base set at $51,300, it is likely that virtually every dollar paid out in wages by a small employer carries an automatic surcharge of 7.65 cents.

Small business was responsible for more than 60 percent of new job creation in the U.S. in the 1980s. But pressures restraining job creation continue to mount, and higher Social Security taxes must be considered as an element in that process. High payroll taxes add to the marginal disincentives to expand one's work force. A combined employer-employee FICA tax rate of 15.3 percent means that any job must be worth at least 15.3 percent more to the employer than it pays to the employee before anyone is hired. This weighting will be compounded in April, when an increase in the minimum wage drives up direct employment costs and their attendant tax encumbrances.

Unlike income taxes, payroll taxes have no relation to a company's profitability. They must be paid from day one, whether a business is flourishing or floundering. Consequently, high payroll taxes constrain not only employment but also overall financial capacity, particularly for small firms. For labor-intensive businesses, high tax rates compound the difficulties of effectively competing at home and in international markets.

The discussion here is about reducing the FICA tax, not abolishing it. Business has been a willing participant in the Social Security system, in the interests of providing a floor of financial security for the nation's elderly. For a small business, the employer's contribution to Social Security may constitute the bulk (or indeed the whole) of the contribution he can afford to make to national retirement protection. However, as discussed above, that portion of tax monies spent to finance current spending protects no one. The business owner quite reasonably could feel that his dollars would more properly be invested in his operation and his employees than in paying the government's bills.

The point may be raised that the Treasury does credit interest on the cash it borrows to the Social Security trust fund. It must be noted that the government's paying interest to itself, a matter of an accounting entry, does nothing to increase the productive capacity of the economy.

IMPACT ON INDIVIDUALS

As noted above, FICA taxes have been rising steadily. For 3 out of 4 of today's workers, Social Security takes a larger bite out of wages than do income taxes. With all of this tax money flowing inexorably toward Washington, it would be comforting if a worker could feel secure about his retirement. Instead, he now begins to realize that the government is collecting Social Security taxes only to use them elsewhere. There is no "cushion" for him. This knowledge can only make him feel fretful, abused, and somewhat helpless.

A member poll by the American Academy of Actuaries, released in 1989, found a consensus that no more than half of baby-boomers, who will reach age 65 between 2010 and 2028, will be economically strong enough to retire. Reasons cited by the actuaries include a shrinking base of workers to support Social Security benefits, ever-rising health care costs, and inadequate tax incentives to encourage employer pensions and personal savings.

The last point deserves highlighting. Social Security is, after all, but one of the legs in the classic three-legged stool of retirement income, the others being employer-sponsored retirement plans and personal savings. Social Security never was intended to be a full-scale retirement plan. While all three legs of the stool appear to be in need of strengtheg—one might cite the increasingly complex and burdensome regulation of retirement plans—the Chamber believes that the personal savings element could be buttressed by expansion of the savings vehicles, such as Individual Retirement Accounts, available to workers. The evident unwillingness of Americans to save is much lamented. Encouraging retirement saving in conjunction with a payroll tax reduction would be a positive step on several fronts: the economy, the pressure on Social Security, and the partial privatization of retirement financing, which gives the individual a greater role in ensuring his own future security.

It would be a mistake for Congress to assume that the American worker is endlessly gullible. He cannot continue to accept reassurances that his taxes are a form of saving for retirement when he sees that tax money used for another purpose altogether.

BUDGET CONSIDERATIONS

Senator Moynihan's tax-cut proposal has raised a wide-ranging debate about its impact on the Federal deficit. The Chamber shares the belief that the need to reduce the deficit is critical. It maintains, however, that imposing unnecessarily high taxes in order to generate deficit-masking surpluses is not a constructive approach. To the extent that surplus receipts permit Congress to defer applying fiscal discipline to the government as a whole, they do the country a disservice. Hard choices need to be made, and they should be addressed now. The Chamber believes that the revenues necessary to offset a tax cut in order to continue deficit-reduction progress should be in the form of reduced Federal expenditures. The Chamber vigorously opposes any proposals to raise other taxes in order to make up for a Social Security tax reduction.

Reducing Social Security taxes today will be a benefit to employers and employees alike. It will not materially alter the situation faced by retirees in the next century. Nevertheless, it must be borne in mind that increased funding needs are inevitable in the next century. Structuring a framework for continued economic growth is the most crucial step in preparing to meet those needs. In addition, the Chamber recommends that this Committee and Congress as a whole be vigilant in controlling future Social Security benefit increases.

CONCLUSION

It is desirable to reduce the Social Security tax rate, the general burden of taxation, and the growth rate in government spending. Thus, the Chamber urges Congress to reduce the Social Security payroll tax, matched by a reduction in expenditures necessary to meet Gramm-Rudman-Hollings deficit reduction targets without increasing other taxes.

The Chamber also urges the Congress to undertake, seriously and with open minds, the study of privatization alternatives to the Social Security system. Representative Porter's proposal, embodied in H.R. 3083, is one approach currently on the table. The Chamber intends to give serious study to this issue as well.

The Chamber thanks the Committee for its attention and particularly wishes to thank Senator Moynihan for focusing public attention on this issue. The Chamber stands ready to work with the Congress for a resolution beneficial to all.

Prepared Statement of Martha McSteen

Mr. Chairman, my name is Martha McSteen. I am president of the National Committee to Preserve Social Security and Medicare, a grassroots senior advocacy organization dedicated to protecting the entitlements on which millions of older Americans rely. Before my association with the National Committee, I served 39 years with the Social Security Administration, the last three as acting commissioner.

Mr. Chairman, National Committee members welcome the debate on Social Security—its financing—and its future. And we appreciate your holding these hearings on Senator Moynihan's proposal to trim the Social Security payroll tax rate.

To be sure, Senator Moynihan did the nation a favor by focusing national attention on the way the Social Security surplus is being used to disguise the true size of the budget deficit. This is a debate that is sorely needed—and a debate that is long overdue. The National Committee continues to believe that tax rates can be reduced and that future tax rates should be adjusted through an automatic tax rate stabilizer to keep Social Security on a pay-as-you-go financing plan.

Our members confirmed this position in a survey conducted two weeks ago by Cooper and Secrest Associates. A summary of the survey results is attached. As long as benefits are not threatened—and our members don't think they would be—they support reduced payroll taxes.

It is entirely consistent for the National Committee to oppose excessive Social Security payroll taxes as strongly as we have opposed budget-driven proposals to trim or tax Social Security benefits. Social Security trust funds should not be a part of the budget. They did not create the imbalance in the budget. And they should not be part of the solution.

Removing Social Security trust funds from the budget calculations as some members of Congress have proposed—is an essential step to maintain the integrity of the Social Security system. Our poll shows that National Committee members overwhelmingly believe that the Social Security surplus should be used exclusively for Social Security benefits. Stopping the use of Social Security surpluses to pay for current government expenses is so important to our members that they would accept a higher deficit or the sacrifices necessary to balance the budget exclusive of Social Security.

As I see it, there are only two ways to prevent Social Security funds from being used to pay for current government expenses. One way is to balance the budget without the help of trust funds. But given that we've had such a difficult time reducing the deficit even with the Gramm-Rudman-Hollings Act, balancing the budget exclusive of Social Security and still maintaining the current payroll tax rates would be a formidable task.

That leaves us with a second option—eliminating the unneeded surplus, as Senator Moynihan has proposed. It's much like getting rid of the ice cream and doughnuts before you go on a diet. You remove the temptation—and force yourself to make tough decisions. By removing the surplus—and eliminating the temptation—the country would return to the pay-as-you-go financing system under which Social Security has been funded for most of its history.

Traditional pay-as-you-go financing provides a basis for stable financing of Social Security that is fair to both taxpayers and beneficiaries. Current financing methods are not providing the stability which has been promised because the trillion dollar reserve, eventually reaching $12 trillion, is really hollow—consisting solely of taxpayer obligations. But taxpayers are being told they are prefunding some future benefits with higher payroll taxes.

Consider this—how will beneficiaries react to the refusal to correct any inequities in Social Security—such as the retirement test—when Social Security is running up surpluses of more than $100 billion a year?

Regardless of how we plan to finance Social Security over a long period of time, one point is clear—and that is, the cost will permanently increase when the baby boom generation begins to retire. Some even say the cost of a pay-as-you-go plan will be unaffordable. But Social Security experts like Alicia Munnell say the burden will be—in her words—"completely manageable." Dr. Munnell points out that even around 2020 when taxes have to rise beginning, the increases will be of roughly the same magnitude as those experienced by workers over the 1968 to 1990 period.

National Committee members by a better than two-to-one margin believe that a pay-as-you-go plan makes more sense than current law.

While the National Committee believes that the large reserve is both unnecessary and even unwise, it is clear that a reserve of some fashion will be needed to cushion Social Security in the event of an economic downturn. Senator Moynihan recommends a reserve equal to a full year's benefit payments—a figure that will be reached next year. Some others say the reserve should be larger. The truth is—no one really knows how large the reserve should be. What is clear is that much discussion, debate and research is needed before a clear consensus will emerge on exactly how large the reserve should be.

More than three-quarters of National Committee members surveyed consider a full year's reserve just right or even too much. But how much will be just right in the future? One of the lessons from the 1977 and 1983 Social Security Amendments is that any one set of assumptions about the future will be wrong in the short run. In 1977, the assumptions were too optimistic; in 1983, the assumptions were too pessimistic. Consequently, the National Committee believes that future tax rates should be adjusted using an "automatic tax rate stabilizer"—to insure the stability as well as the soundness of the trust fund. Such a stabilizer would remove tax increases and decreases from the political process and trigger automatic annual adjustments to the payroll tax rates to keep the reserves at mandated levels. This automatic stabilizer would insure that tax rates are as low as possible for workers and employers—yet high enough to reassure beneficiaries that the program is financially solid. Former chief Social Security actuary Robert J. Myers has developed an automatic tax rate stabilizer that Congress might want to review.

President Bush has said that tax rate reductions would threaten current benefits. On this point, National Committee members disagree—and disagree strongly, by a more than two-to-one margin. They believe that a more realistic threat to cut or tax benefits comes from continuing to include Social Security in the budget process.

While for the most part, National Committee members would not benefit directly from payroll tax rate reductions, they nevertheless do not want to stand in the way of tax relief for their children and grandchildren. On the other hand, seniors do expect Congress to treat beneficiaries fairly and to stop claiming that improvements in Social Security are unaffordable. After all, current surpluses are not solely the result of tax rate increases. They also came from mutual sacrifices by workers and beneficiaries back in 1977 and 1983. Beneficiaries helped to put Social Security back on good financial footing back then by agreeing to several reductions in benefits. Now, Congress has a chance to show its recognition of those sacrifices by giving serious consideration to some benefit improvements.

Of course, changes in Social Security do not take place in a vacuum. The fate of Social Security financing is closely linked to the fortunes of the economy. Many opponents of cutting the Social Security payroll tax believe that our country's economic future depends on increasing national savings and that the best place to generate the needed savings is with the Social Security surplus.

The National Committee supports the goal of increasing national savings. But this particular approach—even if politically feasible—has to be balanced against the regressive impact of the payroll tax on low-income workers and against the job creation disincentive on labor-intensive employers. Economists Gary and Aldona Robbins argue that a payroll tax rate cut along the lines of the cut proposed by Senator Moynihan could increase our gross national product by $346 billion, increase available capital by $162 billion and create 930,000 new jobs over the next 10 years.

Before concluding, Mr. Chairman, I want to mention one other important issue related to Social Security and that is the need to make it an independent agency with a strong governing board. The cabinet secretaries who now serve as Social Security trustees—especially the Secretary of Treasury as managing trustee—are faced with an unresolvable conflict of interest. They must balance the needs of Social Security with the other legitimate needs of the nation, such as reducing the deficit. But in so doing, their decisions may not always represent the best interests of Social Security. For example, the Administration's opposition to reducing tax rates is based on its concern for the deficit—not what is best for Social Security. Social Security's trustees must insist on and stand up for what's right for Social Security first—and not leave this burden of conscience to members of Congress alone. Under the current arrangement, it's too easy for Social Security's trustees to get caught up in political manipulation of the system. It's for that reason, Mr. Chairman, that the National Committee urges the Senate Finance Committee to support legislation that would create an independent Social Security agency with a strong governing board.

The National Commission on Social Security Reform deserves our thanks for rescuing Social Security from the brink of bankruptcy back in 1983. While many have attributed long-term financing intentions to the National Commission, it did not systematically examine long-term financing issues or consciously recommend a long-term financing strategy. That would have been too much to ask back then because the ship was in danger of sinking.

Well, Mr. Chairman, now that the ship has been saved, it is time to begin the debate about long-term financing issues and to come up with necessary strategies. Senator Moynihan has focused national attention on this issue. And we know that you and other conscientious members of Congress will give it your closest attention.

Thank you.

Enclosure.

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POLLING UPDATE

TO: Interested Parties

FROM: Cooper & Secrest Associates

DATE: February 23, 1990

SUBJECT: Member Poll Results: National Committee to Preserve Social Security and Medicare

We present for your review and consideration the findings compiled from a comprehensive national membership survey of the National Committee to Preserve Social Security and Medicare.

Between February 17 and 18, 1990, Cooper & Secrest Associates conducted a comprehensive national survey of the attitudes of members of the National Committee to Preserve Social Security and Medicare. All told, 500 15-minute interviews were conducted with National Committee members ages 60 and over. The margin of error for this project is plus or minus 5%. The findings that emerge offer a clear insight into the emerging opinions of National Committee members.

As long as Social Security benefits are not threatened, National Committee members favor reducing Social Security payroll taxes rather than letting Social Security surpluses be used to meet current government expenses. Most members do not believe that a payroll tax reduction will threaten benefits and they think that a one year's reserve is adequate. Ideally, members would like to reserve Social Security surpluses exclusively for future Social Security benefits, even at great sacrifice required to balance the budget exclusive of Social Security. But if that is impossible -- and most members give low marks to current deficit reduction efforts -- National Committee members do not want Social Security to be in the budget calculations or used to meet current government expenses.

Social Security Surpluses Should be Used Exclusively for Social Security Benefits

* The majority of National Committee members (86%) want Social Security to be used exclusively for future Social Security benefits. The response is similar to the nationwide response to the same question included in a Times Mirror survey done by Gallup last year.

* Even when told the significant sacrifice required to balance the budget exclusive of the Social Security surplus, 42% of the members favor large tax increases and/or cuts in federal programs to balance the budget while 39% oppose these sacrifices. Before answering this question, respondents were told that Social Security surpluses cannot be reserved exclusively for Social Security "as long as the government's deficit is larger than the Social Security surplus."

* Assuming the government can balance the budget, National Committee members favor saving the Social Security surplus rather than reducing payroll taxes by a 65% to 25% margin. Responses were more evenly divided when members were asked whether they wanted to save the Social Security surplus (45%) or increase benefits (43%).

Social Security Surpluses Should Not be Used to Reduce the Deficit

* A majority (54%) rated the government's effort to reduce the deficit as "poor" and another third (31%) said it was "only fair."

* By a 53% to 22% margin, National Committee members prefer a higher deficit rather than letting Social Security be used to reduce the deficit. While a large percentage of members are not sure (43%), four out of five members with an opinion even prefer reducing Social Security taxes on workers rather than using Social Security to meet government expenses.

* Three-quarters (75%) of National Committee members, especially upper income members, want to take "Social Security out of the nation's budget calculations so that Social Security cannot be counted against the federal deficit" and more than half (55%) want a faster timetable than that proposed by President Bush.

National Committee Members Favor Reducing Social Security Payroll Taxes

* National Committee members were reminded of "recent proposals to cut Social Security payroll taxes by people who argue that the government is not saving the surpluses but using the money to pay other government bills. Senator Moynihan of New York calls this 'thievery'." By a 48% to 36% margin members agreed with the idea of cutting Social Security taxes on workers and members favored a payroll tax cut by more than four to one "if the Social Security payroll tax cut could be reduced without any reduction in Social Security benefits."

* Later National Committee members were presented with two options to finance Social Security in the long-term, "During the next thirty years, payroll taxes under current law will be higher than needed to pay benefits. Under an alternative approach, payroll taxes could be lower for the next thirty years and higher after that." By a 45% to 20% margin, National Committee members prefer the alternative of "lower taxes now, higher taxes later."

* More than half (58%) disagree with President Bush that "the proposal to cut Social Security payroll taxes and reduce the surplus is really intended to get him to cut Social Security benefits."

* These answers may be partially explained by the fact that 53% of National Committee members believe that Social Security is in excellent or good financial shape and that two-thirds of respondents believe that Social Security's financial shape has gotten better (26%) or stayed the same (41%) in the last five years. In fact, the Social Security reserve level at the end of 1990 is considered just right or even too much by 78% of National Committee members.

* Another factor in National Committee members' consideration may be the welfare of their grandchildren. While 74% of National Committee members believe that their children are at least as well off as they were at the same age, only 48% think their grandchildren will be as well off.

<u>Views About the Impact of Payroll Tax Reduction on Other Taxes</u>

* National Committee members <u>disagree</u> with President Bush that "the proposal to cut Social Security payroll taxes would lead to higher taxes elsewhere'" but only by a 45% to 39% margin. However, members with income over $30,000 agree with President Bush by a 49% to 43% margin.

* By similar margins National Committee members oppose a reduction in the capital gains (57% to 26%) and prefer a payroll tax cut to a capital gains tax cut (57% to 25%). Conservatives, Republicans, and upper income members are somewhat more sympathetic to a capital gains tax cut, but upper income members would prefer a payroll tax cut rather than a capital gains tax cut even more than lower income members.

COOPER & SECREST ASSOCIATES, INC.

February, 1990

Telephone Number________________

Interviewer Name________________

Area
Northeast 28%
Southeast 17%
Midwest 22%
South Central 11%
West 22%

Interview dates Feb. 10-11

STUDY #9017 NCPSSM S.S.

Sample Point________

CHECK QUOTA:
Male.......45.1
Female.....55.2

Hello, my name is________________ with Cooper & Secrest Associates, the national public opinion research company. May I speak with Mr./Mrs. (name on the list) please? (ONCE CORRECT PERSON IS ON THE LINE, REPEAT INTRODUCTION AND SAY:) We are conducting a national survey of public attitudes toward some important issues and I'd like to ask you a few questions so that your opinion will be counted.

Q1. First of all, what is your age, please? (READ CATEGORIES.)

Below age 50....--1 (TERMINATE)
Age 50-59.......--2 (TERMINATE)

Age 60-64.......24 3
Age 65-69.......32 4
Age 70-74.......21 5
Age 75-79.......14 6
Age 80 and over..9 7
(ASK Q2.)

Refused.........--8 (TERMINATE)

Q2. Would you say that your children are better off, worse off, or just about the same economically as you were when you were their age?

Better off.......61..1
Worse off........12..2
About the same...13..3
No children (VOL)10..4 (SKIP TO Q4).
Not sure..........4..5

Q3. Would you say that your grandchildren will be better off, worse off or just about the same economically when they get to be their parents' age?

Better off............37.1
Worse off.............16.2
About the same........11.3
No grandchildren (VOL).5.4
Not sure..............31.5

Q4. How would you rate the federal government's effort when it comes to reducing the budget deficit -- excellent, good, only fair or poor?

Excellent........2.1
Good.............5.2
Only fair.......31.3
Poor............54.4
Not sure.........8.5

Q5. Now, how would you describe the financial status of the Social Security system? Is it in excellent financial shape, good financial shape, only fair shape, or poor shape?

Excellent shape...14.1
Good shape........39.2
Only fair shape...24.3
Poor shape........15.4
Not sure...........8.5

Q6. Over the past five years, has the financial security of the Social Security system gotten better, gotten worse, or stayed about the same?

Gotten better.........26 1
Gotten worse..........21 2
Stayed about the same.41 3
Not sure..............12 4

Q7. To the best of your knowledge, is the amount of money collected from payroll taxes for Social Security more than the amount the government pays out to people receiving Social Security, or is the amount collected from payroll taxes less than the amount paid out in benefits, or is the amount collected about equal to the amount paid?

More than government pays out.........38.1
Less than government pays out.........12.2
About the same as government pays out 14.3
Not sure..............................36.4

Q8. Are you familiar with the Social Security Trust Fund?

Yes........43.1
No.........53.2
Not sure....4.3

Q9. As you may know, the federal government has a surplus in the amount of money collected for Social Security. Some people feel that the surplus money should be put aside and reserved exclusively for Social Security payments in the future. Others favor borrowing the surplus money to meet current government expenses and help reduce the federal budget deficit. Which view comes closer to your own -- using the surplus exclusively for future Social Security payments or using it to meet current government expenses and to help reduce the deficit?

Use exclusively for future S.S. payments 86.1
Use to meet current government expenses.6.2
Not sure................................8.3

Q10. As long as the government's deficit is larger than the Social Security surplus, the Social Security surplus is not put aside and reserved exclusively for Social Security payments in the future, but is used to pay the current bills in the rest of the government. Balancing the budget would require an annual tax increase to about $1,000 per adult or across-the-board spending cuts of approximately twenty percent. Do you favor or oppose large tax increases and/or cuts in federal programs to balance the budget?

Favor..............42 1
Oppose.............39 2
Not sure...........19 3

Q11. Assuming the government cannot balance the budget, which do you favor: using the Social Security surplus to meet current government expenses or reducing Social Security taxes on workers?

Use S.S. to meet gov't expenses..11 1
Reduce S.S. taxes on workers.....46 2
Not sure.........................43.3

Q12. Assuming the government can balance the budget, which do you favor: putting aside the Social Security surplus and reserving it exclusively for Social Security payments in the future or reducing Social Security taxes?

Saving Social Security surplus...65.1
Reducing Social Security taxes...25.2
Not sure.........................10.3

Q13. Assuming the government can balance the budget, which do you favor: putting aside the Social Security surplus and reserving it exclusively for Social Security payments in the future or increasing benefits?

Saving Social Security surplus...65.1
Increasing benefits..............[illegible].2
Not sure.........................14.3

Q14. What if the choice came down to using the Social Security surplus to reduce the deficit or having a higher deficit, which would you choose?

Use surplus to reduce deficit....22..1
Have a higher deficit............53..2
Not sure.........................25..3

Q15. Some people have proposed taking Social Security out of the nation's budget calculations so that the Social Security Trust Fund cannot be counted against the federal deficit? Do you favor or oppose taking Social Security out of the nation's budget calculations?

Favor.........75.1
Oppose........17.2
Not sure.......8.3

Q16. President Bush has proposed a timetable to take Social Security out of the budget beginning in 1993 and completely by 1996. Do you agree with the timetable of this proposal or should Social Security be taken out of the budget earlier?

Agree with Bush timetable..26.1
S.S. out of budget earlier.55.2
Not sure...................19.3

Q17. You have heard about recent proposal to cut Social Security payroll taxes by people who argue that the government is not saving the surpluses, but using the money to pay other government bills. Senator Moynihan of New York calls this "thievery." Do you agree or disagree with the idea of cutting Social Security taxes on workers?

Agree..........48.1
Disagree.......36.2
Not sure.......16.3

Q18. President Bush says the proposal to cut Social Security payroll taxes and reduce the surplus is really intended to get him to cut Social Security benefits? Do you strongly agree with him, somewhat agree with him, somewhat disagree, or strongly disagree?

Strongly agree.....8...1
Somewhat agree....17...2
Somewhat disagree.30...3
Strongly disagree.38...4
Not sure..........17...5

Q16. If the Social Security payroll tax could be reduced without any reduction in Social Security benefits, would you favor or oppose a payroll tax cut?

Favor........72..1
Oppose.......16..2
Not sure.....12..3

Q17. President Bush says that the proposal to cut Social Security payroll taxes would lead to higher taxes elsewhere. Do you strongly agree, somewhat agree, somewhat disagree, or strongly disagree with that?

Strongly agree...20..1
Somewhat agree...19..2
Somewhat disagree19..3
Strongly disagree26..4
Not sure.........16..5

Q18. President Bush and others are proposing to reduce the capital gains tax, that is, the tax on income generated from the sale of stocks, bonds and real estate. Supporters of this capital gains tax reduction say it will encourage economic growth. Opponents say it is just a tax break for the rich, and bad policy. What do you think? Do you favor or oppose the reduction in the capital gains tax?

Favor......26..1
Oppose.....57..2
Not sure...17..3

Q19. Presuming there were no impact on the deficit or on Social Security, which do you believe is more fair -- a capital gains tax cut or a payroll tax cut?

Capital gains tax cut...25.1
Payroll tax cut.........57.2
Not sure................18.3

Q20. During the next thirty years, payroll taxes under current law will be higher than needed to pay benefits. During the following thirty years, payroll taxes will be lower than needed to pay benefits. Under an alternative approach, payroll taxes could be lower for the next thirty years and higher after that. In sixty years the payroll tax rate would be identical under either plan to pay benefits. Which do you prefer, higher than needed tax rates now and lower tax rates than needed later, or lower taxes now and higher tax rates later?

Higher taxes now, lower later.20.1
Lower taxes now, higher later.45.2
Not sure......................35.3

Q21. This year Social Security will take in $320 billion and spend $250 billion. Social Security will end the year with total reserves of almost $250 billion -- a full year's reserves. Do you feel that this reserve is too much, too little, or about the right amount?

Too much.......13..1 (SKIP TO F1).

Too little......8..2 (ASK Q22.)

Right amount...65..3 (SKIP TO F1).
Not sure.......14..4 (SKIP TO F1).

(ASK IF "TOO LITTLE" IN Q21.)

Q22. How much would you say is a sufficient reserve in the Social Security system, $375 billion -- equal to a year and half's reserve, $500 billion -- equal to a two year's reserve, $1 trillion -- equal to a four year's reserve, or more than $1 trillion?*

$375 billion/year and half reserve.10.1
$500 billion/two year reserve......15.2
$1 trillion/four year reserve......24.3
More than $1 trillion..............22.4
Not sure...........................29.5

* Base too small to be statistically reliable.

Prepared Statement of Ron Mulvaney

INTRODUCTION

The American Association of Retired Persons (AARP) representing Americans, age 50 and above, appreciates this opportunity to present its views on proposals to change the way Social Security is financed.

AARP believes that Americans of all ages are indebted to Senator Moynihan for sparking the debate on the federal deficit and the future of Social Security. Senator Moynihan has correctly and dramatically defined the problem. His proposal to reduce the growth in the Social Security reserves calls attention to the fact that the buildup in the reserves is not being properly saved for the baby boom generation's retirement, but instead is masking an increasing portion of the federal deficit. Although many have been decrying this practice, the alarms have been diffuse. Now the proposal to reduce payroll taxes has focused the nation's attention.

However, after careful consideration, the Association's first preference remains retaining existing Social Security policy to continue to build the reserves for future generations. But as this debate has dramatically pointed out, continued buildup of the reserves must be accompanied by a change in fiscal policy to move the rest of the federal budget toward balance

If that combination cannot be implemented in a reasonable amount of time, then adoption of pay-as-you-go financing for Social Security will have to be seriously considered. In any case, no pay-as-you-go financing should be implemented until the trust funds accumulate a prudent level of reserves equal to 18 to 24 months of benefits.

AARP calls upon the President and the Congress to enact legislation this year to begin to separate Social Security's financing from the calculation of the Federal deficit. We stand ready to work with the President and the Congress to achieve this purpose.

AARP believes that the nation must manage the Social Security program in ways that best assure three goals:

1. strengthening public confidence in the integrity and safety of the Social Security system, now and in the future, particularly on the part of younger Americans;
2. ensuring higher national savings and investment in order to promote long-term economic growth so that the Social Security benefits promised to today's workers can be honored; and
3. protecting current benefits from year to year fluctuations in the economic cycle.

MAINTAINING CONFIDENCE IN SOCIAL SECURITY

Social Security represents a striking, and uniquely American, amalgam of social welfare and individual equity principles. It is one of the most successful government programs in the history of the United States. But, this success has been hard-won.

Social Security was born amid economic distress and controversy, and along the way has weathered inevitable stresses and strains. But in 1990, after more than fifty years, it is in robust health and overwhelmingly supported by Americans of all ages. It provides valuable support for older family members, a basis for retirement income security, and an insurance policy for almost all younger workers and their families in the event of death or disability. And, according to a December 1988 Commerce Department study, Social Security is the nation's most effective anti-poverty program.

The very health of Social Security now constitutes part of the present dilemma, because of the rate at which the reserves are accumulating and being lent to the Treasury to finance current government operations. Such a circumstance is not in the nation's long-run interest, with respect to Social Security or the rest of the Federal budget.

Furthermore, while Americans' support of Social Security is solid, confidence could be undermined by rhetoric about conflicts among generations and the potential for benefit cuts as a consequence of payroll tax reductions. Adjusting payroll tax rates just when the system is building needed reserves could weaken public confidence and support. It is vitally important that current workers, especially those in the baby boom generation, have assurance that the system will be there for them.

PROMOTING SAVINGS AND INVESTMENT

The rationale for building up the Social Security reserves to partially pre-fund retirement benefits for the baby boom made sense in 1983 when this policy was adopted and continues to make sense today. However, this policy can only be successful if the reserves can be used to enhance savings and productive investment to create a stronger economy that will be able to fund benefits when they begin to come due in only twenty years. Future benefits will have to be financed from the future economy. Therefore, the trust fund buildup must be used to strengthen that future economy.

The reserves cannot enhance growth if we continue to allow the buildup in the reserves to mask the true extent of the deficit in the remainder of the Federal budget. Exclusive of Social Security, the Federal deficit will continue to rise, from $206 billion in 1990 to almost $250 billion in 1994.

Reducing the rate of growth of the trust fund reserves at this time would be a tacit admission that we as a nation cannot or will not face the problem of the deficit. Further, it is likely that any proposal to reduce the growth of the reserves now through a reduction in payroll taxes could result in even greater private spending on consumption, unless accompanied by offsetting revenue increases.

In the short-run, a spurt of growth could be anticipated as the "tax rebates" of millions of workers and businesses found their way into the spending stream. This could lead to a rise in the inflation rate, which the Federal Reserve would be likely to counter by raising interest rates. Without offsetting revenue increases, then, cutting payroll taxes could further worsen the national savings rate, increase government debt and dampen economic growth.

BUILDING A "SAFE" LEVEL OF RESERVES

AARP believes that it is imperative to protect benefits from cyclical economic fluctuations. To do this, the Association believes that the trust fund reserves should continue to build to a level at least equal to 18-24 months's worth of outlays. (An eighteen month reserve will not be reached until 1993.) This is the minimum level necessary to protect benefits in the event of serious economic downturn similar to those experienced in the early 1980s.

For example, if beginning in 1988, the pessimistic (Alternative III) set of Social Security actuarial assumptions had prevailed (including higher-than-anticipated inflation, unemployment, and ratio of beneficiaries to contributors), outgo from the Old-Age, Survivors and Disability Insurance Trust Funds (OASDI) would draw even with income by 1991 and exceed income by 1992.

SOCIAL SECURITY AND THE DEFICIT

Senator Moynihan, as well as other members of the House and Senate, have long been associated with efforts to protect the short and long-term integrity of the Social Security program. They have offered legislation to remove Social Security from the annual Gramm-Rudman-Hollings (GRH) deficit calculation.

AARP strongly supports these legislative efforts for several reasons:

1. Inclusion of the large buildup in the trust fund reserves in the annual deficit figures masks the true extent of the deficit in the rest of the Federal budget.
2. Including Social Security in the deficit calculation completely obscures the economic necessity of treating the growing trust fund reserves in a manner that promotes long-term economic growth.
3. Social Security has long-term obligations; in fact the program is measured over a 75 year time frame. It is not appropriate to look at Social Security in the context of the one-to-three year projection framework of the Gramm-Rudman-Hollings calculation.

The prospect of continued large deficits is a serious danger to our national economy and its ability to finance future Social Security benefits. So long as apparent progress is being made toward deficit reduction by including Social Security in the deficit equation, the need to deal with the structural deficit appears less urgent.

AARP recognizes and shares the frustration of many in Congress on the lack of progress on meaningful deficit reduction. The Association, however, is not prepared to give up on the effort to bring the operating deficit down. We are therefore concerned with the potential loss of $55 billion or more in annual revenue as a result of the proposal to rollback OASDI payroll taxes. This loss would have to be made up by increasing other taxes, cutting spending or increasing the debt. Current payroll tax cut proposals do not indicate what combination of these measures would be used as offsets.

There are those who support reductions in the payroll tax because, they say, it is a regressive tax and the entire tax system has become less progressive. While these statements have some validity in the context of the use of the trust funds for operating expenses, they ignore the fact that we should not look at the payroll tax in isolation. While the payroll tax is regressive relative to the income tax, the Social Security benefit structure is progressive. The Social Security system as a whole is weighted in favor of low and moderate income families.

Those who wish to address the lack of progressivity in the tax system as a whole should deal with this issue directly and not look to changes in the payroll tax as a first option. Other options for restoring greater progressivity include extending the 33 percent top income tax rate to higher income taxpayers and liberalization of the Earned Income Tax Credit (EITC) for low income taxpayers.

CONCLUSION

In the final analysis, there are three choices with respect to the Social Security Trust Fund buildup. First, we can make the reserves economically productive by dealing with the deficit in a responsible way. Second, we can return Social Security to pay-as-you-go financing to limit the accumulation of the reserve. Or third, we can continue current policy—allowing the Trust Fund buildup to mask the deficit.

AARP's preference is the first choice listed above—the United States should move quickly toward a more balanced Federal operating budget that would enable the rapidly building OASDI trust funds to contribute to national savings. It is this policy that offers the best prospects for long-term economic growth, a prerequisite for the long-term health of the Social Security program.

If, however, we cannot make substantial progress toward this policy in the coming months, we will be forced to re-evaluate the second option, pay-as-you-go financing of Social Security.

The risk of not changing our current policy toward Social Security's relationship to the deficit is enormous—the risk is that we will not understand the urgency of taking steps today that will promote the ability of our children and grandchildren to pay not only for future retirement benefits, but also for a better quality of life for them.

RESPONSE TO THE REQUEST OF SENATOR SYMMS FOR COMMENTS ON S 2026

The American Association of Retired Persons (AARP) has serious reservations regarding S. 2026, the Social Security Benefits Enhancement Act. Some of these concerns relate to privatizing Social Security and others involve specific features of Senator Symm's proposal.

S. 2026 embodies one type of response to the problem created by the simultaneous buildup of the Social Security trust funds and continued federal deficits. Because by law Social Security must be invested in treasury bills, as long as the deficit persists Social Security will continue to finance current consumption. The solution, however, is not to reduce payroll taxes and change Social Security; rather, it is to reduce the deficit.

AARP believes a buildup of the trust funds is necessary to help ensure retirement benefits for the very large baby boom generation and to provide a contingency reserve for current benefits in the event of an economic downturn. At a minimum, the Social Security reserves should attain a level of a year and a half to two years of benefits. We would oppose the provisions in S. 2026 to repeal the 1988 and 1990 payroll tax increases because it makes that goal unattainable.

The Association has consistently opposed efforts to privatize Social Security. The program contains unique features that even a partially privatized system cannot fully duplicate: disability insurance, survivors benefits, life insurance, a progressive formula that replaces a greater portion of earnings of a low wage earner than those of other workers, and inflation adjusted benefits upon retirement. These cannot be maintained without adequate funding and substantial worker participation.

Senator Symms proposes that payroll taxes which are not needed to fund current benefits should be rebated to the worker and invested in a Social Security Family Savings Account. He believes that Americans want Social Security to be a savings plan, a way for them to invest for future needs. Polls consistently show that Americans view Social Security as retirement income, not a savings account, and, for most, it is their only form of retirement savings. By permitting withdrawals from these accounts for education and purchasing a home, the bill would diminish the ultimate retirement income some workers would receive.

AARP believes Social Security has worked well and enjoyed widespread popular support. While adjustments may be needed in this social insurance program from time to time, it does not need to be replaced or drastically overhauled.

PREPARED STATEMENT OF ROBERT J. MYERS

Mr. Chairman and Members of the Committee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies during 1934-70, being Chief Actuary for the last 23 of those years. In 1981-82, I was Deputy Commissioner of Social Security, and in 1982-83, I was Executive Director of the National Commission on Social Security Reform. Currently, I am Chairman of the Commission on Railroad Retirement Reform.

This testimony will deal with the present financial status of the Social Security program Old-Age, Survivors, and Disability Insurance (OASDI) as shown by the 1989 Trustees Report. I shall also discuss the problems that I see with the manner in which OASDI is being financed and funded under present law. Such problems relate both to the program itself and to the general budgetary situation of the Federal Government.

In particular, I shall discuss how S. 2016, introduced by Senator Moynihan, relates to these matters and how it would solve the problems without any danger of weakening the financial status of the program or endangering the benefit rights of the beneficiaries. May I point out that I recommended the return to pay-as-you-go financing that would result under this bill when I testified before your Subcommittee on Social Security and Family Policy on May 20, 1988.

PRESENT FINANCIAL STATUS OF OASDI PROGRAM

The OASDI system is currently in excellent financial health. The assets of the OASD I Trust Funds at the end of 1989 amounted to $162 billion (and were $110 billion at the end of 1988). The fund at end of 1988 was $71 billion higher than was estimated for that date in the pessimistic (Alternative III) estimate made when the 1983 Amendments were enacted—on which estimate the short-range financing (for the 1980s) was founded in the legislation. Such excess of actual over estimated fund balance was $51 billion for the intermediate (Alternative II-B) estimate.

Under current law, large annual excesses of income over outgo—which cannot properly be referred to as "surpluses"—develop in the next three decades under OASDI. Such excesses, under the intermediate estimate, amount to about $70 billion in 1990, and increasingly larger amounts thereafter (e.g., $125 billion in 1995 and $200 billion in 2000). As a result, very large fund balances will be built up during the next four decades. The fund ratio—which is the fund balance at the beginning of the year expressed as a percentage of that year's outgo peaks at 546% in 2015, when it is estimated at $7.2 trillion in current dollars, or $2.6 trillion in 1989 dollars. After 2015, the fund balance continues to grow in terms of current dollars, reaching a peak of $12 trillion in 2030. Under the pessimistic assumptions, the fund balance in 2015 is $3.3 trillion in current dollars, or $0.9 trillion in 1989 dollars.

After the end of the build-up period, the assets of the trust funds will be drawn upon, and, under the intermediate estimate, they will be exhausted in 2046. At that time—if the benefit provisions are left unchanged—additional financing in the form of higher payroll tax rates will be necessary. These increases would, on the basis of the intermediate-cost estimate, be 2.0% for both the employer and the employee over the rate now in effect for 1990 and after—not an unmanageable rise.

No legislative intent has seemed to have been present, or expressed, to change over to this funding basis from the current-cost approach adopted in 1972 and supported over the subsequent years by the Board of Trustees. I am constrained to say that this procedure of building up a mammoth fund balance and then depleting it does not make good sense, especially when the program's cost (as a percentage of taxable payroll) is just as high in all years after 2030 as it is then.

RELATIONSHIP OF OASDI TO THE BUDGET

The manner in which, under present law, the OASDI Trust Funds first build up huge amounts in the next four decades and then decrease over the next two decades until being exhausted would have significant, deleterious effects on public-debt management and on Budget operations.

The relationship between the operations of the OASDI Trust Funds and the Budget is frequently misunderstood by the general public. Beginning in fiscal year 1986, the operations of the OASDI Trust Funds have been out of the Unified Budget, so that any excess of their income over outgo does not reduce the Budget deficit. However, anomalously, these trust-fund excesses of income over outgo are counted to meet the Gramm-Rudman-Hollings targets for Budget-deficit reduction. The result is thus virtually the same as if these trust-fund operations were included in the Budget, but the imbalance is really still there, and the National Debt is increased by the amount of the trust-fund excesses of income over outgo. In other words, the result of this procedure is, in the short run, to make the targets easier to meet and thus to make the Budget deficits appear smaller than they really are.

WIDESPREAD FALLACIES ABOUT FINANCING BASIS OF OASDI

One myth is that the National Commission on Social Security Reform, in its recommendations which led to the 1983 Amendments, intended to have the system accumulate a huge fund while the baby boomers are employed, and then draw it down.

This was by no means the thinking of the Commission when it made its recommendations. Nor was it the intention of Congress when the legislation was enacted. No reference to any such intention can be found in the Commission's report or in the congressional debate.

Moreover, the information about the huge growth in the trust-fund balances had not been available when the Commission made its consensus recommendation, or even to Congress later when considering the legislation. Such figures were actually not available until mid-1983, although those with actuarial knowledge realized earlier that the approach taken would result in trust-fund buildups.

The Commission developed its recommendations by ensuring, as much as possible, that the year-by-year financing in the 1980s would be adequate and that, over the long range and on the average, sufficient financing would be provided. As is well known, the use of averages can be deceptive. That certainly is the case in this situation, as compared with looking at the year-by-year development of the trust fund balances over the long run.

Accordingly, the building up of a huge fund that would peak in the midst of the baby boomers' retirement was a coincidence—or, at most, an unintended by-product of the recommendations.

VARIOUS METHODS OF FUNDING OASDI

Next, I will briefly discuss the advantages and disadvantages of current-cost funding as against advance funding (either full-reserve or partial-reserve) for benefit systems with rising relative costs over the years, when considered as percentages of taxable payroll. The discussion thus applies to systems like OASDI. By current-cost, or pay-as-you-go, financing is meant that, on the whole, income will approximately equal outgo each year. Under this approach, a fund would be built up and maintained that would be approximately 6–12 months of outgo. Such a contingency reserve would be utilized to finance the system when business recessions temporarily reduce tax contribution income. It would then be built up again during times of economic recovery.

Certain matters in connection with funding relating to plans of individual employers (especially non-governmental ones) are not applicable to national social insurance systems—for example, the possibility of going out of business or of not having new entrants. The following discussion will relate only to the OASDI system.

The advantage of full-reserve funding—and, similarly, to a considerable extent, of partial-reserve funding—is simply that thereby the contribution rate ultimately will be lower than It would be under current-cost funding. This occurs because the interest on the assets accumulated from the excess of income over outgo In the early years of operation is available to meet the outgo. Assuming that the assets of the OASDI Trust Funds are invested In government-debt obligations (as seems to be the only proper procedure), the resulting interest income is "valid". If these obligations were not held by OASDI they would have been held by the general public, and the same interest on them would have been paid.

It could be argued that the higher contribution rates In the early years and the lower ones later, under full- or partial-reserve financing would result in greater intergenerational equity. This is so because the initial covered population, especially those near retirement, receive "windfalls" (as measured by considering the value of their benefits as against the contributions paid by them or on their behalf) as compared with the situation for young new entrants. Accordingly, a level contribution rate (or, even, a higher rate in the early years than later)—as might be provided under a full—or partial-reserve funding approach—would alleviate the situation.

The disadvantages advanced against full- or partial-reserve funding are more of a "political" nature than of a theoretical, actuarial nature. One problem would result from the huge amounts of investments involved, which could absorb a very large port ion of the National Debt (or even all of it) and thus not leave sufficient for the general investment market. Another problem might be that the ready availability of large amounts of money that could easily be borrowed by the General Fund of the Treasury would encourage excessive governmental spending.

Yet another problem is that the presence of a very large fund balance could create politically irresistible demands for greatly liberalized benefits on the grounds that "all that money is there". The difficulty, then, if such liberalization did occur, and the fund balance were drawn down, would be that the OASDI costs in future years would be greatly increased over those under present law and the long-range financing problems would become greater.

ACTUAL FUNDING BASIS OF THE OASDI PROGRAM

Next, I will take up the subject of how OASDI has been funded over the years. The original system (1935 Act) was funded on a partial-reserve basis and not on a fully-funded basis, as sometimes alleged. The 1939 Act, which expanded the program to include auxiliary and survivor benefits, was also funded on a partial-reserve basis—and did not institute current-cost funding, as is often erroneously stated, However, the system was then funded at a lower relative level than under the 1935 Act.

During the 1960s and 1970s, the emerging experience of OASDI was such that the funding was actually on a more or less current-cost basis. However, until 1972, the funding basis as to the estimated future experience was still on a "partial-reserve" basis. The 1972 Act introduced the concept of current-cost funding over the long range, but the 1977 Act (and the 1983 Act as well) did not follow this principle, but rather resulted in the build-up of a mammoth fund balance—and then its depletion before the end of the 75-year valuation period.

VIEWS OF J. DOUGLAS BROWN ON OASDI FINANCING

Dean J. Douglas Brown of Princeton University, who was one of the leaders in the initiation of the OASDI program and in its subsequent development over the years, said cogent words about the necessity for not distorting the OASDI system by making it become an instrument of fiscal policy. In his book "An American Philosophy of Social Security" (Princeton University Press, 1972), he stated:

"It has been strongly urged by succeeding Advisory Councils that this posture of neutrality be maintained despite the growth of social insurance income and disbursements. The repeated recommendation that the size of the reserve be kept as close as possible to one year's benefit payments is based, in large part, on this concept of neutrality. Pronounced changes in social security reserves through unwise planning of contribution schedules or benefit disbursements were to be avoided to limit any inflationary or deflationary effects on the general economy. Advisory Councils have likewise urged that the fiscal agencies of the government avoid any tendency to interfere in the determination of social security policy for the ulterior purpose of easing their current fiscal problems. This trade-off of neutrality on the part of two major agencies of government which deal with large flows of funds in respect to each other's policies is of great importance in maintaining the integrity of the American social insurance system. If the system became an instrument of fiscal policy, the precious confidence of the American people would be undermined. The system in its own normal operations provides a stabilizing factor in the American economy. But its primary purpose is to provide security to the individual American worker and his family. It should not be distorted into a mechanism for the manipulation of fiscal balances."

DESIRABLE CHANGES IN FINANCING OF OASDI PROGRAM

I believe that the financing basis of the OASDI program should immediately be changed back to the pay-as-you-go basis that has been followed, in effect, for the past few decades. This would be accomplished admirably by Senator Moynihan's bill. The fund ratio of the OASDI Trust Funds at the end of this year will be very close to 100%, which, in my actuarial-opinion, is adequate for pay-as-you-go financing to be viable.

I well recognize that the actual experience over long-range periods will not necessarily follow the intermediate assumptions. This, however, does not create any problem, because the contribution schedule will necessarily, in any event, need to he reexamined from time to time as the experience unfolds. Then, adjustments in the schedule—either upward or downward—can readily be made.

Some individuals have asserted that pay-as-you-go financing will mean permanently higher tax rates over the long run than under present law. They base this viewpoint on the fact that the ultimate tax rate for both employers and employees under Senator Moynihan's bill is 8.1%, as against the 6.2 scheduled under present law for all future years. However, they forget that, under present law, once the fund balance has been depleted (in some 55 years, under the intermediate estimate), the contribution rate must increase to the same 8.1 as under pay-as-you-go financing if the benefit provisions remain unchanged. In other words, if OASDI is financed on a pay-as-you-go basis as in Senator Moynihan's bill, payroll tax rates would be lower than now scheduled for the next 25 years, the same for the next 5 years, and somewhat higher for the following 25 years, but the eventual rates ultimately will be about the same.

Some people have expressed the fear that benefits are more likely to be reduced under pay-as-you-go financing than under the present "roller coaster" financing method. This is not at all likely to be the case because, as just indicated, the tax rates under pay-as-you-go financing are not all that different from what would have to be done under present law. In essence, changing to pay-as-you-go financing is not a drastic change in direction for the Social Security program or an abandonment of the consensus reached in connection with the 1983 Amendments. Rather, it is merely a fine tuning of the financing procedures.

I believe that pay-as-you-go financing would increase public confidence in the OASDI program. No longer would there be the confusion and the fear of "thievery" and "embezzlement" in connection with the use of trust-fund monies to balance the budget.

Some people also question whether the level of the OASDI Trust Funds—at about 100% of annual outgo currently, as well as estimated to be the case over the 75-year valuation period, as shown by the accompanying chart, prepared by the Office of the Actuary, Social Security Administration—would be adequate if poor economic conditions should occur. It should be recognized that, under such circumstances, the contribution rates could be increased somewhat to provide the necessary financing (and still be lower during the next two decades than under present law).

A further safeguard under such economic circumstances is the stabilizer provision already in law, which provides for the Cost-of-Living Adjustments to be the smaller of wage increases or price increases when the fund ratio is low (under 20). This provision is certainly equitable to the beneficiaries, because one can well argue that their COLAs should not be larger than the wage increases given to the workers who are currently making contributions to support the system. At the same time, any part of the COLA which is "lost" when wages increase less than prices is desirably restored when the normal situation of wages rising more rapidly than prices again occurs (and the fund ratio is substantially higher—over 32). It is my belief that this existing provision should be changed so that the trigger level is somewhat higher than a fund ratio as low as 20%, and that certain technical changes in it are desirable for consistency and comparability.

THE ROLE OF OASDI OPERATIONS IN THE GRAMM-RUDMAN-HOLLINGS TARGETS

In my view, the operations of the OASDI program should be removed from the computation of the Gramm-Rudman-Hollings targets for the Budget deficit reductions. The deficit situation would then be portrayed vividly and honestly. However, if we go to pay-as-you-go financing, as under Senator Moynihan's bill, this question becomes relatively moot, because the targets would be only minimally affected whether or not the OASDI operations were so included.

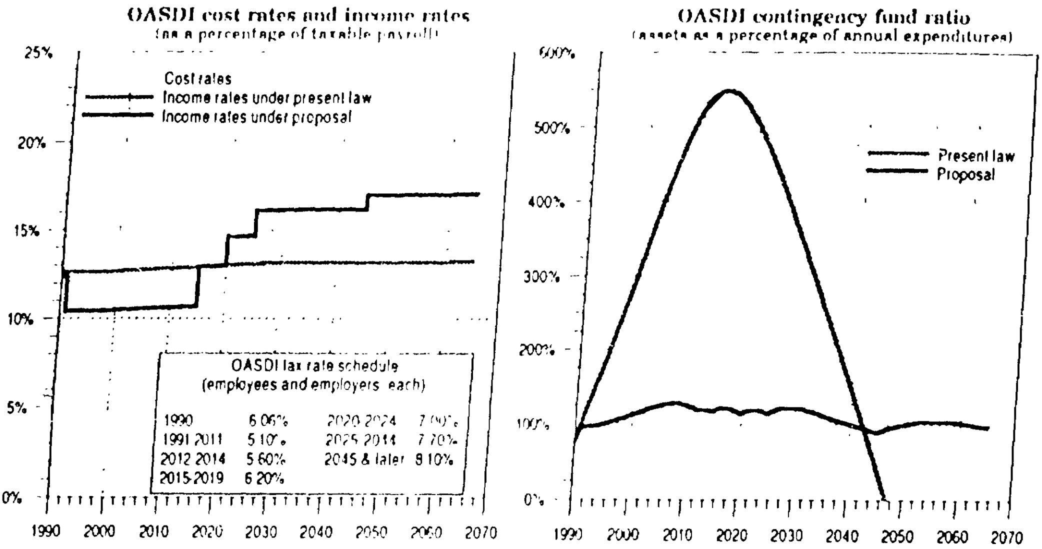
Some people believe in the large build-up of the OASDI Trust Funds for budgetary reasons and/or for encouraging greater savings efforts in our nation. This is despite the good reasons against having the Social Security program distorted to become a mechanism for the manipulation of fiscal affairs, as Dean Brown so sagely warned against. I might say—not entirely facetiously that if this use of the program is so desirable, then why not increase the contribution rates and build up even larger fund balances, so that the program is more nearly actuarially fully funded, as ERISA requires private pension plans to do.

CONCLUSION

In passing, I should mention that a technical change should be made in the bill. It should be provided that the revised tax rates will also apply to Tier I of the Railroad Retirement system (its Social Security component). Before legislation in 1983, any changes in the social Security tax rates automatically passed through to such Tier I, but now separate legislative action must be taken to accomplish this necessary result.

In summary, the time has arrived when the financing of the OASDI program should be rationalized, stabilized, and made crystal clear by going to a pay-as-you-go basis, as proposed by Senator Moynihan. The system would then be financed on a clear, visible, and understandable basis, and would be actuarially sound. Such a change would not endanger the benefit rights of either current beneficiaries or those who will come on the rolls over the long-run future. At the same time, this would give the nation a better and clearer opportunity to solve the problems with the Budget and with the savings capacity of its citizens.

Projected OASDI Financial Operations Under Senator Moynihan's Bill, S. 2016, As Introduced



Calendar year	Income rate	Cost rate	Balance	Contingency fund ratio
1990	12.35%	10.52%	1.83%	77%
1991	10.40	10.55	-.15	94
1992	10.41	10.58	-.17	96
1993	10.41	10.57	-.15	96
1994	10.41	10.51	-.10	97
1995	10.41	10.45	-.03	99
1996	10.41	10.40	.01	101
1997	10.41	10.35	.06	103
1998	10.41	10.32	.09	106
1999	10.44	10.31	.12	108
2000	10.45	10.28	.17	111
2005	10.54	10.26	.28	123
2010	10.61	10.76	-.16	124
2015	12.88	12.03	.85	115
2020	14.57	13.70	.87	112
2025	16.06	15.22	.83	113
2030	16.11	16.22	-.11	120
2035	16.14	16.60	-.46	110
2040	16.15	16.57	-.42	99
2045	16.95	16.66	.40	89
2050	16.96	16.73	.23	99
2055	16.98	17.00	-.02	103
2060	16.99	17.19	-.19	101
2065	17.00	17.29	-.29	96

Period	Summarized income rate	Summarized cost rate	Summarized balance	Alternative balance
1989-2063*	13.85	13.70	.15	-0.01%

* Summarized income rate, balance, and alternative balance include beginning trust fund assets. Alternative balance also reflects requirement for ending fund assets equal to 100 percent of annual expenditures.

Note: Estimates are based on the alternative II-B assumptions from the 1989 OASDI Trustees Report.

Office of the Actuary
January 25, 1990

RESPONSES OF ROBERT J. MYERS TO QUESTIONS SUBMITTED BY SENATOR DOLE

Question No. 1. You have suggested that a return to a pay-as-you-go system would increase public confidence in the system Others suggested the only way to achieve that confidence is to privatize the system, allowing workers to establish their own savings accounts. What about privatization?

Response to Question No. 1. I agree that some people would have more confidence in a privatized social security system involving individual savings accounts than they do in the present program. However, many others might not feel this way, considering the recent savings and loan situation, but rather would prefer a governmental program to provide basic economic security.

Moreover, there are many factors involved other than public confidence that lead me to oppose such privatization These include the facts that many workers are not knowledgeable about investing; that the administrative expenses would be high and often would offset any favorable investment results; that it would be difficult (or even impossible) to provide adequate insurance protection in the form of monthly benefits for disability and death cases; and that cost-of-living adjustments in the benefits would not be available.

Question No. 2. Returning to a pay-as-you-go system would seem to put enormous faith in our actuarial estimates. Mr. Myers, you suggest a fund ratio of 100 percent is sufficient security. And if not, adjustments "can readily be made." Having struggled through the '83 Amendments, I would argue adjustments in benefits or rates are very tough to achieve. What is a *safe* ratio and over what period of time should calculations be made if not 75 years?

Response to Question No. 2. I certainly agree that "adjustments" in the financing of Social Security program generally cannot be "readily made." However, what I was referring to was that, if the employer and employee tax rates for the Old-Age, Survivors, and Disability Insurance program are reduced from the present 6.2% each to 5.1%, in order to return to pay-as-you-go financing, small increases in the 5.1% rate that would still result in a lower rate than 6.2% should be able to be made "readily." And if the experience turns out to be unfavorable, any necessary increases would certainly be well less than the 1.1% tax-rate decrease proposed.

I am convinced that a safe ratio is 100%. And I might say that this is not based on a mere feeling, but rather on the results of a study of past experience that I made. The results of this study are contained in a paper that I wrote in UPDATE, National Academy of Social Insurance, May 1990 (copy attached). In brief, I found that, if the fund ratio of the OASDI Trust Funds at the beginning of 1977 had been 100 (instead of 47), we would not have had any financial problem in 1980-82—and thus no need for the National Commission on Social Security Reform.

I believe that the valuation period for the OASDI program should continue to be 75 years.

Question No. 3. If reserves do fall short, what makes you think this simple adjustment" would be a *payroll tax increase* and *not a benefit cut?*

Response to Question No. 3. You are quite correct that the solution to any financial problem in the short range (say, the next 10-20 years) could be a benefit reduction. Although this could reasonably be a solution in the long range (as I will discuss later), I do not believe that it would be appropriate in the short range *as long as the necessary tax-rate increase would not bring the rate above that now payable under present law* (see also my response to Question 2).

Question No. 4. There are those who argue that the payroll tax is regressive and to roll it back would benefit those most disadvantaged by the existing tax. However, others suggest that the payroll tax is quite progressive at the bottom of the income tax scale. In fact, over a lifetime the Social Security tax and benefit system is progressive—with low income earners receiving relatively more benefits.

Mr. Myers, how would you propose filling in the $55 billion revenue costs that results from the Moynihan proposal. Wouldn't VAT's or gas taxes, or similar options be even more regressive?

Response to Question No. 4. In my view, when the OASDI program is considered as a whole (i.e., both taxes and benefits)—as it properly should be—it is progressive. However, it is true that, if a portion of the tax is more than is needed for the purposes of the program (i.e., more than enough to finance it on a pay-as-you-go basis), then that portion could be considered as a regressive tax.

As to "filling in the $55 billion revenue costs that results from the Moynihan proposal" with VAT's, gas taxes, or similar options, I believe (although without great expertise) that such taxes would be even more regressive that the Social Security payroll taxes considered alone (i.e., without considering the Social Security benefits).

My personal choice for making up the $55 billion revenue loss would be increases in personal income tax rates.

Question No. 5. In your testimony, you say OASDI under the 1935 Act was funded on a partial-reserve basis? Why was the system set up this way and not under a Moynihan-type pay-as-you-go funding system?

Response to Question No. 5. The 1935 Act was set up on a financing basis of partial-reserve financing (not full-reserve financing as is done for private pension plans). In part at least, this was done by those responsible for its design in the belief that significant funding was desirable, so that a sizable portion of the ultimate (1980) costs would be met from interest earnings (about 44% of the cost).

In the next few years after 1935 there was considerable discussion on this subject, especially because the projected fund balance of $47 billion in 1980 was higher than the National Debt in the late 1930s. The 1937-38 Advisory Council on Social Security recommended a change to pay-as-you-go financing, with a relatively small contingency fund, but the 1939 Amendments did not specifically adopt this recommendation—although moving the financing basis in that direction.

In my opinion, it would not have been feasible (or desirable) to have had the financing basis of the original system on a completely pay-as-you-go basis, because the benefit outgo for a number of years would be so low. This was because no monthly benefits were to be paid for five years—and, too, the benefit amounts were quite dependent on length of covered employment. Even more important, the program then was quite immature as to the number of beneficiaries (i.e., the vast majority of the population aged 65 or over were not eligible, because they had retired before the program began), which is no longer the case. A "true" pay-as-you-go rate initially, in the years shortly after 1936, would have been so low as to be impractical.

What I believe should have been done initially—and what was substantially accomplished by the 1939 Amendments and by subsequent amendments in the 1940's—was to have a low level tax rate of leach on employer and employees (as was done in the 1935 Act only for 1937-39) for many years, and not to increase the rate until the fund balance fell below one year's outgo.

Question No. 6. If I understand Senator Moynihan's bill correctly, it does more than shift to pay-as-you-go financing. It also closes a long-range deficit in the retirement program through tax increases. I'm sure you remember that the majority of the members of the 1983 Reform Commission, and Congress, opposed tax increases as the solution to the long-range financing problem in 1983. Do you support this aspect of the bill?

Response to Question No. 6. You are correct that the tax schedule under Senator Moynihan's proposal is intended to finance the program adequately over the 75-year valuation period, such that the fund balance at the end of the period is equal to about one years outgo. On the other hand, under present law, according to the intermediate-cost estimate, the trust funds would become exhausted in 2043; after that, benefits could not be paid in full unless tax rates were increased, or benefits were reduced—and, in any event, there would then be pay-as-you-go financing in effect.

I believe that the approach in the Moynihan proposal to shift back to pay-as-you-go financing was, properly, to "take one step at a time" and to not complicate the considerations by also bringing in a long-range benefit reduction that would take place many decades from now. Then, I believe that once pay-as-you-go financing had openly been adopted, the long-range cost situation could, and should, be re-examined, so as to reduce eventual scheduled tax rates by making benefit changes.

I would reduce long-range benefit costs by increasing the Normal Retirement Age beyond the presently scheduled age 67 (to be effective in 2027) sufficiently so as to lower the ultimate employer and employee tax rates for Social Security to about 7 each. That compares with the ultimate rate of 8.1% under the Moynihan Proposal (also necessary at that time under present law if benefits are not reduced). This would require an eventual Normal Retirement Age of about 68. As you will recall, your bill S. 1, introduced in early 1983, would have had higher eventual Normal Retirement Ages than present law—as would also have been done by legislation proposed by Congressman Pickle in 1981 (which provided an eventual Normal Retirement Age of 68).

Attachment.

Update, National Academy of Social Insurance, May 1990

This month, the editors of *Social Insurance Update* invite readers to apply Lawrence H. Thompson's framework for understanding the Social Security financing debate (which appeared in Perspectives in Update No. 12) to two points of view from key policy analysts involved in that debate. Robert J. Myers' piece brings new evidence to bear on the issue of the size of the contingency fund under pay-as-you-go financing. Robert M. Ball's piece outlines the reasoning behind his support for the current system of partial reserve financing. The editors encourage other opinion pieces on this continuing debate. As always, the opinions published in "Perspectives" are the views of the authors and should not be attributed to the National Academy of Social Insurance. The Academy is a nonpartisan research and education organization which seeks to open the range of opinion based on a foundation of facts.

SOCIAL SECURITY UNDER THE MOYNIHAN PROPOSAL IS RESPONSIBLY FINANCED

[By Robert J. Myers [1]]

Senator Daniel Patrick Moynihan has recently introduced a bill (S. 2016) that would return the financing of the Social Security program (Old-Age, Survivors, and Disability Insurance) to a pay-as-you-go basis. Under this procedure, the income to the trust funds from taxes would, each year, slightly exceed its outgo—so as to maintain a fund balance of about one year's outgo. Some critics of the proposal allege that it is financially irresponsible. Such is not the case, as will be shown hereafter.

Specifically, under the Moynihan bill, the payroll tax rate on both employers and employees would be reduced in 1991 from the presently scheduled 6.2% (exclusive of the 1.45% for the Hospital Insurance portion of Medicare) to 5.1%. That rate would be maintained until 2012, when it would rise to 5.6%. Then, increases would be scheduled—to 6.2% in 2015-19, 7.0% in 2020-24, 7.7% in 2025-44, and 8.1% in 2045 and after. The last-mentioned rate would also be necessary under present law if the benefits were to be maintained after the trust-fund balance becomes exhausted at that time. Thus, the Moynihan proposal is merely fine tuning the tax contribution schedule in present law—a lower rate for the next 24 years, the same rate for the next 5 years, and the same rate thereafter.

The foregoing tax schedules are adequate to finance the Social Security program according to the intermediate estimate in the 1989 report of the Board of Trustees of the OASDI Trust Funds. Obviously, if the future experience differs significantly from that estimated in the Trustees Report, both tax schedules would have to be revised (either upward or downward) in order to maintain the program's financial viability.

Some critics point out that the fund ratio (fund balance relative to the next year's outgo) was only 75% at the beginning of 1990. They then allege that an adequate fund ratio to meet contingencies is 100-150, and probably the upper end of the range.

Other critics refer to the situation after the 1977 Amendments, which were supposed to finance the program adequately for at least the next 50 years, but instead a serious crisis occurred within 5 years. They then assert that about the same thing could occur under the Moynihan proposal. However, as will be shown, these various criticisms are not valid.

Although the fund ratio was 75% at the start of 1990, it will be almost 100% at the end of the year. At various times in the past, students of the subject, as well as Advisory Councils on Social Security, have set a range for the fund ratio of 75-125% as being sufficient. Now, some individuals have drawn the figure of 150% as the desirable ratio completely "out of the air." As will be shown next, by an analysis of the experience in 1977-82, a 100% fund ratio is ample guarantee of financial viability of the Social Security program.

At the beginning of 1977, the fund balance was $41.1 billion, with a fund ratio of only 47% (see Table I). By the beginning of 1983, the fund was virtually exhausted, being only $12.3 billion (net of the loan of $12.4 billion from the HI Trust Fund) with a fund ratio of only 7%—less than one month's outgo. Benefit payments were made in a timely manner only because of the aforementioned loan.

So, the critics wrongly say that it would be irresponsible to lower the payroll tax rate in 1991, because of what happened under the 1977 Amendments. However, the current situation is completely different, because we now have a 100% fund ratio, not one that is slightly less than 50%.

Table I shows the results of my computations as to what the situation would have been under the 1977 Amendments *if, at the beginning of 1977, the fund ratio had been 100%*. The larger fund balance would not only have provided more "cushion"

[1] Chief Actuary, Social Security Administration, 1947-70, Deputy Commissioner, Social Security Administration, 1981-82, Executive Director, National Commission on Social Security Reform, 1982-83

to draw on, but also would have provided more interest income to meet the excess of outgo over tax income; it was assumed that the average interest rate earned on the larger fund balance would have been the same as that earned each year under the actual experience.

The result of this hypothetical situation is startling! The fund balance would have stayed in a narrow band of about $80-$85 billion in 1977-82, and so the fund would not have approached bankruptcy, as it would have in 1983 if the legislation of that year had not been enacted. The fund ratio, however, would have decreased significantly in 1977-83, reaching as low as 45% at the beginning of 1983.

The fund balance under this hypothetical situation would have fallen in 1983-84, although not greatly, because economic conditions had improved by then. As a result, the "vicious circle," from a cost standpoint, of prices rising more than wages (so that the automatic COLAs were higher, percentage-wise, than the rises in wages, which affect increases in payroll-tax receipts) was abated (see Table 2). Then, in 1985, an increase in the tax rate that was legislated in 1977 would have occurred (from the previous 5.4% each for the employer and the employee to 5.7%), and the financing would have been ample through the 1980s. Then, in 1990, another increase in the tax rate that was legislated in 1977 would have become effective—to 6.2% (actually, the rate now in effect), so that all would have been well.

Thus, it is clear that, if the fund ratio had been 100% at the beginning of 1977, the "back-to-back" business recessions of the late 1970s and early 1980s would not have caused the OASDI Trust Funds to have the financial crisis in 1982-83 that they actually had. A fund ratio of 150% was, by no means, necessary to assure financial soundness!

Some critics of the Moynihan proposal have pointed out that, if economic conditions in the 1990s are those contained in the pessimistic estimate of the 1989 Trustees Report, the OASDI Trust Funds will become exhausted in 1999. They then allege that the proposal is irresponsible.

Such is not the case, because under responsible pay-as-you-go financing, the Congress and the Administration would continuously review the financing situation and take appropriate measures when the fund—or, even more importantly, the fund ratio—drops significantly. Even under continuous poor economic conditions, such as those in the pessimistic estimate, the restoration of only part of the reduction in the tax contribution rate made by the Moynihan bill would maintain solvency.

In summary then, the Moynihan proposal is financially responsible and viable. No possibility exists that the payment of benefits would be endangered. The fund level at the end of 1990—a fund ratio of about 100%—is adequate to assure the integrity of the Social Security program under any conceivable economic scenario. This has been demonstrated by what would have happened after 1977 if such a funding situation had been present then, as against the disaster that actually occurred.

Table 1.—PROGRESS OF OASDI TRUST FUNDS UNDER 1977 AMENDMENTS, ACTUAL AND HYPOTHETICAL, IF FUND BALANCE AT BEGINNING OF 1977 HAD EQUALLED ONE YEAR'S OUTGO

[Dollar in billions]

Beginning of Calendar Fund	Actual Experience		Hypothetical Experience	
	Fund Balance	Fund Ratio (In percent)	Fund Balance	Fund Ratio (In percent)
1977	$41.1	47	$87.3	100
1978	35.9	37	84.4	88
1979	31.7	30	83.0	77
1980	30.3	25	84.6	68
1981	26.5	18	84.8	59
1982	24.5	15	87.5	55
1983	[1] 12.3	7	79.5	45

[1] Not counting the loan of $12.4 billion from the Hospital Insurance Trust Fund

Table 2.—ANNUAL INCREASES IN PRICES AND WAGES

[In percent]

Calendar Year	Increase from previous year		
	Prices [1]	Wages [2]	Difference [3]
1977	6.5	6.0	−.5
1978	7.6	7.9	+.3
1979	11.5	8.7	−2.8
1980	13.5	9.0	45
1981	10.2	10.1	−.1
1982	6.0	5.5	−.5
1983	3.0	4.9	+1.9
1984	3.4	5.9	+2.5
1985	3.5	4.3	+.8
1986	1.5	3.0	+1.5
1987	3.6	6.4	+2.8
1988	4.0	4.9	+.9

[1] CPI (W)
[2] Social Security indexing wage
[3] Column 2, minus Column 1

SUBMITTED BY SENATOR BOB PACKWOOD

[EXCERPTS FROM GAO REPORT, JANUARY 21, 1986]

Appendix B

Economic Assumptions

GAO's Responsibility

The Balanced Budget and Emergency Deficit Control Act of 1985 requires that the Comptroller General report his estimate of real economic growth for the fiscal year, for each quarter within the fiscal year, and for the two quarters preceding the fiscal year.

GAO estimates real economic growth in the second and third quarters of calendar 1985 (the two quarters immediately preceding fiscal year 1986) to have been 1.1 percent and 3.0 percent respectively. GAO estimates real growth in the fourth quarter of calendar 1985, (the first quarter of fiscal year 1986) to have been 3.2 percent. Each of these estimates represents the most recent estimate released by the Department of Commerce.

GAO estimates that real growth in each of the first three calendar quarters of 1986 (the last three quarters of fiscal 1986) will fall within a range, the midpoint of which is 3.0 percent, and that real growth for fiscal 1986 as a whole will fall within a range, of which 2.85 percent is the midpoint. GAO does not expect two consecutive quarters of negative real growth.

GAO analyzed current economic conditions and reviewed current estimates of future trends. On the basis of this analysis, GAO concluded that no set of economic assumptions that might have been adopted for estimating the budget deficit would have resulted in a deficit of less than $191.9 billion--the smallest deficit estimate necessary to trigger the maximum possible sequester this year. Since using our own economic assumptions would not have affected either the aggregate amount needed to be sequestered or the distribution of sequesters in fiscal year 1986, GAO did not develop an independent economic forecast.

The Act requires the Comptroller General to develop his estimates with due regard for the data, assumptions, and methodologies used in reaching the conclusions set forth in the report submitted by OMB and CBO. Although we did not develop our own set of assumptions for this report, we did review the assumptions reported by OMB and CBO. These assumptions are shown in Table B-1.

In our review, we first examined how the accuracy of economic forecasts made by OMB and CBO in the recent past compared with the accuracy of forecasts made at similar times by private sector forecasters. Then we compared current private sector forecasts with the current OMB and CBO forecasts. The remainder of this appendix discusses these two comparisons and our conclusion about the reasonable range for estimates of real growth during fiscal year 1986.

Table B-1: Economic Assumptions Reported by OMB and CBO Fiscal Year 1986

Economic Variable	OMB Assumption	CBO Assumption
Nominal GNP (billions of current dollars)	4209	4192
Nominal GNP Growth (percent change, year over year)	6.9	6.5
Real GNP (billions of 1982 dollars)	3675	3658
Real GNP Growth (percent change, year over year)	3.5	3.0
Quarterly Real GNP Growth (percent change, annual rate)		
April-June, 1985	1.1	1.1
July-September, 1985	3.0	3.0
October-December, 1985	4.2	3.2
January-March, 1986	4.0	3.5
April-June, 1986	4.0	3.3
July-September, 1986	4.0	3.4
GNP Implicit Price Deflator (percent change, year over year)	3.3	3.4
CPI-W (percent change, year over year)	3.3	3.3
Civilian Unemployment Rate (percent, fiscal year average)	6.9	6.9
Three-Month Treasury Bill Rate (percent, fiscal year average)	7.3	6.9
Ten Year Treasury Note Rate (percent, fiscal year average)	9.2	9.2

Sources: Office of Management and Budget, Congressional Budget Office

Historical Analysis

GAO reviewed past forecasts to assess relative accuracy and to seek evidence of a systematic tendency either to over predict or under predict certain key economic indicators. Data in Table B-2 show the actual behavior of these indicators and the difference between the actual value and the value forecasted by OMB, CBO, and several private sector forecasters. The private sector forecasts include those released by three individual organizations and two surveys that provide measures of the consensus of the forecasts of a larger number of individual forecasters.[1]

Table B-2 shows the prediction errors of these forecasts for the past 6 years. A positive number indicates that the value that had been forecast exceeded the actual value. The "mean error" is the simple average of the errors in each of the 6 years. The "root mean square error" is a measure of the accuracy of the forecast without regard to whether errors were positive or negative. The OMB and CBO forecasts are those released in January or early February when the President submits his budget to the Congress. The private sector forecasts are the forecasts released in January of each year (or the most recent one available in January). All comparisons focus on the accuracy of the forecast of the upcoming calendar year only.

Our analysis of the data in Table B-2 suggests several conclusions:

1. Neither OMB nor CBO has been substantially less accurate than the private sector forecasters in forecasting the upcoming year and neither has had a greater tendency to over predict or under predict than have the private sector sources. For any particular variable, mean errors of the OMB and CBO forecasts tend to be of the same sign, and both mean errors and root mean square errors tend to be of similar magnitudes, to the corresponding measure of private sector accuracy.

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[1]The three private firms are Chase Econometrics, Inc., Data Resources, Inc., and Wharton Econometric Forecasting Associates; each produces forecasts that are used widely in business and government. The two surveys present the consensus of a broad range of informed opinion about the future course of the economy. The American Statistical Association and the National Bureau of Economic Research (ASA/NBER) jointly sponsor a survey of 25 economic forecasters in industry, finance, consulting firms, and universities. The Blue Chip Economic Indicators' survey includes about 50 economists from similar backgrounds in its panel. The results reported represent the median of the forecasts surveyed by ASA/NBER and the mean of the forecasts surveyed by Blue Chip.

Table B-2: History of Forecast Errors, 1980-85
(Predicted Less Actual, Percentage Points)

Nominal GNP Growth	1980	1981	1982	1983	1984	1985[a]	Mn.[b] Error	RMS[c] Error
Actual	8.8	12.4	3.8	7.7	10.8	6.1		
Differences:								
OMB	-0.5	-1.0	4.3	-1.0	-0.7	1.7	0.5	2.0
CBO	-0.9	-0.6	3.7	-0.9	-0.5	1.2	0.3	1.7
Chase	-1.5	-1.0	3.6	-0.6	-0.9	1.6	0.2	1.8
DRI	-0.7	-1.8	3.4	-0.7	-1.1	0	-0.2	1.7
Wharton	0.1	-0.5	4.3	0	0	1.7	0.9	1.9
ASA/NBER	-1.6	-1.6	4.6	0.1	-0.6	1.7	0.4	2.2
Blue Chip	-0.8	-2.0	4.3	0.1	-0.7	1.4	0.4	2.1
Real GNP Growth								
Actual	-0.3	2.5	-2.1	3.7	6.8	2.5		
Differences:								
OMB	-0.3	-1.6	2.3	-2.3	-1.5	1.4	-0.3	1.7
CBO	-0.6	-1.2	2.0	-1.6	-1.4	1.0	-0.3	1.4
Chase	-0.9	-1.5	1.8	-1.6	-1.7	0.9	-0.5	1.4
DRI	-1.1	-2.4	1.6	-2.1	-1.5	0	-0.9	1.6
Wharton	-0.3	-0.9	1.8	-1.3	-1.2	1.3	-0.1	1.2
ASA/NBER	-1.0	-1.3	2.6	-1.3	-1.6	0.9	-0.3	1.6
Blue Chip	-0.7	-1.8	2.4	-1.2	-1.5	0.8	-0.3	1.5

Table B-2 (continued).

Inflation - GNP Deflator	1980	1981	1982	1983	1984	1985[a]	Mn.[b] Error	RMS[c] Error
Actual	9.2	9.6	6.0	3.8	3.8	3.5		
Differences:								
OMB	-0.3	0.9	1.9	1.4	0.7	0.3	0.8	1.1
CBO	-0.4	0.7	1.5	0.8	0.9	0.1	0.6	0.9
Chase	-0.6	0.7	1.7	1.2	0.8	0.6	0.7	1.0
DRI	0.4	0.8	1.7	1.5	0.4	0	0.8	1.0
Wharton	0.4	0.5	2.5	1.4	1.1	0.4	1.0	1.3
ASA/NBER	-0.4	-0.1	1.9	1.5	1	0.8	0.8	1.1
Blue Chip	-0.1	0	1.7	1.3	0.9	0.6	0.7	1.0

Unemployment Rate (Civilian)								
Actual	7.1	7.6	9.7	9.6	7.5	7.2		
Differences:								
OMB[d]	-0.1	0.2	-0.8	1.3	0.4	-0.1	0.1	0.6
CBO	-0.1	0.2	-0.8	1.0	0.3	-0.1	0.1	0.5
Chase	0.1	0.5	-0.6	1.3	0.3	-0.1	0.3	0.6
DRI	0.1	0.3	-0.8	1.1	0.5	0.3	0.2	0.6
Wharton	0	0	-0.9	0.9	0.6	0.3	0.1	0.6
ASA/NBER	0.2	0.1	-1.5	0.1	0.8	0	-0.1	0.7
Blue Chip	0.3	0.3	-1.1	0.7	0.5	0	0.1	0.6

Table B-2 (continued)

Three-month Bill Rate	1980	1981	1982	1983	1984	1985	Mn.[b] Error	RMS[c] Error
Actual	11.5	14.0	10.7	8.6	9.6	7.5		
Differences:								
OMB	-1.0	-0.5	1.0	-0.6	-1.1	0.6	-0.3	0.8
CBO	-1.5	-1.5	1.3	-1.8	-0.7	0.8	-0.6	1.3
Chase	-0.8	-0.7	1.3	-1.6	-0.7	1.3	-0.2	1.1
DRI	-1.4	-1.1	0.2	-0.7	-1.0	-0.1	-0.7	0.9
Wharton	-1.2	-0.8	1.2	-1.2	-0.6	0.9	-0.3	1.0
ASA/NBER	na	na	0.8	-0.5	-0.8	2.0		
Blue Chip	na	na	0.1	-0.9	-0.8	1.1		

Note: (-) indicates underprediction
na indicates data not available

[a] 1985 actual growth rates in nominal GNP, real GNP, and GNP deflator based on December 20 "flash" estimate.
[b] Simple average of errors.
[c] Root mean square average of errors.
[d] OMB forecast the total unemployment rate for 1983-85. The difference between the actual civilian and total unemployment rates was added to OMB's forecasted value to make it comparable with the other forecasts.

2. Over this period, no one source consistently produced the most accurate forecast of all of the key indicators. If any one source can be considered to have had the most success in forecasting these indicators over these years, it is the CBO. The root mean square error of CBO's prediction is equal to or lower than that of every other source for three of the five indicators.[2] Wharton Econometric Forecasting Associates had the lowest error in forecasting real GNP, and CBO was tied for second. In forecasting the Treasury bill rate, the OMB had the lowest root mean square error.[3]

3. Forecast errors tend to result from developments that few if any forecasters anticipated, causing forecasts generally to err in the same direction. Thus, with few exceptions, the error reported in Table B-2 for every source's forecast of a particular indicator in a particular year has the same sign. For example, (except for one perfect forecast) all sources overestimated real GNP growth in 1982 and 1985, and all sources underestimated real growth in the other 4 years. Over the entire 6 year period, the mean error of all sources' forecasts of real growth was negative, while the mean error of all sources' forecasts of inflation was positive. This result is more likely a reflection of the particular events occurring in those 6 years than it is a reflection of an underlying bias in all sources' forecasting techniques.

Current Forecasts

GAO surveyed current private sector forecasts to provide one basis for evaluating the reasonableness of the current OMB and CBO forecasts. Key results of our survey are shown in Table B-3.

Compared to CBO, OMB forecasts higher real growth and higher interest rates but a slightly slower rate of growth in the GNP deflator. The real growth rates forecast by both OMB and CBO exceed those forecast by the typical private sector sources we have examined. OMB's real growth rate is 0.8 percentage points above the consensus measured in the American Statistical Association/National Bureau of Economic Research (ASA/NBER) survey, and is 0.6 percentage points above the consensus measured in the Blue Chip survey. CBO's forecasted real growth also exceeds these two measures of private sector consensus, but the gap between CBO and ASA/NBER is only 0.3 percentage points and the gap between CBO and Blue Chip is insignificant. The three commercial forecasting services expect even slower growth than is

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[2]In these years CBO's forecasts tended to be released several weeks after the release of the other forecasts listed in this table. We do not know the extent to which this accounts for their somewhat better record.

[3]In fact, despite its relative success during these years, OMB did not claim to be forecasting interest rates. Its projections merely assumed that interest rates would rise or fall with forecasted changes in the rate of inflation.

Table B-3: Comparison of Current Economic Forecasts (in Percent)

	Annual[a] 1986		
	Real GNP	GNP Deflator	Nominal GNP
1. OMB	3.5	3.3	6.9
2. CBO	3.0	3.4	6.5
3. Chase	2.3	2.9	5.3
4. DRI	2.1	3.3	5.4
5. Wharton	2.6	3.1	5.7
6. ASA/NBER	2.7	3.4	6.2
7. Blue Chip	2.9	3.2	6.1
	Unemployment Rate	3 Month Bill Rate	
1. OMB	6.9	7.3	
2. CBO	6.9	6.9	
3. Chase	7.3	6.9	
4. DRI	7.2	6.6	
5. Wharton	7.2	6.4	
6. ASA/NBER	7.1	7.1	
7. Blue Chip	7.0	7.1	

Table B-3 (continued)

	Quarterly Growth[b]			
	1985 IV	1986 I	1986 II	1986 III
Real GNP				
1. OMB	4.2	4.0	4.0	4.0
2. CBO	3.2	3.5	3.3	3.4
3. Chase	2.9	1.3	1.2	3.8
4. DRI	2.9	-0.6	3.1	3.0
5. Wharton	2.8	2.0	2.6	4.2
7. ASA/NBER	3.2	2.8	2.7	3.2
8. Blue Chip	3.2	3.0	3.1	3.2

[a] For real and nominal GNP and GNP deflator, amounts shown are fiscal year over fiscal year growth rates. For unemployment and Treasury bill rates, amounts shown are fiscal year average rates.

[b] Annual Rate

reflected in the two surveys. Thus, the differences between the agencies' and the commercial services' forecasts is greater than the difference between the agencies' forecasts and the results reported in the two surveys.

The GNP deflators forecast by OMB and CBO are similar to those forecast by the commercial forecasting firms and to those contained in the surveys. Thus, most of the difference between either the OMB or the CBO forecasts of real growth and the real growth forecast by the other sources translates directly into differences in the respective forecasts of nominal GNP growth.

With respect to unemployment rates, differences between OMB and CBO as well as differences between either OMB or CBO and the commercial forecasting firms are consistent with the real growth differences noted previously: both agencies forecast slightly lower unemployment as a result of higher real growth.

The focus thus far on the relationship between the OMB and CBO forecasts and the survey averages obscures the extent of the variation in current private sector opinion about future economic activity. When the individual projections of calendar 1986 real growth reported by the 50 firms in the Blue Chip survey are divided into quintiles, the median of each quintile is:

First Quintile:	3.9 percent
Second Quintile:	3.3 percent
Third Quintile:	3.0 percent
Fourth Quintile:	2.8 percent
Fifth Quintile:	1.9 percent

In a separate announcement, the Administration has said that it expects real GNP in the fourth quarter of calendar 1986 to exceed real GNP in the fourth quarter of calendar 1985 by 4.0 percent. Together with the quarterly growth rates reported for fiscal 1986, this implies a forecast of 3.7 percent growth between calendar 1986 and calendar 1985. CBO has informed GAO that it expects 3.4 percent real growth in the fourth quarter of 1986, implying that 1986 real GNP will exceed 1985 real GNP by 3.2 percent. In the Blue Chip distribution of calendar 1986 forecasts, the OMB forecast would fall at the bottom of the first quintile and the CBO forecast would fall near the bottom of the second quintile.

In summary, the OMB and CBO real growth forecasts are well within the range of current private sector forecasts. At the same time, both agencies, but especially OMB, forecast somewhat faster real growth than is expected by either of the two measures of the private sector consensus or by any of the three commercial forecasters discussed here. Each agency's forecast of inflation is consistent with private sector forecasts, so that each agency's forecast of nominal GNP is also somewhat more optimistic than the typical private sector source. Differences with respect to unemployment are minor and are consistent with the differences in the forecasts of real growth. Finally, the OMB and CBO forecasts of interest rates seem to be consistent with current private sector thinking.

Current Economic Conditions

Economic indicators continue to follow the mixed pattern that has prevailed since mid-1984, suggesting considerable uncertainty in forecasting the economy. The most likely outcome is neither brisk nor sluggish real growth during 1986.

Several positive factors suggest that a recession is unlikely:

- The deterioration in the trade balance should be behind us as a result of last year's decline in the dollar;
- Last year's rapid monetary growth and declining interest rates suggest higher real growth in 1986. In particular, lower interest rates should support renewed strength in housing starts.
- Expected further declines in oil prices should moderate inflationary expectations, giving the Federal Reserve room to respond to any weaknesses that seem to be developing.

Several negative factors make sustained and very rapid economic growth equally unlikely:

- Consumer spending has been outstripping income growth, leading to a historically low personal savings rate;
- The moderate rate of manufacturing capacity utilization and the high office and apartment vacancy rates should weaken the attractiveness of business investment. Recent surveys suggesting a decline in constant dollar capital spending during the first half of calendar 1986 may overstate the severity of the problem, but it does not now look as though fiscal year 1986 is likely to enjoy a capital spending boom.

In this environment, we believe that real growth over each of the last three quarters of fiscal 1986 is unlikely to be more than 5.0 percent or less than 1.0 percent. If we start with the Commerce Department's very preliminary estimate of a 3.2 percent real growth rate in the fourth quarter of calendar 1985, real growth at an annual rate of 5.0 percent in each of the first three calendar quarters of 1986 implies growth in fiscal 1986 averaging 3.6 percent. From the same base, real growth at an average annual rate of 1.0 percent in each of the next three quarters implies growth in fiscal 1986 averaging 2.1 percent. Historically, quarterly growth rates have been much more volatile than have average growth rates over the course of a year. Thus, it is entirely possible that growth in one or two of the remaining quarters in fiscal 1986 will be outside of GAO's range. Nonetheless, we expect the average for the three remaining quarters to fall within GAO's range and we do not expect two consecutive quarters of negative growth.

Summary

GAO does not expect real growth in each of the next three quarters to be more than 5.0 percent or less than 1.0 percent, and we do not expect real growth for fiscal year 1986 to average more than 3.6 percent or less than 2.1 percent.

Individual quarterly growth rates are much more variable and are thus much more difficult to predict than annual growth rates, and we are less confident that the actual rate for any particular quarter will fall within the range we have predicted.

The quarterly real growth rates forecast by both OMB and CBO fall well within the range GAO considers reasonable. The fiscal year real growth rates also fall within the range that GAO considers reasonable, although as a result of its assumption about the strength of the fourth quarter of calendar 1985, OMB is very near the top of that range. Compared to the private forecasts reported here, the OMB forecast is fairly optimistic. The CBO forecast is closer to the private forecasts, but is still somewhat more optimistic about real growth prospects than are most measures of private sector consensus. It is also true, however, that in recent years, on average, CBO has been among the more accurate of the forecasters of real GNP.

The unemployment rates forecast by both OMB and CBO are slightly lower than those forecast by other sources we checked, a result that is consistent with their forecast of higher real growth. Their forecasts of inflation and interest rates fall within the range of the other forecasts.

[EXCERPTS FROM GAO REPORT, SEPTEMBER 4, 1986]

Appendix II

Economic Assumptions

Projections of the federal deficit are based on forecasts of those economic variables that influence federal revenues and outlays. Thus, a necessary part of any review of the deficit projections of OMB and CBO is a review of the economic assumptions upon which they are based. This appendix outlines the process we followed in reviewing the OMB and CBO assumptions; the conclusions we reached; and the implications for revenue, outlay, and deficit projections.

We performed our review by developing our own set of economic assumptions for fiscal year 1987 and comparing our assumptions with those adopted by OMB and CBO. In certain important respects, our assumptions are less optimistic than either OMB's or CBO's. For instance, we assume that real economic growth in fiscal year 1987 will be 2.8 percent, whereas CBO assumes 3.2 percent and OMB assumes 3.7 percent. On the other hand, we are more optimistic than the other two agencies about interest rates. We assume that the 3-month Treasury bill rate will average 5.8 percent in fiscal year 1987, whereas OMB and CBO assume it will average 6.2 percent and 6.3 percent, respectively. Taken as a whole, our view of the economy appears to correspond more closely to that of CBO than to that of OMB.

We asked both OMB and CBO to estimate the budgetary effect of using our economic assumptions. We were unable to obtain such an estimate from OMB. CBO estimates that our assumptions would reduce fiscal year 1987 revenues by $5.5 billion from the level it projects using its economic assumptions. Primarily as a result of the lower interest rates, CBO estimates that our assumptions would reduce fiscal year 1987 outlays by $2.2 billion. Thus, using all of the other assumptions that CBO employed in preparing its estimates for the joint OMB/CBO report, but substituting our economic assumptions for CBO's, would increase CBO's fiscal year 1987 deficit projection by $3.3 billion.

Given the uncertainties involved in projecting both the economy and the deficit, we do not view the differences between our economic assumptions and the deficit they produce and CBO's economic assumptions and deficit to be significant enough to justify our producing a third set of account-by-account estimates. The difference between our view of the economy and the view adopted by OMB is greater, and we do not know what OMB's deficit estimate would be using our assumptions. Thus, for those calculations in this report that are sensitive to economic assumptions, we have decided to use the CBO assumptions.

How We Developed Our Forecast

In order to review OMB's and CBO's economic assumptions, it was necessary for us to develop an independent judgment of the most likely future course of the economy. We decided not to select any one particular individual's or organization's forecast as the standard against which to evaluate the OMB and CBO forecasts. History suggests that it is unreasonable to expect absolute accuracy in the economic projections of any individual or organization and that any forecast will prove inaccurate, at least to some degree. Experience also suggests that it is unreasonable to assume that a forecaster, or forecasting technique, that produces the most accurate forecast for one particular year will necessarily produce the most accurate forecast for a subsequent year.

Mindful of these inherent forecasting limitations, we decided that the most effective method for developing an independent view of future economic events would be to develop on our own a forecast that reflects a consensus of the views of experienced private-sector forecasters. Accordingly, we organized a panel of outside experts and worked closely with them to develop a GAO economic forecast.

We began by assembling, both for our own use and for the panel's use, information on current economic conditions. In addition, we asked three leading economic consulting firms—Data Resources, Inc. (DRI); Chase Econometrics, Inc.; and Wharton Econometric Forecasting Associates, Inc.—to supply us with their best estimates of economic conditions in 1987,[1] assuming that the targets specified in the Balanced Budget Act were achieved. We also asked each of the panel members to supply us with his own individual forecast.

On the basis of this work, we developed a tentative economic forecast that we distributed to the panel members along with summaries of the other information we had gathered. The panel convened in late July in Washington, reviewed the information we had given it, and gave us its suggestions for modifying our tentative forecast. The GAO forecast incorporates the suggestions we received and the latest economic data available to us early in August.

The GAO Forecast

Our forecast assumes that real economic growth will continue at a moderate pace through the end of fiscal year 1987. Specifically, we assume that the growth rate for real GNP in both fiscal year 1986 and fiscal year

[1] Throughout this appendix, years are calendar years unless otherwise indicated

1987 will be 2.8 percent. Our forecast is based on several important general assumptions, including

- that the total deficit targets contained in the Balanced Budget Act are achieved;
- that Federal Reserve monetary policy is accommodative, permitting monetary aggregates and interest rates to be consistent with moderate economic growth and no substantial acceleration of inflation;
- that despite short-run volatility, the average level of oil prices over the next 5 calendar quarters will be close to their level in late July; and
- that tax reform following the basic outlines being discussed in late July will be enacted this fall.

Components of Final Demand

Our forecast of GNP growth embodies the following assumptions about the major components of aggregate demand.

Consumption

Our forecast assumes that consumption spending will grow more slowly in fiscal year 1987 than it did in the Commerce Department's most recent estimates for the 4 quarters ending in June 1986 but that consumption will continue to grow more rapidly than GNP. Our assumption about continued strength in consumption is consistent with several positive developments:

- Current estimates are that real disposable personal income grew at an annual rate of 6.9 percent in the first half of 1986 and that real total net worth grew at an annual rate in excess of 10 percent in the 2 quarters ending in March 1986 (the most recent data now available), providing the basis for continued strength in consumption spending.
- Revised estimates released in July suggest that the personal saving rate was not as low in 1985 and early 1986 as had been thought previously, quieting fears that consumers would reduce spending.
- Both the University of Michigan and the Conference Board indexes of consumer sentiment are quite high. The July figure in the Michigan survey is down somewhat from June, but the June figure is 2.9 percent above a year ago, while the July level is 4.1 percent above a year ago. The June survey also shows record high sentiment in favor of purchases of automobiles, large household durables, and houses.

Business Fixed Investment

Our forecast assumes that real business fixed investment will recover a little following its decline in the first half of 1986, but not by enough to lift the constant dollar level in fiscal year 1987 above the fiscal year 1986 level. The declines in the first half of 1986 appear to be largely the result of developments in the mining and petroleum industries and in the computer equipment market. While we are assuming that these declines are behind us, we do not assume very much growth. This rather pessimistic assessment is based on factors such as the following

- the current low rate of capacity utilization, which was estimated at 78.9 percent for the second quarter of 1986.
- the results found in recent surveys of business capital spending plans. The April/May Commerce Department survey of investment anticipations projected a 1.3 percent real decline for 1986. The McGraw-Hill spring survey revealed plans by business to cut its real spending by 4.2 percent in 1986 (and a further decline in 1987, although the survey is less reliable the longer the horizon).
- the expectation that tax reform will increase effective tax rates on most real estate investment and the persistence of high office vacancy rates in many parts of the country.

The investment outlook does contain some positive factors. In particular, the decline in interest rates should make capital spending more attractive. Nonetheless, we assume that these positive factors will be too weak to offset fully the drop in business investment that occurred in the first half of 1986.

Housing

Our forecast assumes that housing investment will continue to grow through the end of 1986 but will level off in real terms thereafter. According to the Commerce Department's August estimates, residential investment grew by 9.8 percent between the second quarter of 1985 and the second quarter of 1986. In large measure, this growth is in response to a drop of 170 basis points in the new-home mortgage rate during this same period of time. So far in 1986, prices of new and existing homes have been rising faster than the consumer price index (CPI). However, the decline in mortgage rates has more than offset any housing price increases so that conventional measures show new housing to be more affordable today than it was a year ago.

Our forecast assumes continued strength in single-family housing. We also assume, however, that investment in multifamily housing will be somewhat weaker. New multifamily housing starts declined in the second quarter of 1986. Considering the rising vacancy rates in many parts of the country and the prospects that tax reform will reduce the incentive to invest in such housing, we are assuming that the weakness in the multifamily sector will continue.

Inventories

Historically, inventory investment has been quite volatile and difficult to predict, and current estimates of inventory-to-sales ratios give no indication of impending sharp increases or declines in inventory investment. Our forecast therefore assumes that inventory investment will continue at roughly the same level as it has in the recent past.

Government Purchases

In accordance with our fiscal policy assumption, our forecast assumes that real federal government expenditures for goods and services will decline in fiscal year 1987. Current Commerce Department estimates show real state and local government purchases of goods and services increasing 4.0 percent between the second quarter of 1985 and the second quarter of 1986. Our forecast assumes continued growth in real state and local purchases but, partially in response to declines in federal grants-in-aid, we assume a slight decline in the rate of growth.

Net Exports

Forecasting net exports is particularly difficult at this time. Since February 1985, the dollar has fallen by about 35 percent against the major European currencies and the Japanese yen. Most forecasters expect that, sooner or later, the decline in the value of the dollar will lead to improvements in net U.S. exports. However, the current data show real net exports continuing to decline, although at a decreasing rate.

The recent continued deterioration in net exports may be due to any of several factors. For one thing, although the dollar has fallen against the currencies of many of our important trading partners, it has either not changed or risen in value against the currencies of other trading partners, including Canada and Mexico (our largest and third largest trading partners, respectively) and many of the Pacific rim countries now becoming industrialized. In addition, it may take a little longer than some had thought before relative prices change and domestic and foreign buying decisions adjust to the change. Finally, it appears that the most recent data may overstate our trade deterioration; a significant part of the deterioration in the second quarter of 1986 can be attributed to a bulge in petroleum imports that most observers expect to be temporary.

Taking into account all these factors, we decided to assume a moderate improvement in the net export component of GNP. Our assumption lies between the net export trends expected by the optimists and those expected by the pessimists.

Interest Rates

Our forecast assumes that the Federal Reserve will be able to supply sufficient liquidity to accommodate moderate growth without jeopardizing its inflation and exchange rate constraints. Therefore, we assume that 3-month Treasury bill rates during fiscal year 1987 will average roughly the same level as prevailed in early August 1986. Our forecast also assumes that the bond markets will lower their expectations about future short-term interest rates and, as a result, that the yield curve will be somewhat flatter in fiscal year 1987 than it was in 1985 and early 1986. Thus, given our assumption that short-term interest rates remain largely unchanged, we assume that long-term bond rates will be lower.

Income Shares

Our assumption about aggregate wage and salary disbursements is built from assumptions about compensation trends and from assumptions about employment trends that were derived from our forecast of GNP. In our forecast, wage and salary disbursements rise slightly as a percent of GNP. Our forecast assumes they will average 49.4 percent of GNP in fiscal year 1987, whereas current estimates show them averaging 49.2 percent of GNP in the 4 quarters ending in June 1986.

Our forecast assumes that corporate profits (with the inventory valuation adjustment and the capital consumption adjustment) will average 7.4 percent of GNP, 0.4 percentage points higher than the ratio prevailing in the second quarter of 1986, according to the Commerce Department's August estimate. We are assuming that the decline in the value of the dollar will take some of the pressure off profit margins and, together with the decline in interest rates, will allow the profit share to increase somewhat.

Comparison of Forecasts

The economic assumptions we developed are shown in table II.1 along with those adopted by OMB and CBO. Under GAO's assumptions, real GNP grows by 2.8 percent in fiscal year 1987. By comparison, CBO assumes real GNP growth will be 3.2 percent, and OMB assumes it will be 3.7 percent. During fiscal year 1987, quarterly real growth rates are in the neighborhood of 3.0 percent in GAO's assumptions, 3.5 percent in CBO's assumptions, and about 4.2 percent in OMB's assumptions. The assumptions about unemployment rates during fiscal year 1987 reflect the differences in the assumptions about real GNP growth.

Table II.1: Summary of Economic Assumptions, Fiscal Year 1987

Economic variable	OMB	CBO	GAO
Nominal GNP (billions of current dollars)	$4,449	$4,423	$4,403
Nominal GNP growth (percent change, year over year)	6 8	6 2	5 7
Real GNP (billions of 1982 dollars)	$3,797	$3,777	$3,760
Real GNP growth (percent change, year over year)	3 7	3 2	2 8
Quarterly real GNP growth (percent change, annual rate)			
April-June 1986[a]	1 1	1 1	1 1
July-September 1986	4 0	3 0	3 1
October-December 1986	4 0	3 6	2 7
January-March 1987	4 2	3 9	2 9
April-June 1987	4 2	3 7	3 1
July-September 1987	4 2	3 3	3 0
GNP implicit price deflator (percent change, year over year)	3 0	2 9	2 9
CPI W (percent change, year over year)	2 1	2 6	2 5
Civilian unemployment rate (percent, fiscal year average)	6 7	6 8	6 9
Three-month Treasury bill rate (percent, fiscal year average)	6 2	6 3	5 8
Ten-year Treasury note rate (percent, fiscal year average)	7 5	7 7	7 1

[a]Estimate reported by the Department of Commerce on July 22, 1986, subsequently revised

According to the Commerce Department estimates released in August, real GNP was 2.8 percent higher in the 4 quarters ending in June 1986 than in the previous 4 quarters and was 3.9 percent higher in the 4 quarters ending in June 1985 than in the previous 4 quarters. Thus, we assume real growth during fiscal year 1987 at the same rate experienced in the 4 quarters ending in June 1986; CBO assumes real growth at a rate somewhat higher than the rate experienced in that time period; and OMB assumes real growth during fiscal year 1987 at a rate almost as high as the rate experienced in the 4 quarters ending in June 1985.

OMB, CBO, and GAO have nearly identical assumptions about changes in the implicit GNP price deflator, the broadest measure of inflation. GAO also has nearly the same assumption as CBO about changes in the CPI. OMB's assumption about CPI growth is, however, somewhat lower than either CBO's or GAO's.

GAO's interest rate projections are lower than either CBO's or OMB's, and, in this case, the OMB assumptions are closer to ours than are the CBO assumptions. In OMB's assumptions, both the short-term and the long-term Treasury rates are 40 basis points above the level GAO assumes. CBO assumes that the short-term rate will be 50 basis points higher and that the long-term rate will be 60 basis points higher than we assume. In the week ending July 26, 1986, 3-month Treasury bills yielded 5.72 percent (on a bank discount basis), which is 8 basis points below the average level we assume for fiscal year 1987. In effect, both OMB and CBO assume that these rates will rise over the next 15 months, whereas GAO assumes that they will not. Similarly, in the week ending July 26, the gap between 10-year Treasury note yields and 3-month Treasury bill yields was 154 basis points. Both GAO and OMB assume the gap will narrow to 130 basis points in fiscal year 1987, whereas CBO assumes it will narrow to 140 basis points.

Table II.2 compares GAO's assumptions (and those of OMB and CBO) with the July forecasts of three of the major private-sector economic consulting firms. In many respects, GAO's assumptions are quite similar to the simple average of the forecasts of the three firms, indicating that we have achieved our objective of developing a set of economic assumptions that is consistent with the private-sector consensus (at least as it existed in July 1986). For example, the commercial firms' fiscal year 1987 real growth forecasts are 2.6 percent, 2.5 percent, and 3.6 percent, respectively. The average is 2.9 percent as compared with GAO's assumption of 2.8 percent. GAO's assumption about the profit share in GNP is the same as the three-firm average, while its assumption about the wage and salary share is slightly above the three-firm average. GAO's interest rate assumptions are somewhat below the corresponding three-firm averages.

Table II.2: Comparison of Agencies' Economic Assumptions With Selected July 1986 Commercial Forecasts for Fiscal Year 1987

	Government agencies			Commercial firms			
	OMB	CBO	GAO	Average	Chase	DRI	Wharton
Growth rates (percent, fiscal year/ fiscal year)							
GNP	6.8	6.2	5.7	5.7	5.5	4.9	6.6
Real GNP	3.7	3.2	2.8	2.9	2.6	2.5	3.6
GNP deflator	3.0	2.9	2.9	2.7	2.8	2.4	2.9
Income shares (percent of GNP)							
Wages and salaries	(a)	49.3	49.4	49.1	48.9	49.1	49.2
Economic profits	(a)	7.4	7.4	7.4	7.7	7.0	7.5
Interest rates (percent)							
Three-month Treasury bills	6.2	6.3	5.3	6.0	5.8	6.0	6.3
Ten-year Treasury notes	7.5	7.7	7.1	7.5	7.6	7.6	7.4
Labor market							
Employment (millions)	(a)	(a)	111.0	111.1	110.7	111.6	111.1
Unemployment (percent)	6.7	6.8	6.9	7.0	7.2	6.9	6.8

[a]Not published

Effect of GAO's Assumptions on the Estimated Deficit

We asked both OMB and CBO for their estimates of aggregate revenues, aggregate outlays, and the total deficit using the same technical assumptions that they would be using in their joint report but employing our economic assumptions. CBO gave us its estimate, but OMB informed us that it would be unable to do so.

Compared with its estimate using its own economic assumptions, CBO estimates that GAO's economic assumptions would reduce fiscal year 1987 revenues by $5.5 billion. CBO estimates that our assumptions would reduce fiscal year 1987 outlays by $2.2 billion, largely because we assume lower interest rates. The net effect is an increase of $3.3 billion in the total deficit estimate for fiscal year 1987.

Conclusions

Our judgment as to the most likely future course of the economy is more compatible with the economic assumptions adopted by CBO than with those adopted by OMB. CBO's real growth rate and nominal incomes are higher than ours, but the effect of these differences on CBO's estimate of the deficit is partially offset by the fact that we assume lower interest rates than does CBO.

CBO finds that when the only change made is the use of GAO's economic assumptions, its estimate of the fiscal year 1987 deficit rises by $3.3 billion. Given the uncertainties inherent in forecasting the economy and the deficit, we do not consider the difference introduced by the use of our economic assumptions to be significant. Thus, we conclude that our use of the CBO economic assumptions will produce estimates that we consider to be reasonable. In contrast, we do not know how an OMB estimate of the deficit using our economic assumptions would differ from OMB's estimate using its own economic assumptions, and, therefore, we do not know whether the use of OMB's assumptions would produce estimates that we would consider acceptable. Thus, on the basis of the information available to us, we have decided to use the CBO economic assumptions for our report.

For budget items sensitive to economic assumptions, the average of the OMB and CBO figures represents an averaging of differences traceable to economic assumptions as well as to other causes. Having adopted CBO's economic assumptions for the purpose of this report, we must remove that part of any difference between the OMB and CBO estimates that is traceable to the economic assumptions. Thus, for these items, the estimates we use for this report differ from the average presented in the OMB/CBO report. We have adopted the CBO estimate of total revenues instead of the average of the OMB and CBO revenue estimates. In estimating outlays, where it was possible to do so, we adjusted the OMB estimate to reflect the effect of different economic assumptions and, absent any other source of disagreement with either the OMB or CBO estimate, we adopted the average of the CBO estimate and the adjusted OMB estimate. When we could not adjust the OMB estimate to reflect our economic assumptions and when we had no other reason to disagree with the estimates, we used CBO's estimate instead of the average.

August GNP Revision

On August 19, 1986, the De[illegible] ment of Commerce released its "first revision" of its estimate of G[illegible] during the second quarter of 1986. In the August estimate, real growth in the second quarter was 0.6 percent, as compared with 1.1 percent in the July "preliminary" estimate. Since our assumptions were completed during the first week of August, they do not reflect these revisions; the OMB and CBO assumptions also do not reflect these revisions.

The major factors contributing to Commerce's lowered estimate of second quarter real growth were a reduction of $8 billion (40 percent) in inventory investment and a reduction of $4.2 billion (2.9 percent) in net exports. The effect of these reductions was offset partially by increases of $4.4 billion (1.4 percent) in real federal government purchases and $3.4 billion (0.1 percent) in consumption. Had these estimates been available to us when we developed our assumptions, we would have adjusted slightly our assumptions about the individual GNP components, but we probably would not have changed materially our forecast of fiscal year 1987 aggregate real growth.

The August 19 estimate also revised the earlier estimate of second quarter corporate profits from current production (i.e., profits including the inventory valuation adjustment and the capital consumption adjustment). In the preliminary estimate, these profits were 7.4 percent of current dollar GNP. In the revised estimate, they fell to 7.0 percent of GNP, reflecting a $19.3 billion downward revision. Had this information been available to us in early August, we might well have assumed somewhat lower profits in our forecast.

PREPARED STATEMENT OF REPRESENTATIVE TIMOTHY J. PENNY

Mr. Chairman: Thank you for the opportunity to testify before your committee today. As a sponsor of H.R. 3865, a bill similar to Senator Moynihan's, that would rescind the Social Security (FICA) tax increase, I am extremely interested in the progress of this legislation.

On Monday, your committee heard the pros and cons on this issue from Social Security experts. Since I don't profess to be an expert, I won't go into detail as to the merits of reducing the payroll tax. However, I want to applaud Senator Moynihan for his determination to end the "great budget charade of the 1980's." It is clear that the administration intends to continue to allow social security revenues to mask the deficit and further use the Social Security payroll tax as a continuing source of funds for the Federal budget. Senator Moynihan's proposal forces the administration and Congress to be honest about the deficit, and to talk about how to set national priorities and get to a balanced budget. And to me, that is the real significance of his legislation.

I am well aware that reducing the payroll tax now would be a "mixed bag." A tax break would put money into the hands of working men and women and that might stimulate the economy to some degree. But it might not be enough to offset the effect on the economy of increased government borrowing.

I strongly feel that any reduction in the FICA tax should not be done in isolation of the big picture; that being a more fiscally responsible treatment of the rest of the budget. In fact, if we would be honest about the need for cuts and revenues in order to balance the rest of the budget, the original promise that social security funds would be protected for future retirees would be met, and the reduction in the payroll tax would be less imperative.

As a "baby boom" legislator, I would like to request that your committee take another look at the long-term solvency of the Social Security system. Whether social security is returned to pay-as-you-go or not, it is likely that payment of future retirees' benefits will require burdensome increases in the FICA tax on future workers. It might be prudent for Congress to enact benefit adjustments that would take effect 20-30 years in the future. This would signal today's workers that they should make their retirement plans accordingly, and it would signal tomorrow's workers that we do not intend to resort to higher and higher FICA taxes to sustain benefits. I plan to introduce several bills in the near future that would address some of these concerns.

As we have heard many times in the past month, reducing the payroll tax is a dramatic and controversial step. But I believe the proposal may finally bring us to our senses about the deficit. There are many options available to achieve deficit reduction. However, unless we face the deficit honestly, American taxpayers—both now and in the future—will be the real losers.

PREPARED STATEMENT OF REPRESENTATIVE JOHN EDWARD PORTER

Mr. Chairman, thank you for extending me the opportunity to testify before the Finance Committee regarding the Social Security surplus and the future of the Social Security system. I believe that the future funding of Social Security is one of the most important issues Congress will address in this session of the 101st Congress and I appreciate you allowing me to come and share my views with the Committee.

I am very pleased that the issue of the disposition of the Social Security Trust Fund as come to the forefront of national debate. Senator Moynihan has done our country a service by taking Social Security out of the politically unmentionable category and putting it on the table for discussion and debate. He also deserves our thanks for forcefully putting before the American electorate the fact that Congress spending the Social Security reserves currently to make general revenue deficits look smaller than they really are. $54 billion last year, $65 billion this year and many more billions in the future will not be available when they are needed for the baby boomer's retirement in the next century.

An increasing number of members of Congress are raising the alarm that this practice—"thievery" is not too strong a word—will destroy Social Security allowed to continue and constitutes a breech of equity between generations of Americans. Young people in America are already going to be paying through the nose to service the huge national debt which we're leaving them. Now we're imperiling their Social Security benefits as well.

The Senator from New York is absolutely right in acknowledging that simply taking Social Security off-budget will not protect the reserve from congressional abuse. We can be absolutely sure of death and taxes and one thing more: if future

Congresses see $3 trillion in a reserve—any reserve, on budget or off—they will find ways to spend it as they are right now.

We must take Social Security off-budget *and* force Congress and the administration to face the real budget deficit—which has hovered around $200 billion for the last six years—and have the courage to make the tough decisions needed to balance the budget without the Social Security buildup.

And we must reduce he reserve to "checking account" status—using only the money needed to pay benefits to current retirees—so Congress can't get its hands on the fund and spend it for anything other than Social Security retirement.

Beyond these principles, however, any plan to reduce the reserve by cutting the FICA tax rate, is misguided.

The determinations made by the National Commission on Social Security Reform in 1983, of which Senator Moynihan was a member, are still valid. Demographics have a stranglehold on Social Security. In 1990, there will be approximately 30 retirees drawing benefits from the system for every 100 workers paying in. By 2050, this number will have jumped up to 54 for every 100. Partially pre-funding the system remains the only way to avoid the massive crisis America will face if these workers retire having no reserve to help pay their Social Security retirement benefits.

If the FICA tax rate is cut American workers will get a tax refund. And what will happen? As much as we may like to believe otherwise, we'll consume it, buying more Japanese VCRs and German cars, and putting aside very little for savings. By returning to current cost financing the future of the Social Security system will be put in jeopardy, our base of domestic savings will not be enhanced, and we'll extend our consumption party financed by foreign capital a little longer.

Why not instead leave the tax rate where it is, and refund annually the part of the Trust Fund not needed to pay current retirees into a retirement account for very American worker?

Making such refunds every year, the Social Security Administration would adjust the worker's claim on the system to reflect the fact that part of his or her retirement benefits are now going to come from these Individual Social Security Retirement Accounts (ISSRAs). Each worker would own his or her own ISSRA and invest and reinvest it through a bonded trustee who would insure that all ISSRA accounts meet standards of safe and prudent investment and are not made available to the worker until retirement. The trustee would be criminally liable for legal investments or disbursements.

Upon reaching retirement age, a worker could buy a lifetime annuity that would pay benefits as generous as current returns. In fact, investment history tells us ISSRA retirees could probably take out a huge cash payment as well.

The FICA tax rate would e effectively cut, but the refund would be *saved and invested* in the American economy rather than consumed. A greater domestic savings pool would mean an end to dependence on our Japanese, German and Saudi friends to finance us, and would lead to lower interest rates that would increase American economic growth.

Gradually, over a fifty year period, we would move from an unvested, unfunded Social Security System subject to the political whims of Congress to a fully vested, fully funded system in the hands of American workers where it belongs.

In addition, every worker in America would have a direct financial stake in the success of the American economy. People who never had a dime of savings would have thousands, tens of thousands and eventually hundreds of thousands invested.

And the higher interest rates of private sector investment would no longer be out of reach for low-income Americans who, in essence, are required currently to invest their retirement savings (FICA taxes) in very low returning government bonds rather than realizing a market rate of interest as middle and upper income workers do. Also, in contrast to Social Security benefits which are simply lost when the recipient does, each worker would own their ISSRA, which would become part of their estate upon death.

There are three courses of action available to Congress. We can do nothing and continue to allow the Social Security reserve to cover our embarrassment of ripping off our children and grandchildren. We can cut the FICA tax rat fueling further consumption, and let people in the 21st century attempt to sort out our mess. Or, we can begin the process of building the type of Social Security system that will invigorate our economy, energize our workers and strengthen our world economic position.

Thank you.

PREPARED STATEMENT OF ROBERT D. REISCHAUER

Mr. Chairman, it is a pleasure to be here today to discuss S. 2016, Senator Moynihan's proposal to reduce the Social Security payroll tax and return Social Security to a pay-as-you-go system. This statement tries to clarify a number of the issues underlying what has been a spirited, but somewhat confused, debate about the merits of alternative approaches to the financing of Social Security. It examines the following four issues:

- The ways in which current budget policy can enhance the nation's ability and willingness to support the increased costs of future Social Security benefits;
- The likely effects of S. 2016 on the economy;
- The impact of payroll tax reductions on the distribution of tax burdens and after-tax incomes of families; and
- Some programmatic factors that relate to the choice between pay-as-you-go and partial reserve financing of Social Security.

PAYING FOR THE BABY BOOM'S RETIREMENT

The only links between today's policies and the payment of tomorrow's retirement benefits are the effects of current actions on the size of the economy. After all, no matter how Social Security is financed today, the government will have to pay the retirement benefits of future generations by claiming a share of the gross national product (GNP) that is produced then. It can do this either by raising taxes, or reducing other spending. Indeed, a permanent increase in taxes or reductions in other federal programs appears to be a certainty, since the retirement of the baby boom will mark the beginning of a permanent increase in the ratio of retirees to workers. Borrowing would be both an unwise and unsustainable response. The nation will be better able to bear these increased taxes or reduced government programs if overall GNP is as large as possible.

The primary way for the government to affect the size of the economy in the future is to take actions that add to national saving—in other words, to reduce its deficit. Reducing the federal deficit will increase national saving during the 20 or so years that remain before the baby boom begins to retire. Added saving will increase the productivity of the economy and the amount of income that will be available to be shared between future workers and the retirees. These improvements should make the reallocation of resources to retirees less of a strain on the working population of that time.

The reason for this is not that the share of GNP required for Social Security benefits will be smaller than would be the case if deficits persist. The share will not be smaller because increased productivity of the economy will generate higher wages and these in turn will result in increased Social Security benefits. As a result, the part of GNP that goes to retirees will grow just as fast as GNP as a whole will. But presumably a society with more income is better able to devote a fixed share of its resources to retirees than one that is not so well off.

This argument suggests that reduced budget deficits will increase the nation's future ability to finance retirement benefits. But they may also affect its willingness to do so because lower deficits now will reduce the share of future tax revenues that will go to pay the Federal government's interest costs. If deficits are cut, the Federal government's interest payments in the next century will be reduced. Consequently, more government resources could be devoted to purposes that directly benefit future citizens and taxpayers. Hence, they may be more willing to reallocate resources to retirees than would a population that had to devote a significant portion of its tax payments to paying the debt-service costs of government services that had been consumed—but not paid for—by another generation.

Appropriate and Inappropriate Uses of Social Security Reserves

If deficit reduction is the primary way in which the government can act to ease the burden imposed by future increases in Social Security expenditures, the question becomes one of whether the increases in the Social Security surplus over the past six years have, in fact, acted to reduce the overall deficit. This question is unanswerable but has nonetheless sparked a lively debate.

Most commentators have jumped to the conclusion that the current growth of Social Security surpluses has encouraged larger deficits in the non-Social Security portion of the budget. They argue that sharper reductions in the Federal deficit would have been more likely had the Social Security surplus not helped obscure the fact that the deficit in all other Federal accounts combined has changed little since 1983. They feel that this represents a violation of a trust that was established at the time the 1983 amendments on Social Security were passed. In particular, a number of people are concerned that the Social Security surpluses have been allowed to "mask" the "true" Federal deficit, and that the practice of investing Social Security reserves in Treasury securities is an illegitimate use of these resources to finance other activities of government.

There are several reasons to question this line of argument. First, we do not know how fast the deficit in the rest of the Federal budget would have declined without the growing Social Security surpluses of the 1980s. It was well known that Social Security would generate large surpluses when the Balanced Budget Act's targets for the deficit were set. Had those surpluses not been a prospect, the targets in all likelihood would have been set higher. If they had not been, the gap between the targets and the actual deficits probably would have been commensurately larger. The reason the deficit has not been cut by more is not that the deficit targets were insufficiently ambitious or that the size of the problem, as measured by the total deficit, was not large enough to frighten the American public into demanding action. Rather it was that the steps needed to bring the deficit down were too painful and there existed little leadership or public support for such actions.

Moreover, it is difficult to make a case that the Social Security surplus has been hiding the deficit in the remainder of the budget since the Balanced Budget Act was passed in 1985. The Balanced Budget Act took Social Security off-budget precisely to highlight its importance to the overall deficit. Both CBO and OMB began explicitly showing figures on the Social Security surplus and the deficit in the rest of the budget in early 1986, and they have continued to do so ever since. The budget resolutions adopted by the Congress for the fiscal years following 1986 clearly indicated the size of the expected Social Security surplus and the projected deficit in the balance of the budget. If policymakers have chosen not to reduce the deficit in the non-Social Security budget more during that period, it has not been because that deficit has been hidden from view.

As this last argument suggests, efforts to lend still more prominence to the Social Security surplus could divert time and energy to what amounts to a procedural issue instead of attacking the substance of the problem before the Congress—reducing the Federal deficit. Those interested in "unmasking" are trying to recast the dimensions of the budgetary problem in a way that will stimulate further action on the deficit. As others have observed, however, the procedure is not the problem; the problem is the problem. We have long known that further reductions in the Federal deficit are needed, and efforts to repackage its constituent parts only threaten to put off a serious effort to deal with it directly.

In addition, the Social Security surplus is not an accurate measure of Social Security's offsetting effects on federal borrowing. A significant component of the surplus is made up of transfers from other Federal accounts. These transfers work to increase the apparent size of both the Social Security surplus and the non-Social Security deficit, as is shown in Table 1. In other words, the amount of surplus that the Social Security trust fund is generating independently of the rest of the government is less than it appears and, similarly, the size of the deficit that the non-Social Security budget is running independently of Social Security is less than it appears.

Finally, the notion that lending Social Security reserves to the Treasury represents a misuse of those funds reflects a misunderstanding of earmarked revenues in the Federal budget. First, Social Security contributions are used for Social Security benefits; every dollar results in budget authority for the Social Security trust fund. But second, the U.S. Treasury always uses whatever cash is on hand to make payments before borrowing. Thus, when any fund shows a surplus, the excess cash is used to meet the Treasury's current obligations, whether the excess cash comes from Social Security contributions, gas taxes, or oil lease receipts. In that sense, the money is used for nonearmarked purposes. There is no sensible alternative to this procedure: should the Treasury borrow funds when it already has them?

Table 1.—SOCIAL SECURITY INCOME AND OUTLAYS

[By fiscal year, in billions of dollars]

	1990	1991	1992	1993	1994	1995
		Income				
Income from Public:						
Off-budget revenues	288	309	330	352	376	401
Intrabudgetary Income:						
Interest	16	22	27	34	42	50
Employer share of employee retirement	6	6	7	7	8	9

Table 1.—SOCIAL SECURITY INCOME AND OUTLAYS—Continued

[By fiscal year, in billions of dollars]

	1990	1991	1992	1993	1994	1995
Taxes on benefits	4	5	5	6	6	7
Other	2	(1)	(1)	(1)	(1)	(1)
Subtotal	28	32	39	47	56	66
Total Income	316	341	369	399	432	467
		Outlays				
Payments to Public:						
Benefit payments	243	260	277	294	312	331
Administrative expenses	2	2	2	2	3	3
Subtotal	245	262	279	297	315	334
Intrabudgetary payments [2]	4	4	5	5	5	5
Total Outlays	250	267	284	301	320	339
		Surplus				
As conventionally measured	74	85	98		112	128
Less: Intrabudgetary transfers (net)	−24	−28	−35	−42	−51	−61
Surplus excluding intra-budgetary transfers	42	47	51	56	61	67

[1] Less than $500 million.
[2] Primarily interest paid to Treasury on normalized tax transfers and payment to Railroad Retirement.
SOURCE: Congressional Budget Office.

Third, strictly speaking, the only way to avoid devoting earmarked receipts to other purposes is for the Treasury to have no need to spend any excess funds derived from the earmarked accounts. This means not only balancing the budget, but running an overall surplus. In other words, what some consider to be ill-advised uses of Social Security reserves will end when the government contributes to national saving rather than using it up.

This discussion helps show why the currently fashionable view that only the non-Social Security deficit can be viewed as the "true" Federal deficit is wrong. The Federal budget necessarily differs from business accounts. In particular, the chief importance of the Federal deficit is in accounting for the federal government's use of private saving, rather than tracking operating profits and losses. In turn, the true measure of federal absorption of private saving is the deficit of the whole federal government (other than for Federal investments), including Social Security.[1]

ECONOMIC IMPLICATIONS OF S. 2016

What would enactment of S. 2016 do to the economy? If the measure were enacted without offsetting reductions in the deficit, it could have adverse economic effects over both the short and long run. CBO has estimated that S. 2016 would increase the $138 billion baseline deficit by $40 billion in 1991 and by greater amounts in later years (see Table 2). This figure is slightly lower than other estimates, partly because it incorporates an assumption that wage rates would increase somewhat in response to the reduction in the employers' payroll tax rate, thereby raising other tax revenues enough to offset a part of the direct revenue loss.

Short-Run Effects

Because the economy is operating close to its full capacity now, a significant reduction in payroll tax rates without offsetting deficit reductions elsewhere could harm the economy's performance over the next several years. A significant tax cut could increase total demand for goods beyond the economy's capacity to produce them, leading potentially to increases in both inflation and the trade deficit. The Federal Reserve would be likely to try to head off extra inflation by raising interest rates, which are already quite high by historical standards in inflation-adjusted terms. These higher rates could further reduce investment and complicate many problem areas, such as the cash-flow problems of developing countries and domestic corporations that are already heavily indebted, and could make resolving problems of the thrift industry more difficult.

[1] These principles were clearly stated in 1967 by the President's Commission on Budget Concepts, a group of distinguished accountants, bankers, Members of the Congress, and economists.

Table 2.—BUDGETARY EFFECT OF S. 2016

[By fiscal year, in billions of dollars]

	1990	1991	1992	1993	1994	1995
Off-Budget (Social Security) Baseline surplus	66	74	85	98	112	128
Changes:						
Payroll taxes	−5	−42	−58	−62	−67	−71
Interest	(1)	−2	−6	−11	−17	−23
Total changes	−5	−45	−64	−74	−84	−94
Surplus, S. 2016	61	30	21	24	29	34
On-Budget (All Other) Baseline deficit	−204	−212	−221	−239	−242	−246
Changes:						
Income tax offset [2]	1	4	6	6	7	7
FERS offset [3]	(1)	(1)	(1)	1	1	1
Interest	(1)	(1)	1	1	2	2
Total changes	1	5	7	8	9	10
Deficit, S. 2016	−204	−208	−214	−231	−233	−235
Total Budget Baseline deficit	−138	−138	−135	−141	−130	−118
Changes:						
Payroll taxes	−5	−42	−58	−62	−67	−71
Income tax offset [2]	1	4	6	6	7	7
FERS offset [3]	(1)	(1)	(1)	1	1	1
Interest	(1)	−2	−6	−10	−15	−20
Total changes	−4	−40	−58	−66	−75	−84
Deficit, S. 2016	−143	−178	−193	−207	204	−202

[1] Less than $500 million.

[2] Assuming that nominal GNP is held constant, a reduction in Social Security taxes would increase income and, therefore, increase income taxes These estimates are net of increased income tax revenues.

[3] A reduction in Social Security taxes would automatically increase the tax rate for the Federal Employees Retirement System

SOURCE: Congressional Budget Office.

Long-Term Effects

In the longer term, significant increases in the Federal deficit could exacerbate several current economic problems, such as low net investment, slow growth in productivity, and faltering competitiveness in international markets. A further increase in the Federal deficit from a cut in taxes would divert more of our limited saving away from investment (including research and development) that could increase our productivity, competitiveness, and living standards. Competitiveness would also suffer if the higher interest rates that would accompany lower saving caused the dollar to appreciate on foreign exchange markets, making American goods more expensive, and foreign goods cheaper.

Some analysts have argued that reduced payroll tax rates for employers could help improve the competitiveness of American goods by reducing this component of labor costs, but this outcome seems unlikely. Most studies of the payroll tax conclude that the employers' share ultimately has little effect on employers' costs because it is absorbed by workers in the form of lower wages than they would otherwise get. This implies that reduced employers' rates would be met with offsetting increases in wage rates or additional fringe benefits. As a result, there might be little improvement in employers' costs, and therefore in the competitiveness of the goods that they produce.

THE FAIRNESS AND EFFICIENCY OF FEDERAL FINANCES

A major impetus behind the current effort to reduce the payroll tax is the recent trends evident in the distribution of income and the progressivity of the tax system. Between 1980 and 1990, average adjusted real family income—family income divided by the appropriate poverty threshold—of the top fifth of families rose by 31.7 percent, while the average income of families in the bottom four income quintiles either rose much more slowly or actually declined in the case of the bottom income quintile (see Table 3). During this same period, the total Federal effective tax rate of families in the top two income quintiles declined, while in the bottom three quintiles it rose (see Table 4). Although Federal taxes in 1990 are more progressive than they were in 1985, they are less progressive than they were in either 1977 or 1980.

The increased reliance placed on social insurance payroll taxes is the major explanation for the reduced progressivity of the tax system. Lowering payroll tax rates over the next 25 years with no offsetting changes in other Federal spending or taxes would ameliorate this situation somewhat. If the Balanced Budget Act deficit targets were adhered to, however, offsetting changes in spending or taxes would be required. Whether the end result would be to make Federal taxes more or less progressive or the distribution of income more or less equal would depend on the nature of these offsetting measures. Among the many possible offsets to the deficit-increasing effects of a payroll tax cut, two—an increase in income tax rates and the imposition of a federal value-added (sales) tax (VAT)—are examined in this statement.

Table 3.—AVERAGE ADJUSTED FAMILY INCOME

[Income expressed as multiples of the poverty thresholds]

Quintile [1]	1977	1980	1985	1990 [2]	Percent change 1977-1990	Percent change 1980-1990	Percent change 1985-1990
Lowest [3]	0.95	0.86	0.80	0.84	−11.8	−3.2	4.5
Second	2.06	1.92	1.86	2.00	−2.7	4.3	7.3
Third	3.09	2.93	2.96	3.18	2.8	8.4	7.2
Fourth	4.34	4.17	4.35	4.70	8.4	12.6	8.0
Highest	8.70	8.61	9.83	11.34	30.3	31.7	15.3
Top 10 percent	11.46	11.39	13.39	15.76	37.6	38.4	17.7
Top 5 percent	15.22	15.42	18.65	22.52	48.0	46.1	20.8
Total	3.84	3.69	3.96	4.39	14.3	18.7	10.8

[1] Ranked by size of adjusted family income
[2] Projected based on Internal Revenue Service and Census Bureau data, using CBO economic forecast
[3] Excludes families with zero or negative incomes
[4] Includes families with zero or negative incomes not shown separately
SOURCE Congressional Budget Office Tax Simulation Model

Table 4.—TOTAL FEDERAL EFFECTIVE TAX RATES

Quintile [1]	1977	1980	1985	1990 [2]	Percent change 1977-1990	Percent change 1980-1990	Percent change 1985-1990
Lowest [3]	9.5	8.4	10.6	9.7	2.6	16.1	−8.1
Second	15.6	15.7	16.1	16.7	6.6	6.0	3.8
Third	19.6	20.0	19.3	20.3	3.6	1.2	5.1
Fourth	21.9	23.0	21.7	22.5	2.6	−2.2	3.6
Highest	27.1	27.3	24.0	25.8	−4.6	−5.5	7.4
Top 10 percent	28.7	28.4	24.4	26.4	−8.1	−7.3	8.2
Top 5 percent	30.5	29.5	24.5	26.7	−12.5	−9.5	9.0
TOTAL [4]	22.8	23.3	21.7	23.0	1.2	−1.0	5.9

[1] Ranked by size of adjusted family income
[2] Projected based on Internal Revenue Service and Census Bureau data, using CBO economic forecast
[3] Excludes families with zero or negative incomes
[4] Includes families with zero or negative incomes not shown separately
SOURCE Congressional Budget Office Tax Simulation Model
NOTE: Federal taxes include the individual and corporate income taxes, social insurance taxes, and excise taxes.

Effects on the Distribution of Tax Burdens and After-Tax Incomes

If payroll taxes were reduced by $50 billion and not offset by increases in other taxes, the tax burdens—Federal taxes as a percent of pre-tax incomes—of lower-income families would be reduced relatively more than those of middle- and upper-income families (see Figure 1). These results reflect the assumption that the employers' share of payroll taxes is ultimately paid by workers in the form of lower wages. The percentage decrease in tax burdens would range from 10.5 percent among the fifth of families with the lowest incomes to 3.4 percent among the families in the top income quintile.

While low-income families would receive the largest percentage decreases in taxes, the effect of these reductions on their disposable incomes would be considerably smaller because they pay relatively little of their income in taxes. Two-fifths of families in the lowest income quintile pay no payroll taxes, as compared with one-fifth in the next highest quintile, and 10 percent to 15 percent in the remaining quintiles. The average tax reduction among the one-fifth of families with the lowest incomes would be $81, while that received by the one-fifth of families with the highest incomes would be $974. The payroll tax reductions would raise the after-tax incomes of families in the lowest income quintile by 1.1 percent and the after-tax income of families in the highest income quintile by 1.2 percent. Thus, lowering payroll taxes would not appreciably increase the share of after-tax income received by low-income families.

Offsetting Increases in Income-Tax Rates

If the $50 billion in lost revenue from the payroll tax were replaced through a surcharge of about 10 percent on individual income taxes, the U.S. tax system would be more progressive (see Figure 2). About four-fifths of taxpayers would receive net cuts in taxes paid, with the size of the estimated cuts ranging from an average of $75 among the one-fifth of families with the lowest incomes to an average of $239 among the one-fifth with middle incomes. The one-fifth of households with the highest incomes would pay an average of $703 more in net taxes. These changes would lower the tax burdens of families in the bottom income quintile by almost 10 percent, while raising the tax burdens of families in the top income quintile by 2.4 percent. Moreover, the changes would move effective tax rates among different groups almost back to where they were in 1980.

At the same time, these amounts represent relatively small percentage changes in after-tax incomes. The relative change in after-tax incomes would, however, be progressive, ranging from a 1 percent increase among families in the bottom quintile to a 0.9 percent decrease among families in the top quintile.

Replacing payroll taxes with income taxes would also change the distribution of taxes paid among different types of taxpaying households. The high-income elderly, most of whom do not pay Social Security taxes, would be more likely to pay higher net taxes than younger taxpayers. Elderly families in the one-fifth of the population with the highest incomes would face a net tax increase averaging $1,224 as compared with $703 for all families in the top quintile.

Effects of Imposing a Federal Value-Added Tax

If the revenue lost from lowering payroll tax rates were made up by imposing a value-added tax, it would make the tax system less progressive, as shown in Figure 3.[2] The impact of levying a value-added tax of a little over 3 percent would be to increase the net taxes of the two-fifths of families with the lowest incomes by between $22 and $147. The remaining families would receive net tax reductions of between $43 and $106. The one-fifth of families with the lowest annual incomes would face the largest net increase in taxes. Many of these households spend more than their annual income by borrowing or by selling assets, as for example would be likely among the elderly. Households in such circumstances would pay relatively little in payroll taxes, and thus would receive little or no tax relief from lowering such taxes, but they would pay value-added taxes on their purchased consumption.

These changes would increase the tax burden of the one-fifth of families with the lowest annual incomes by 19.1 percent, while raising or lowering the tax burdens of the remaining families by small percentages. As in the case of increases in income tax rates, these changes in net taxes represent fairly small changes in the after-tax incomes of families. Unlike the income tax, they would be regressive, ranging from a 2.0 percent decrease in after-tax incomes among the one-fifth of taxpayers with the lowest incomes to a 0.1 percent increase among taxpayers in the highest income quintile.

While replacing payroll taxes with a VAT would make the present tax system less progressive, let me note that these measures overstate the increase in regressivity because a portion of families with low incomes in a particular year are not needy by other standards. Some households, for example, are able to sell assets to pay for spending that exceeds income. Value-added taxes would take up a larger share of the income of such households than it would of households that finance spending entirely from their annual income. In this case, value-added taxes would appear regressive, even though some families able to pay for spending out of existing wealth may not be needy.

A switch from payroll taxes to a VAT would also change the taxes paid by different types of households. It would increase net taxes paid by all older families, though the increase would be considerably less under a value-added tax than under a surcharge on the individual income tax.

[2] The simulations are for a VAT that excludes food purchased for home consumption, housing expenditures (including utilities), medical care, educational expenditures, and contributions to religious and charitable organizations. This VAT is similar to that proposed by Senator Hollings as a replacement for lower payroll taxes.

The Administrative and Compliance Costs of Changing to Different Taxes

Changing the mix of taxes in the way described above would also affect the costs of administering the tax system, and the cost of complying with it. However, the effect is only likely to be significant when a new tax like the value-added tax is imposed. Based on a Treasury Department estimate for 1984, the administrative cost to government of instituting and collecting a value-added tax would be about $1 billion.

Effects on Incentives to Work and Save

The possible shifts among different types of Federal taxes described above could also result in modest changes in the tax incentives affecting important economic decisions regarding how much to work and how much to save, though these changes are unlikely to have significant economic effects. Replacing $50 billion of payroll tax revenue with an income tax surcharge would slightly increase the marginal tax rate on income from saving and investment. However, changes in the after-tax return to saving do not seem to have much effect on the amount that households save; thus, the small increase in marginal tax rates is unlikely to have much effect. The effects on incentives of substituting a value-added tax for the revenue lost from reducing payroll tax rates will probably have little perceptible effect on incentives to work or to save.

Other Alternatives

Reduced payroll taxes could be offset in many more ways than the two examples discussed above. Some people have suggested that higher gasoline taxes should be considered. A detailed discussion of this alternative is not included in my testimony largely because it could have far-reaching effects on the economy, which would require considerable analysis. In order to raise $50 billion in net revenue, it would be necessary to raise the gasoline tax by about 50 cents per gallon, an increase that is beyond the realm of U.S. historical experience. Preliminary simulations of the distributional effects of replacing $50 billion in payroll taxes with higher gasoline taxes, however, suggest that this alternative would be even more regressive than a VAT.

IMPLICATIONS OF S. 2016 FOR SOCIAL SECURITY FINANCING

The previous discussion of the overall economic, budgetary, and distributional implications of S. 2016 does not address the more narrow but equally important issue of how the nation should finance Social Security benefits. S. 2016 has rekindled an old debate on Social Security financing. Should payroll tax rates be set so as to produce annual revenues approximately equal to annual outlays? Or should a reserve be built up, thereby establishing substantial interest earnings as an important source of financing?

Until 1972, tax rates were scheduled so that significant trust fund buildups would develop in the long run without subsequent legislative action. These substantial reserves never materialized, primarily because benefits were increased sufficiently to absorb the reserves before they could build up. As a result, the program was run on a de facto pay-as-you-go basis during the 1951-1972 period. The 1972 amendments, which indexed benefits to inflation, effectively legislated the pay-as-you-go structure. Five years later, the 1977 amendments reversed course and restored a significant trust fund buildup over the 1980-2010 period by moving a scheduled payroll tax increase from 2011 to 1990. For the first time, however, the long-range financing was not sufficient to meet anticipated program costs for the next 75 years, and the trust fund buildup was to be dissipated by 2030. This pattern of trust fund buildup and subsequent depletion (now projected to occur in 2046) was magnified by the Social Security Amendments of 1983.

S. 2016 would eliminate this pattern of reserve accumulation and depletion. The bill would establish a payroll tax rate schedule designed to result in total trust fund income sufficient to pay benefits and to maintain a one-year contingency reserve in the trust funds. Payroll tax rates would be lower than under current law from now until 2014, and higher after 2019. In other words, the Social Security payroll taxes paid by baby-boom workers would be reduced while those levied on the relatively smaller cohorts of workers who follow them would be raised.

Evaluating Alternatives to Social Security Financing

Several important characteristics of the Social Security program and the underlying demographic trends help to focus the discussion of the program's financing. First, under current law, benefits depend on a formula based on earning records, not on tax payments. Thus, there is no direct link between the benefit a worker receives and the Social Security taxes the worker paid. Even if the payroll tax were halved, individuals would receive their payments so long as adequate spending authority (regardless of its source) resided in the trust funds. For example, if all income were provided to the Social Security trust funds through a transfer of general revenues rather than through the dedication of payroll taxes, benefit payments would be unaffected. Therefore, the difference in Social Security between S. 2016 and current law exists only with respect to the source of revenues, not to outlays.

Second, because both future benefits and the payroll tax base are indexed to wages, changes in economic growth do not substantially affect the balance between Social Security costs and income. Real wage growth translates relatively quickly into benefit payments. Although about 2 percent more of GNP will have to be devoted to Social Security benefits in 2030 and thereafter compared with now, this increased share is little affected by the rate of economic growth. Thus, as a share of payroll or of GNP, the changes in Social Security resulting from faster or slower growth are smaller than generally imagined. For example, if real wages grow by 0.8 percent a year rather than 1.3 percent as is assumed in the "intermediate II-B assumptions" used by the Social Security Trustees, real wage levels in 2030 would be 18 percent lower. However, the fraction of GNP needed to pay benefits would increase by only 0.3 percentage points (from 6.68 to 6.94 percentage points). The required payroll tax—under a pay-as-you-go approach—would have to increase the payroll tax rate on both employers and employees by about 0.3 percent. As these figures show, the economic growth does relatively little to change the slice of the economic pie consumed by Social Security, but it has significant effects on the size of the whole pie to be carved up.

Third, under current demographic forecasts, the maturing of the baby boom does not represent a one-time swelling of the elderly's share of the population, but rather a permanent shift to a higher ratio of the aged population to the working-age population. If there is an economic logic in the accumulation of trust fund reserves, there is little such justification for dissipating those reserves given the underlying demographics. To avoid this depletion of the trust fund, a recent Brookings Institution study advocates scheduling future increases in tax rates. By building and maintaining Social Security reserves, the study argues, each cohort of workers would be making more of a contribution to its own future retirement benefits.

Under current law, the tax rate needed to assure adequate funding of benefits in the year 2045 is identical to that proposed in S. 2016. Therefore, considering only the financing of the existing benefit structure and not economic growth, the real question when the baby boom retires is: what revenues will be increased or what spending will be reduced? According to the 1989 Social Security Trustees' Report, about 75 percent of benefits in the year 2030 will be supported through payroll tax revenues, 5 percent through income from the taxation of benefits, and 20 percent through interest payments on the trust fund reserves. Obviously, other Federal revenues must be used to pay the interest. These revenues would equal about 1.3 percent of GNP, or an amount roughly equivalent to raising current corporate income tax revenues by two-thirds or personal income taxes by 15 percent. In contrast, S. 2016 relies almost totally on payroll tax and the taxation of benefits to support the program in 2030.

Financing Decisions and Future Benefits

Although there is no direct effect on benefits of moving back to pay-as-you-go financing, as is incorporated into S. 2016, other indirect effects may take place. First, some observers believe that a one-year contingency reserve is too small to weather severely adverse economic conditions such as those experienced from the mid-1970s to the early 1980s. A larger reserve—perhaps 135 percent to 150 percent of annual outlays—would be necessary to ensure the timely payment of benefits under current law without an infusion from the general fund, at least if these conditions were to be repeated in the 1990s.

While the 1983 amendments provide for some safeguards against rapid depletion of reserves, the "stabilizer" provision does not kick in until the contingency ratio falls to 20 percent. The stabilizer mechanism itself may involve a reduction in annual cost-of-living adjustments, but only if the rate of inflation exceeds wage growth. In addition, such low reserves would probably encourage calls for tax increases or benefit reductions in order to restore adequate reserves.

Alternatively, current funding practices would result in substantial reserves over the next 30 years even if economic or demographic patterns were to worsen substantially. Thus, the reserve accumulation may provide significant protection for continuing benefits under current law, although it could inhibit making some desirable changes.

Second, when the retirement of the baby boom causes total benefits to rise in the next century, a pay-as-you-go system would entail a series of payroll tax increases as S. 2016 prudently schedules. At that time, workers might demand greater scrutiny of the Social Security benefit structure in exchange for accepting these payroll tax hikes. In contrast, the accumulation of reserves expected under current law would provide spending authority for the trust funds for many years after Social Security costs exceed the program's tax revenues. In this respect, they delay the stage at which trust fund financing would force any reassessment of the benefit structure. But the baby boom's retirement will in any event lead to overall fiscal pressures on the Federal government, requiring additional taxes or reduced spending.

Third, while a return to pay-as-you-go financing may increase the potential for future benefit adjustments, it may also create additional flexibility for adapting to changing conditions. Social changes—such as greater participation of married women in the labor force, expanded private pension participation, increased life expectancies, and the continued shift to service occupations—may make some restructuring of Social Security desirable. In addition, economic conditions can change. For example, if the 1990s were to mimic the 1970s, static or actually declining living standards of workers and their families might lead policymakers to reconsider the degree to which resources from the working population to the aged are redistributed as embodied in Federal tax and spending policies. Although the financing problems of the late 1970s and early 1980s required the Congress and the President to agree to painful tax increases and benefit cuts, many of the changes—taxing benefits, extending coverage, imposing tighter limits on family benefits—could be justified both for programmatic reasons and on the grounds of overall equity and efficiency. Had the trust funds held significant reserves as are projected for the next several decades, these sound policies might never have been carried out.

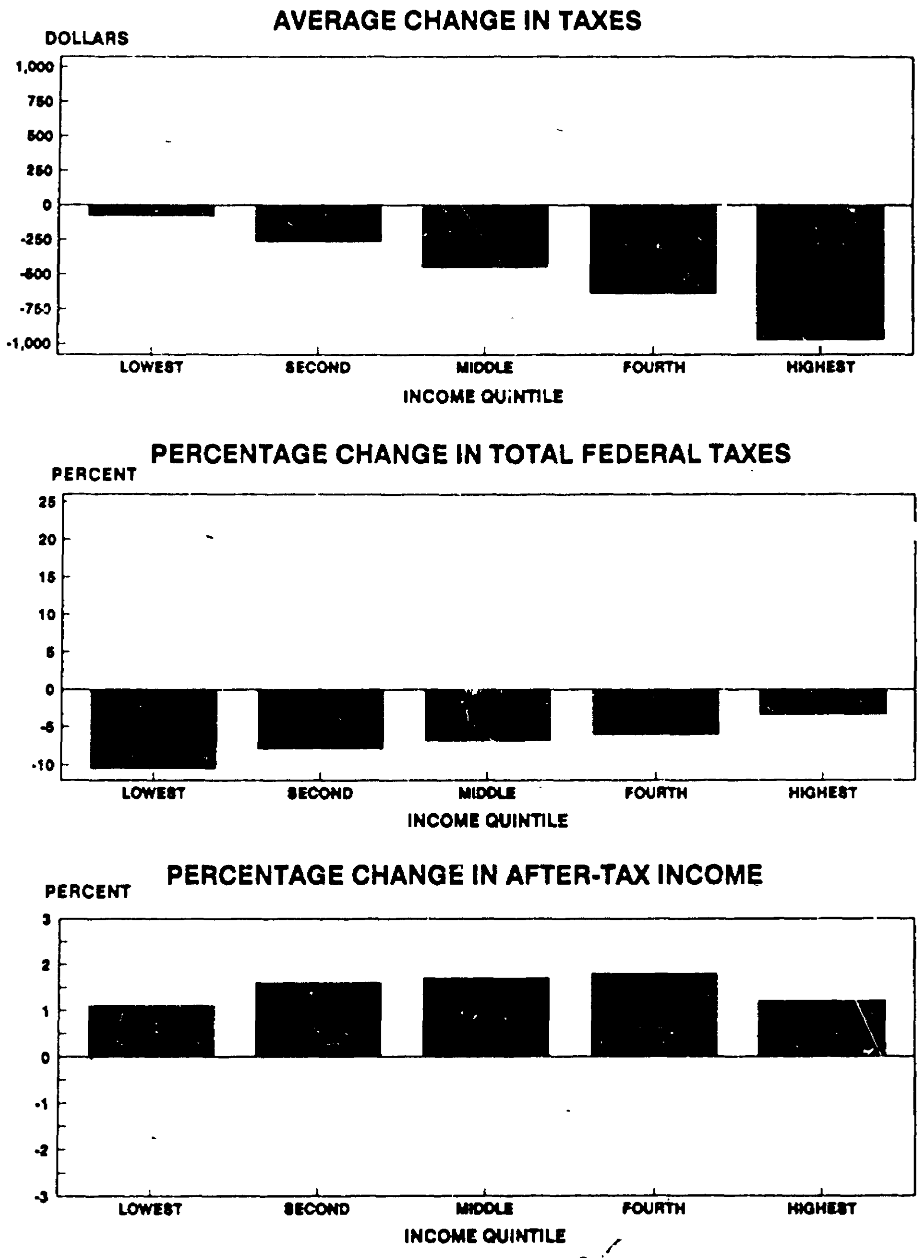
Fourth, in contrast to the trust fund buildup projected under current law, the one-year reserve levels envisioned under S. 2016 are sufficiently small to provide some restraint on increasing benefits. Many observers fear that the current projected trust fund surpluses may encourage an expansion of benefits that would further increase the aged's claim on future resources.

CONCLUSION

Large Federal deficits combined with relatively low U.S. savings rates jeopardize the future growth in the standard of living for Americans. Without significant economic growth, future taxpayers may be both less willing and less able to support existing federal commitments including those for Social Security and Medicare. Therefore, S. 2016 raises the issues of not only how we structure our taxes to finance Social Security, but also what our overall commitments should be to savings, investment, and economic growth.

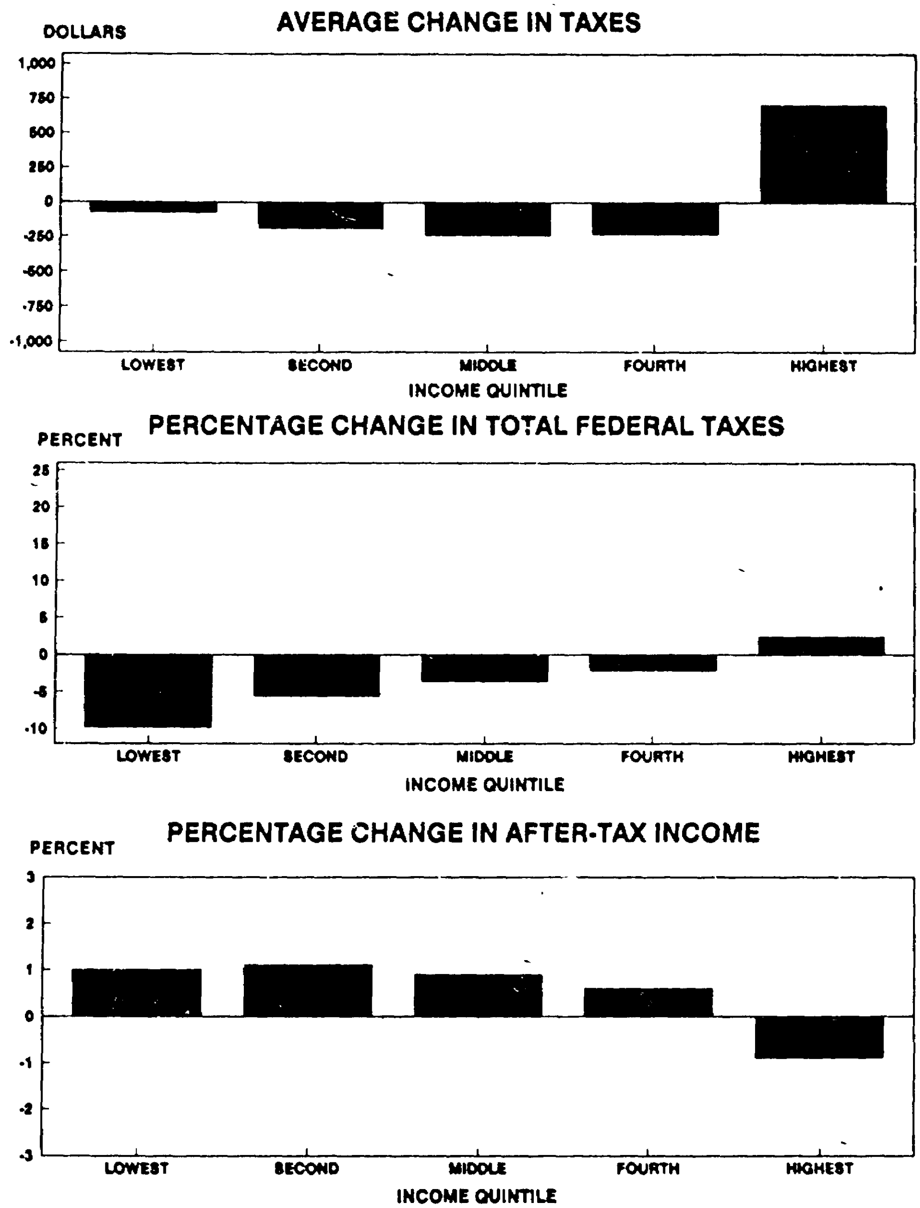
Social Security is woven deeply into the fabric of American society. The program affects roughly 133 million workers and over 39 million beneficiaries, with its payroll taxes accounting for more than one-quarter of total Federal revenues and its benefits constituting one-fifth of total Federal expenditures. Nearly two out of every five workers find their own FICA payments exceeding their income tax liabilities, and about three-quarters face combined employee/employer payroll taxes that are greater than their income taxes. Over one-half of aged Social Security recipients depend on these benefits for the major share of their total income. Moreover, millions of other family members receive insurance protection against income lost with the retirement, disability, or death of a worker. These statistics highlight that any program changes, whether they alter benefit payments or the way the program is financed, deserve much careful study and debate.

FIGURE 1. S. 2016



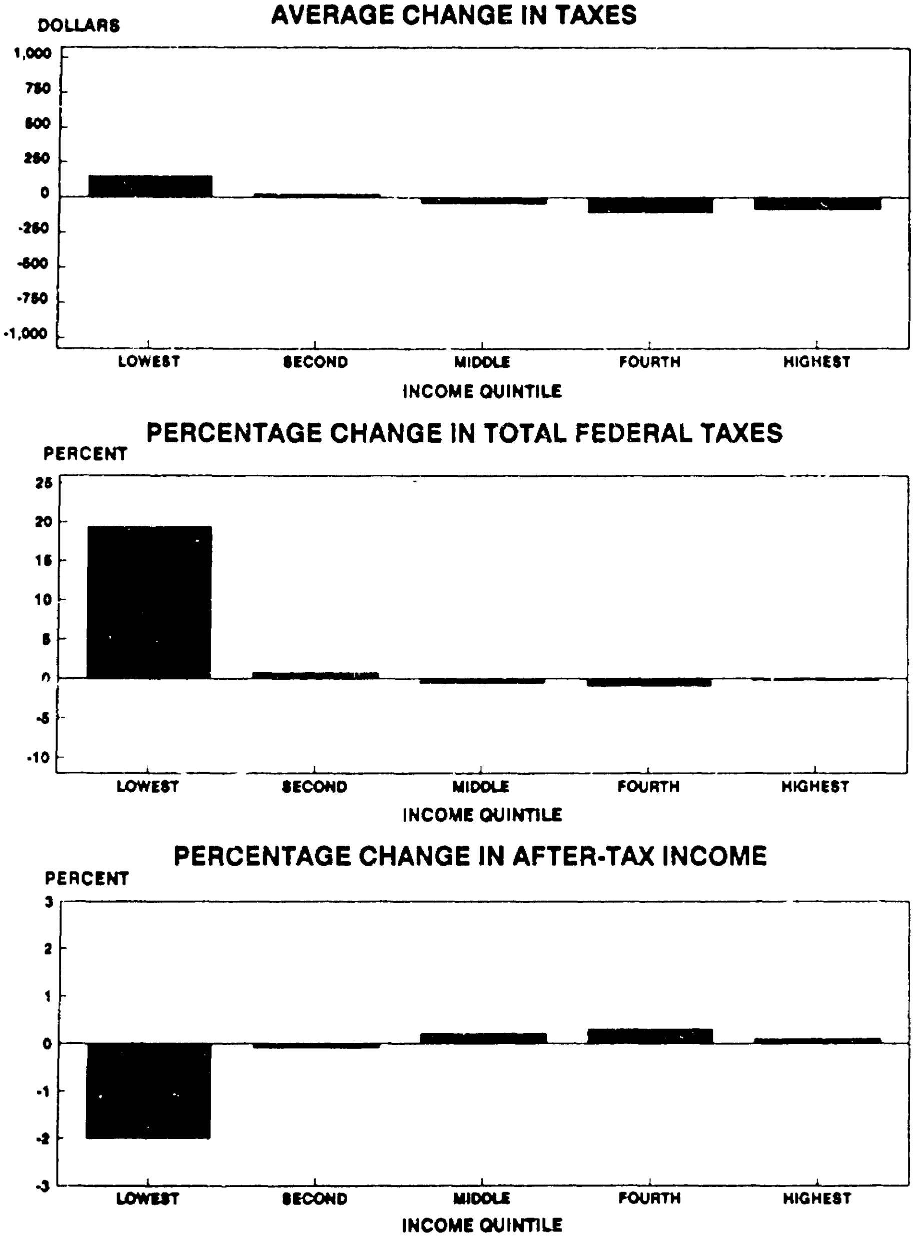
SOURCE: CONGRESSIONAL BUDGET OFFICE TAX SIMULATION MODELS.

FIGURE 2. S. 2016 WITH OFFSETTING INCOME TAX SURCHARGE



SOURCE: CONGRESSIONAL BUDGET OFFICE TAX SIMULATION MODELS.

FIGURE 3. S. 2016 WITH OFFSETTING VALUE-ADDED TAX



SOURCE: CONGRESSIONAL BUDGET OFFICE TAX SIMULATION MODELS.

PREPARED STATEMENT OF ALICE M. RIVLIN [1]

Mr. Chairman, I am grateful to Senator Moynihan, as I believe we all should be, for focusing the attention of the Administration, the Congress, the press, the policy community and the public on the budget and Social Security. Thanks to the Senator, we are having a lively national debate on two crucial and interrelated questions: (1) What Federal budget policy would help most to make the American economy healthy and productive in the future? (2) What kind of Social Security program is best suited for the future—a contributory social insurance system or an income maintenance program?

I would like to state briefly where I come out on both questions and why I think rolling back the payroll tax should not be part of the answer to either of them.

DESIRABLE BUDGET POLICY

Of the many actions the Federal Government could take to help ensure that we and our children live better in the future, among the most important is to increase national saving by running a substantial surplus in the unified budget. Higher national saving is required to finance the increased physical, human, and intellectual investment we need to raise productivity and ensure that the United States does not become a second rate economic power.

National saving dropped dramatically in the 1980s—to less than half the levels of the three previous decades. The dearth of saving has given us high real interest rates, sluggish investment, and dependence on the rest of the world for capital. This dependence which has brought us the dubious distinction of being the world's largest debtor, has reduced the extent to which the United States controls its own short- and long-run economic destiny.

Moving as quickly as possible from deficit to surplus in the Federal budget would enable the government to reduce the Federal debt held by the public, put strong downward pressure on interest rates, and stimulate private investment. It would reduce our dependence on foreigners to finance investment, perhaps even turning us into a capita exporting country again.

Running a Federal budget surplus, however, would seem as politically unlikely as it is economically desirable, except for one fortunate consideration. Prudent measures taken by the Congress in 1983 to put the Social Security System on a sounder basis have given us a politically attractive mechanism for generating such a unified budget surplus, by taking advantage of the fact that the Social Security System building up reserves. All that is required to use that surplus to increase national saving is to reduce the deficit in the general fund to levels that have always been considered normal.

WHAT KIND OF A SOCIAL SECURITY SYSTEM?

Starting the Social Security System more than half a century ago was a farsighted, constructive policy which Congress and all Americans can be justly proud. It was a good idea and has been responsibly implemented.

The good idea was not just to tax working people to support income maintenance programs for the elderly and disabled. It was to create a contributory social insurance system to which workers (and their employers) would contribute a fraction their earnings and from which they were entitled to receive benefits related their contributions. Within this framework, it was possible to make the benefits of low earners higher in relation to their contributions than those of high earners without appearing to be giving them charity. Although financed by a slightly regressive payroll tax, the Social Security System as a whole as progressive, but it was not welfare.

The contributory social insurance concept has proved extremely powerful. People have been willing pay taxes into the system because they identified their future benefits with those levies. The existence of Social Security has raised the standard of living of older people dramatically and reduced the incidence of poverty among the aged from high levels to about the same as other groups in the population.

As long as the labor force was growing at fairly steady rates, it was feasible to run the Social Security System on a pay-as-you-go basis without doing visible violence to the contributory principle—and perfectly responsible to do so. The fact that benefits were essentially paid out of current taxes enabled the System to start up

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[1] Senior Fellow in the Economic Studies Program of the Brookings Institution. The views expressed in this testimony are those of the author and do not necessarily reflect the views of other staff members, officers, or trustees of the Brookings Institution.

quickly. A system based on the government's power to tax needs only enough reserves to allow for unexpected developments in the economy. There is no danger, as there is with a company, that the government will go out of business and leave the pensioners without benefits. In fact, most beneficiaries of Social Security have gotten back far more than they contributed, but few of them know that and even fewer have objected!

The big bulge of baby boomers moving through the system, however, made it necessary either build reserves or to abandon the contributory concept in an obvious way. Sticking with pay-as-you-go through the baby boom bulge would necessitate a big increase in the payroll tax on workers about 2010 to pay the pensions of retiring baby homers. Such a big jump in payroll tax rates would destroy the connection between contributions and benefits, make it obvious that the baby boomers had not paid their way, and turn Social Security into an ordinary income maintenance program—a program in which current taxpayers are obviously supporting current beneficiaries. (To be sure, if the baby boomers' benefits are paid by drawing down reserves, general taxes will still have to rise to redeem the bonds. But this general tax rise does not so directly undermine the contributory concept of Social Security.)

At the moment, we are in a fortunate position. The appropriate policy for maintaining a contributory Social Security System—a buildup of reserves to prefund the baby boomers' retirement claims—turns out to facilitate appropriate fiscal policy for the 1990s—a surplus in the unified budget. The only problem is that we have not achieved the unified budget surplus because the large deficit in the general fund more than offsets the surplus in Social Security.

Using the Social Security surplus to fund other programs, as Senator Moynihan has forcefully pointed out, is a breach of faith with payroll taxpayers who think they are contributing to their generation's benefits. It also makes use of a regressive tax to fund general expenses of government.

The only satisfactory way of correcting these problems, however, is to reduce the deficit in the general fund. Senator Moynihan's proposal to roll back the payroll tax would have two undesirable effects. First, it would increase the unified budget deficit, initially by about $55 billion. This would raise interest rates, discourage investment, and make us more dependent on foreign capital. Second, returning to pay-as-you-go would risk turning Social Security from a contributory social insurance system into an income maintenance program. The big payroll tax increases that could be necessary when the baby boomers retire, would likely lead to intergenerational conflict, benefit cuts, and perhaps conversion of Social Security to a means-tested program. I believe the contributory social insurance concept has proved its value and should not be abandoned.

In short, Mr. Chairman we should all thank Senator Moynihan for clarifying the problem. We should then get on with the serious business of reducing the general fund deficit. I would urge the Committee and the Congress not to make matter worse by rolling back the payroll tax. Thank you, Mr. Chairman.

Prepared Statement of Michael O. Roush

On behalf of the more than 500,000 small business members of the National Federation of Independent Business (NFIB), the largest small business advocacy organization, I am pleased to participate in this hearing. NFIB commends Chairman Bentsen for his foresight in holding these hearings to alleviate the enormous burden payroll taxes have become to business owners and in particular small businesses. Our membership parallels the nation business population in that approximately 50% of our members own retail and service enterprises; 25% manufacturing and construction; and the remaining 25% operate agricultural, transportation, mining, wholesale, financial, insurance, or real estate enterprises. The average NFIB member has 13 employees and grosses about $350,000 in annual sales.

As you can see our membership and small businesses in general are concentrated in those sectors of business which tend to be primarily labor intensive. They em Joy people rather than machines. Payroll taxes, dominated by FICA axes, therefore place a disproportionate burden on them.

Mr. Chairman the term FICA—the Federal Insurance Contributions Act—tax is as outdated as the term "Trust Funds." Webster defines trust as "the assured reliance on the character, ability, strength, or truth of someone or something." Sadly in many small business owners' minds, the Social Security trust funds could better be defined as a "black hole" in which every day small business owners and working Americans throw their money, believing that they may well never see it again.

Unfortunately the myth that the trust fund surplus is being saved up for future retirees ha been put forward at the expense of current beneficiaries of Social Security, small business owners and other taxpaying Americans who expect to be able to draw on the reserve at retirement. In fact, these funds are going right back out the door to pay for current government services and current Social Security benefits while a mountain of IOUs are growing higher every day. As time goes on and the number of retirees increases proportionally to the number of workers, the need to take drastic action with regard to Social Security intensifies. The first and most obvious step is to stop the crushing tax increases which small business owners and working Americans are being forced to pay.

LEGISLATIVE PROPOSALS TO REDUCE FICA TAXES

To that end, NFIFB applauds Senator Moynihan for his courage in introducing legislation to reduce the FICA tax rate. Senator Moynihan's proposal would repeal the FICA increase to the 1989 level of 6.06%, leaving the Medicare rate in tact at 1.45%. My understanding is that his proposal would further reduce the 6.06% rate to 5.1% in 1991 and then begin to bring the rate back up again in 2012 to 5.6%, increasing to 8.1% in 2045. NFIB fully supports the provision in Senator Moynihan's proposal to repeal the 1990 FICA tax increase which will provide small business owners and their employees much -needed relief from this regressive and unnecessary tax.

Senator Kasten has also proposed legislation, S. 2052, the Social Security Integrity an Tax Reduction Act of 1990. NFIB would like to thank Senator Kasten for introducing a bill which will reduce Social Security taxes for small business owners. Senator Kasten's legislation would reduce the 1990 Social Security tax on both employers and employees from 6.2 percent to 5.9 percent, and further reduce the rate to 5.6 percent in 1991 and 5.3 percent in 1992. As Senator Kasten points out, his legislation provides an added reserve in the Trust Funds to ensure solvency in the event of a downturn in the economy. The Social Security Administration has stated that under Senator Kasten's legislation, the OASDI reserves would rise to 150 percent in the year 2000.

Mr. Chairman I mention this point because NFIB members have in the past voted with a resounding 80% vote in favor of lowering FICA tax rates when surpluses in the Social Security trust funds surpass safe actuarial levels. Today, the reserves have grown twice as fast as expected by the 1983 House Way and Means Committee. The Social Security trust fund is expected to contain a surplus of $61.9 billion this year. By the year 2000, excess FICA tax receipts could boost the surplus to nearly $203 billion, according to the Social Security Administration. Much of the excess surplus can be attributed to the strong economic growth the nation has experienced in the last decade.

NFIB POSITION ON SOCIAL SECURITY FICA TAX CUTS

NFIB support a responsible way to further reduce FICA taxes to the levels suggested by Senators Moynihan and Kasten while at the same time ensuring that Congress is not forced to raise taxes. To prevent this, a workable mechanism must be found—such as the phased-in FICA tax reduction suggested by Senator Kasten—which will allow Congress and the President to meet their deficit reduction obligations without raising taxes.

The need to reduce the FICA tax rate is of critical importance to NFIB and small business owners across the country for the following reasons:

Highest Tax

First, it's important to remember that a majority of small business owners pay significantly more in FICA taxes than income taxes. Small business owners must pay half of the 15.3 percent FICA tax for all their employees. Self-employed business owners (unincorporated firms which represent approximately two-thirds of all businesses in the U.S.) must pay the entire 15.3 percent FICA levy. In 1980, an NFIB study indicated that payroll taxes, dominated by FICA, comprised more than 50 percent of the taxes paid by small business owners. This study analyzed the taxing provisions of 17 different states for 5 typical small businesses. The study revealed that for most small businesses, the greatest tax burden is not generally imposed at he income tax level—either Federal, state, or local. Instead, the most significant portion of the burden is the result of payroll and property taxes—taxes which are not based on the profitability of the taxpayer, but rather the components of the business which generate the profits: facilities, equipment, and people.

In almost every case in the study cited above, payroll taxes comprised more than half of the total tax burden. Since 1980, income taxes have been slashed while the

FICA tax rate has gone up 6 times with an increase of 1.52 percentage points, from 6.13% in 1980 to 7.65% in 1990. Social Security tax revenue as a percent of total Federal revenue rose by 23 percent from 1980 to 1988, while corporate and personal income tax revenue as a percent of total Federal revenue declined by 23 percent and 6 percent respectively.

Startup and Marginal Small Businesses

The FICA tax burden discourages many individuals from pursuing the American dream of starting up a new small business because of the prohibitive cost of the tax. For those small businesses in trouble, struggling to keep their doors open, the FICA tax burden can be the "last straw" before a business is forced to close down. The bottom line is that the Social Security FICA tax is a decidedly regressive tax; new and marginal businesses must pay the same rate as healthy businesses. The tax is not related to profitability.

Job Creation

Over 70% of the 17 million net new jobs created in this decade have been in small firms. Small business is now known as the nation's "Job generator." According to the 1988 report to the President entitled *The State of Small Business,* 10.5 million net new jobs were created from 1980-1986, of which 63.5 percent 6.6 million jobs came from firms with fewer than 500 employees. More than 4 million jobs were created in firms with fewer than 20 employees. More than half of all Americans working in the private sector are now employed small businesses. More often than not, small businesses are also the place where young people receive their first full-time employment with it valuable on-the-job training. Small businesses also employ more older workers than do large businesses.

The FICA tax is a tax on labor and jobs because payroll tax payments must be paid "up front," regardless of profits, at least once a month by small business owners. This tax could prove fatal not only to small business owners who are heavily dependent on people, but also to the labor force. With payroll taxes continuing to grow, small businesses may not be able to hire as many individuals in the future; some small businesses may even have to close, displacing individuals in the labor market.

A recent IRET study estimated that a proposal such as Senator Kasten's to reduce FICA rate to 5.3 percent by 1992 would add between 450,000 and 920,000 new jobs, raise GNP by almost $300 billion, and increase the capital stock by $180 billion.

Small Business Costs

Small businesses cannot pass on costs in the same way larger businesses can. The FICA tax therefore disproportionately disables small businesses and increases their costs. The 1986 White House Conference on Small Business called on Congress to freeze the employer FICA contribution wage base and tax rate at the 1986 rate. The recommendation in part urged Congress to develop long-range alternatives to the present Social Security system, which places an undue and inequitable escalating financial burden on businesses and their employees. Our own NFIB mandate survey for August 1987 revealed that an overwhelming 79 percent of small business owners favor repealing the 1988 and 1990 payroll tax increases.

Self-employed Small Business Owners

While most small business owners must pay half of the 15.3 percent FICA tax, self-employed business owners must pay the full FICA tax payment, which increased dramatically for these business owners from 13.02% in 1989 to 15 3% in 1990. According to a study by the Employment Benefits Research Institute (EBRI), self-employed business owners employ 32% of the American workforce. Considering that these business owners must face a myriad of other challenges such as the inability to fully deduct their health insurance, the effect of the FICA tax increase is multiplied. Although in 1990 self-employed individuals may deduct one-half of their Social Security taxes many will not be able to take advantage of it because they don't make enough money to pay taxes. The elimination of the 2% tax credit, combined with the increase in FICA taxes, therefore hits self-employed business owners especially hard.

SMALL BUSINESS OWNERS' SOCIAL SECURITY POSITION OVER TIME

NFIB members have consistently expressed their strong opposition to any increase in payroll taxes. As I have already mentioned, NFIB recently asked its membership whether the payroll tax increase scheduled for 1988 and 1990 should be repealed. An overwhelming seventy-nine percent of our members voted against the tax increases. In fact, in the last fifteen years during the dramatic changes which have caused the Social Security system to be restructed, NFIB small business owners have consistently opposed the incremental Social Security FICA tax increases. Just prior to the Social Security crisis which precipitated passage of the 1983 Social Security Amendments, Michael Boskin, the President's Chairman of the Council of Economic Advisors, prepared a paper for NFIB in which he stated:

> "Given the huge outcry against the large (payroll tax) increase legislated in 1977 it is clear that the time has come to reexamine the future course of Social Security. The alternative is continued unpopular tax increases which add to costs and prices, reduce net wage rates, redirect the system further from an earned entitlements or annuity basis and continually erode public support of the Social Security system."

Small business owners agree with Mr. Boskin's assessment that the FICA tax increases "add to costs and prices, reduce net wage rates, redirect the system further from an earned entitlements or annuity basis and continually erode public support of the Social Security system." Although the environment in which Mr. Boskin was writing has changed, the basic premise still holds true that increasing FICA taxes only adds to the crushing tax burden of small businesses and doesn't begin to resolve the Social Security dilemma.

CONCLUSION

I recently received a letter from a small business owner, Mr. Richard Keeley, in Adrian, Michigan. Mr. Keeley wrote in part that he recently had to lay off twenty-one people in an effort to reduce costs. He said that the cost of FICA taxes greatly affected his decision. Mr. Chairman, Mr. Keeley and thousands of small business owners across the country need your help today to alleviate the payroll tax burden on small businesses in this country by passing legislation which reasonably reduces the FICA tax rate while still ensuring fiscal responsibility with regard to the budget. Thank you again for the opportunity to be able to testify today.

Attachements.

SEPARATING THE TRANSFER AND ANNUITY FUNCTIONS OF SOCIAL SECURITY

[By Michael J. Boskin, John B. Shoven, Marcy Avrin, Kenneth Cone]

1. INTRODUCTION

Since its enactment, the social security system has enjoyed unique popularity among public income support programs. In the past several years, however, rising payroll taxes, a huge long-term deficit and concerns over its effects on the economy have led an increasing number of observers to conclude that social security is in urgent need of reform.

This system serve two major goals: to replace income lost at retirement, and to provide minimum income support for the aged. The former, the insurance goal is based on earned entitlements the welfare, or transfer, goal aims at social adequacy of support. Each goal enjoys wide public support as well as important policy justifications. For example, imperfections in the private annuities market and imperfect foresight regarding future incomes, inflation, life expectancy, etc., may lead many citizens to "undersave" for retirement, forcing them as general charges on the public via welfare or other programs in the absence of social security.

Over the last four decades, the social security system has helped mitigate these problems in an important way. It has provided substantial income security to the elderly; it has kept many elderly persons out of extreme poverty; and it has transferred billions of dollars annually from the younger, wealthier generation of workers to the older, poorer generation of retirees. These are significant achievements indeed. However, the system, which was designed decades ago, has not kept up fully with rapidly changing economic, social, and demographic conditions. It is having several substantial and probably unintended adverse effects on the overall economy; and it faces a long-term funding crisis of immense proportions. In addressing the problem of reform, it is important that we build on the program's achievements while ameliorating its harmful effects on the economy and improving the prospects for its long-term viability.

Social security is thought of in several alternative ways: as an actuarially fair pension fund, as a separable system of taxes and transfer payments, and as a pure consumption loan intergenerational transfer program where each generation transfers a fraction of its labor income to the retired generation with the expectation that the succeeding generation will treat it similarly. In truth, the existing Old Age Survivors Insurance (OASI) system is none of the above, but has components of each (as well as additional complexities).

The current system differs from the private pension fund analogue in several respects. First, it is unfunded in that current payouts are financed by contemporaneous "contributions" or taxes. This had the advantage of allowing retirement benefits to be initiated immediately making the initial recipients "windfall" beneficiaries. That is, they received retirement come supplements with little or no previous contributions. Income was similarly transferred from the initial working population to the initial retirement generation. This intergenerational transfer has continued as the system has matured, although the net transfer (the expected value of a participant's receipts less parents) has diminished and in some cases disappeared. One drawback of this system is that while people accumulate future claims against the system, no corresponding wealth accumulation occurs for the system as a whole. Thus, while the working population is being forced to "save," no funds are made available for capital formation in the economy. At any point in time, the system is "bankrupt" in that it has massive future retirement obligations and only a relatively trivia amount of assets A government can operate such a system because of its powers to tax future income in order to finance its obligations.

There are other major differences between social security and the private annuity or pension fund analogue. The benefits are distinctly tilted in favor of the low income worker, the worker with a short work history, and the retiree with a spouse with an uncovered work history. That is, relative to a system where each participant earned a common rate of return on his or her contributions, the current social security system involves a set of taxes and transfers. This redistribution within a generation, in contrast to the intergeneration transfer mentioned above, is accomplished by such mechanisms as a progressive benefit formula, a minimum benefit, a uniform dependent's benefit, and an earnings test.

2. THE MAJOR PROBLEMS CONFRONTING SOCIAL SECURITY

Three major sets of problems plague social security today. The first is the issue of equity—both inter and intra-generational. A large proportion of benefits received by retired workers is really an intergenerational transfer. Also, different groups in a given generation of the population are treated differently by the social security system. Lower income workers receive a higher fraction of their previous earnings in benefits than do high-income workers; married couples usually receive half again as much as single persons with the same earnings history for the primary earner, those with short-covered earnings histories are favored, etc.

A second set of problems plaguing the social security system is the potentially adverse effects that it may have on labor supply, capital accumulation and costs of production.

Probably the most overwhelming problem confronting social security as a pay-as-you-go system is the long-term funding crisis. Even after the 1977 social security amendments, a long-term deficit of well over $606 billion remains. This is the amount by which the present value of legislated benefits exceeds the present value of legislated taxes. To put this in perspective, this amount is larger than the regular national debt. The major cause of this projected deficit is the drastic change in the age structure of the population. Once the post-World War II baby boom retires—around 2010—the ratio of retirees to workers will increase enormously. The best estimate is that the ratio of retirees to workers will increase by about 50 percent—from slightly less than one to three to about one to two. Given the pay-as-you-go nature of the system, this implies either a huge increase in taxes to maintain the ratio of benefits to wages or a significant decline in the ratio. Neither prospect is appealing, but there is no avoiding the choice.

In addition to the rapidly changing age structure of the population, the trend to earlier retirement combined with increased life expectancy has increased the average length of retirement considerably. When social security was enacted, on-half of all males over the age of 65 were in the labor force; today that figure is only one in five. Average life expectancy has increased over two years. Thus, the length of the average retirement period has increased by about one-third over 1935 levels. This has greatly strained the financial resources of the elderly; to achieve any given level of annual consumption, a retiree now needs substantially greater savings, intrafamily transfers, or public support.

What does all this imply for the long-run financial outlook for social security? Even the massive tax increases of the 1977 amendments will prove insufficient to finance the program through the first-half of the next century. If the current law is maintained until 2025, payroll tax rates would have to increase by more than 8 percentage points to meet benefit payments.[1] This would imply combined employer and employee tax rates of over 23 percent of payroll. Given the huge outcry against the large (but much smaller) increases legislated in 1977, it is clear that the time has come to reexamine the future course of social security. The alternative is continued unpopular tax increases which add to costs and prices, reduce net wage rates, redirect the system further from an earned entitlements or annuity basis and continually erode public support of the social security system.

While several short-run "quick fixes" have been proposed, such as bringing into the system those, such as government employees, not currently included, or eliminating the ceiling on taxable earnings, these cannot produce a reduction in the long-term deficit unless they are accomplished in a manner which is actuarily disadvantageous to the groups concerned.[2] For example, bringing government employees under social security would increase current tax revenues, but add to future obligations. This could only reduce the deficit if government employees were given a "bad" deal. But we could then expect them to resist such a proposal en masse.

3. THE TRANSFER AND ANNUITY COMPONENTS OF SOCIAL SECURITY

In order to appreciate the relation between the annuity and the intergenerational transfer components of social security, let us begin by examining the most extreme case: the first cohort of retirees under the U.S. social security system. Consider an individual who was age 62 in 1937 and retired in 1940 at age 65.

For a worker making average earnings and investing the sum of employer and employee contributions at interest rates then prevailing, the accumulated retirement principal in 1940 would have been only $68.36, yielding an annuity of $6.59 per year. Clearly benefits far in excess of contributions would be required if any substantial benefits were to be paid.

The actual average annual benefit paid in 1940 to a male age 65 was $270.60. Since an annuity would have yielded only $6.59, $264.01 of the benefits were a pure transfer, or welfare payment.[3] Since the benefits may and, in fact, did change over the retirement period, it is more convenient to compare capitalized savings and benefits over the expected time span than to compare annuity payments and annual benefits. For the individual in question, the present value of lifetime benefits was $2,962.09, of which $2,893.73 was a transfer. Thus, this individual paid for only 2.3% of the benefits received. This percentage has been increasing for individuals over time. Those retiring at age 65 in 1970 paid for approximately 3 percent of the benefits received.

Different individuals receive vastly different "deals" in the sense of the ratio of benefits received to taxes paid plus interest. This occurs for a number of reasons including the progressive benefit formula, the minimum benefit, the spouse's benefit, the different periods of coverage, etc.

4. SEPARATING THE TRANSFER AND INSURANCE COMPONENTS

Many problems in the social security system relate to the conflict between its twin goals of earned benefits and income adequacy. Most critics of the program propose reforming it in the direction of one goal or the other. Separating he transfer and annuity goals would have different effects on individuals depending on their age, income, industry, etc.

The three sets of problems plaguing social security—the long-term funding deficit, the apparent inequities, and the adverse incentives—fortunately point toward common reform: the separation of the transfer and annuity goals of the program. In principle, it is desirable to separate the financing of these different goals of the system.

Separating the transfer and annuity functions of the social security system and funding them, respectively, out of general revenues and ear-marked payroll taxes is desirable for a number of reasons.

First, the current system is so complex as to obscure the relation between contributions and benefits and impede a rationalization by firms and employees of total retirement support, private pension plus social security.

Second, as we shall demonstrate presently, many groups in the population are getting a "bad" deal from social security compared to an actuarily fair system. Separating the transfer and annuity goals would provide the *same rate of return for all workers* under social security's annuity program. The inequities which undermine support of, and faith in, the system, would be eliminated in this par of the program.

Third, there considerable evidence[4] that in the short-run part of increased costs due to payroll tax increases are passed on in higher prices, i.e. they are inflationary. It appears that such is not the case for individual income tax increases. The 1977 amendment increases plus the much larger predicted future increases do not auger well on this score. Further, such increases discriminate across firms and industries, as well as individuals. Large firms with a substantial market share may more easily pass cost increases forward onto consumers in the short run than small firms, and this in turn may erode competition. Comparing firms in different industries, the tax amounts to a larger fraction of the wage bill for industries whose workers are all below the cutoff, than for an industry where significant amounts of labor income are paid out above the cutoff income, or where many workers are not covered. Our preliminary estimates reveal that, for 1973 data, the effective tax rate varies by a factor of almost one-third across two-digit industries.

Fourth, transfers to the elderly poor (beyond SSI) should be financed from general revenues. It makes little sense to finance an income guarantee for the aged poor from a tax which bears so heavily on the working poor. The current income tax exemptions, deductions, and low-income allowance, which together exempt the first several thousand dollars of earnings from tax, indicate the general belief that those at the very bottom of the income scale should not have to help finance general income support programs.

The same argument applies to any intergenerational transfers providing earnings-relate benefits beyond those provided by pure insurance and the minimum income guarantee. It makes little sense for current unskilled workers to surrender income (beyond their *own* insurance) to subsidize retired doctors and lawyers beyond actuarially sound returns.

In separating the insurance from the transfer goals, general revenue financing will also require the transfer goals to compete openly with other government priorities, including tax cuts. General revenue financing will permit policymakers and the public openly to determine the value of transfers to the elderly in relation to other social priorities and to promote cost-effective measures for doing so. It will permit differential needs assessment to deal with different circumstances (marital status, etc.) in the context of a transfer program, where many precedents for doing so already exist.

Since the current aggregate transfer component of social security is over one-half of benefits paid, we do not advocate an instantaneous realignment of the system and switching of all transfers to general revenue finance. Rather, we offer the suggestion that gradually doing so has much to recommend it. Perhaps the best place to start is in conjunction with the reconsideration of the 1977 amendments and the impending payroll tax hikes they legislated.

5. TOWARDS A SOLUTION

As we begin to grapple with the immense problems of the social security system, from the apparent inequities and inefficiencies, to the long-term deficit, serious consideration should be given to separating the dual functions of social security and to financing them separately. Separating the transfer component of the system and funding it out of general revenues would encourage more cost effective transfers and enable us to strengthen the earned entitlements function, which in turn, would eliminate many inequities and help restore public confidence in the financial integrity of the system.

Because of the complexities of the system and the long-run deficit, we must resist piecemeal, short-run stop gap attempts to raise payroll taxes now without worrying about the future obligations so created.

In this paper, we have developed a series of long-run policy alternatives along these lines and have calculated the projected costs and benefits of each for workers of different ages. The age cohorts, cohorts I through 5, are ages 25-34, 35-44, 45-54, 55-64 and 65+ respectively. Cohort X Is less than 25 years. We have also calculated the implications of these alternatives with regard to the social security surplus or deficit to the year 2050. Basically, for each alternative, we ask the following: For each age cohort, that is the ratio of the present value of benefits it can expect to receive at age 65 to the accumulated value of lifetime contributions to social security? What is the result in terms of the deficit of the social security system through 2050?

We have investigated these questions in terms of the following alternative plans:

1. The "Base Case" analyzes the social security system as it stands today.[5]
2. The "Trans" alternative reduces benefits to eliminate transfers for Cohorts 1-4.
3. The "Trans 80" alternative eliminates transfers and adjusts taxes in 1980 to close the future deficit as of 1980. (Taxes were actually lowered by 1.5% of income.)
4. The "Tax 80" alternative raises taxes by 1.7% of income In 1980 to close the future deficit as of that year.

5. The "Tax 2030" alternative raises taxes by 3.9% of income in 2030 to close he future deficit as of that year.
6. The "Ret" alternative changes the retirement age to 68.

Thus, these alternatives allow us to determine the effects of decreasing benefits by eliminating transfers, increasing taxes and increasing the retirement age.
In order to understand the basis of these calculations, it is important to consider the data on which they are based, the method of analysis used and the assumptions upon which they rely.

Data

The data used in the calculations are the 1975 Social Security Exact Match File that merges individual records from the 1975 Current Population Survey with OASI earning and benefit records. With these data, the pattern of actual OASI benefits, as well as lifetime contributions into the system by all individuals can be found. These data permit redistribution across cohorts to be separated from the annuity aspect and enable us to estimate values for Individual households. Since the data used include only a sample of 1000 individuals in each Cohort, sample weights and population statistics are used to general is the sample results to the entire population. The weights are present on the file.
The data actually used in the analysis from the Social Security Longitudinal earnings tape include the sum of covered earnings from 1937-1950, covered earnings from 1951 to 1975, estimated quarters of coverage from 1937-1950 and actual quarters of coverage from 1951-1975.
From the 1975 CPS the following data were used: region, farm residence, age, sex, race maritial status, class of worker, occupation, industry, weeks worked in 1972 as a civilian, industry of longest civilian job In 1972, years of school completed, and wage and salary amount.

Method of Analysis

For cohorts 1-5 we determine the relationship between the summation of aggregate contributions and the expected aggregate benefits of all individuals currently in the social security system, assuming in all cases but "Ret" that the retirement age is 65 for husbands and singles and that wives retire with their husbands.[6] For an individual, the value of total contributions into the system at the point of retirement is the summation of actual and expected OAI taxes paid both by himself and by his employer compounded by a real rate of interest (3% in the base case). These calculations use actual and forecasted income, historical and forecasted maximum taxable income limits and historical and forecasted tax rates.
The expected value of OAI benefits over the worker's remaining life is calculated considering the probability of survival and the wage index from *Social Security Bulletin, Annual Statistical Supplement 1975.*[7] Wives receive benefits based on their own or their husbands benefits, whichever is larger. The entire analysis is converted to 1977 dollars.[8]
In order to determine the expected contributions for individuals who have not yet reached the age of 65, we applied the contribution rates specified in the 1977 amendments to the Social Security Act to known earnings and predicted future earnings for each individual. Earnings were predicted separately for males and females using an estimating equation based on positive 1972 earnings of all individuals in the sample. The predictions, determined from the estimated coefficients of the independent variables in the equation and the characteristics of the individuals, were indexed over time using 7% for inflationary earnings increases and the assumption of a 1.5% per year earnings increase due to productivity for the "Base Case." [9] Female income is adjusted for labor force participation.[10]
More formally, we "age" our survey data so that we know both the past work history and the projected future work history and retirement benefits for the sample population. Having done this we calculate the present value of each household's total contribution at retirement. These are calculated as:

$$C_R^i = \sum_{t=1}^{R} C_t^i e^{r(R-t)}$$

where R is a given retirement age, and r is the interest rate "credited" to a social security "account" under our pension plan analogue. In fact, all projected contributions and benefits are calculated so that they are the anticipated dollar amount times the probability of the individual surviving to that time.

We calculate the expected retirement benefits at age of retirement as:

$$B_R^i = \sum_{t=R}^{N} B_t^i e^{-r(t-R)}$$

where N is 100, beyond which the survival probability is taken to be zero.

Given that survival probabilities are already embedded in B_t and C_t, an actuarially fair system would be one where $C_R^i = B_R^i$. We define the expected present value of any transfer received by the participant as: $T_R^i = B_R^i - C_R^i$.

The same type analysis is performed for Cohort X, which involves making several assumptions regarding the future.[11]

After performing the analysis of taxes and benefits by cohort for various scenarios, we sum the results in order to determine the budget surplus or deficit that results from each scenario.

6. AN OVERALL COMPARISON OF ALTERNATIVE SOCIAL SECURITY SITUATIONS

Let us begin by examining some general measures of the overall situation for the OASI system under alternative scenarios. In particular we consider aggregate taxes, benefits, and deficit under alternative social security situations and, correspondingly, the total transfers and transfers as a percentage of income for alternative social security situations. The situation to be discussed include the base case, i.e. current law, including currently legislated but not yet implemented tax increases; the base case with a slightly lower rate of productivity growth; two situations in which the transfer component is eliminated and dealt with separately under general revenues: Trans 80 and trans; and RET which adjust the retirement age to 68. Table 1 presents estimates of the aggregate taxes, benefits, and resulting present value of the long term deficit under these alternative scenarios. Recall that we are making very conservative assumptions with respect to the projected long term deficit in considering the base case in order to try to maintain comparability, roughly speaking, with the assumptions made by the trustees of the Social Security System.

The base case is estimated assuming an annual rate of productivity growth of 1.5% per year, an annual inflation rate of 7% per year, and the total taxes and benefit are discounted at a real rate of 3% with all figures being presented in $1977. Thus for the base case, we note the total taxes amount to approximately 3.3 trillion dollars whereas total benefits amount to about 4 trillion dollars. Again, recall that these figures are adjusted for inflation and discounted to 1977. With these

Table 1.—AGGREGATE TAXES, BENEFITS AND DEFICIT UNDER ALTERNATIVE

[In billions of discounted 1977 dollars]

Case	Total Taxes	Total Benefits	Defecit
Base	3336.9	3968.8	632.0
Base with productivity 40%	2839.6	3570.5	731.0
Trans '80	2798.6	2656.5	−142.1
Trans	3336.9	2656.5	−680.3
Ret	3500.9	3345.6	−155.3

assumptions, the estimated long term deficit amounts to 632 billion dollars. Recall that this does not include Medicare and disability in which case taxes, an benefits and deficit would all be substantially larger. This enormous deficit occurs primarily because of the changing age structure of the population noted above. When the baby boom generation starts to retire, we face the awkward prospect of an extremely large and rapid increase in the ratio of retirees to workers in our society. Even if the actuarial assumptions of the Social Security Trustees are accurate—and I believe they are extremely optimistic—we will have to raise Social Security taxes or lower Social Security benefits, or raise other tax revenues, or some combination of these options, by an enormous amount in the years ahead. This combination would have to amount to 632 billion dollars today: If we waited for the baby boom generation to retire the tax increase necessary will be between 2½ to 3 trillion dollars the year 2030.

The estimated taxes, benefits and deficit for the base case are very sensitive to the assumptions incorporated in making projections over the long term. Because of the importance of compounding even small differences in growth rates, even so small a difference as ½ of 1% in the rate of productivity growth increases the long term deficit—holding other assumptions constant—by almost 100 billion dollars in present value terms. Table 1 demonstrates that when the productivity growth assumption is lowered from 1½ to 1% per annum, the base case results in a decreased tax revenue again in present value discounted 1977 dollars, of almost 500 billion dollars to 2.8 trillion and a reduction in total benefits by about 400 billion dollars from slightly under 4 trillion to slightly under 3.6 trillion. The recent behavior productivity does not give us much cause for optimism for restoring a rapid rate of economic growth in our economy, and does not augur well for the long term deficit of social security.

Another assumption which is extremely important in the calculation of taxes, benefits and the deficit concerns the length of retirement. As noted above, forecasts of life expectancies made earlier drastically underestimated the rapid increase in the life expectancy of the elderly since 1960. In the last two decades, the life expectancy of the elderly increased about three years for women 1½ years for men. Simultaneously, there has been a rapid acceleration of earlier retirement. In 1948, ½ of males over age 65 were in the labor force: today that figure is only ⅕. If *either* life expectancy increases still further or the trend to earlier retirement continues, the long term deficit in social security will increase drastically. As a rough approximation, increasing the length of retirement, and eligibility for social security benefits, by an extra year would add about 250 billion dollars to the long term deficit. Because the population has increased the length of its retirement period so much—by increased life expectancy and earlier retirement—and because we have an ever growing fraction of the population which has entered the labor force later, shifted out of physically demanding and dangerous jobs, etc., one major avenue of reform of the social security would be to raise the age at which people could collect social security benefits. We simulated one such scenario: raising the retirement age from 65 to 68. Going back to the other assumptions of the base case for productivity growth, inflation, etc., we note that such a move would result in a very modest increase in taxes from the additional years of work of about 170 billion dollars, but would result in a 620 billion dollar benefit decrease. *Note that this would be accomplished without decreasing the annual benefit received by an worker once retired.* The reduction in total benefits in discounted 1977 dollars comes about solely because people will be collecting benefits for a shorter period because of their later retirement. This changes enough to more than offset the impending enormous social security deficit and the impending enormous tax increases above and beyond those already voted. Indeed, such a program in conjunction with the other assumptions noted above would leave the social security with a surplus of over 150 billion dollars. An alternative scenario, of gradually raising the retirement age less rapidly and not quite as high, could still put the social security system into a long term balance. This scenario highlights the extreme importance of the length of the retirement period for the total benefits paid out and the long term deficit of the system.

The long term benefit pay outs and tax collections, but especially the former, are also extremely sensitive to the presence of the enormous percentage of transfer payments involved in social security benefits, especially for older current workers and retirees. Leaving aside current retirees, two other scenarios were simulated in which the transfer payments currently accruing to people who have not yet retired were simulated: trans and trans 80. The trans alternative removes the transfer component of benefits completely. They are to be shifted to general revenues in a manner to be decided on the merits of the case once a genuine earned entitlement system is set up. We must note however that when they are shifted to general revenues and the transfer payment system for the elderly is set up out of general revenues, that this may obviously involve increases in general revenue taxes as well as the sharp reduction in payroll taxes and projected future payroll tax increases we are about to describe. Under trans, taxes will not go down at all, but total benefits will go down about ⅓, from slightly under 4 trillion to about 2.7 trillion dollars. This totally reverses the deficit picture from a ⅔ of a trillion dollar deficit to a ⅔ of a trillion dollar surplus discounted to 1977. The ⅔ of a trillion dollar surplus obviously could result in further reductions in social security taxes from *present* levels let alone totally eliminating the need for future tax increase. It could also be used to finance approximately over ½ of the transfer payments if we shifted total transfers into general revenues.

The trans 80 alternative substantially reduces taxes as well as total benefits. Indeed, the total benefits would be treated exactly as under trans. The difference is that tax revenues would be reduced somewhat from 1980 on, leaving the social security system itself with a very modest surplus of 140 billion dollars or so and the substantial reduction in taxes from current levels. The tax reduction would be on the order of 1.5 percent of income from now on. That is, not only would we obviate the need for the already planned future tax increases legislated in the 1977 amendment, an the projected enormous tax increases necessary to deal with the long term deficit, but we would also enable the social security system to educe current taxes by 1.5 percent. Again, transfers would be shifted to general revenues and the exact amount and nature of those transfers should be worked out in accord with general principles of transfer payment under general revenue finance.

This overall version of the total situation with respect to taxes, benefits, and the long term deficit highlights not only the current extreme long term deficit of the social security system as presently constituted, and the enormous tax increases above and beyond the 1977 legislated tax increases impending in view of the long term deficit, but also the opportunities and possibilities for deriving a solution by rationalizing the benefit payments along the lines of separating the benefits paid to achieve the twin goals of social security: earned entitlement and income adequacy during retirement. It also highlights the extreme sensitivity of the long term deficit and benefit payments and tax receipts to such things as slower productivity growth and changes in the length of the retirement period. We might conclude this brief section by noting that the long term future of social security is not something to be left to the long term to deal with. Every year we postpone dealing with the problem gives us one less year to generate a smooth transition to more rational and cost effective system of providing adequate income support for our elderly population.

To analyze the transfer component involved in social security at the aggregate level in a little more detail, we present in Table 2 estimates of the total transfers and transfers as a percentage of total national income, under the same scenarios discussed above in conjunction with Table 1. We estimate here the total transfers to Cohorts 1–4, leaving aside the issue of the transfers already being paid to retired workers. These will be discussed below under the disaggregate results. Obviously, most of the benefits being received by currently retired workers are in the nature of transfer payments. For the base case, under the standard, if optimistic, assumptions, total transfers to Cohorts 1–4 would be almost 2 trillion dollars and the amount to slightly under 5 percent of total national income! Placed in perspective, this in only slightly less than the share of income being devoted to defense expenditures! Under the standard assumptions of the base case with our slightly lower rate of productivity growth, transfers decline slightly to 1¾ trillion dollars but increase the percentage of the now smaller income (due to the lower productivity growth) to slightly over 5%. Obviously, under the trans alternative total transfers have been eliminated completely and hence are zero in both total and as a percentage of income; the trans 80 alternative allows transfers to be-paid for several additional years before taxes are adjusted (remember we start from a base year of 1977, since that is when our data ends), and transfers would be virtually abolished

Table 2.—TOTAL TRANSFERS AND TRANSFERS AS PERCENT OF INCOME, VARIOUS REFORMS

Case	Total Transfers to Cohorts 1 4[1]	Transfers as percent of National Income
Base	1,818 8	4.7
Base with productivity = 1%	1,746 3	5 3
Trans '80	72.3	0 2
Trans	0	0
Ret	1,542 0	3.8

[1] All figures in billions of discounted 1977 dollars

in this case. Finally, we note that the increase in the retirement age would substantially reduce transfer payments by about a ¼ of a trillion dollars to Cohorts 1-4, and reduce transfers as a percentage of national income by approximately 1 percentage point. These enormous amounts for total transfers to Cohorts 1-4—which would be augmented substantially if we included the transfers to be paid to current retirees for the remainder of their life—reveal that fundamental changes In the social security system towards separating the transfer and annuity goals of the program would involve major changes in the necessary taxes under social security.

7. DETAILED RESULTS FOR THE BASE CASE

In order to prevent disaggregate figures concerning the benefits and taxes and transfers received by the *average* family of different age, income, and occupation, we will focus for the next few pages on the base case assumption. Recall from the discussion above, however, that these assumptions may be somewhat optimistic and that slower productivity growth or increased retirement periods would add substantially to the taxes necessary to finance promised benefit. The base case simply ignores the long term deficit and assumes that current workers will not be forced to pay any tax increases above and beyond those already legislated despite the enormous long term deficit. Were part of the solution to the long term deficit to gradually raise taxes, as discussed in the next section, the break given to current workers would be substantially worse than under the base case; indeed younger workers would lose substantially with respect to social security. Under the base case, assuming that taxes would not be raised roughly until the baby boom generation retires or later, almost all current workers come out fairly well in terms of their average net benefits above and beyond taxes paid plus interest, but there is an enormous bad deal for workers under the age of 25 who will ultimately be forced to finance such benefits.

Table 3 analysis the base case the six different age Cohorts; current retirees, for simplicity persons over 65; for ten year age intervals: 25-34; 35-44; 5-54; 55-64; and Cohort X, persons under the age of 25. The situation of family in these ages are discussed in terms of a

Table 3.—BASE CASE

1977 dollars	65 +	64-55	54-45	44-35	34-25	<25
Average Tax/Family	7058	18,345	33,883	53,326	73,843	
Average Ben/Family	49,400	47,639	56,600	66,321	73,577	
Avg. Net Ben/Family	42,343	29,294	22,718	12,994	-267	large. negative
Avg Net Ben as % Tax/Fam	600 0	160 0	67 0	24.4	-.36	
Total Taxes pd by Cohort Bill.	172	235	349	389	540	552 + (?)
Total Ben pd to Cohort Bill	1282	29	570	483	503	
Transfers as % of Total Ben.	86 6	62 7	38 8	19.4	- 7.39	large, negative

Assumes 7% inflation, 1 5% productivity growth, 3% discount
N B For survivors only

variety of estimates: the average tax paid per family in each age Cohort; the average benefit received per family in each age Cohort (the difference between the benefits and taxes]; the average net benefit as a percentage of the taxes the family paid. Also included are discussions of the total taxes paid by the Cohort and the total benefits paid to the Cohort when they ultimately retire under current estimates, as well as the transfers as a percentage of total benefits received by the Cohorts when they ultimately retire.

There are variety of important points illustrated by the base case. First, the average tax per family even adjusted for inflation and discounted to 1977 will increase markedly as time goes by and hence is much higher for younger workers than older workers or current retirees. This occurs for a number of reasons: some of the retirees will not have paid taxes through their entire life; the tax rates actually paid and taxable ceiling used for each year have been growing through time and hence the annual taxes paid have been growing through time and will continue under current law. The average tax paid in 1977 dollars adjusted for inflation will be 10 times as high for 25-34 year olds as for people currently retired.

Benefit payments increase much less rapidly through time and hence as we get to younger ages. Current retirees and persons soon to retire will receive benefits based not so much on what they paid in taxes, but upon an estimate of what the current tax revenue will support. Since the current tax revenues are levied at a higher rate and a larger income base than were taxes collected from the current retirees and soon to be retired, their benefit are obviously much higher than the taxes paid plus interest. Therefore, 25-34 year olds will receive only about ½ again as much in the real 1977 value of benefits once they retire as current 65 and over beneficiaries. Again, recall the base case assumes no changes in life expectancies, or retirement patterns, as discussed above. Differencing the benefits and taxes reveals the enormous net benefits, or transfers, received by the current retirees and those who retire in the near future. The average current retirees receives about $42,000 as a net transfer from the social security system by the taxes paid by current worker. This amounts to six times what these people on average paid plus interest. An average family in the next Cohort, 55-64 years olds, will receive back 1.6 times what they paid in plus interest as a transfer payment, an aggregate of slightly over $30,000. The aggregate average net benefit, or transfer, declines as we get to progressively younger ages both in absolute amount and still more rapidly has a percentage of tax paid per family, since the latter will rise rapidly. By the time we get to young workers 25-34 they are actually losing in terms of the taxes paid plus interest being less than the average benefits they can expect to receive. Those persons under the ages of 25 will suffer an enormous loss under the current calculation. The amount of this loss is so dependent upon the nature of future tax increases to support the deficit, as well as a variety of other assumptions, we merely list it as large and negative. The total taxes paid as benefits received by each Cohort follow the obvious pattern: Taxes rising substantially as we pass through time. Again these tax amounts do not include any increases that must be voted if we are to close the long run deficit by increasing taxes rather than decreasing benefits or by one of the structural forms suggested in one of the alternatives discussed below. Transfers as a percentage of total benefits follow a pattern similar to that for the average family. The overwhelming bulk of benefits are transfers for current retirees; for the next Cohort about 60 percent will be transfers; for the 45-54 age Cohort slightly under 40 percent; the transfers will eventually vanish and become negative as we reach the younger Cohorts. Obviously, for ages under 25 there will be a large negative transfer. Also, the transfers as a percentage of total benefits will decrease for all age Cohorts not currently retired if we start to raise taxes now in anticipation of closing the deficit. The time pattern of such tax increases will be reflected in differential rates of reduction of the transfers as a percentage of total benefits for the different age groups. In the extreme, if we wait until the baby boom generation retires, these numbers will be approximately accurate and the transfers as a percentage of total benefits will be an astoundingly large negative number for those currently under the age of 25.

Table 4 takes a deeper look at the net transfers received by individuals from social security in the different Cohorts. We examine the net benefits received and the percentage break (the net benefits divided by the total benefits) for four different income classes.

Table 4.—NET TRANSFERS BY INCOME CLASS

	Income Class [3]			
	< 6000	6000-8000	8000 10,000	10,000 +
Net Benefits [1]	5,972	3,505	2,267	-1,923
Cohort 1 [4]				
Percent Break [2]	8.1	4.9	3.1	-2.5
Net Benefits [2]	15,700	15,586	13,185	11,054
Cohort 2:				
Percent Break	26.7	23.4	20.4	16.3
Net Benefits	24,519	25,645	24,170	20,733
Cohort 3:				
Percent Break	50.1	46.7	44.5	35.1
Net Benefits	30,446	30,224	29,432	30,292
Cohort 4:				
Percent Break	69.2	64.3	61.3	57.8
Net Benefits	39,376	36,587	39,671	42,476
Cohort 5:				
Percent Break	87.6	80.0	81.0	75.3

[1] Net benefits = Benefits for average family in income class where both survive to retirement, in 1977$, discounted to year of retirement, less taxes paid computed analogously
[2] Percent Break = Net benefits — benefits paid
[3] In 1977
[4] Cohort 1 = 25-34, Cohort 5 = 65 +
N B Base case with inflation = 7%, productivity 1 5%, discount rate 3% net of inflation

For each Cohort, we note looking across the row of percentage break that at the percentage break declines rapidly as income increases. For example, for the Cohort 25–34 years old the percentage break goes from slightly over 8 percent for family income under $6000.00 to minus 2.5 percent for families with incomes above $10,800.00. The same is true for each Cohort. Again, for Cohort 5, the current retirees, the percent break declines from 87.6 percent to 75.3 percent as we move up the income scale. This particular feature of the relationship between the percentage break and income reflects primarily the progressivity of the benefit payment formula which is tilted heavily towards replacing a larger fraction of preretirement income for low income workers than for higher income workers. Of course, the total net benefits may be slightly larger for some Cohorts for higher income people reflecting both the larger intergenerational transfer and the larger tax payment which higher income individuals make.

Finally, in examining the base case we take a look at one other type of transfers as a percentage of benefits paid: disaggregating by industry of employment. The transfers as a percentage of benefits paid vary substantially across industries for a number of reasons: The different average income earned by workers of different industries; slightly different tax treatment in effective payroll tax rates because of differential promotions of workers above and below the taxable ceiling; etc. It is important to note that once again we observe the

Table 5.—TRANSFERS AS PERCENT OF BENEFITS PAID FOR SELECTED INDUSTRIES BY COHORT[1]

Industry	Cohort 1	2	3	4	5
Agriculture	[illegible]	14.9	40.9	57.7	80.0
Mining	42.1	10.1	5.1	39.5	N A
Construction	37.9	18.5	11.3	43.8	70.2
Manufacturing	27.3	6.3	17.3	46.8	64.5
Transportation Communication	24.1	16.4	24.4	48.5	69.0
Wholesale	31.7	4.2	17.6	38.1	69.4
Retail	9.2	14.7	41.4	58.4	82.5
Service	3.8	21.4	41.5	62.8	83.5
Banking Insurance Real Estate	19.4	9.3	28.7	51.3	79.3

[1] Estimate for average individual in each industry

substantial net transfer to current retirees, and expected net transfers to the oldest Cohorts of workers, which will turn negative for the youngest Cohorts of workers. These negative transfers occur even without considering the hug tax increase if necessary which will bear so heavily on them when necessary to finance the impending long run deficit.

With these insights into the current social security situation in mind, were turn to a brief discussion of the alternative scenarios discussed above.

9. DISAGGREGATED ESTIMATES FOR ALTERNATIVE REFORM POSSIBILITIES

Ue have calculate for a series of potential benefit and tax reforms, disaggregated estimates of average taxes paid per family, average benefits receive per family, the average net benefits per family, the average net benefits as a percentage of taxes per family, the total taxes paid by and benefits to each Cohort, and the transfers as a percentage of total benefits for each Cohort.

The first alternative considered, in Table 6 is that labeled trans. Recall that this eliminated all transfers and set up a situation where they could be treated separately under general revenues if so desired. In this scenario, we note the familiar pattern of the average taxes paid per family rising substantially as we move to younger and younger Cohorts. We also note the same pattern for average benefits. However, now a different pattern emerges for the average net benefits received per family. In this case the average net benefits are virtually zero for all age Cohorts. They differ slightly because we have not constrained the transfer to be zero for each age Cohort but have reduced the aggregate benefit payout each year in order to eliminate the transfers. Thus, the aggregate net transfers and the average net benefits received per family will be approximately zero for each Cohort in each case, not exactly so. Once again, the total taxes paid by each Cohort and total benefits received by each Cohort increase substantially as we go to younger and younger Cohorts and are approximately zero in the aggregate for each Cohort.

Table 6.—TRANS

1977 $	Cohort-Age in 1977					
	65+	64-55	54-45	44-35	34-25	<25
Avg Tax/Family	7,058	18,345	33,882	53,326	73,843	...
Avg. Ben/Family	6,629	17,793	34,769	53,461	73,576	...
Avg Net Ben/Family	-429	-552	886	134.9	-267	...
Avg. Net Ben as % Tax Fam	-6 07	-3 01	2 62	25	-36	...
Total Taxes pd by Cohort Bill	172.1	235 0	349 4	389.0	539.6	552
Total Ben pd to Cohort Bill	172 1	235 0	350 4	389.0	502.5	...
Transfers as % of Total Ben	01	-01	29	0	-7.39	...

Moving from tran to trans 80 in Table 7, which you recall involved a small tax cut as well as eliminating the transfers. yields a very similar pattern to that discussed above for trans; indeed, the benefits received by the average family in each Cohort are identical to the situation under trans as are the total benefits paid out to each Cohort. However, now the taxes differ somewhat to take account of the modest surplus that would result by eliminating all the transfers. In this case the average taxes per family are somewhat lower for each Cohort, decreasing progressively more in percentage terms as we move to younger and younger age Cohorts. The total taxes paid per Cohort follow the same pattern.

Table 8 presents the same analysis under the base case assumptions for the scenario we label RET to indicate the retirement age at which benefits can be collected at full levels has been raised to 68 from 65. As noted above in the discussion of the aggregate simulation comparing scenarios, RET results in a situation where slightly higher taxes will be paid by the Cohorts because they will be working slightly longer, but the benefits received while maintainable at the same annual level would be paid out over a somewhat shorter period. Again, the aggregate benefits and the average benefit in each Cohort will decline somewhat. We note for example that the average net benefit per family declines from $42,000 for current retirees to virtually zero for people at the age of about 40 to a large negative number for people around the age of 30. The same is obviously true of average net benefits as a percentage of taxes per family. We note however that the total benefits received by each Cohort

Table 7.—TRANS 80

1977 $	Cohrt-Age in 1977					
	65+	64-55	54-45	44-35	34-25	<25
Average Taxi/Family	7045	17,818	31,368	47,729	64,409	...
Average Ben/Family	6629	17,793	34,770	53,461	73,577	...
Avg. Net Ben/Family	-415	-24.6	3,401	5,732	9,168	...
Avg. Net Ben as % Tax/Family	-5.89	-14	10 84	12.0	14.23	...
Total Taxes pd by Cohort	171 .6	228 8	324 6	349.0	470.0	459.7
Total Ben pd to Cohort	172.1	234.9	350.4	389.0	502 5	...
Transfer as % of Total Bene	.25	2.60	7 36	10.28	6.46	...

Table 8.—RET-CONDITIONAL ON CURRENT LIFE EXPECTANCY

1977 $	Cohort-Age in 1977					
	65+	64-55	54-45	44-35	34-25	<25
Average Tax/Family	7,058	22,491	40,305	62,644	84,883	....
Average Ben/Family	49,400	47,336	55,824	64,781	70,021	....
Average Net Ben/Family	42,343	24,845	15,519	2,137	−14,862	....
Avg. Net Ben as % Tax/Family	600	110 47	38 50	3.41	−17.51	....
Total Taxes pd by Cohort (bill)	172 1	236 6	355.7	382.3	508.4	712.9
Total Bene pd to Cohort (bill)	1282 2	525.7	465.4	395 3	396.7	....
Transfers as % of Total Ben	86.58	55.0	27 88	3.29	−28.18	....

will decline substantially with the later retirement. This decline becomes progressively more important as we approach the younger age Cohorts and reflects the importance of doing something about the long term deficit as soon as possible before enormous implicit obligations which are currently funded become cemented in place and we are forced to go to enormous tax creases to fund them.

This is vividly documented by comparing RET with the two tax scenarios—tax 80, a very small tax increase now which will totally close the deficit and tax 2030 a large tax increase to finance the baby boom generations retirement at that date. Estimates for the latter two alternatives are contained in Tables 9 and 10 respectively. The average tax and average benefit paid and received per family look rather similar to the RET case, the average net benefits differ somewhat. What is most important is the enormous difference in the total benefits received or each Cohort as part of the social security system and the total social security taxes paid for each Cohort. Under either trans, trans 80 or RET, the transfers have been released out of the social security system either directly or indirectly and the total benefits paid to each Cohort are much lower than the implicit unfunded obligation involved in the transfers are paid. The total benefits paid to younger Cohorts differ enormously under the tax 80, and tax 2030 programs, as do the taxes paid. For example, while the total benefits paid to each Cohort are identical under tax 80 and tax 2030, the tame pattern and hence aggregate amount of taxes paid by each age Cohort differ enormously. The aggregate

Table 9.—TAX 80

1977 $	Cohort-Age in 1977				
	65+	64-55	54-45	44-35	34-25
Avg. Tax/Family	7074	18,966	36,839	59,907	84,935
Avg. Ben/Family	49,400	47,640	56,600	63,321	73,576
Avg. Net Ben/Family	42,327	28,674	19,761	6,414	−11,358
Avg Net Ben as % Tax/Family	598 3	151 2	53 64	10 71	−13 37
Total Taxes pd by Cohort	148 3	292 9	617 2	966 3	1840 0
Total Ben pd to Cohort	992 2	754 8	923 4	1069 5	1479 0
Transfers as % of Total Ben	85 05	61 19	33 17	9 65	−24.43

Table 10.—TAX 2030

1977 $	Cohort-Age in 1977				
	65+	64-55	54-45	44-35	34-25
Avg. Tax/Family	7058	18,346	33,883	53,326	73,843
Avg. Ben/Family	49,401	47,640	56,600	66,321	73,576
Avg. Net Ben/Family	42,343	29,294	22,717	12,994	−2.67
Avg. Net Ben as % Tax/Fam	600	159.68	67.05	24.37	− 36
Total Taxes pd by Cohort	147.4	283.7	569.1	861.4	1569.2
Total Ben to Cohort	992 2	754.8	923.4	1069.5	1478.5
Transfers as % of Total Ben	85.15	62.42	38 37	19.46	−7.97

taxes paid by current retirees and by workers aged 55 to 64 are virtually identical under these two scenarios. By the time we get to 35 to 44 year olds, tax 80 has this Cohort paying 100 billion dollars more in social security taxes than if we wait until after they retire to raise the tax rates in order to finance the unfunded deficit. For those aged 25 to 34 the difference amounts to 270 billion dollars! This highlights the importance in choosing a time frame for dealing with the long term funding problems of social security. Choosing to doing nothing about this implies that we are trying to stick younger and younger generations with the bill. Will they be willing to finance future retirement payments at much higher tax rate than now exist?

In summary for this section, we may note the variety of potential strategies, or avenues for disentangling the enormous problems of high and rising social security taxes and dual purpose unrationalized benefits create. We can simple say that we are going to raise taxes by even more than those legislated in the 19977 amendments by an enormous amount, either currently (tax 80), or in the distant future (tax 2030) and try to shift around the burden of paying for these increased social security benefits which are not currently funded, or we can try to rationalize the benefit payments by separating out the transfer and annuity goals of the system, strengthening the earned entitlement function and having a separate transfer payment program funded out of general revenues that whatever level is deemed socially desirable: Such alternatives exist under trans and trans 80; and are easily combined with a slight increase in the retirement age as suggested by RET. These different scenarios suggests that here will not only be an enormous long run impact on our overall economy depending upon which of these types of avenues we pursue, but that different groups in the population will be taxed and benefited disproportionally depending upon which of these alternatives we select. It is time for fundamental refocusing of social security along the lines suggested in the introduction of this paper to rationalize the benefit structure, roll back and indeed eventually decrease the long run burden of payroll taxes, and provide not only a strengthened earned entitlements social insurance program, but a more cost effective and sensible transfer payment mechanism funded out of general revenues.

FOOTNOTES

1. See A. Robertson, "Financial State of Social Security Programs after the Social Security Amendments of 1977," *Social Security Bulletin*, March 1978.

2. They might be defensible on other grounds.

3. This example is taken from D. Parsons and D. Munro, "Intergenerational Transfers in Social Security," *The Crisis in Social Security*, M. Boskin, ed., 1977.

4. In econometric estimates presented by George Perry and John Brittain. See Brittain, *The Payroll Tax for Social Security*, Brookings, 1973.

5. Sensitivity of the "Base Case" estimates to various assumptions were also tested.

6. A fraction of each cohort that is in non-covered industries or who have insufficient quarters of coverage are considered to be ineligible for benefits. Wives who do not qualify on their own or on their husband's behalf receive no benefits.

7. The year of death of an individual was predicted using his or her age, race and sex. Individuals predicted to have died before reaching the age of 65 are excluded from the analysis. Year of death predictions used *The U.S. Fact Book* [1978] for all ages less than 65 and ages 65, 70, and 80. For ages not given, year of death was predicted interpolating from the 1969-71 death rates in: National Center for Health Statistics, *U.S. Decennial Life Tables*, Volume I, Number 1, Washington, D.C.: U.S. Government Printing Office, May 1975.

8. Benefits are increased by 17% for cohort 5 to adjust for widows.

9. The actual dependent variable used was the log of earnings. The independent variables include dummy variables for a Southern location, rural location, race, married, white collar, service collar, blue collar, industry, self-employed. Additional variable included were weeks worked and level of education.

10. Female labor force participation was assumed to keep the same age distribution as in 1975, but to slowly increase for each age group until 2005. The rate increases 12.5 percentage points for each age group by 2005. (This is based on assumptions of the *1977 Annual Report of the Trustees of the Social Security stem.*)

11. Assumptions:

(1) In terms of cohort size, actual population statistics are used for individuals born from 1953 to 1977. Estimates of size for 1978 to 205 were made assuming that birthrates decline from 1.7 to 1.65 in 1980 and then slowly increase to 2.1 in 2005.

(2) Female labor force participation was assumed to keep the same age distribution as in 1975 but to slowly increase for each group until 2005. The rate increases 12.5 percentage points for each group until 2005.

(3) Coverage by the social security system is assumed constant at 90%.

(4) The percentage of women married is assumed constant at 93% based on 1975 data from the *Statistical Abstract.*

(5) Unemployment is assumed constant at 5%.

(6) The mortality rates for each age group remain constant.

(7) The couple retires together at age 65.

All assumptions are based on the assumptions of the 1977 Annual Re9ort of the Trustees of the Social Security Administration.

(8) The wage was adjusted to account for the fact that all income used in the estimates is below the taxable limit since the wage equation a the Social Security Match Tape data are used. The adjustment is based on taxable/total ratio in 1977.

Attachment.

STATEMENT OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS

[By William J Dennis, Jr., Director of Research, Before the Advisory Council on Social Security, July 19, 1983]

On behalf of the National Federation of Independent Business (NFIB), a trade association representing more than 560,000 owners of small and independent businesses, I appreciate this opportunity to present small business views on a major question before this Council. The focus of both my oral remarks and written comments will be on that question—the employment of additional payroll taxes to finance the Medicare program. While I do not pretend to be an expert in the financial needs or lack thereof of Medicare, I do feel competent to advise the Council that recommending additional payroll taxes to finance any projected revenue shortfall is both imprudent and unnecessary.

GROWTH OF THE PAYROLL TAX

The payroll tax in 5 the last of the primary government revenue sources that came into broad usage. A combination of property taxes, customs duties, and excise taxes, most notably on alcohol, had largely financed American governments to 1900. By 1920, both personal and corporate income taxes had been introduced; by 1942, income taxes (personal and corporate combined) accounted for more than 50% of all Federal tax collections. So, when the payroll tax was employed to finance the newly created Social Security and Unemployment Insurance programs in the late 30's, the last step in the gradual shift of the nation's revenue base had begun.

The shift we have witnessed and are now witnessing has moved the principal revenue base from consumption taxes to income taxes and increasingly toward payroll taxes.[1] In the 45 years since institution of the payroll tax, its relative share of Federal revenue has increased from nothing to about 30%. Almost one of every three Federal tax dollars now collected is from a payroll tax.

Chart I illustrates their growth over the last quarter century, along with changes in the shares of other major tax sources. Note that the payroll tax is the only revenue source on the ascent. The personal income tax's share remained constant over the period. But both the corporate income tax and indirect business taxes (excise taxes) have declined significantly as a percentage of the total.

It is important to recognize that these trends have occurred gradually over the years. They have transcended the White House occupancy of any person or any party.[2] And while professions of disdain for this form of taxation abound, payroll taxes have consistently escalated.

Chart 2 presents a 20-year history of the Federal payroll tax from a slightly different perspective. The chart illustrates the period as one of one tax increase followed by another. Observe that between 1970 and 1990, there have been or are scheduled to be 11 FICA tax rate increase totaling 60%, 19 FICA tax base increases making a 630% rise, 3 FUTA tax rate increases creating a 94% jump, and 3 FUTA base increases amounting to 133%.

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[1] The property tax seemingly a constant factor over the period due to its continued dominance at the local level, declined in the face of Washington's expanding role.

[2] Other major changes have occurred as well, most notably in the areas of labor an capital taxes (Douglas H. Jaines, "Estimates of Effective Marginal Tax Rates on Factor Income," *Journal of Business*, April, 981) and in so-called "earned" and "unearned" income (Richard L. Kaplan, "The Shifting Burden of Federal Taxes," *Tax Notes* April 4, 1983).

To personalize Chart 2, the wage/salary experience of three example employees is presented on Table 1. John Doe represents a relatively low wage employee; Jane Doe represents an average employee; Larrymoe Andcurley represents a high wage employee. Between 1970 and 1990, each employee is allocated, for illustrative purposes, a wage/salary increase of between 150% and 200%, the result of both merit and inflation pay raises. Over the same period, payroll tax liability increases amounted to between 300% and 1000%. Thus, while it may argued that individual payroll tax increases are very modest, as indeed they often have been, the accumulative effect has been incredible.

Table 1.—A TWENTY YEAR HISTORY OF FEDERAL PAYROLL TAX INCREASES-ILLUSTRATED [1]

	1970	1980	1990	Twenty Year Increase	
John Doe:					
Wages-Salary	$6,000	$12,000	$18,000	$12,000	(200%)
Payroll Taxes:	672	1,664	3,188	2,516	(374%)
Employer's Share	(384)	(928)	(1,811)	(1,427)	(372%)
Employee's Share	(288)	(736)	(1,377)	(1,089)	(378%)
Jane Doe:					
Wages-Salary	10,000	17,500	25,000	15,000	(150%)
Payroll Taxes:	844	2,338	4,259	3,415	(405%)
Employer's Share	(470)	(1,265)	(2,347)	(1,877)	(399%)
Employee's Share	(374)	(1,073)	(1,913)	(1,539)	(411%)
Larrymoe Andcurley:					
Wages-Salary	20,000	40,000	60,000	40,000	(200%)
Payroll Taxes:	844	3,368	9,156	8,312	(985%)
Employer's Share	(470)	(1,780)	(4,795)	(4,325)	(920%)
Employee's Share	(374)	(1,588)	(4,361)	(3,987)	(1066%)

[1] Includes legislated increases

ECONOMIC EFFECTS OF PAYROLL TAX INCREASES

Who Pays the Tax?

The law reads that employers and employees split the FICA tax; half is paid by the former and half by the latter. The total FUTA tax is presented the employer. But while the law allocates taxes in those proportions, who actually bears the burden?

Everyone seems to agree that the burden of the employee's share of the payroll tax is born by the employee both in the immediate and the long term. However locating the burden imposed by the employer's share is no as clear. Three locations of burden bearing are possible: a. employees, in the form of lower wages or fewer jobs (backward shifting); b. consumers, in the form of higher prices (forward shifting); and c. employers, in the form of lower earnings. Each will be discussed in turn.

a. the employee—

It is a widely accepted tenet among economists of all ideological persuasions that in the long run, employees absorb the employer's share of the payroll tax and any increase in it.

> "The tax, whether nominally paid by the worker or the employer, is bourne by the worker. His employer simply transmits the amount,"

is the typical view.[3]

The argument that employees pay the total tax in the long term is based on the proposition that labor costs (of which the employer's share of payroll taxes is one) can only reach competitive levels. A labor tax increase is simply met with lower wages or greater use of capital (mechanization—both of which fall on the employee. The latter alternative becomes particularly attractive when a legislatively mandated wage, most prominently the minimum wage, becomes a factor.

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[3] Milton Friedman, "Payroll Taxes, No; General Revenues, Yes," *The Crisis in Social Security Problems and Prospects* (ed.) Michael J. Boskin (Institute or Contemporary Studies: San Francisco, CA), 977, p. 26.

If indeed the view that employees ultimately pay the employer's share of payroll taxes as well as their own is correct, Chart 3 presents a startling view of the payroll tax's regressive nature [4] and its total cost to wage earners. Note the line representing Federal income tax as percentage of gross income.[5] Income tax liability is zero (the low income credit is not included) until just less than $7,500, at which point the personal income tax "kicks in." Tax, as a percentage of gross, then travels upward in a convex arc until the $50,000 level at which the average taxpayer will be paying approximately I of his gross income in personal income taxes. Compare that to the line marked "Payroll I." Assuming that the only payroll tax paid by the employee is a 50% share of FICA, we can conclude that taxpayers earning less than $15,000 a year pay more in payroll taxes than income taxes, and those earning more than $15,000 a year pay more in income taxes than payroll taxes.[6] However, suppose employees actually pay both the employee and the employer share, as is generally argued in the economics literature ("Payroll II" on Chart 3). Then the cost to employees from the payroll tax (in terms of direct payments and wages foregone) more than doubles, and instead of $15,000 being the intersection point at which the form of taxation providing the greater burden changes, the intersection point moves to the $35,000 range. In other words, the average family of four earning $35,000 will pay more in Federal payroll taxes (directly and indirectly) than in Federal personal income taxes, assuming the employee absorption argument is valid.

Chart 3 would be altered somewhat if state income and payroll taxes were added. The exact alteration would depend on the state and its tax structure. However, any change will be modest, meaning that the relative share of payroll taxes under scenario "Payroll" and income taxes are reasonably represented in Chart 3 whether from the Federal or Federal and state perspective.[7] "Payroll I" would be proportionately smaller if state taxes were added.

b. the consumer—

Most of the discussion on the backward shifting of payroll taxes is focused on an undefined "long-term." But, as a practical matter, even if the employee absorption argument is accepted as an accurate description of long-run phenomena, common sense tells us that every payroll tax increase is not met by an immediate wage and benefit reduction and/or the dismissal of employees. The employer's share of the

[4] It is argued that the progressivity-regressivity of taxes must include the benefits the tax provides. If a "regressive" tax has "progressive" benefits, for example, then the tax structure may be neutral or even progressive. See, Edgar K. Browning, "The Burden of Taxation,' *Journal of Political Economy, August, 1978, as an illustration.*

Robert M. Ball, a former Commissioner of Social Security, in his book *Social Security: Today and Tomorrow,* (Columbia University Press: New York, N.Y.), 1978, attempts to make that argument for payroll taxes financing the cash benefits program (OASI) of Social Security. Mr. Ball believes that a regressive tax structure is offset by a progressive benefit structure, a view which totally fails to recognize major shifts in taxes and benefits over time and the manner in which succeeding age cohorts are treated relative to one another. The same claim was not made for the DI or HI portions of Social Security or Unemployment Compensation, the latter being a payroll tax funded program which lay outside the purview of Mr. Ball's work.

[5] Chart 3 was developed to present a reasonable illustration of the tax burden of individuals of varying gross incomes by major form of tax for he year 1983. The personal income tax calculation assumed a worker, spouse, and two dependents. The standard deduction was employed until the $15,000 level, at which point the standard deduction was multiplied by the percent of taxpayers taking it, added to the average of deduction for interest, state and local taxes, health care, and contributions, multiplied by the percentage of taxpayers itemizing. The result was assumed to be the average deduction. While the latest data available on itemizing was 1981 and all deductions were not listed, the general pattern of the income tax as graphed is a reasonable representative of reality—certainly much more so than employment of the standard deduction throughout. The "Payroll I" calculation was straightforward—50% of the FICA tax on the base. The "Payroll II" calculation assumed the entire FICA tax on the FICA base plus the entire Federally collected FUTA tax on the FUTA tax base. The resulting figure was then divided by gross income. It could be argued that a more appropriate representation of "Payroll II" would be to divide the calculated tax figure by gross income *plus* the "employer's share." If the calculation were made in this manner, the line representing "Payroll II" would drop somewhat, placing the intersection of "Income" and "Payroll Tax II" at about the $30,00 level.

[6] This would roughly correspond to some calculations developed by others which demonstrate that payroll taxes are not as relatively large as is commonly thought. For example, see Bruce D. Schobel, "A Comparison of Social Security Taxes and Federal Income taxes," Actuarial Note 102, Social Security Administration, April, 1981.

[7] Adding state income and payroll taxes would have the effect of raising both the "Income" and "Payroll II" figures. However, their relationship to one another would remain fundamentally unchanged on a state by state basis, due largely to the deductibility of state and local taxes which mute the impact in relatively high state taxes.

payroll tax in increase must, therefore, be financed in another manner, at least temporarily.

The most obvious possibility is for the employer to pass on the tax increase in the form of higher consumer prices. Since employment taxes are part of total labor costs and total labor costs are part of product costs, an employee wage tax increase might theoretically filter through the production-distribution chain until it is ultimately plucked from the consumer's pocket. The employer effectively then only serves as the government's collection agent.

In fact, there is increasing evidence that some portion of payroll tax increases are forward shifted and not just in the short-run. The Congressional Budget Office has even incorporated some forward shifting into its simulations. CBO estimated, for example, the impact of the GNP deflator of the Social Security Finance Act of 1977 to be 0.5% over a four year period.[8] Nor is CBO alone in viewing forward shifting as a temporary phenomenon. Independent estimates have resulted in evidence that 50% or more of the increase is passed on to the consumer in the form of higher prices.[9]

From the perspective of the employer, passing on increased costs is a happier solution to wage tax increases than is either back-shifting or absorbing the increase. And while evidence exists that forward shifting occurs, most of the empirical studies establishing the forward shifting phenomenon were conducted using data from the 70's, a period of historically high inflation rates, arguably permitting the pass through of costs with some degree of ease. In fact, it will subsequently be argued that cost pass-throughs, at least for small businesses, were relatively easy during the late 1970's, but beginning in 1980 matters reversed themselves; cost increases became incredibly difficult and later impossible. Thus, the cost pass-through hypotheses may have validity, but only under certain conditions.

c. the business—

The consensus among economists is that businesses do not pay any portion of the payroll tax. In the long-run, employees absorb the employer's burden in one fashion or another. Some forward shifting may occur in the longer term also, but those cost pass-throughs are principally a short-term phenomenon. Between the two (backward and forward shifting), payroll tax increases are handled with none but the most passing effect on business. Yet business, particularly small business, continues to complain over the impact of payroll taxes.

There is evidence at least from the small business population, that the complaints of entrepreneurs have more than a little merit. Charts 4, 5 and 6 summarize the small business profit, price, and employment experience over the past 6½ years by two classes of small firms—borrowing small businesses and non-borrowing small businesses.[10] Since borrowing adds a fixed cost (interest), it is assumed for analytical purposes that the disposition of interest costs reasonably represents the disposition of other fixed costs such as payroll tax increases.[11]

Charts 4, 5 and 6 each contain two distinct periods: IV/76-IV/79 and IV/80-II/83. Over the first three-year period, borrowers, presumably those firms with higher fixed costs, increased employment and prices more rapidly than did non-borrowers, presumably those with lower fixed costs. However, a quarter-to-quarter change in net earnings showed little if any difference between the two groups. The second period was considerably different. Both borrowers and non-borrowers raised prices in almost identical fashions, but the borrowers (high fixed-cost firms) had considerably poorer employment performance. Meanwhile, the change in net earnings data showed non-borrowers (low fixed-cost firms) doing considerably better than borrowers, though the entire population was subject to a general slide.

These data strongly suggest that business, at least small business, must simply absorb fixed cost increases during certain periods. They don't have the luxury of totally forward or backward shifting costs. That is not to say that small firms absorb all fixed cost increases all the time, as is evidenced by the first period on the Charts. But as will be argued later, an extended period of fixed cost absorption can't be tolerated by small firms for the same reason they cannot use 7-year carry-forwards and carry-backs; small businesses simply can't survive long enough.

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[8] *Aggregate Economic Changes in Social Security Taxes, Technical Analysis Paper, Congressional Budget Office, August, 1978.*

[9] Hammermesh estimates, for example, that after an adjustment period, ⅔'s or more of the increases are forward shifted; the remainder are backward shifted. See, Daniel Hammermesh, "New Estimates of the Incidence of the Payroll Tax," *Southern Economic Journal, April, 1979.*

[10] Data drawn from: *Quarterly Economic Report for Small Business,* (National Federation of Independent Business: San Mateo, CA), various editions.

[11] Sales change among borrowers and non-borrowers are almost identical, eliminating any effect produced from this potentially significant intervening variable.

The Decision to Work and by How Much

Among other effects, taxes alter the relative price of things. For example, a 5c/gallon tax on gasoline raises the relative price of gasoline and lowers the relative price of all other goods and services. The same effect occurs with a payroll tax. Labor becomes relatively more expensive (at least until the added cost can be shifted forward or backward) vis-a-vis capital as does the cost of work vis-a-vis the cost of leisure.

We know the employee's share of payroll taxes directly reduces his take-home pay; the employer's share indirectly reduces it, too. Hence, the cost of work to the individual is raised by payroll taxes.

The effect of payroll tax increases on the labor supply in practice has generally been found to have a differential impact on two groups.[12] Prime age (25-55) married males have been found relatively unresponsive to net wage changes.[13] Apparently, social and economic factors make work (a job) for adult males an accepted practice and non-work (no job) a non-accepted one. However, teenagers, married women, and elderly workers have been found highly sensitive to such changes. Raise take-home pay and they enter the market; lower take-home pay and the opposite occurs. Female, heads of household fall in the middle.

One largely unaddressed question is whether potential employees in the impacted group voluntarily choose leisure over work or whether the choice is made for them. Since there is a surprisingly high correlation between "secondary workers' such as those found to be highly sensitive to changes in take-home wages and minimum wage earners,[14] is probable that employers often make the choice for the employee by reducing available employment in these kinds of jobs. Since employer in the long run cannot backshift the tax increase to a minimum wage employee through the wage structure due to legal constraints, they achieve the same effect through job elimination. In effect, a payroll tax increase for a minimum wage earner has the same effect on the employer as does a minimum wage increase. And an entire economic literature has developed on the disemployment effects of that political expediency.

CEO estimated that through 1982, the 1977 Social Security Financing Act added 0.3% to the unemployment rate.[15] The distribution of that employment reduction over varying socio-economic groups is not clear. Nonetheless, it is likely that distribution bears a strong resemblance to those groups with considerable elasticity in the labor supply.

THE SMALL BUSINESS INTEREST

A majority of small businesses pay more in payroll taxes than in any other form of taxation.[16] It shouldn't be surprising, therefore, that small businessmen and women are concerned about the current level of payroll taxation as well as its future course.[17] However, the small business interest in payroll taxes is often considerably more subtle than the straightforward payment of a tax which cannot be backward or forward shifted.

The primary problem for a small business (assuming 100% backshifting) is alteration in the competitive abilities of various firms. Some firms competitively benefit; some firms lose. As a group, small business falls in the latter class. The small business competitive disadvantage occurs for three reasons: 1. the deductibility of wage axes from income taxes is less useful in the 15% bracket than in the 46% bracket; 2. the wage base provides a competitive advantage to higher wage and more unionized businesses; and 3. small firms are more labor intensive that are large firms.

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[12] Harvey S. Rosen "What Is Labor Supply and Do Taxes Affect It?," *American Economic Review*, May, 1980.

[13] Some recent work disputes the consensus view on prime age married males. Hausman concludes prime age married males reduce work by approximately 8% due to combinations of taxes. See, Jerry A. Hausman, "Labor Supply," *How Taxes Affect Economic Behavior*, (ed.) Henry J. Aaron and Joseph A. Pechman Brookings Institution: Washington, DC), 1981.

[14] Edward M. Cramlich, "Impact of Minimum Wages on Other Wages, Employment and Family Incomes," *Brookinge Papers on Economic Activity.* 2:1976

[15] *Aggregate Economic Effects of Changes in Social Security Taxes, op. cit.*

[16] *NFIB Fact Book on Small Business* (National Federation of Independent Business: San Mateo, CA), February, 1979. For the tax liability of five hypothetical, though typical, small businesses located in 17 different states, see *Relative Burden of Federal State and Local Taxes on Small Business*, Touche Ross an Co., (ed.) Sharon Virge, (National Federation of Independent Business: San Mateo, CA), 1982.

[17] *NFIB Small Business Problems and Priorities* (National Federation of Independent Businesses: San Mateo, CA), April 1983.

Graduation in the Federal corporate income tax was permanently codified in 1978 (prior to that time it had been temporary) in order to equalize the effective tax rates of larger and smaller corporate taxpayers. While certainly very desirable from the small business perspective, its perverse effect was to raise the relative cost of payroll taxes to small firms. For example, if two firms each had $100 in payroll tax expenses and one paid income tax at the 15% rate while the other paid the 46% rate, the latter firm would clearly find any increase in payroll taxes a competitive advantage.

Second, the wage base provides those businesses with relatively highly paid employees a competitive advantage. Simply put, the advantage arises because the tax is paid on a lower percentage of total payroll. However, the problem has increasingly become a function of the FUTA rather than FICA wage base. Over the past decade, the FICA wage base has risen more rapidly than the wages on which it applies. The result has been a substantial reduction (estimated at .629% of payroll in 1971 to .170% of payroll in 1979) in the advantage of larger firms although it still exists.[18] The same is not true on FUTA, however.

The Federal FUTA base is $7,000. While most states utilize that figure as well, nineteen states have higher bases with the largest in the continental U.S. being Utah at $14,800. Table 2 provides the distribution of employees by firm size and wage class. Observe that the FUTA wage base is such that the percentage of payroll covered is considerably higher for small firms than larger ones.

Table 2.—DISTRIBUTION OF EMPLOYEES BY FIRM SIZE AND WAGE CLASS—1980

Annual Wages	Small Business	Large Business
Under $10,000	29.9%	16.9%
$10,000-$20,000	46.5	49.1
Over $20,000	20.0	36.6

SOURCE SEA

The third reason or competitive alteration caused by payroll taxes lies in the labor intensive nature of smaller firms. able 3 has been developed from data found in *Social Security: A Tax on Labor* produced by SEA's Office of Advocacy.[19] Observe that small business is more labor intensive than larger firms when measured by either payroll as a percent of sales or OASDI taxes as a percent of sales. Both indicate the existence of about a 15% difference.

Table 3.—LABOR INTENSITY BY FIRM SIZE AND INDUSTRY—1977

Industry	Small Firms	Large Firms	All Firms
All	[1] 14.4 [2] (1.9¢) +	12.3 (1.7¢)	13.4 (1.8¢)
Mining	9.7 (2.6¢)	9.7 (1.3¢)	12.1 (1.6¢)
Manufacturing	23.5 (3.1¢)	16.3 (2.2¢)	17.8 (2.4¢)
Wholesale	6.5 (0.9¢)	3.0 0.4¢)	4.6 (0.6¢)
Construction	23.4 (3.1¢)	29.1 (3.9¢)	24.5 (3.3¢)
Retail	12.3 (1.6¢)	12.6 (1.7¢)	12.3 (1.6¢)
Service	2.6 (4.6¢)	35.0 (4.7¢)	34.1 (4.7¢)

[1] Payroll as a percentage of sales.
[2] OASDI taxes per dollar of sales.

The curious part of Table 3 is the industry by industry comparison. Note that large firms are significantly more capital intensive than are small firms in the mining, manufacturing, and wholesale sectors. I retail and service, small firms are marginally less .abor intensive than large firms, and in the construction industry they are considerably less so. It is of doubtful coincidence that in the former three

[18] Joel Popkin, *The Differential Impact of Payroll Taxes on Small Business vs. Large Business* (progress report), mimeo, December 15, 1982.
[19] Social Security: A Tax on Labor (Office of Advocacy, Small Business Administration, Washington, D.C.), January, 1983.

industries, small business has been and is losing market share rather rapidly; in the latter three industries, small business remains a vibrant force.

The competitive balance is altered in another way as well. Small businesses have minimal "staying power." Most simply do not have the financial resources to withstand prolonged periods of negative or very poor positive earnings. Thus, even though the full cost of the employer share may be backshifted in the long-run, small business often can't reach the long-run. The concern is survival in the short-run.

As has been pointed out earlier, there is strong evidence from the small business population that increased fixed costs can't always be back or forward shifted. In those cases, the small business must directly absorb any payroll tax increase. Absorbing the increase makes the small firm more vulnerable financially than it would ordinarily, and in the case of new firms, the blow could be devastating.

THE PAYROLL TAX AND MEDICARE

> "There is no ease to be made for the present payroll tax as part of the general tax system. From the point of view of in ome-base proponents, it should be incorporated into the personal income tax. From the point of view of consumption-base proponent it should be replaced by a personal expenditure tax." [20]

The quotation just reproduced is a clear expression of a rather widely agreed upon analysis.[21] Yet, the author that provided it immediately goes on to suggest maintenance of the tax, albeit in a modified form, due to the "context" in which the program (Social Security) exists.

Actually, there are two "contexts." The first is the commonly held belief that payroll taxes are used to finance "social insurance" programs. The second is the political context in which each group with vested interests to protect uses the payroll tax as a means to leverage their higher priorities. Unfortunately, both contexts are perpetuations of myths which, if ever true, have certainly outlived their utility.

The alleged social insurance programs financed by the payroll tax have never been insurance programs in any meaningful sense of the word. While the Social Security cash benefits program has always contained a crude relationship between taxes paid and benefits received, for example its essential nature is that of a massive inter- and intra-generational transfer program. On the other hand, Medicare (also a massive inter-generational transfer program) provides benefits which bear little relationship to family income or wage experience. And though Unemployment Insurance might be broadly termed insurance from the perspective of the employer, the lack of adequate experience rating scales often introduces large "socialization" elements which undercuts the insurance concept in that program.

The myths of social insurance and payroll taxes have been reinforced by political expediency. The political right usually adopts the position that payroll taxes are a necessary evil in order to retard the overall growth of social insurance spending and to maintain some semblance of fiscal discipline. Evidence of that dubious logic in that position can be found in the '72, '77, and '83 Amendments and a $200 billion Federal deficit. The political left, on the other hand, though often not reticent to employ general revenues, tend to believe that at least some payroll taxes (contributions, as the are euphemistically called) assure payment of benefits as promised and payment without a means test being instituted. Of course, the thresholds of income taxation on Social Security and unemployment benefits, the creation of SSI, and the '83 Amendments challenge the efficacy of that position.

It was not until the 50's that funding Social Security from sources other than payroll taxes became heresy.[22] Despite the heresy, there is a long history of government panels recommending the introduction of general revenues at some point. The Committee on Economic Security, as early as 1935, indicated some general revenues would be needed by 1965. Advisory Councils on Social Security in 1943 and 1948 made similar recommendations. Since 1965 the recommendation has become almost pro forma for Social Security advisory bodies. In fact, your immediate predecessors concluded that

> "The time has come to finance some part of social security with nonpayroll tax revenues. The majority of the advisory council recommends that the

[20] Richard A. Musgrave, "A Reappraisal of Financing Social Security," *Social Security Financing* (ed.) Felicity Skidmore, (The MIT Press: Cambridge, Mass. 1981, pp 110-111.

[21] There are some arguments in favor of payroll taxes of which ease of enforcement and collection is probably the most compelling.

[22] Marilyn E. Manser "Historical and Political Issue in Social Security Financing," *Social Security Financing, op. cit.*

hospital insurance program be financed entirely through earmarked portions of the personal and corporate income tax . . ."[23]

It is not my purpose to argue that Medicare should be financed from the income tax, nor is it my purpose to argue that it should be financed from consumption based taxes. It is my purpose to argue that Medicare should *not* be financed through payroll taxes. Further, it is my argument that the "contexts" which allegedly require maintenance of the payroll tax are irrelevant.

There exists no rational link between the payroll tax and the provision of medical benefits to the elderly. If it is assumed that the need for medical care is a random phenomenon among individuals of any age, then financing that type of health insurance through a system of taxes based on percentage of income implies significant cross-subsidization. Such subsidization means automatically that the payroll tax is a totally inappropriate means to finance the program. Further, it is clear the political expediency arguments of both the political right and political left have little merit. Events subsequent to their adoption has made them largely moot. Thus, there no longer remains a context behind which income-based and consumption-based proponents can hide.

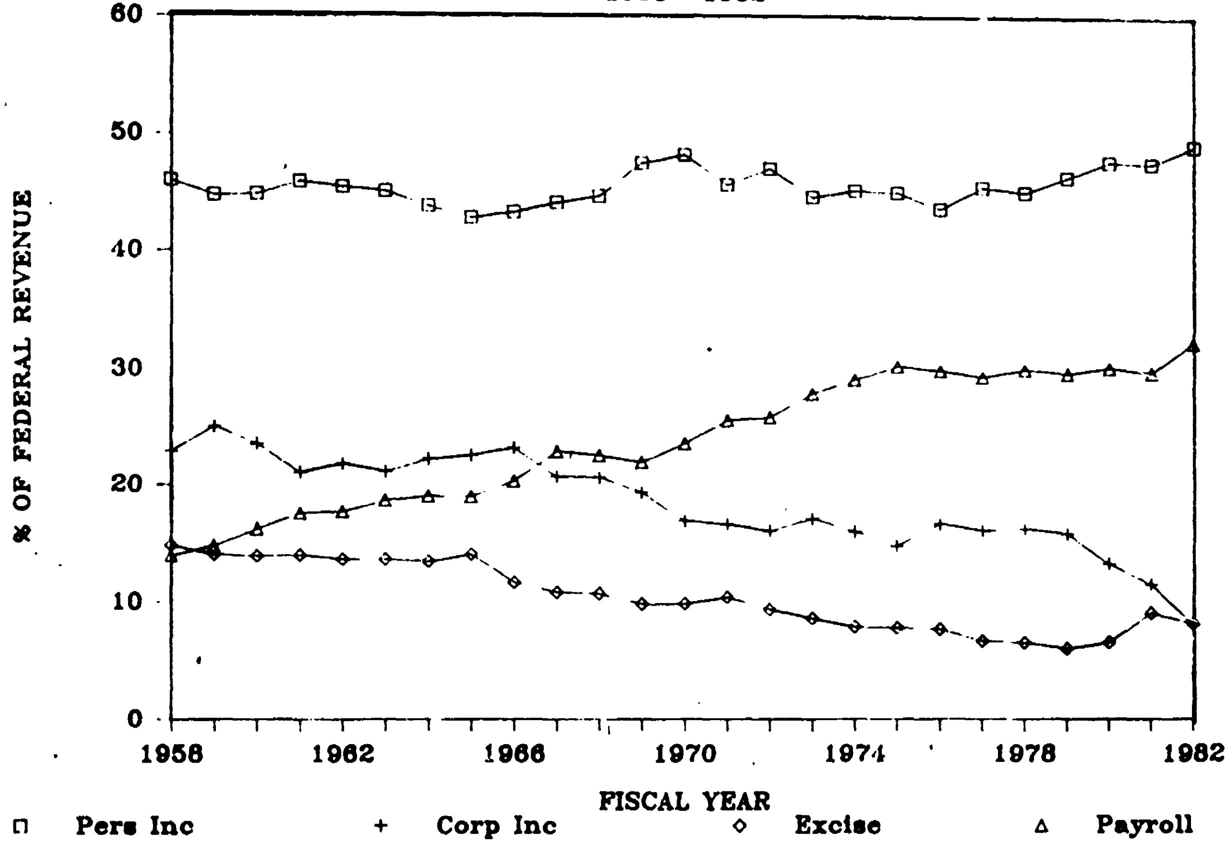
It is clear that payroll tax increases are no longer a viable means to raise revenues. NFIB urges the Council to recognize that first, and then make its recommendations.

[23] *Reports of the 1979 Advisory Council on Social Security* (Government Printing Office: Washington, DC), 1979, p 35.

CHART 1

SELECTED SOURCES OF FEDERAL REVENUE

1958 -1982



A TWENTY YEAR HISTORY OF
FEDERAL PAYROLL TAX INCREASES*

1970	FICA RATE	
	FICA BASE	FUTA BASE
	FICA RATE + BASE	
	FICA BASE	
	FICA BASE	
	FICA BASE	
	FICA BASE	
	FICA RATE + BASE	FUTA BASE
	FICA RATE + BASE	
1980	FICA BASE	
	FICA RATE + BASE	
	FICA RATE + BASE	FUTA RATE
	FICA BASE	FUTA RATE + BASE
	FICA RATE + BASE	
	FICA RATE + BASE	FUTA RATE
	FICA RATE + BASE	
	FICA BASE	
	FICA RATE + BASE	
	FICA BASE	
1990	FICA RATE + BASE	

Summary
FICA Rate - 9 increases totaling 60%
FICA Base - 19 increases totaling 631%
FUTA Rate - 3 increases totaling 94%
FUTA Base - 3 increases totaling 133%

FICA = Social Security Taxes
FUTA = Unemployment Taxes

* includes currently legislated increases

CHART 3

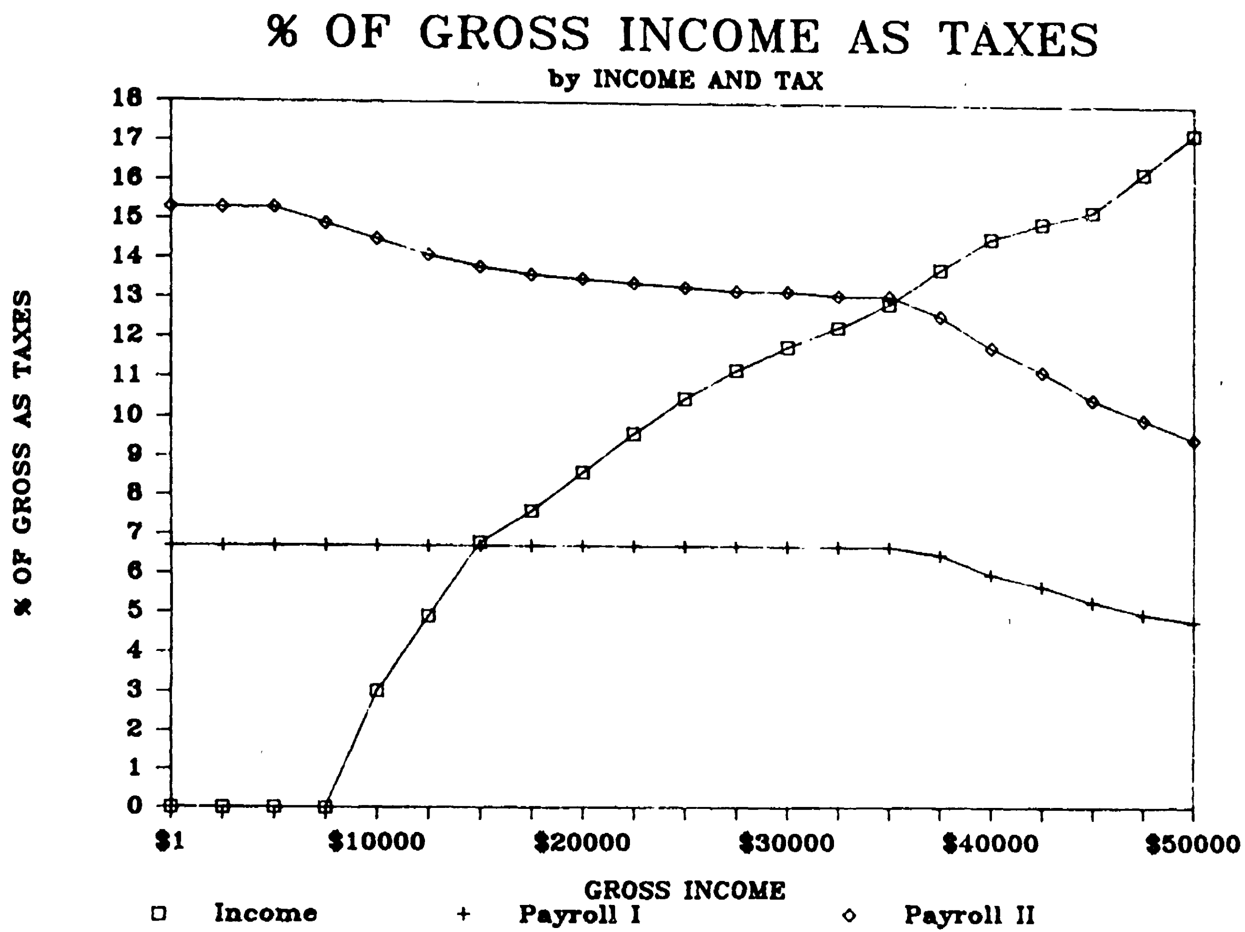

% OF GROSS INCOME AS TAXES
by INCOME AND TAX
% OF GROSS AS TAXES
18
17
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
$1
$10000
$20000
$30000
$40000
$50000
GROSS INCOME
Income
Payroll I
Payroll II

CHART 4

NET EARNINGS CHANGE

by BORROWERS AND NON-BORROWERS

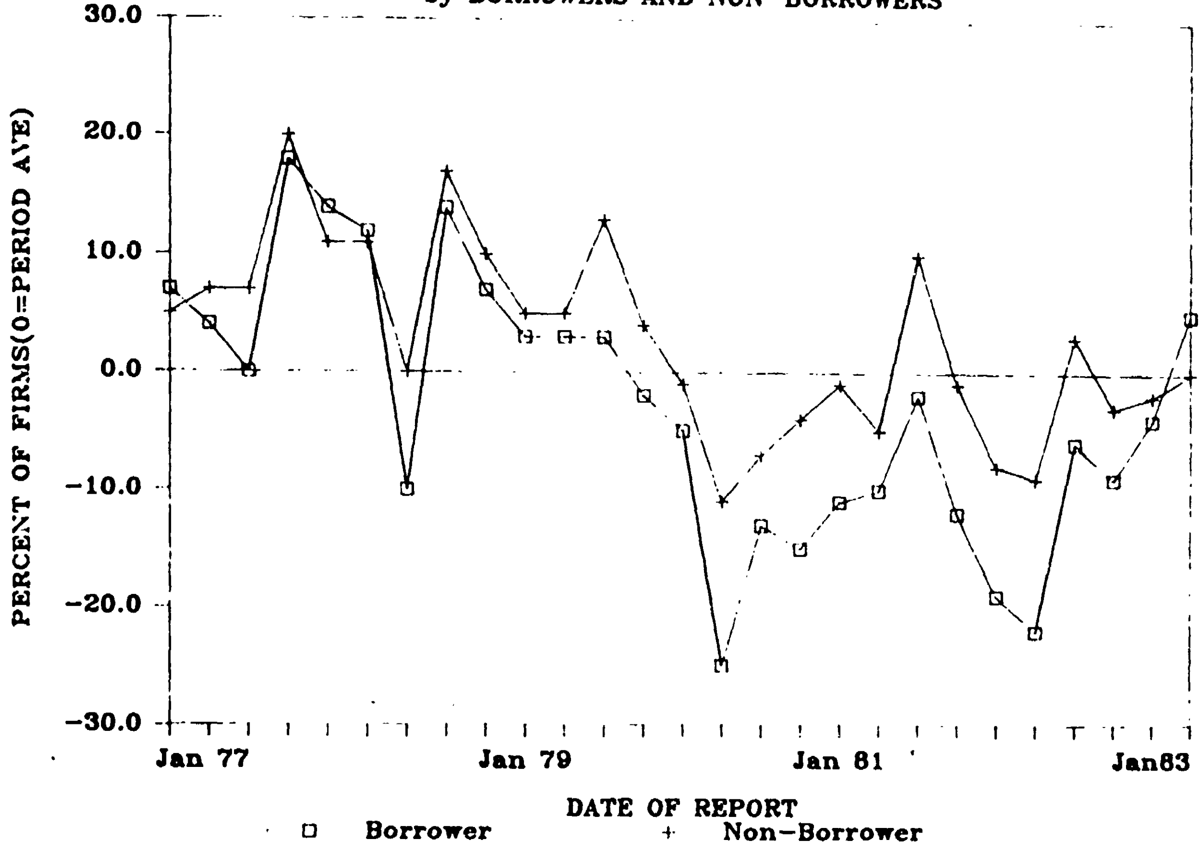


CHART 5

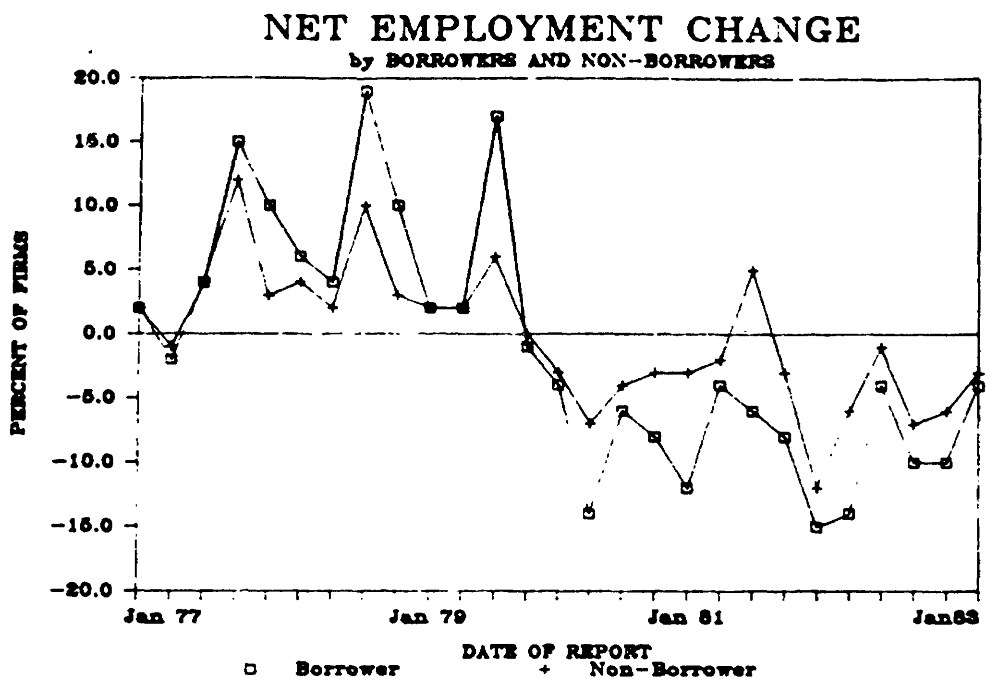
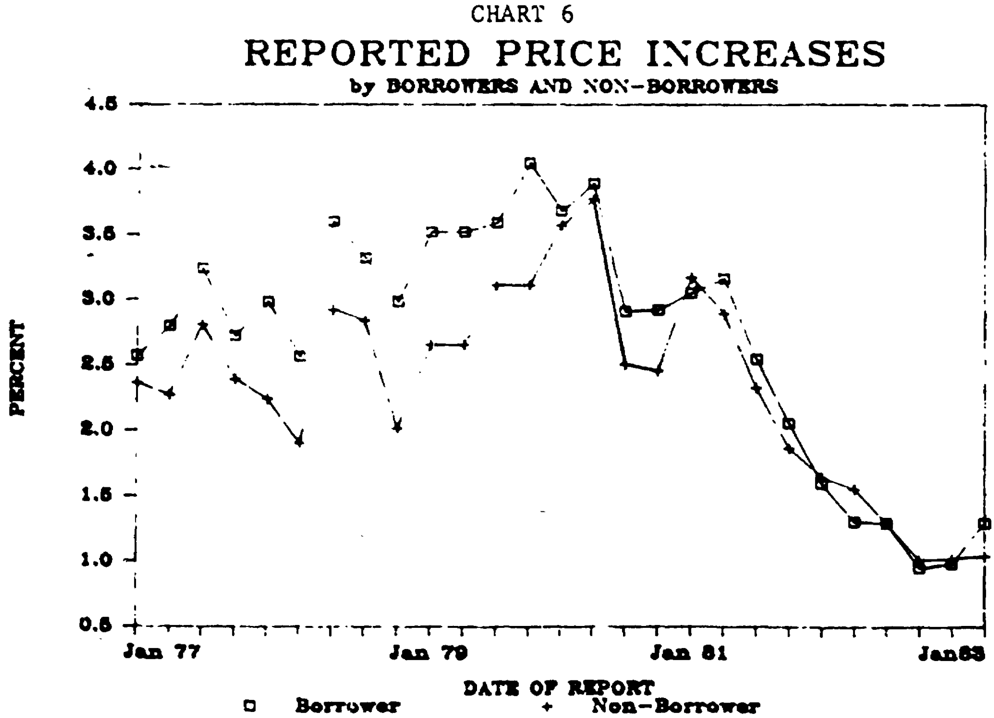
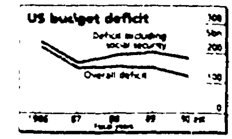


CHART 6



The urge to splurge



Washington's motto: cut taxes, spend the peace dividend, hang the deficit

AMERICAN politicians must be worried that their budget deficit might, from sheer neglect, dwindle as an economic danger. This would explain some recent initiatives, like Senator Patrick Moynihan's proposal to cut the social-security tax. When President Reagan first called for social security to be taken "off-budget", fiscal conservatives such as Mr Moynihan saw the issue as a distraction from the deficit-cutting job at hand. Now many see it as a way to embarrass President Bush, and the deficit be damned. As a result, in 1990 Congress might cut the capital-gains tax, (Mr Bush's idea), cut the social-security tax (Mr Moynihan's idea) and spend the as-yet-tiny "peace dividend" several times over.

Some will find that prospect thrilling. The architects of the next Gramm-Rudman law might again win headlines worthy of their legislative talents. And the revolutionary guards of Laffer-curve economics, indifferent to the size of government borrowing (but ready to blame the Federal Reserve for any financial-market mayhem that results), are already chanting their approval of both Mr Bush and Mr Moynihan. Others might wish to separate sense from nonsense in this increasingly confused debate.

Put fiscal wisdom first

Mr Bush is right to attack America's present capital-gains tax, because, among other things, it favours debt-finance over equity-finance. Mr Moynihan is right, too: the social-security tax is regressive, and a big disincentive for middle-income Americans. But neither man deserves to be taken seriously. Mr Bush was once ready to accept a temporary cut in the capital-gains tax, which would have remedied none of its defects while handing a windfall to the rich. Mr Moynihan wants to cut the social-security tax and eliminate the programme's surplus. This ignores the main anomalies and leaves the rationale for the system as a whole in doubt. Messrs Bush and Moynihan are both playing politics.

As long as the deficit remains a worry, responsible tax-reformers should stick to revenue-neutral proposals. Such reforms might sensibly include changes to the capital-gains tax. Applying the tax only to gains in excess of inflation (as in Britain) would be better than an ad hoc cut in the rate.

Reforming the social-security system is trickier. For a start, beware the much-stressed distinction between (a) the official budget deficit, which includes the social-security surplus (ie, the excess of current receipts over payments) and (b) the "real" budget deficit, which excludes the social-security surplus and is therefore $60 billion bigger. This distinction is false. The only budget deficit that matters is the one that financial markets care about—the public sector's total borrowing. That includes the social-security surplus. If official statisticians separate the two, moneymen will add them back together—and behave exactly as before.

Despite that, Congress could still choose, if it wished, to leave the social-security surplus intact while balancing the rest of the budget. The public sector would then run a handsome overall surplus for years. In theory this would build a reserve to pay pensioners the accumulated value of their earlier "contributions", with no need for extra taxes on tomorrow's workers. Mr Bush (with an impressively straight face) says this persistent budget surplus is what he wants.

It looks appealing, but it is unworkable. However dressed up, the surplus would be an irresistible target for spenders and tax-cutters. In any case, the "fully funded" approach is fine for private savings schemes, but makes less sense for what is, in all but name, a tax-and-benefits system. Congress tells people what to pay in, and will later decide how much to pay out; transfers flow within and between generations. These are the hallmarks of a welfare programme, not a voluntary savings plan. Finance it as such: on a pay-as-you-go basis, within a balanced overall budget.

Mr Moynihan favours pay-as-you-go. But on that view the social-security tax ought to be seen as just another tax, and social-security payments as just another form of government spending. It makes no more sense for the two to match than for defined parts of the income tax to be linked to certain sorts of spending. The social-security tax is a bad tax. Reform it—but do not just cut it, as if eliminating its surplus was a good thing in itself. Merge it into the income-tax system, and then collect the present (needed) revenue from a much broader base. How about that, Mr Moynihan?

PREPARED STATEMENT OF CHARLES L. SCHULTZE [1]

Mr. Chairman and Members of the Committee: Thank you for inviting me to testify on the economic aspects of S. 2016, Senator Moynihan's proposal to roll back the recent increases in the social security payroll tax and return the system to the pay-as-you-go approach that prevailed from the mid-1950s to the early 1980s.

Whatever decision you make about the funding of the social security system—leaving the system on an actuarially funded basis or converting it back to a pay-as-you-go system—will not alter certain facts:

1. Starting early in the next century as the baby boomers retire, social security benefit payments will grow substantially as a percentage of national income.
2. One way or the other the taxpayers of the twenty-first century are going to face higher taxes to pay for those benefits—some combination of payroll taxes and the general revenues needed to pay interest on the Treasury securities held by the social security fund.

The only way the current working generation as a whole can "pay" for its own future retirement benefits is to take the steps necessary today to increase national saving, devote the higher saving to investment in productive assets, and so raise the future national income out of which the higher taxes will be paid.

The additional national saving required if this generation is to pay for its own retirement benefits could be generated in two ways: First, through a pay-as-you-go social security system combined with substantial surplus in the rest of the budget, i.e., in the general operating accounts. Alternatively, we could balance the operating budget, and run an actuarially funded social security system; the necessary budget surplus would show up in the social security trust funds and be invested in Treasury securities. In either case the *overall* Federal budget would be in surplus. Each year a significant amount of Federal debt held by the public would, be retired. Those sums would then be available to supplement private saving; the rate at which the nation was accumulating productive wealth would rise, and the future level of national productivity and output would be raised above what otherwise would have bee the case. This generation would indeed be paying for its own social security retirement benefits, rather than shifting the burden to the future.

As my colleague Alice Rivlin has pointed out, there are good reasons of equity and sound politics to choose the second "funded" approach to this goal. In addition, a sound national budget policy is more likely to be justifiable to the public if it aims for a social security surplus and a balance in the rest of the budget rather than a balance in the social security fund and a surplus in the rest of the budget. Whether or not the 1983 report of the National Commission on Social Security Reform actually intended to set up a fully funded system is a debatable but irrelevant nicety; that is what the outcome turned out to be.

Clearly the whole purpose of building reserves in the trust fund is defeated if the social security surplus is not accompanied by something approaching balance in the rest of the budget. And when, under unified budget accounting, the mounting surplus in the social security trust fund actually masks and in effect helps justify a large deficit in the remainder of the budget, the inequity imposed on the next generation is compounded by an inequity to the current generation. The topping of the payroll tax at $50,000 of wage income is justified when it is a payment to a retirement system whose benefits are progressive and similarly capped. But it is an inequitable way levy a tax for the general operating expenses of government.

Senator Moynihan's proposal rightly calls attention to this double inequity of current budget policy. But S. 2016 would deal with the one inequity in a way that sharply worsens the other. In the process it would greatly exacerbate America's already serious problem of undersaving, underinvesting and under-competing.

S. 2016 would increase the *overall* shortfall of Federal revenues, and that's what counts when it comes to determining how much the nation saves. In a few years it would be adding substantially to the overall Federal budget deficit in an amount that, as I shall show in a moment, is much greater than the $55 to $60 billion loss of payroll tax revenues. National saving in the United States—which is equal to private saving *less* the amount absorbed in financing the overall budget deficit—would fall still further below the abysmal level to which it has sunk in the past decade—far below its historical level in our country and the lowest saving rate of any modern industrial nation, in most cases by a wide margin.

[1] The author is Director of the Economic Studies Program at the Brookings Institution. The views set forth here are solely those of the author and do not necessarily represent the opinions of the trustees, officers or other staff members of the Brookings Institution.

THE ECONOMIC EFFECTS OF S. 2016

My Brookings colleague, Ralph Bryant, has employed nine different econometric models to project the consequences of reducing payroll taxes by the amounts suggested in S. 2016.[2] If enactment of S. 2016 were accompanied by unchanged monetary policy, prices would rise substantially in the United States as the higher deficit generated inflationary pressures. And so, Bryant also examined a more realistic scenario in which the additional budget deficits generated by S. 2016 induced the Federal Reserve to tighten monetary policy sufficiently to offset the inflationary potential of the added budget deficits. His estimates of the economic consequences of that scenario—lower payroll taxes accompanied by offsetting monetary policy—are summarized in the table below. The table reports the average result from the nine models. (With permission I would like to submit Ralph Bryant's full write-up of his exercise as a supplement to this testimony.)

ECONOMIC EFFECTS OF S. 2016, ASSUMING OFFSETTING FEDERAL RESERVE POLICY, FY 1992 [1]

Economic Variable	Effect
Short-term Interest Rates	+2 percentage points
Real Long-term Interest Rates	+1½ percentage points
Federal Unified Budget Deficit	+$95 billion
U.S. Current Account Deficit	+$20 billion

[1] Assumes enactment in 1990
Source. Estimates by Ralph C Bryant, Brookings Institution (see text and attached paper).

As the effect of higher deficits and tighter money worked their way through the economy, interest rates would rise substantially above the path they would otherwise have taken—short-term interest rates by 2 percentage points and long-term rates by 1-1/2 points. Both because of the higher interest rates and the higher Federal debt, the budget deficit would increase by much more than the loss of payroll tax revenues. By 1992 some $35 billion in extra interest payments would be added to the almost $60 billion loss of payroll taxes, increasing the overall budget deficit by $95 billion. With the CBO estimate of the 1992 budget deficit as a base, the total (unified) budget deficit in that year would soar to $230 billion. The higher interest rates would boost the value of the dollar and increase the U.S. balance of payments deficit in 1992 by almost $20 billion. The nation's net saving rate, public and private combined, which is already at an appallingly low 3½ percent of national income would fall to under 2-1/2 percent of national income.

Let me add another economic consequence that would follow from any measures which led to a further rise in interest rates. Both economic theory and common intuition tell us that high interest rates particularly penalize the profitability of *long-term* investments. For example, if real interest rates are 4 percent, a *one-year investment* of $100 has to return $104 dollars to make it worthwhile; an increase in interest rates to 6 percent only raises the necessary one year return to $106. But the necessary return to make a *fifteen-year investment* worthwhile goes from $180 to $240, a rise of one-third, when interest rates go up from 4 to 6 percent. Any potential investments that paid off in the $180 to $240 range would be ruled out after the interest rate increase. Long-term investments are especially hurt by high interest rates.

One of the widely heard explanations for America's competitiveness problems and the slow growth of our productivity is that American businessmen are too interested in short-term payoffs, and hence undertake too few long-term productivity improving investments. To the extent this is true—and there is surely some truth in it—the fault may not lie so much with American businessmen, but with a set of national budget and economic policies that have condemned the nation to a long period of extraordinarily high real interest rates.

Mr. Chairman, I agree with Senator Moynihan that our current budget policies are atrocious. But they are atrocious not only—indeed not principally—because they use the regressive payroll taxes to mask large deficits elsewhere in the Federal Government. They are especially obnoxious because they lower national saving, reduce national investment, productivity, and income growth, and leave the next generation with the worst of both worlds—a bulging population of retirees whose benefits have to be paid for and a national income whose growth has been depressed by this

[2] There are six different models but three of them have two separate versions.

generation's consumption binge. But, we should not correct the first inequity by perpetrating an even worse one.

BALANCING PAYROLL TAX CUTS WITH TAX INCREASES ELSEWHERE

Suppose the payroll tax reduction were balanced with an offsetting increase in some other tax that did not have the regressive character of the payroll tax. Would that not set matters straight. Mr. Chairman, there are two problems with that scenario. *First,* except for Senator Hollings I have observed only a deafening silence when it comes to proposals from either party for a specific tax increase to offset the payroll tax reduction. *Second,* if such a tax were proposed and enacted it would very probably remove for the next decade any chance of raising the taxes that are necessary to deal with the current and projected budget deficits.

I realize that for the moment lip-reading has substituted for real deficit reduction. But as Europe reinvigorates itself by forming a true common market and opening economic ties with Eastern Europe, and as Japan continues to grow in productivity, technological capability, and market power, I continue to hope—perhaps naively—that America will finally take the painful steps to end its own decade-long consumption binge and restore its national saving, investment and productivity growth to levels worthy of a modern industrial power. One component of that solution will have to be a substantial tax increase dedicated not to lowering taxes elsewhere but to reducing the budget deficit, eventually to the point where it comes close to balance without reliance on the surplus in the social security funds.

In sum, Mr. Chairman I welcome the renewed debate about budget fundamentals that Senator Moynihan's proposal has launched, while fervently hoping the proposal never gets enacted. I recommend to you the sentiments of an old saying (whether Chinese, Irish, or biblical I cannot recall) "Be careful, you might get what you ask for."

PREPARED STATEMENT OF LAWRENCE T. SMEDLEY

Good morning Chairman Bentsen and members of the Committee on Finance. My name is Lawrence T. Smedley and I am the Executive Director of the National Council of Senior Citizens (NCSC). NCSC is a four and one-half million member organization with over 4,500 local clubs, Area Councils and state affiliates throughout the country. Founded in 1961 in the fight for Medicare and Medicaid, we continue our strong interest in seeing that our nation's seniors are able to live their retirement years in dignity and security.

Old Age Survivors' and Disability Insurance (OASDI) is an indispensable part of the provision of that security. NCSC, along with other senior citizen organizations, fought diligently during the 1983 Social Security reforms to ensure the maintenance of a system which will, in fact, meet its obligations. Since then, we have not rested, but have continued efforts to safeguard Social Security. During the last session of Congress, NCSC, along with Senators Moynihan, Heinz and others, called for the separation of the Social Security Trust Fund from the Gramm-Rudman-Hollings calculation of the Federal budget deficit with a commensurate extension of these targets. NCSC was disappointed that Congress did not then address this issue.

It was then, and is now, our belief that the continued masking of the Federal budget deficit by the Social Security Trust Fund surplus presents a danger to the preservation of, and confidence in, Social Security. The current system creates the illusion that the surplus can be used to pay for general government expenditures; it creates the illusion that the Congress and the President are making actual progress in lessening the deficit; and it creates the illusion that a painlessly redeemable surplus exists for the retirement needs of the "baby boomers." In a word, the current budget system is dishonest. What we need is "truth-in-budgeting" and an honest accounting of the Federal budget deficit. The government should not be claiming the deficit is smaller than it actually is.

For these reasons, the National Council of Senior Citizens applauds Senator Daniel Patrick Moynihan for initiating a national discussion of the long-term status of the Social Security system as well as the dangers of the Federal budget deficit and the need for progressivity in the Federal tax system. We feel the legislation he has introduced has merit.

Clearly, Senator Moynihan brought forth this proposal in part because he believes that, at least in the short run, the government is not likely to balance its books. Therefore, partial pre-funding of Social Security does not provide true savings, as these funds are being used to finance the deficit. Only two ways exist to prevent this practice: one is to balance the Federal budget and allow the surplus to retire part of the national debt; or, two, to stop the surplus build-up and return to a pay-as-you-go program.

Since the prospects of significant deficit reduction in the near future are not very good, consideration must be given to suspending partial pre-funding. However, in the interests of protecting the Social Security system against short-term economic problems, we do believe that a substantial cushion must be maintained. NCSC feels the cushion should be between 125 percent and 150 percent of one year's outgo (15-18 months) and, since the existence of this cushion will mean that some degree of deficit masking will continue, we urge moving the Trust Funds out of the Gramm-Rudman-Hollings calculations even under a return to pay-as-you-go financing.

Once the necessary cushion level is reached, and assuming the deficit has not been brought under control, NCSC supports reductions in FICA OASDI payroll taxes and placing the Social Security program on a pay-as-you-go basis. However, we do hold that, given the demographic changes that will occur in the next thirty years, some measure of pre-funding for the program is both important and justifiable. Important in terms of preserving confidence in the system and justifiable because such funding enhances the prospects for future economic growth, which is essential to the financial soundness of the Social Security system and the economic security of workers and retirees.

Like Senator Moynihan, NCSC would still prefer partial pre-funding of Social Security if it would work as originally intended. We agree with the Senator that the continued misuse of the surplus would make such a build-up inappropriate. However, if the President and Congress make significant reductions in the budget deficit and cease to use Social Security Trust Funds as a source to continue deficit financing, NCSC would support continued partial funding of the Social Security system. In other words, Congress and the President should be put on probation. If they can bring the budget deficit under control by the time a sufficient cushion has been built up, the current FICA tax rates should stay the same. However, if this goal is not achieved, pay-as-you-go financing, as proposed by Senator Moynihan, is the responsible course.

We share Senator Moynihan's concern that the U.S. has the most regressive tax system of any Western nation. There are better ways than cutting the payroll tax to make our tax system more progressive and which, at the same time, will enable our nation to deal with critical national problems.

Specifically, NCSC strongly endorses raising the tax rate for the super-rich from 28 percent to 33 percent (the so-called "bubble") and maintaining the current practice of taxing money from capital gains at the same rate we tax the hard-earned income of average Americans. Progressivity can also be helped by expansion of the Earned Income Tax Credit (EITC), which would further lessen the burden of FICA taxes on the families of the working poor.

NCSC is concerned about the impact of a 55-65 billion dollar loss of annual revenue from the proposed cut in payroll taxes. This could lead to major cuts in other vital programs, other tax increases, increase in the deficit or some combination of these. Senator Moynihan's bill should include provisions that would avoid major cuts in Federal programs.

We cannot endorse the proposal President Bush outlined in his budget message to Congress. For our new President to tell the American people he will begin phasing in "budget integrity" starting in 1993, it sounds like a husband telling his new bride he will phase in fidelity on their fifth wedding anniversary.

In closing, Mr. Chairman, the National Council of Senior Citizens appreciates the time the Committee has given to this important issue. The well-being of a system which almost every American will depend upon at some point in his or her life is a vital concern for our nation. I am confident this Committee will continue to provide the fine leadership it has in the past.

Prepared Statement of Eugene Steuerle

Mr. Chairman and Members of the Committee: Any discussion of Social Security must start with one incontrovertible fact: the Social Security program has been a remarkable success. It has provided a stable source of income for the elderly. It has provided millions with the security of health insurance. Unlike so many other of our attempts to reduce poverty rates, Social Security is primarily responsible for reducing the poverty rate for the elderly below the average rate for the rest of the population.

If I had to summarize in a single sentence why we are having this discussion today, it is that the Social Security System has reached middle age. This is neither a positive nor a negative statement. It is simply a reflection that policy changes toward Social Security being contemplated today are very different from those of the past.

Let me put it another way. The Social Security System we drive around in today is like a Desoto. Now most of the political arguments on Social Security are between those who want to continue driving this Desoto and those who want to abandon it in favor of what came before: the horse and buggy. But anyone who has examined the vehicle closely knows that, along with its extraordinary success, it still contains many components that represent the best technology of a bygone era, not the knowledge of today.

The technology of this bygone era included the following. For several decades, the principal means by which the government would finance shifts in functions would be to increase tax rates on workers, mainly workers at moderate income levels. The evolution of Social Security, for instance, has been so steady that it can be traced by as simple rule of thumb: three percentage points per decade. For almost half a century, by the end of every decade the combined Social security tax rate has been increased by almost 3 percentage points, reaching 3.0 percent in 1950, 6.0 percent in 1960, 9.6 percent in 1970, 12.26 percent in 1980, and 15.3 percent in 1990.

Increases in the Social Security tax rate, along with relative declines in the value of the personal exemption in the individual income tax, are the two most dominant tax increases of the entire post-World War II era. Together they dwarf every other tax change. Together they have successfully paid not simply for the expansion of the Social Security and Medicare systems, but for many other expenditure and tax changes, including expenditures hidden in the tax Code and reductions in both corporate and excise taxes.

These tax increases on workers and households with dependents have been enacted in both Republican and Democratic Administrations, with little fanfare, without conscious choice or recognition by many policy makers, with only occasional publicity, and almost always without a vote during each year that a tax increase actually took place. Debate instead proceeds on the changes paid for by these tax increases. Democrats and Republicans, for instance, most likely will engage in extensive discussions this year on whether or not to provide yet another savings incentive. They will hint that these types of changes pay for themselves. Yet what is the reality? The reality is that these changes cannot be accomplished without increasing the relative tax burden on workers and probably increasing their real burdens as well.

Over and above real tax increases due to real growth in the economy and tax base changes, the 1988-1990 Social Security tax rate increases are responsible for increases in taxes of over $25 billion per year, while Social Security tax rate increases since the end of 1983 raise almost $50 billion annually, and since the end of 1980, close to $80 billion annually.

Let's see what has happened to moderate income workers who still earn considerably less than median income in the economy. As Paul Wilson and I have shown, the direct tax burden of a family that earns cash wages of about one-half median income—that is, a working family with a little more than $20,000 in income in 1990—has gone up from almost nothing in 1948 to about one-fifth of income today.

TAX RATES FOR FOUR-PERSON FAMILIES AT ONE-HALF THE MEDIAN INCOME

[In percent]

Year	Average Income Tax Rate	Social Security Tax Rate
1948	0 00	2 00
1954	0 00	4 00
1960	0 15	6 00
1966	2 72	8 40
1972	4 37	10 40
1978	4 73	12 10
1984	6 50	13 40
1990	5 57	15 30

SOURCE Eugene Steuerle and Paul Wilson, "The Taxation of Poor and Lower Income Workers," in ***Ladders Out of Poverty: A Report of the Project on the Welfare of Families***, edited by Jack A. Meyer, Washington, D C American Horizons Foundation, 1986, and data furnished by Al Lerman, U S Treasury Department Reprinted in ***Tax Notes***, February 16, 1987

AN ANALOGY WITH CHANGES IN THE PERSONAL EXEMPTION

There are some who make an analogy between the recent proposal of Senator Moynihan and the tax reductions proposed by President Reagan in 1981. As is well known, the 1981 reductions had significant effects in later years upon the deficit and also upon the evolution of the budget and the tax system. With our deficit still much higher than sound fiscal policy would dictate as reasonable, the fear is raised that Social Security tax reductions would simply exacerbate deficits for years to come.

I prefer a different analogy. In the late 1970s, I began research on historical changes in the individual income tax. One conclusion drawn from this research was that declines in the value of the personal exemption over time were paying for an enormous range of other regressive and inefficient changes in the tax Code. In addition, this decline in the value of the personal exemption was increasing taxes on the poor and on lower income workers at a significant rate. Finally, households with dependents—not other households—were bearing almost all of this increased tax burden.

This research eventually was to lead to one of the most important liberal-conservative coalitions of the decade of the 1980s: a coalition of those concerned with taxing the poor and those concerned with the taxation of the family. One important member of this coalition, by the way, was the senior Senator from New York, Daniel Patrick Moynihan.

Now, initially, there was great opposition to this coalition from the same group of people who today will tell you that budgetary deficit issues are so important that almost nothing else in the expenditure or tax system matters. When President Reagan, as a result of being presented these data, came out in support of an increase in the personal exemption in 1983, it is true that there was no room in the budget for such an increase. By itself, this proposal was attacked as being fiscally irresponsible.

The formation of this coalition, nonetheless, was invaluable only a year later in the development of tax reform. As Economic Coordinator of the Treasury's tax reform effort, I was allowed to find ways to pay for this change in the personal exemption as part of a broad tax reform package. In the context of other changes in taxes and tax expenditures, an increase in the personal exemption could be made part of program of sound economic and fiscal policy.

I draw this analogy here because I believe the proposal to reduce Social Security tax rates is at the same early stage of development. *To be successful, Social Security tax rate reduction must be into a package that takes into account both short-run deficit concerns and long-run Social Security and Medicare concerns.* A pace of changes, of course, would recognize explicitly what is always true, but sometimes hidden: that every change in expenditures or taxes is balanced by an offsetting change elsewhere. I realize that the conventional wisdom of the day is that government must stagnate because such trade-offs cannot be made. In my view, this conventional wisdom is wrong and reflects a very narrow reading of history.

Why do I think that a package or combination of changes is possible—indeed, eventually unavoidable—in Social Security? As I mentioned earlier, we are driving around in a Desoto. It is becoming more and more incongruous with its surroundings.

What are some of these incongruous features of Social Security?

- It is extraordinarily inequitable. *Two workers with the same amount of income often significantly different rates of Social Security tax.* Those with cash income pay much more tax than those who receive nontaxable forms of compensation.
- *It discriminates against women and minorities who are more likely to receive their compensation in the form of cash* rather than nontaxable fringe benefits. The rapid increase in the rate of growth of fringe benefits add to this discrimination.
- *It discriminates against secondary workers—again, primarily, women—by often giving them absolutely zero benefits for their tax contributions.* In fact, rather than distribute burdens on a more fair basis, this transfer of funds from working women, and decline in household replacement wages for many households with working women, was one of the major ways that Social Security was able to come closer to remaining actuarially sound over the past couple of decades.
- *It discriminates against those who work most of their adult years by giving them absolutely no benefits for several years of work.* Social Security limits the number of years that can be counted toward benefits.
- Although the system as a whole is progressive, *it is turning more regressive as the number of years in retirement increase.* For a typical couple, at least one spouse will be in retirement over two decades. The cost of old age insurance has already

increased by about 113 because more and more years of retirement are supported. Despite a small increase in retirement ages enacted in the 1983 legislation, costs will continue to increase as we move into the 21st century simply because Social Security fails to index for increases in lifespans. Yet these payments to the younger among our elderly are being made by a population of workers who, on average, have lower after-tax incomes, lower wealth, and higher poverty rates than the younger elderly they are supporting. And, by the way, these workers are also supporting their children—a group that has been forgotten for some time now on both the expenditure and the tax side of the Federal budget.

- Because of longer life spans, *the Social Security System is also becoming less progressive among beneficiaries.* In effect, a larger and larger share of benefits go to those less and less in need rather than to those in their last years of life and more likely to have chronic health needs. This issue arose in a draft study that I completed for the Treasury Department entitled: "Financing Health Care for Tomorrow: A Report to the President and to the Congress on Long-term Care and Catastrophic Health Needs." We could easily provide greater long-term care insurance if we were willing to follow the principles on which Social Security was established, but have become increasingly disregarded: that the System is meant to help individuals when they are least able to care for themselves.
- Because a greater and greater share of Social Security benefits are being paid in the form of health benefits rather than cash, *the choices of the elderly are becoming more and more constricted.* Adherence to the principle that the elderly should be given maximum choice over their affairs is now threatened in a subtle way by the enormous expansion in the cost of Medicare, Supplementary Medical Insurance, and Medicaid rather than in an expansion of cash benefits to pay for health needs. (For example, the Federal Government tells you that you must buy acute medical insurance when you may have greater need of insurance for chronic or long-term care needs.)
- *Elderly individuals who work effectively pay significantly higher tax rates than do many other elderly individuals with equal incomes.* In fact, because they engage in leisure activity, these latter individuals may actually have a greater ability to pay taxes.
- *An increasing portion of Social Security taxes and income taxes are doing nothing more than subsidizing suppliers of medical care.* If medical inflation had been constrained since 1965 to the general rate of inflation, Federal, state and local expenditures would be more than $85 billion less today without any decrease in medical services provided.
- And, as every single policy maker in Congress and the Executive Branch knows, *the Social Security/Medicare System as a whole is insolvent.* By waiting for the appearance of a crisis before anything is done, of course, we display the same mentality that has been shown in the savings and loan and Housing and Urban Development situations. We increase significantly the possibility that the inevitable changes will be more inefficient and unfair than necessary.

Let me add that important improvements in the fairness and efficiency of the Social Security tax and benefit structure can be accomplished easily without any change in old age benefits being provided to current retirees and without any decrease in the overall progressivity of the system. In addition, I believe that there are easy ways to put some amount of funding of Social Security off-budget (but not the whole System) without changing benefits, violating budgetary and fiscal policy principles, or changing the overall progressivity of the System.

In summary, Social Security tax rate reduction is a logical consequence of moving away from an era when most major Federal policy changes are required to be financed by workers and those who care for dependents, that is, by those who accept responsibilities in society. Social Security rate reduction should be made part of a package that takes into account deficit concerns in the short run and the long-term structure of Social Security and Medicare in the long run. Rate reduction is a reasonable and essential component of a broad-based attempt to come to grips with some of the clearly regressive, inefficient, and Inequitable aspects of the combined Social Security tax and benefit structure.

Prepared Statement of Robert S. Strauss

I appreciate the opportunity to appear before this Committee to speak about Senator Moynihan's proposal to return the Social Security program to a pay-as-you-go basis.

Testifying after Chairman Greenspan and before this distinguished panel, I have decided to devote my opportunity to a subject I do know pretty well and that is the political process and its relationship to the Moynihan proposal and our current budget dilemma.

Let me commence by saying that it is my absolute conviction with regard to the subject matter of today's hearing that the political process has failed our citizens.

Those of us who live in the public arena—from the Executive and the Legislative branches—to so-called public spokespeople, must take a major part of the blame. Simply put, we have all, without so intending, become a part of a conspiracy of silence and participants in the politics of fear. On a personal note, I well recall the failure of the National Economic Commission I co-chaired, to stand firm and speak out.

We Democrats have concluded, and with some justifiable reason, that if we mention the word "tax" our Republican friends will destroy us with a "tax and spend" label. And contrariwise, our Republican friends have concluded, also with good reason, that if they mention entitlements or Social Security, in any manner whatsoever, we Democrats will use it to destroy them. And believe me, as much as any of you, I understand the realities of such fears on both sides. I know the power of negative advertising and the risks of being downwind of a well-orchestrated attack of half-truths aimed at raising constituent's insecurities.

Conventional wisdom tells us that Walter Mondale lost his Presidential election because he kicked off his campaign by saying he would raise taxes. Conventional wisdom further tells us that George Bush won the Presidency because he said he wouldn't. Take it from one who has been at this a long time that's baloney. Mondale was going to lose anyway, and Bush was going to win anyway.

Yes, we have all been convinced that we'd better be silent on these issues or we'll be hung out to dry. It is simply amazing that we can talk openly about sex, violence, war, condoms, and deviant behavior on television, in the newspaper, and on the floor of the Congress. Yet, we cannot seem to talk honestly and openly about whether or not we need more or less taxes; more or less spending; or what, if anything, we should do about the rising costs of entitlements. We all recall George Bush being accused in the press of boring us to death. I never thought in those days, President Bush would be guilty of scaring us to silence.

So what are we going to do?

My first answer is that whatever we decide to do, we must do it together! My second answer is that we can start by telling the American people the facts as they really are.

With that as a predicate, let's look at the problem. To do so, let me offer a few propositions that I think are reasonably well-accepted givens.

First, we have not had an honest examination of the issues confronting us in the budget and Social Security areas for many years. Senator Moynihan's proposal gives us an opportunity to do so. Maybe it's forced a crack in our own Berlin Wall of indifference. Whatever happens to this proposal in the Congress, the country should be grateful to Senator Moynihan for getting this issue out on the table.

Second, we do not collect enough money to run our government at its current level of activity. The unified budget deficit has dropped from the $221 billion high in 1986 to around $150 billion—where it now seems to be stuck. But as Senator Moynihan's proposal has demonstrated, if you take out the Social Security surplus, there hasn't been any real improvement. On this basis, CBO projects a $249 billion deficit in 1993, a disheartening number.

Third, a "peace dividend," when and if it happens, will come slowly as we reorder our military priorities and our economy adjusts to a slowdown in defense spending. We can't spend what we don't yet have, particularly when we have demonstrated an inability to deal with those constituents who are adversely affected.

Fourth, even with this huge persistent deficit, the $249 billion figure doesn't include the major unmet needs of our nation. To pay for our real environmental demands, fund a proper drug program, clean up nuclear production facilities called for by the Administration's budget, meet the full cost of the S&L crisis, improve the educational standards of our poorest citizens, repair our infrastructure, among other things, will cost more money than we are currently spending.

Fifth, by any measure the rate of private savings in this country is low—low by international standards and low by our own historical experience. We need savings to sustain the level of investment on which long-term growth depends. What savings we do have are, to a great degree, used to finance the budget deficit.

Now despite the above, most say we've certainly done all right over the last few years. I disagree. In fact, we have borrowed and consumed, borrowed and consumed until we appear to have fashioned our fiscal policy out of Mae West's personal philosophy, that "There's just no such thing as too much of a good thing." By 1990, the trends of the last decade are obvious. We were building up our net asset position in the world until 1982. We reversed that trend and in three years—by 1985—we became a net debtor nation. Few realize it but we are losing market share in almost every industry—a startling fact. If the rest of the world were to let us continue this level of borrowing for the next twenty years, when the baby boom retirement begins, we would be in hock to the rest of the world to the tune of over $5 trillion. Of course, the rest of the world won't let us do it. As a matter of fact, I don't know what would be worse—if they let us do it or if they don't. I would remind you of the British experience. They once operated as we are now operating. And they finally had to pay for it by selling off, in a few short years, the British Empire that had taken them 300 years to build. This may seem either foolish or alarmist, Mr. Chairman, but as we all know, the gross public debt of this country—including that held by Social Security and other trust funds—has grown from $900 billion in 1980 to $3 trillion today. Today, gross interest on the debt alone represents 22 cents of every tax dollar we spend.

It has been my long held political belief that if the American people are given clear alternatives by their leaders with an explanation of the costs and benefits of each—they will make the right choice. This is not the same thing as saying that they will respond rationally to every question put to them in public opinion polls. The voter has plenty to do without becoming an expert on how fast we can decrease our military commitments in Europe, or why Medicare costs are rising so fast, or what a value-added tax would do to interest rates. Poll takers aren't the answer. It is the responsibility of the political system to articulate options in a way that provides responsible, meaningful, and understandable choices. Sometimes events make that easy. High inflation, high unemployment, or fighting wars can focus elections around key issues. At other times, it may be difficult. Civil rights legislation and the Marshall Plan are examples of complex issues that were settled by the political process in ways that we can look to with pride.

However, when it comes to dealing with the budget, the political process has become somewhere between timid and irrelevant. The last Presidential election was a perfect example. One candidate said, "Better enforcement." The other said, "Read my lips." The choice offered up to the electorate was a public relations gimmick on the one hand and a speechmaker's phrase on the other. That was the extent of the debate. The Presidential candidates chose not to take on the real issues and the political process failed.

No wonder the public has lost confidence in us individually and institutionally. Instead of hearing answers that even approximate common sense, they are confronted with budgetary double speak and questionable numbers. I'm told that 60 percent of the votes of the U.S. Congress in a given year are budget related, and still we make little or no headway. The sad thing is that although common sense serves up the right answers, the political process has become unable to digest them.

Why has Senator Moynihan's proposal caused such an uproar? Because by focusing our attention on the way we are using the Social Security surplus he has demonstrated that the cost of our government falls squarely on the large middle class who earn between $20,000 to $58,000 per year. This is unfair. We all know that, taken alone, the Social Security tax is proportional, not progressive. But, the American people are comfortable with that because the Social Security program benefit structure as a whole is progressive. Yet that holds good only as long as its costs are tied to its benefits. When that is no longer the case, when it becomes a question of the general costs of government, the entire issue is opened up, with far-reaching ramifications for the political and economic life of our nation.

In my opinion, the Moynihan proposal, standing alone, is not the answer. The only thing worse than using the Social Security surplus to run our government is continuing to borrow the money from the Japanese and Germans to run it. But the questions asked' by Senator Moynihan that led him to make this proposal are valid. How can we maintain a real budget deficit of a quarter of a trillion dollars indefinitely? Did anyone ever contemplate that the Social Security trust fund was to be used for general government expenses? When was a conscious decision made that the costs of the government were to be borne almost entirely by our middle income earners? Those are the types of questions that this Committee must ask if we are to collectively find answers. My expectation is that these questions are profound enough, and their answers simple enough, that the debate can finally go forward and every legitimate means of government solution, including reduced spending and/or additional taxes, should be explored.

I would urge that this Committee and the other leaders of the Senate call upon their counterparts in the House, together with the Executive Branch, to join in a bipartisan effort to deal with the issues we are talking about. And it can't be conducted as just another charade. I must say I think the President, who won the last election and proposed the Federal budget we are now considering, bears the most responsibility to lead and work with members from both sides of the aisle to begin a meaningful process—indeed to take a lead in the creating of this Executive-Legislative Summit to address these problems in the 1990.

This Executive-Legislative Summit should have everything on the table, including but not limited to:

1. Our overall budget problems.
2. The savings issue, so that Middle America can participate.
3. The inequities in our tax structure.

I understand and fully sympathize with the difficulty our political parties and our elected officials face in dealing with the subjects I've discussed. They are political mine fields waiting to explode. But together, Democrats and Republicans, Legislative and Executive leadership can move forward to give the public the kind of choices they are entitled to. That is something the political process must do, not avoid. Good politics is about hard choices and the wise use of power by elected officials. I submit to you that we had better address where we are heading for the rest of this century now, when the economy appears to be doing well. Later, if we are faced with a less prosperous time, we may not have the luxury of choice.

I don't want to sound overly dramatic, but when one looks around the world, from young people on Tiananmen Square to de Klerk and Mandela in South Africa, to Navel, who so movingly spoke before you last week, to the election process in Nicaragua, I say we're selling the American public and ourselves short if we don't think our political process can face, and solve, these budgetary problems if we give the effort leadership.

Someone recently said that President Bush had it upside down in his inaugural address when he said we in the United States have more will than wallet. The fact is we have more wallet than will. We're still the richest country in the world but seem to lack the will to take the steps to stay that way.

Mr. Chairman, the final question must be: Why should this effort that I am describing succeed now, when others have failed before? My answer is that we have a popular President in the White House with an 80 percent approval rating, we have strong leadership in the House and Senate and in the Committees deciding these issues, and in particular, this Committee. With this political base, and with the climate of positive change that is sweeping the world, this effort cannot afford the luxury of failure! It must succeed.

That completes my prepared statement, Mr. Chairman. I would be pleased to respond to any questions or comments from the Committee. Thank you.

Prepared Statement of J. Sweet and Anne C. Canfield

ENHANCING RETIREMENT SECURITY: A PROPOSAL

Mr. Chairman and Members of the Senate Finance Committee, it is a pleasure to be able to submit testimony to this Committee. As two former staff aides to Members of this Committee, it is indeed an honor.

We are particularly grateful to be able to share our views with you because the proper treatment of the Social Security surplus has been an issue of significant professional interest to both of us since 1981 while working in the Senate, and a matter of personal and academic interest to us since leaving the public sector.

We commend Senator Moynihan for generating the current public debate on this issue. It is a very positive development. We believed then and now that the result of the debate over the growing Social Security surplus is probably the single most important domestic policy issue facing this country. As the OASDI trust funds continue to grow exponentially, increasing pressure will be brought to bear by the public to strengthen the system. We believe, Mr. Chairman, that the Congress will face its own unique global warming problem. Right now it's only 80 degrees, but in a few short years, the temperatures in Death valley will feel cool!

We would also like to commend Senators Heinz and Symms for their continued interest in this issue. Both Members also have pending proposals which we believe need to be seriously reviewed and discussed.

The Sweet/Canfield Proposal

The motivation behind the proposal we developed in 1983 is based on two fundamental beliefs: (1) Social Security should provide true retirement security for all

Americans, and (2) Social Security should disproportionately benefit lower income workers. Unfortunately, the current system does not adequately honor either of these two promises.

In our view, those goals are so important that Congress should affirm these elemental principles:

A. OASDI revenues should be dedicated solely for the purpose of paying benefits.

B. Beneficiaries must have a contractual right to their benefits.

C. The current system of skewing benefits to lower income wage earners is correct and should be maintained.

D. All beneficiaries, no matter what their income brackets, should have the benefit of professional money management.

In order to affirm these goals, several steps are necessary. First, the Social Security Administration should become an independent agency. This institutional change is needed to insulate Social Security beneficiaries against harmful policy shifts adopted for unrelated budgetary reasons.

Combined with this proposal, Congress should establish that beneficiaries have contractual right to receive their benefits. A Supreme Court decision rendered in 1960 established that the OASDI tax is a tax on labor contracts and is levied independently of any statutory provisions mandating OASDI benefits.

Thus, in the *Flemming* v. *Nestor* decision (363 U.S. 603, 1960), the Supreme Court declared that Congress could legally eliminate all benefits overnight, and even choose to raise the FICA payroll tax at the same time. A recent example of the amount of latitude that Congress has in reducing benefits is the benefit reductions enacted in the 1983 Amendments. The combination of taxing benefits above specified income levels and delaying the cost-of-living adjustments for six months, represented a 27 percent cut in benefits for retirees in the then 50 percent tax bracket.

Hence, workers cannot be said to have valid property rights guaranteeing them "iron clad" retirement incomes from Social Security. This is why Congress can legally cut cost-of-living increases at any time. We need to develop a system that will give workers such property rights, enforceable in courts of law. We believe this can be done by requiring employers to send 2 percent of OASDI payroll tax receipts to portable pension plans managed by private sector investment managers.

Here is how our proposed public/private sector partnership system will work. Upon being hired, workers will select preferred mutual funds for themselves from a menu of investment vehicles that vary in aggressiveness provided to them by their employers. Thereafter, whenever their employers send 10.4 percent of their combined OASDI taxes to the Social Security Administration, another 2 percent will be sent to their chosen mutual funds. Every month, the mutual funds will mail to each worker statements listing the value of their accounts.

Upon changing employment, workers will transfer their investments to the preferred list of mutual funds on the menus provided to them by their new employers. Their investments in their previous accounts will simply be transferred to their new mutual funds. It is important to Point out that the after-tax paychecks of workers remains the same. Instead of paying 12.4 percent to the OASDI trust funds, workers will pay 10.4 percent to OASDI and 2 percent to their mutual funds, if they elect to do so.

Alternatively, workers can choose to rely exclusively on Social Security benefits, as they do now. In this case, their 2 percent payroll tax contributions will be sent directly to the Social Security Administration along the 10.4 percent that remains mandatory.

Under our proposal, these portable pension plans will be professionally managed, just the way $1.7 trillion is now managed for millions of Americans through the existing private pension fund system. Further, these plans will be subject to the ERISA rules and Department of Labor and SEC oversight to ensure that such funds are prudently managed.

Thus, as today's workers retire, they will receive two types of benefits: A Tier I and Tier II benefit. The Tier I benefit will be an irreducible guaranteed minimum adjusted payment received from the Social Security Administration. The Tier II benefit will take the form of an annuity. Gradually, over time, the Tier II benefit will grow in significance relative to the Tier I benefit. As the system evolves, and the Tier II benefit grows in significance relative to the Tier I benefit, prudence demands that Tier II investments be made less aggressively.

Further, unlike the Tier I benefit, the Tier II benefit will be a private property right enforceable in a court of law because it will be received from regulated private companies, not the Federal government.

To honor the third principle, that benefits be progressively distributed, the Tier I benefit formula would be adjusted. Here is how this can be done.

Presently, the SSA calculates initial benefits as follows. First, it collects the entire earnings history of an applicant who has filed for benefits. SSA then indexes the earnings of the applicant so that each year of his/her earnings history is measured in 1990 dollars. A specified number of the lowest months of earnings are dropped, and the remaining observations are averaged to generate what is known as an Average Indexed Monthly Earnings (AIME) amount for the applicant.

Under current law, 90 percent of the first $339, 32 percent of the next $1705, and IS percent of any AIME amount over $2044 will be paid to the applicant as his/her basic retirement benefit. These dollar amounts defining each benefit bracket are increased annually by the percentage change in average wages that took place in the preceding year. The 90 percent, 32 percent and IS percent benefit brackets are known as "bend points."

Under our proposal, the 15 percent "bend point" would grow more slowly than the growth in average wages. Alternatively, a fourth bracket of 5 percent could also be established when an individual's AIME exceeds $3200. In either case, average Tier I benefits will continue to rise in real terms. In fact, Tier I benefits will more than double for all but the highest paid workers over the next 75 years. For the highest paid workers, the benefits will still increase in real terms, but by a lesser amount.

Clearly, something must be done. The existing system is unfair to millions of Americans. As a result of the 1983 Amendments, today's workers are not only paying for current retirees benefits, but for the first time in the history of the Social Security system, they are being asked to save for their own retirement as well. In addition to paying for two generations' retirement benefits, they are also mandated to subsidize general government spending by accepting a very low, non-market rate of return on their retirement savings. In fact, they are being asked to not only pay twice, but possibly three times for their benefits!

This policy is particularly unfair to lower income earners whose retirement incomes, in large part, take the form of Social Security retirement benefits. Current policy forces them to accept a low rate of return on their principle retirement assets—promises of future Social Security benefits. Meanwhile, higher income individuals enjoy the benefit of professional money management and far higher rates of return in building their private retirement incomes—they are not as dependent on OASDI benefits.

The Sweet/Canfield plan will deliver significantly higher retirement income benefits to those who need it most—lower and moderate income wage earners. Even greater improvements will be possible if more than 2 percent of OASDI taxable payroll is used to fund Tier II benefits.

This will, however, require larger reductions in Tier I benefits as well. We anticipate the public will demand a further shift away from Tier I benefits into higher Tier II benefits once actual experience under the new system demonstrates its advantages.

[1990 Constant Dollars]

	Monthly benefit	Tier I monthly benefit	Tier II monthly benefit	Real rate of return			Total Tier I and Tier II
	Current law	Proposal	Proposal	7 percent	5 percent	2 percent	
Secretary, Age/18 Existing Salary $15,000 retires in 2039	$1143	$1143		$1127	$613	$273	$1416 to $2270
College Graduate Age/30 Existing Salary $35,000 retires in 2027	1301	921		1070	690	380	1301 to 2371
Corp. Executive Age/50 Existing Salary $50,000 retires in 2006	1145	992		237	198	153	1145 to 1229

As the above table illustrates, the rate of return earned on Tier II contributions is very important in determining the size of the Tier II benefits that will ultimately be paid. We, therefore, believe that all Tier II benefits should be professionally managed with both yield and safety as equally important concerns. Current law mandates that the OASDI trustees invest the surplus in Treasury securities, which the Social Security actuaries predict will only yield a 2 percent real rate of return.

In our minds, this is the real "thievery." Now that it is clear what is happening, Congress should not condone this crime. The policy needs to be changed. This investment strategy robs all working Americans, but is most damaging to lower income earners. They, above everyone else, must rely on Social Security to finance their retirements.

During their careers, more privileged workers put aside funds in private pension plans, 401(k) plans, SEPs, and KEOGHs, for example, all of which earn market rates of return that compound over decades. For lower income earners, however, it's just Social Security. For those most in need, we offer ludicrously low rates of return on their investments. Why don't we offer these workers the same opportunities as well paid workers? No pension manager would keep his job if all he did was invest in Treasury securities indefinitely. So why is Social Security compelled to do so?

In addition to improving benefits, our proposal has two other attractive features: It improves public satisfaction with the Social Security program, and increases the reward for working. In a January 1990 Harris poll, 74 percent of all Americans stated that ". . . benefits [were] not worth what you paid in." An even higher number 90 percent, between the ages of 30-39, believed this was true.

This damaging finding proves that workers believe Social Security contributions are really taxes—not a form of deferred compensation. By raising future expected benefits, this perception would be erased and workers will feel that they have received, in effect, a tax cut. Thus, by increasing Social Security benefits in a sound fashion, we will achieve yet another benefit—an increased reward for working.

A January 1990 poll taken by the respected polling firm, Market Opinion Research, showed how popular this general approach will be: 68 percent favored it, 22 percent opposed it, and 10 percent had no opinion.

Congress faced a similar issue in the late 1970s. It repealed Regulation Q, forcing shareholders of banks and S&Ls to pay small savers fair rates of interest on their passbook deposits. Just as it was unjust to compel small savers to accept a 5.5 percent interest when inflation was raging at twice that rate, so today it is also unfair to compel vulnerable, lower income workers to accept low rates of return on their most important retirement asset Social Security. This is particularly unfair when higher income workers are able to achieve greater rates of return on the bulk of their retirement investments by having their savings professionally managed.

The Moynihan Proposal

As mentioned above, we would like to commend Senator Moynihan for igniting the current debate and for recognizing that the Social Security surplus cannot be used twice—to reduce the deficit and to finance retirement security. All workers, but especially workers aged thirty and younger, owe Senator Moynihan a debt of gratitude for forcing a reexamination of this issue sooner rather than later, when they are closer to retirement.

If the current diversion of Social Security annual surpluses to finance unrelated government spending continues, Senator Moynihan's concern that the Social Security system will become actuarily unsound is well justified.

To meet all OASDI claims between now and 2010 will probably require an OASDI payroll tax rate of 10.4 percent or less. Under current law, however, the rate will be 12.4 percent indefinitely. It is this difference that generates the "Social Security surplus."

The Moynihan proposal returns the Social Security system to a pay-as-you-go system by eliminating annual Social Security surpluses through a 2.2 percent payroll tax cut. Thus, after Senator Moynihan's tax cut, the revenues collected each year will closely approximate the amount needed each year to honor all OASDI obligations. This proposal has the virtue of returning surplus OASDI taxes to those who paid them since, under the current system, they are being diverted to reduce the unified budget deficit.

The problem with this approach, however, is that benefits, as expressed as a percentage of workers' paychecks, are expected to rise from 10 percent to 17 percent over the period as the baby boom generation retires and lower fertility rates together shrink the worker/retiree ratio from 3.3 to 1.8.

Adopting Senator Moynihan's tax rate reduction proposal will, without legislating later tax increases, drive the Social Security system into a long-term taxable payroll deficit of at least −2.9 percent, up from the present −0.7 percent proclaimed by the Social Security actuaries. And yet, when the Social Security deficit hit −1.82 percent of taxable payroll in 1982, all commentators agreed that urgent action was necessary to resolve the OASDI crisis

ALTERNATIVE II-B FORECAST

Calendar Year	OASDI Total Cost Rate Expressed as a percent of Taxable Payroll
2000	10.27
2010	10.76
2020	13.70
2030	16.23
2040	16.58
2050	16.74
2060	17.19

Source The 1989 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance 26—Comparison of Estimated Income Rates and Cost Rates by Trust Fund on 1989-2065 (Cont)

As the chart shown above illustrates, under the "pay-as-you-go" system, the OASDI tax would therefore *also* have to leap from 10 percent to 17 percent, in tandem. This practically guarantees an intergenerational donneybrook in the 21st century.

And, as the graph below indicates this conflict would take place at a time when Health Insurance (HI) payroll taxes are expected to significantly increase to finance the burgeoning of the Medicare system as well.

ALTERNATIVE II-B FORECAST

Calendar Year	HI Total Cost Rate Expressed as a percent of Taxable Payroll
1990	2.66
2000	3.54
2010	4.27
2020	5.26
2030	6.50
2040	7.06
2050	7.22
2060	7.40

Source The 1989 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund Table E2

President Bush's Proposal

The President implicitly acknowledges the problem recognized by Senator Moynihan, but tells us to wait until 1996 to begin to solve it. Like Senator Moynihan, the President agrees that the current trust funds cannot be used for dual purposes. He proposes to address this issue by phasing-in his proposed Social Security Integrity and Debt Reduction Fund.

Under this proposal, the accumulating OASDI surpluses would still help balance the budget in 1993, 1994 and 1995, but by diminishing amounts. From years 1996 to 2000, all OASDI surpluses will be used exclusively to lower the national debt. Under the President's plan, the national debt held by the public will peak at $2.4 trillion and fall to $1.7 trillion or less in 2000.

Left unsaid is what will happen in 2001 and beyond. If his policy is continued thereafter, the entire national debt will be retired in 2005. And for at least several decades, the nation would have a national surplus, instead of a national debt! This surplus is expected to soar to $11 trillion in 2035 if very conservatively invested—an amount equal to $1.7 trillion in 1990 constant dollars or 15 percent of the anticipated Gross National Product (GNP) in that year. We do not believe it would be healthy for the Federal Government to own, for its own account, private assets of this magnitude.

Senator Symms' Proposal

The proposal made by Senator Symms is a break with conventional thinking, and offers an innovative solution to the current debate. Senator Symms' proposal and a similar proposal made by Congressman Porter embody the philosophy of attempting to get a better return on today's workers' retirement investments. Even more importantly, the philosophy behind their plans will, with some essential adjustments, ensure true retirement security for workers and retirees while simultaneously raising benefits.

Under the Symms proposal, 2 percent of taxable OASDI payroll would indeed be set aside to generate Tier II benefits in portable pension plans privately managed by professional money managers. The Symms plan would, however, allow individuals to withdraw funds for purposes other than retirement, including expenses for higher education, downpayments for first-time homebuyers, and medical expenses.

While the qualified withdrawal objectives are laudatory, we believe that these objectives violate our first principle which dictates that OASDI revenues should be dedicated solely for the purpose of paying benefits. Additionally, Senator Symms' plan does not explain how the subsequent shortfall in OASDI resources will be replenished given the fact that current law benefits in his plan are not adjusted. In effect, current law benefits will be honored, but no method is proposed to fully finance those benefits. (It should be noted that Senator Symms has publicly stated that he supports a proposal, made by former Social Security Commissioner Robert Ball in testimony before the Senate Finance Committee in 1982, to expand immigration levels as a means of paying for future benefits.)

Congressman Porter's Proposal

The Porter plan, like the Symms proposal, sets aside 2 percent of taxable OASDI payroll to generate Tier II benefits, but unlike the Symms proposal, it proportionately reduces current law Social Security benefits. In effect, the Porter plan reduces the growth rate of real Social Security benefits across the board and by equal percentages for all beneficiaries, and then uses the savings to fund Tier II portable pension plans.

His proposal reduces the progressiveness of the current system, and thereby violates one of our basic principles. To made whole, Tier I benefits should be skewed to maintain the current progressive structure.

Social Security Actuaries' Changing Forecasts

We do wish to bring to the Committee's attention, at this time, the largely unnoticed, but significant changes being made by the Social Security Administration's actuaries. In 1983, under the actuaries' most commonly cited forecast, the so-called Alternative II-B forecast, the OASDI trust funds were scheduled to have a surplus of over $20 trillion in 2046. The actuaries, however, are now projecting that the OASDI trust funds will be bankrupt in 2046! In the meantime, the economy grew smartly, which improves OASDI solvency. This puzzling changes gives new meaning to the phrase "close enough for government work."

Congress and the Administration are the actuaries' customers. If this happened elsewhere, they would be sued for malpractice. We would recommend that the Committee hold a hearing to determine how these incredible changes could happen.

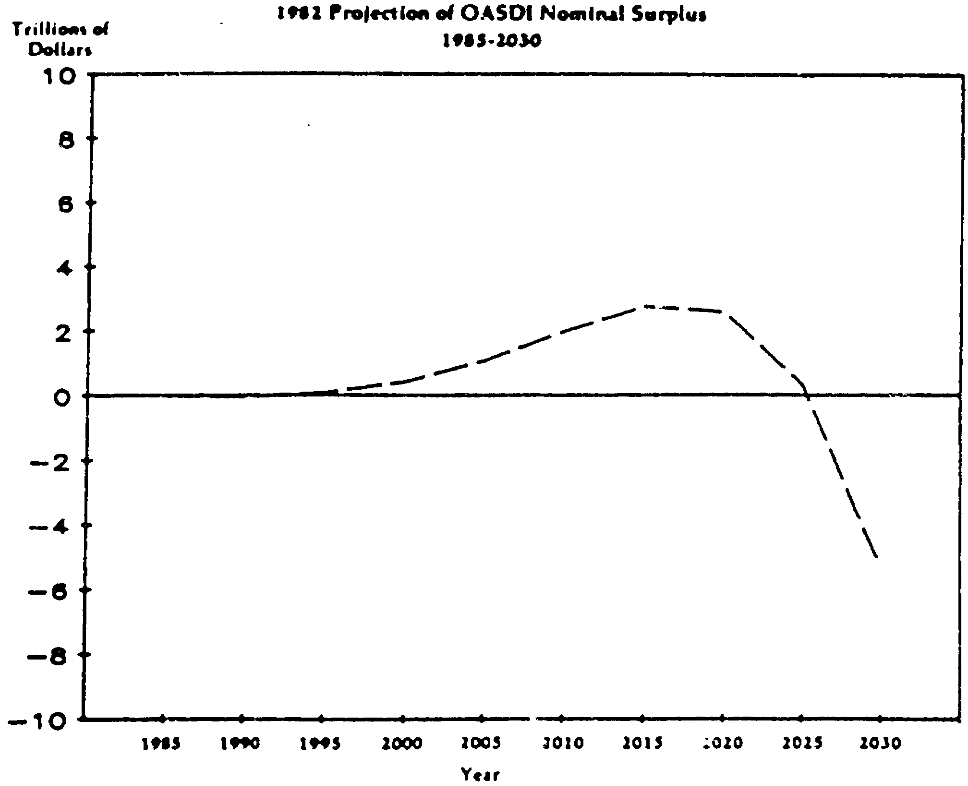
At the same time, the SSA actuaries, using the Alternative II-B forecast, assume that the OASDI trust funds will yield a 2 percent real rate of return. This is unlikely. From 1935 to 1985, Treasury securities have barely kept pace with inflation, yielding 0.1 to 0.5 percent real rates of return. If the SSA actuaries' rate of return assumptions prove optimistic, then the retirement benefits of those thirty and younger are at risk.

Given the fact that Congress and the Administration formulate policy impacting hundreds of millions of workers and retirees based on forecasts provided to them by the Social Security actuaries, it is imperative that a "truth in calculating" requirement be imposed.

Social Security in the 1980s

In examining the fiscal pattern of the OASDI trust funds, it is apparent that there were essentially three phases to the trust funds fiscal balances prior to the enactment of the 1983 Social Security Amendments. During Phase I, 1982-1990, the trust funds balances were projected to lose $100 billion. This situation was forecasted to reverse itself in Phase II, 1990-2017, when the trust funds were projected to accumulate a surplus totalling $2.7 trillion. In Phase III, beginning in 2017, the OASDI trust funds were projected to begin to lose money, tumbling into significant deficits in 2026 and beyond. These phases are reflected in the graph shown below:

1982 Projection of OASDI Nominal Surplus
1985-2030

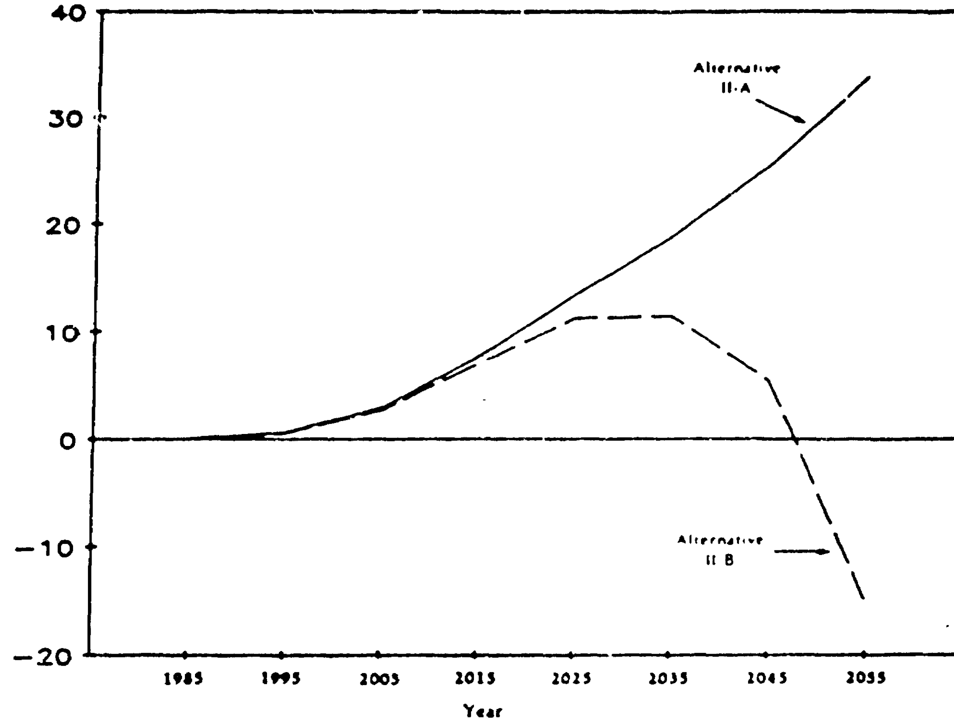


Note: The 1982 projection year of the OASDI surplus used extremely pessimistic economic assumptions of an Alternative III for the years 1982-89 and the Alternative II-B assumptions for the period 1990-2030.

Source. SSA Alternative II-B Computer Run of March 18, 1982 by Orlo Nichols

In ranking the magnitude of the problems to be solved by any reform package at that time, it is clear that the long-term deficit projected to occur in Phase III was the most serious. The second largest problem was the surplus that was projected to accumulate in Phase II. The most minor problem was the deficit being projected in Phase I—the 1980s, but this dominated debate. The Social security Commission, viewed OASDI as an ongoing funding problem over the next 75 years. Although on average, OASDI was projected to take in 74 percent of what it was going to spend between 1983 and 2060, this masked the timing differences identified above. As Mark Twain once said: "A man with one foot in ice water and another on hot coals is, on average, comfortable." Thus, the Commission, on average, made up for the shortfall.

Projections of Nominal OASDI Surplus,
1985-2055



Source. Official OASDI tables prepared as supplements to the 1985 OASDI Trustees Report

As indicated in the above illustrated graph, when the Social security Commission recommended and the Congress legislated reforms to resolve the Phase I insolvency threat, the effects of those reforms carried over into Phases II and III, generating a multi-trillion dollar OASDI surplus in the 21st century.

In the process, the 1983 Amendments fundamentally changed the structure of the Social Security retirement and disability system from a "pay-as-you-go" system to one which attempted to vest itself by establishing a massive sinking fund. In effect, the Amendments mandated that today's workers not only pay for today's retirees' benefits, but that they also begin saving to accumulate funds to pay for their own retirement benefits.

Following the enactment of the 1983 Social Security Amendments, the Phase II surplus grew immensely. Congress had turned Social Security into a cash cow!

Conclusion: Back to the Past?

This is not the first time Congress has been faced with the issue of what to do with a large Social Security surplus. In 1939, faced with an accumulating reserve fund of $47 billion, Senator Vandenberg (R-Michigan) of the Senate Finance Committee stated that this accumulation of funds was "the most fantastic and the most indefensible objective imaginable. It is scarcely conceivable that rational men should propose such an unmanageable accumulation of funds in one plan in a democracy." Senator Vandenberg would undoubtedly be shocked at today's mounting trillions!

The proposal we have been advocating since 1983 suggests using the Social Security OASDI surplus, in conjunction with more aggressive investment policies, to transform Social Security into a national pension system that provides true retirement security. Such an evolution will remove the economic distortions caused by the Social Security payroll tax and, by creating a large real Social Security surplus, eliminate the necessity for future Social Security OASDI tax increases.

Interestingly, Congress debated this issue once before. In 1935, during debate to create a Social Security system, Senator Clark (D-Missouri) offered an amendment allowing employers who had their own compulsory annuity program for their employees the right, along with their employees, to opt out of the program.

The Clark amendment was defeated in the Senate Finance Committee on a tie vote, but was later passed by the "New Deal" Senate, with a Democratic majority of more than 2:1, by a vote of 51-36. We think the Senate was right on June 19, 1935, and a "motion to reconsider" would be in order!

Later, the Clark amendment held up final agreement on the Social Security legislation in the House-Senate Conference Committee for three months. Unfortunately, the Senate receded to the House on the Clark amendment, with the proviso that a special, joint legislative committee be formed to study the underlying issue and report to Congress the following year. The Clark amendment was never reconsidered, but we hope that Congress will do so now by forming a new Commission on Social Security to study methods of strengthening the public/private retirement system. It's time to go back to the past.

SOCIAL SECURITY AS AN INDEPENDENT AGENCY

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

ON

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TO ESTABLISH THE SOCIAL SECURITY ADMINISTRATION AS AN INDEPENDENT AGENCY

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STATEMENT BY STUART J SWEET AND ANNE C CANFIELD

Mr Chairman and Members of the Subcommittee, we are pleased to have the opportunity to submit testimony on the related issues of making the Social Security Administration an independent agency and removing the Social Security trust funds from the unified budget

We would like to commend the Subcommittee for reviewing proposals today which, in our opinion, are central to maintaining the integrity of our nation's key retirement income policy—Social Security

As we begin, we would like to state that we are testifying as two former Senate Legislative Assistants, with over 18 years experience, who specialized in public policy issues considered by the House Ways and Means and Senate Finance Committees Our only purpose for testifying is to bring a promising idea to the attention of the Subcommittee

Since its birth fifty years ago, Social Security has played a dominant role in the financial planning of individuals By providing basic protection against economic hardship during old age or disability, Social Security has saved millions of Americans from deprivation during the most vulnerable periods of their lives

For the more fortunate, Social Security has meant reduced demands for paying benefits to the impoverished; the number of elderly or disabled individuals who would have become public charges at the federal, state, or local level would have been far greater without Social Security In effect, many of the "near poor" have been paying for the safety net they eventually use

Nevertheless, public confidence in Social Security is eroding at an alarming rate Young workers in overwhelming numbers tell pollsters they do not believe future generations will honor the system established by their grandfathers For them, contributing to Social Security increasingly takes on the characteristic of an expensive charity at a time when they are financially pressed to afford what their parents have, a home and a secure future. This feeling is fueling support for a reduction in Social Security tax rates And those nearing retirement, or already retired, fear that their benefits may be sacrificed as part of the effort to drive federal spending and revenues closer into balance.

We need to reassure the young and the old that the federal government will honor its Social Security promises. Consequently, we believe that institutional changes are needed to insulate Social Security against harmful policy shifts adopted for unrelated budgetary purposes We must also find a way to prove to younger workers contributing to Social Security is not a charitable activity

Therefore, we endorse the proposals to make the Social Security Administration an independent agency and to remove the Social Security trust funds from the unified budget These proposals reinforce the promise that Social Security exists solely to provide security for the retired and disabled In addition, the proposals also establish new procedural impediments that will stand in the way of anyone seeking to amend the Social Security program for artificial reasons

The need to protect the Social Security Trust Funds from outside interference will grow geometrically in the years ahead Projections of substantial Social Security reserves are currently being made by Social Security Administration actuaries Presently, OASDI balances total $30 billion However, these balances are projected to soar to $1 trillion before the 21st century even if the economy grows below historic rates By 2010, the OASDI reserve will leap to over $5 trillion, rocket ahead to $10 trillion by 2020, before peaking at $18 trillion in 2040.

These enormous reserves are required, the actuaries say, to ensure that the "baby boom" generation receives the retirement benefits it has been promised Starting in 2030, payroll tax revenues alone will be insufficient to pay benefits Thus, the actuaries believe we need to build a large reserve between now and 2025 That way interest earned on the reserve, plus the reserve itself will fill the gap between payroll tax revenues and expenditures between 2030 and 2060.

As the reserve grows, the temptation to invade it will be tremendous Historically, Congress has spent previous OASDI reserves by boosting benefits However, given the size of the upcoming reserve, expanding other federal programs, or funding new ones, is also a probability Given the increasing unpopularity of high Social Security tax rates, Congress may also lower payroll taxes

Any of these actions threaten the retirement security of the "baby boom" generation and their decendents We need this "rainy day" reserve because there are excellent reasons for believing it will pour in 2030

Ensuring that Social Security is administered independently of the political process becomes a necessity considering the potential misuse of the reserve This underscores the wisdom of removing Social Security from the unified budget and transforming the Social Security Administration into an independent agency.

However, these reforms are not sufficient The "rainy day" reserve will be so large that it is unwise to leave it in the hands of any federal agency, even an independent one Therefore, we recommend that employers be required to send payroll tax receipts in excess of the amount needed to finance ongoing benefit payments to qualified private sector investment managers. Under our proposal, these managers will invest OASDI funds in excess of immediate cash needs professionally—just the way they already do for millions of Americans through pension funds. Finally, the managers will write checks to the Social Security Administration as needed to finance the "baby boom" retirement

There is a major side benefit to this protective reform Presently, funds in the Social Security Trust Funds may only be invested in special obligation Treasury securities Historically, these securities have yielded rates of return well below those received by investing in the equity and corporate bond markets. By way of demonstration, the Social Security actuaries forecast that special obligation Treasury securities held by the Social Security Trust Funds will only yield a 2% real rate of return Private pension funds, by comparison, earned a 7% real rate of return by investing in the stock market over the past fifty years.

Recently, the actuaries provided a Member of the Senate Finance Committee with an analysis of how significant such a reform will be. The difference in the size of the "rainy day" fund is shown below

ESTIMATED OASDI INCOME AND COST, 1985-2060 BASED ON ALTERNATIVE II-B

[Current dollars in billions]

Calendar year	Current law income with ultimate 2 percent real rate of return	Proposal income with ultimate 7 percent real rate of return	Cost
1985	$199 5	$199 5	$193 2
1995	469 6	474 9	368 2
2005	953 2	1,165 1	640 3
2015	1,815 1	2,775 2	1,324 7
2025	3,085 5	6,262 2	2,790 1
2035	4,879 6	14,205 4	5,098 4
2045	7,588 0	34,313 4	8,605 0
2055	11 708 5	88,021 1	14,033 8

If our recommendations are implemented, Congress can responsibly increase Social Security benefits and cut payroll taxes without jeopardizing the retirement security of current and future retirees and the disabled Both the old and the young will benefit handsomely The reverse is also true We must act now to root the cornerstone of our national retirement system, Social Security, on solid ground. [illegible] in building a sound pension program for Americans

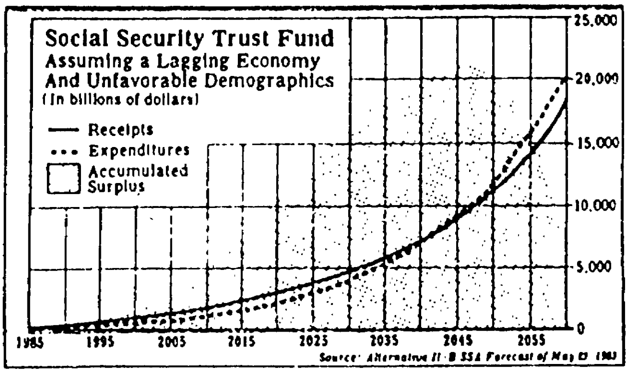
A Looming Federal Surplus

By STUART J. SWEET

Most Americans were relieved when Congress and President Reagan last year approved, with practically no change, the bipartisan plan submitted by the National Commission on Social Security Reform to "save the system." What they don't know is that the plan stands to lead to more sweeping changes in the American economy than if the South had won the Civil War. The cause for alarm is peculiar: For the next 40 years, the Social Security cash-benefits programs are too well funded.

Currently, the collective balances in the Old Age and Survivors (OASI) and the Disability Insurance (DI) trust funds are only $27 billion. However, the surplus is projected by actuaries of the Social Security Administration (SSA) to exceed $1 trillion before the beginning of the next century—even if the economy performs below expectations and unfavorable demographics are assumed. By 2010, the surplus is projected to soar to more than $5 trillion, then to $10 trillion by 2020 before peaking at $20 trillion in the 2040s.

The challenge facing American government is illustrated by the accompanying chart. It shows that an enormous amount of funds must be accumulated to pay off the promises being made to existing workers and their children.



And one doesn't have to be a cynic to see how tempting it will be for politicians to spend "surplus funds" that won't be needed for nearly 60 years. Who believes they will be able to resist handing out new benefits when a $20 trillion surplus will accumulate in OASDI funds if they forbear? In today's terms, that would be like asking Congress not to tamper with an OASDI balance of more than $1 trillion.

If Congress refuses to undo what it did in 1983, probably the only way that today's workers and their children can be assured that Social Security promises will be honored is through passage of a constitutional amendment. Such an amendment will have to forbid Congress from distributing OASDI funds without the consent of those who provided them.

But the problems do not end there. They only begin, and some are quite surprising given the fiscal concerns that dominate political dialogue today. The first vexing problem is: How does the government invest $20 trillion without violating traditional boundaries between the public and private sectors?

Under current law, the Treasury secretary, the secretary of health and human services, and the secretary of labor are the trustees of OASDI funds. They must invest any cash balances in the funds in U.S. Treasury securities. With the U.S. debt held by nonfederal entities at more than $1.1 trillion and with less than $30 billion in OASDI assets, limited investment choices have not been a problem. But they will be a problem unless the government commits itself to 40 years of large federal deficits in the non-OASDI portions of the budget. Otherwise, there will not be enough Treasury debt to purchase.

What, then, will we do with a growing, massive federal surplus? The options are not attractive. One choice would be to buy publicly traded stocks. But even this has limited possibilities. Right now, the New York Stock Exchange has a market value of less than $3 trillion. And do we really want cabinet officers deciding which Fortune 1000 companies the federal government will take over by buying controlling interests? It may, in fact, be possible for the government to own all of them. There are many opportunities for manipulation. It's possible to imagine Congress and the administration being lobbied by shareholders in certain concerns to buy their shares rather than those of other companies. Bonds do not offer a way out either. While purchasing bonds avoids direct ownership problems, there will not be enough bonds to go around in 2010 either.

The reason this dangerous accumulation was created is simple: politics. In 1982, the Social Security Commission, whose members were chosen by congressional leaders and the president, decided that any solution it recommended would leave no chance that Congress would ever face another OASDI funding shortage in this century. That meant contingency planning, assuming the worst was going to happen. The commission concluded that OASDI needed an increase in cash flow during the 1980s equal to $175 billion to $200 billion, an average of $25 billion a year. This was nearly three times the needed increase estimated by the SSA in 1982.

Another way to visualize this is to consider what the negative cash flow would have been, assuming a continuation of prior experience. During 1982, which was a poor year for OASDI due to the recession, the funds lost $11 billion. If the recession had continued throughout the 1980s, the funds would have lost about $11 billion a year for seven years, a total of $77 billion. Assuming that the recession was going to last longer than the Great Depression of the 1930s is certainly cautious planning. The commission can be excused for not anticipating the robust recovery already under way. But was it necessary to increase the estimate for needed cash almost threefold even if one extrapolates bad times into the future?

The Social Security Administration didn't think so. In its annual report to Congress in 1982, it forecast that checkbook balances in OASDI would drop, under its likely but pessimistic scenario, from a positive $19 billion to a negative $54 billion in 1989. This $73 billion drop is a serious shortage, but it was only a fraction of the $175 billion to $200 billion that the commission chose as its baseline.

Congress's own budget office didn't believe $175 billion to $200 billion was needed either. In November 1982, the Congressional Budget Office projected OASDI balances through 1989. Its forecast showed that the combined checkbook balances would fall even less—to a negative $29 billion in 1989, unless Congress acted. The effect of political overcaution was to generate a power curve toward a $20 trillion dilemma.

We must see that the huge fund buildup engineered by the Social Security Commission never takes place. If $20 trillion never accumulates, we won't have to worry about breaking commitments by future raids on OASDI. And we won't have to invest it. To do so, however, a contract must be reached with today's workers. In exchange for permanently reducing their OASDI taxes, workers under 50 years of age must agree to lower their claims on OASDI benefits during the 21st century.

How could this be accomplished? One sound suggestion is to expand the use of IRAs or comparable savings vehicles to individuals under certain conditions. The chief condition is that favorable tax treatment of deposits into such accounts be linked to reduced OASDI benefits received at retirement. One approach would be to reduce benefits by 1% for a specified level of deposits. Chances are, millions would leap at the opportunity. Since skepticism remains deep, especially among the young, over whether benefits ever will be collected, it should be an appealing offer to give up 1% of nothing and get a tax break now and for years to come.

A final note: If the economy performs better than expected—and the odds of that happening equal the odds assumed by the commission that it will perform below expectations—the surplus projected by the SSA for 75 years from now is $73 trillion. And the administration, taking account of the current recovery, has released figures showing an even more favorable trend. Meanwhile, the bipartisan group composed of congressional and administration representatives that is working on the fiscal 1985 budget, which begins next Oct. 1, was quick to agree on just one thing: Don't tamper with the Social Security compromise.

Mr. Sweet is legislative director for Sen. Paula Hawkins (R., Fla.).

Prepared Statement of Senator Steve Symms

[February 5, 1990]

I want to express my appreciation for my colleagues, Senators Moynihan, Hasten, Sasser, Sanford, and Heinz, who have led the way in this debate on the proper accounting for the Social Security Trust Fund and the correct level of Social Security tax.

I want to begin my statement by bringing to the Committee's attention this quotation from the General Accounting Office report on the Social Security surplus.

On page 6, it says, regarding the surplus,

> "In our view, the preferable course of action would be to make the accumulation of social security trust fund reserves an economically meaningful process, one that represents a net addition to national savings."

My bill, which I introduced January 25, S. 2026, provides for *an economically meaningful process*, which actually will increase the national private savings rate for every American family.

My bill provides for establishing for every American worker a new account within the framework of Social Security: *a "defined contribution" account*, using the accumulating Social-Security surplus to finance real savings. These accounts will be substantially the same as President Bush's "Family Savings Accounts" but I would start the process by putting the accumulating Social Security surplus into each worker's account.

Putting the surplus into each worker's Family Savings Account would protect it from spending by Congress, and it could not be used to pay off the national debt or cover up the Federal deficit. This is what the American people really want. That is why the debate has become so heated in the past few weeks.

The Social Security system is a so-called "defined benefit" program. I would not change that in any way.

I am not *"messing around"* with Social Security. My proposal is to create an additional benefit within the framework of Social Security—to establish a "defined contribution" account, similar to what Federal Employees already enjoy with the Federal Employees' Thrift Savings Plan.

THE CURRENT REALITY OF "PAY AS WE GO"

Many people around the country have an idea that there is a real, accumulating surplus in the Social Security trust funds as if the excess tax revenues that are coming in this year and next (and for the next 20 years) are being saved for the Baby Boom generation.

That it is a myth. The excess Social Security taxes this year are being used to buy government bonds. Government bonds do not represent savings: money is spent currently.

You can't borrow money from yourself and spend it and then tell your creditors that you have real assets.

WHAT DOES EVERY AMERICAN WANT?

Constituents are writing us in anger that their Social Security taxes are being used for other purposes than for savings toward their own retirement. But it makes people mad that Social Security taxes are used to conceal the true size of the deficit in other Federal Funds accounts. They want real savings.

The Social Security Benefits Enhancement Act would use those surplus funds to increase the private savings rate of every American family, rather than spending it for other government programs. This is what our constituents want.

I want to point out to the Committee that the future financing problem is very much a *hypothetical* problem, in the sense that it is based on assumptions about immigration that may well change in the next 25 years, and on economic assumptions that are very tenuous at best—given the current state of economic science.

A SIMPLE EXAMPLE

Finally, Mr. Chairman, let me give one simple illustration of the individual family's benefits under this proposal.

Let's take the example of an average worker, one who earns the average wage today of $20,400 for his family. That is the average wage of someone subject to Social Security tax today.

Let's assume this person works his entire life, 49 years until retirement, at this average wage. Assume this average wage grows at the real (adjusted for inflation) rate of ½ percent per year. That is a rather slow rate for real wages to grow—they have often grown faster in the past.

Under current law, the real Social Security benefit of this worker will increase from $7,100 per year now to $13,272 in the year of his retirement. That is a substantial increase in his current defined benefit under Social Security as it exists in current law.

Now assume, further, that we take the Social Security surplus, approximately two percent, and save it in a tax-sheltered account, just as I have proposed. Here is the substantial amount of increased benefits at various rates of interest:

2 percent	$37,787
3 percent	50,082
4 percent	67,364
5 percent	91,816
6 percent	126,604
7 percent	176,324

This is why I have called my bill the "Social Security Benefits Enhancement Act." These additional amounts of savings available to the average worker cannot be provided under the current "defined benefit" Social Security law. The accumulating surplus is simply taken by the government and used elsewhere. That is manifestly unfair, Mr. Chairman.

The Social Security actuaries have assumed, in all of their calculations of the Social Security surplus, that the trust funds accumulate interest on their government bond funds at the very low rate of 2 percent. The average yield on the stock market since the mid-1920s has been closer to 9 percent! The current real yield on corporate AAA bonds is between 5 and 6 percent.

PREPARED STATEMENT OF SENATOR STEVE SYMMS

[February 27, 1990]

Mr. Chairman, I would like to particularly commend to my colleagues' attention the testimony we will hear later this morning by two former Senate aides, Anne C. Canfield, who used to work for me, and Stuart J. Sweet, who used to work for Senator Heinz.

Anne and Stu were the first two individuals in the country to bring to the public's attention the expected Social Security surplus in *1982*, prior to the enactment of the 1983 Social security Amendments, which, of course, only increased the size of the surplus.

They did a significant amount of analysis on this issue while working here and developed a proposal in 1983, which is described in their testimony. Since leaving the Senate, they continued their work really as a matter of personal and academic interest.

I would recommend that all of us on the Committee, as well as the witnesses and members of the press carefully review their testimony because it offers a very creative solution as to what we should do with the social security surplus.

It should be mentioned that they briefly review in their testimony and have reviewed in many previous publications the Social Security actuaries' forecasts.

What I find most interesting about their testimony today is their revelation that the Social Security actuaries have changed their 1983 forecast of a $20 trillion surplus in the OASDI trust funds to a $12 trillion surplus in their 1989 forecast—at a time when the economy grew smartly and therefore only improved OASDI solvency. As they state in their testimony, "this puzzling change gives new meaning to the phrase 'close enough for government work'."

I believe we should accept their recommendation for hearings specifically on the issue of the actuarial process at Social Security. We need "trust in calculations from the actuaries."

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Social Security and Family Policy, Committee on Finance, U.S. Senate

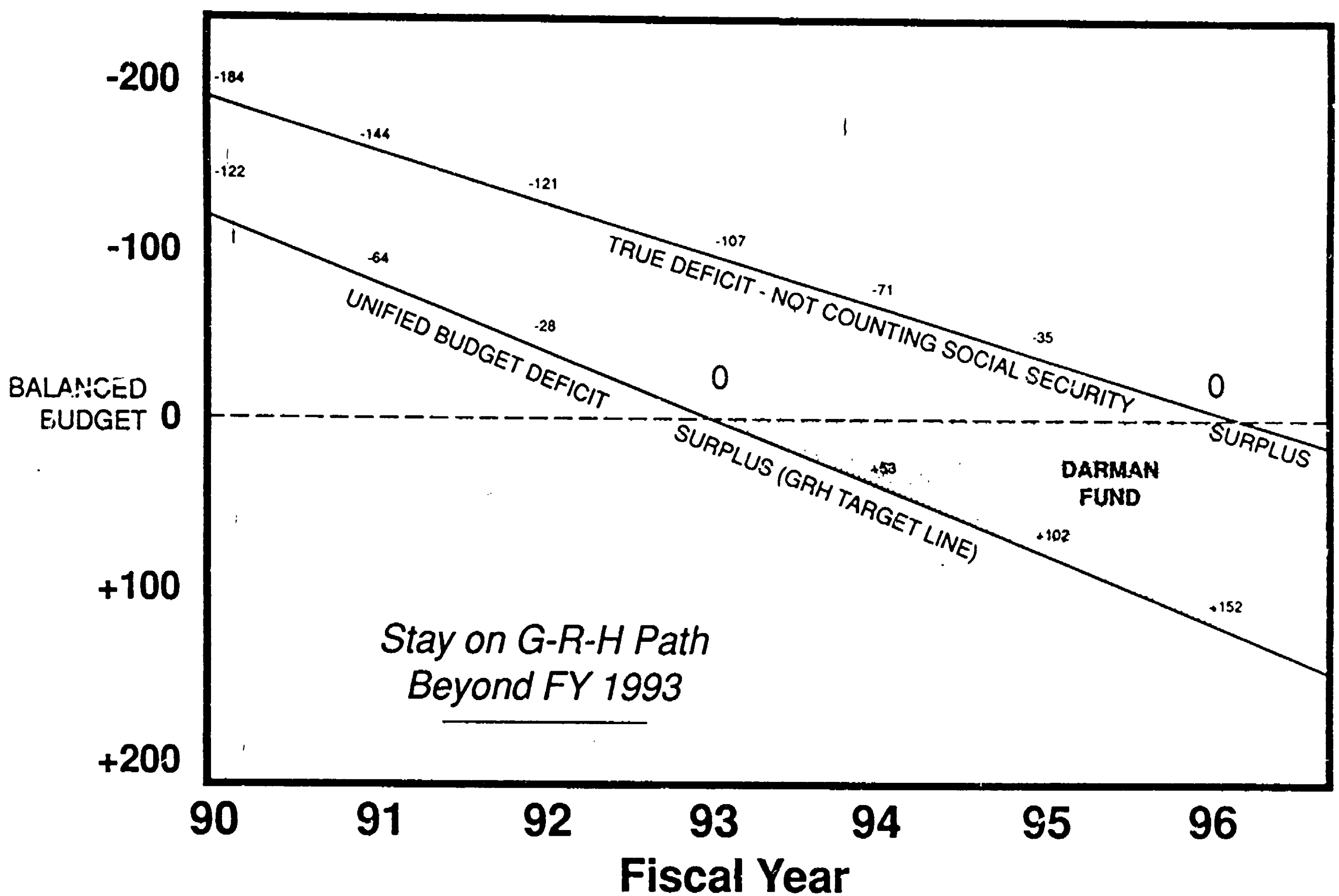
January 1989

SOCIAL SECURITY

The Trust Fund Reserve Accumulation, the Economy, and the Federal Budget

GAO/HRD-89-44

Bringing Deficits Down Without Counting Social Security



CHART/Senate Republican Conference

How Much Will Benefits Increase?

A typical young worker, age 18 today earning $20,400 (real wages grow at 1/2% per year) retires at age 67 . . .

	Now	Year 2040
Social Security (defined benefits plan)	$7,100/yr.	$13,272/yr.
Family Savings Account (defined contribution=2% of wages)		
At 2% compound interest	-0-	$37,787
At 3% compound interest	-0-	$50,082
At 4% compound interest	-0-	$67,364
At 5% compound interest	-0-	$91,816
At 6% compound interest	-0-	$126,604
At 7% compound interest	-0-	$176,324

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Prepared Statement of Carolyn L. Weaver

Thank you, Mr. Chairman. It is an honor to be here today to testify on Senator Moynihan's proposal to cut the social security tax. It's also a pleasure to be here when the concern is over whether social security's reserves are too large, rather than whether they are about to run out, which was the case during much of the time I worked for the Committee in the early 1980s.

It was 7 years ago—give or take a week or two—that the consensus recommendations of the National Commission on Social Security Reform were introduced into Congress by Senator Dole, and within two weeks of that, hearings and markup had begun in the House. The sense of urgency was great, with the nation's giant retirement program already having exhausted its reserves and relying on funds from Medicare to keep benefits going out on time. By April, the 1983 Social Security Amendments were law.

In the past 7 years, social security has fared far better than generally anticipated. Buoyed by a strong economy, the annual surpluses in the OASDI trust funds are running at $65-$70 billion, fully 55% higher than projected in 1983 on the basis of SSA's intermediate assumptions. The accumulated reserve, which now stands at $170 billion, is nearly double the 1983 projection. Based on the more pessimistic economic assumptions the reform commission used, the progress has been even more remarkable. For the first time in many years, Congress is facing the prospect of a decade or more of sustained and substantial reserve accumulation.

Senator Moynihan, in introducing a bill (S.2016) to cut the payroll tax this year and move back toward pay-as-you-go financing, has commenced a debate that is both important and long-overdue. Are the social security surpluses, and the payroll taxes needed to sustain them, actually being saved and increasing capital formation so as to lighten the burden of retirement benefits in the next century? If not, is a return to pay-as-you-go financing the answer.

Let me say at the outset that I do not support the Moynihan bill. While I share the Senator's concerns about the management of the social security surpluses, and believe that the issues he has raised must be resolved, a return to pay-as-you-go financing, in my opinion, would be a mistake at this point. Social security faces an enormous liability in the years ahead that will begin to be felt in earnest in the early part of the next century. Every effort should be made to increase saving in anticipation of this liability, and advance funding is one way to do this.

ADVANCE FUNDING AND NATIONAL SAVING

Under the 1983 amendments, tax income to the OASDI trust funds is projected (using SSA's intermediate assumptions) to be higher than necessary to meet retirement benefits for the next 25 years. During this period, the trust funds are scheduled to amass a large, interest-bearing reserve of government bonds. Interest earnings, together with tax income, are projected to keep the retirement program in surplus for another 15 years. Beginning in 2030, when expenditures begin to outstrip tax and interest income, benefits are to be met by redeeming the trust funds' bond holdings. Fifteen years later, reserves are projected to be exhausted and the program insolvent. (Including Medicare, the reserves would not become as large and they would be depleted more quickly.)

The popular idea behind advance funding, as this arrangement has come to be known, is that if we can just live with somewhat higher payroll taxes over the next few years and save the excess revenues, we can increase future real incomes and lighten the burden of social security in the next century. In effect, today's workers can help finance a portion of their own retirement benefits.

The economic logic is that by running trust fund surpluses that are used to retire outstanding (publicly held) government debt, the government can increase the funds available for private investment. This, in turn, would allow for increased capital formation and ultimately higher future real incomes with which to meet the cost of retirement benefits. Payroll taxes can be lower than otherwise because of the substantial interest accruing to the trust funds. Meanwhile, income taxes need be no higher, since interest payments that would have been made to private investors would be made to the trust funds instead. Advance funding thus offers the potential of lowering the overall tax burden in the next century.

I underscore the word potential because, as Senator Moynihan and others have highlighted in recent months, advance funding does not automatically or even necessarily increase saving and lighten future burdens.

THE PROBLEM WITH THE CURRENT ARRANGEMENT

The problem with the current arrangements is that any apparent saving through the social security system can be undermined by actions taken in the rest of the budget, or even by subsequent actions in social security. There is nothing in the law that requires or ensures that the surpluses are saved on an ongoing basis—that is, that real resources are transferred from present to future generations.

For example, if the excess payroll taxes now being collected have the effect of relaxing fiscal restraint in the rest of the budget—financing new spending programs or reductions in income taxes—they are effectively frittered away on current consumption. The trust funds accumulate a portfolio of government bonds, or IOUs from one part of the government to another, but there is no commensurate increase in saving or capital investment that might lighten the burden when those bonds come due. Such a practice, if sustained, would simply shift the current cost of government to social security taxpayers, and shift the problem of meeting future benefits to the general fund of the Treasury, which must meet the ever-growing interest payments to the trust funds. Rather than representing sums that would have been paid to private lenders, these interest payments would amount to a new liability incurred on account of the trust fund build-up, and they would have to be met without the benefit of the economic growth that real savings could have fostered.

The concern here is not with social security "funding the deficit," where this is taken to mean reducing the government's new borrowing from the public. This is precisely what should occur with the social security reserves being invested in government bonds. The problem arises when the social security surpluses fund an increase in the deficit in the rest of the budget, allowing it to be higher than it otherwise would be. This makes an assessment of the current situation quite a bit more subtle than generally realized.

Mismanaging the budget, of course, is not the only way the social security surpluses can be dissipated. Social security expansion, financed in part by depleting reserves, would have precisely the same adverse consequences for national saving. Rather than adding to the nation's capital investment, the extra payroll taxes levied today would underwrite an expansion of social security's long-range liability and the government's overall indebtedness.

As reserves accumulate, the political pressures will be strong to pay larger benefits to groups deemed particularly deserving—whether aged widows, the incapacitated near-elderly, the working elderly, "notch babies," two-earner couples or any other group. And there will always be Medicare in need of a helping hand. The long-range Medicare deficit is so large that it alone could consume all available reserves and surplus monies in OASDI, rendering the entire system insolvent by 2030.

Keep in mind that social security operates free of any funding requirements, such as those imposed on private pension plans by ERISA (the Employee Retirement Income Security Act). There is no requirement in the law, for example, that a certain level of reserves be maintained against a portion of accruing liabilities, or even that annual balance between spending and revenues must be maintained. The system can, and periodically does, operate with deficits and declining reserve ratios.

Evidently, advance funding offers the potential of increasing national saving while keeping payroll taxes lower than they otherwise would be, but it also poses the risk of aggravating the nation's long-range fiscal problems. Ensuring that the surpluses are saved—for decades into the future—requires maintaining control over both social security and the rest of the budget.

THE MOYNIHAN BILL

The Moynihan bill would cut the payroll tax in the near-term and return to pay-as-you-go financing of OASDI. While this precludes the risks outlined above, whereby advance funding can increase rather than reduce the overall tax burden in the next century, it also precludes the possibility of reducing that burden through advance funding. This is my first reservation with the bill. In addition, by substantially narrowing the reserve margins in the next 4 to 5 decades, the bill increases the risk of periodic funding crises and thus makes further payroll tax increases quite likely. In the longer term, the bill raises the ultimate tax rate in the law rather than controlling costs or enhancing the economic resources available at that time, both necessary ingredients for securing future benefits. Finally, it leaves uncorrected the central flaw in the government's current plan to advance fund social security—the absence of a meaningful and enforceable plan for saving the surpluses. The trust funds would still accumulate hundreds of billions of dollars worth of government bonds that presumably would be put to no better use than the bonds held today.

Under the Moynihan bill, the payroll tax increase that took place on January 1 would be canceled, leaving the overall FICA rate (OASDHI, employer and employee combined) at 15.02% of taxable earnings. In 1991, the rate would be cut to 13.1%, or a $660 annually for workers earning $30,000. The maximum tax saving, for those earning at or above roughly $55,000, would be $1,200. The 1991 rate would prevail through 2011. That's the good news.

Though few in the popular press have noticed, a cut in the payroll tax can not be sustained indefinitely if the government is to meet rising real benefits to a growing population of retirees. The switch to pay-as-you-go financing substantially reduces the reserves and thus the interest earnings that can be used to finance benefits in future years. A series of payroll tax increases in future years is unavoidable. The Moynihan bill then goes one step further: beyond switching to pay-as-you-go financing, the bill includes additional tax increases to close an emerging long-range deficit in the retirement program.

As spelled out in the bill, in the span of just 15 years, between 2010 and 2025, the payroll tax would increase 40%, climbing to 18.3% of taxable earnings. In the aggregate, that amounts to a tax increase over the period of $1.5 trillion, in today's dollars, for a group of workers expected to outnumber retirees by only about 2 to 1. Twenty years later, the social security tax would bounce to 19.1%, fully 25% higher than the maximum rate in the law since 1977. And this is before dealing with Medicare. (Were the long-range Medicare deficit tackled in the same way, the maximum rate in the bill would be closer to 25%.)

From an economic standpoint, these rates are truly staggering. They are payable on the first dollar earned and every dollar earned up to the ceiling amount, with no deductions or exemptions. In addition, social security taxes are not deductible from the Federal income tax. Average tax rates on the order of 20% or more, layered on top of all other Federal, state and local taxes levied at that time, would impose serious distortions on already-strained labor markets

There are those who argue, Robert Myers among them, that the ultimate tax rate under the Moynihan bill is the same as it would have to be under the present financing arrangements. The argument is that the retirement fund is projected to be insolvent in 2045 and when Congress takes steps to close the long-range deficit, it will result in the same overall tax rate. But this glosses over an important point: the long-range gap can be closed by raising taxes or by restraining long-range benefit growth.

When proposals were put forth in 1983 to close the long-range deficit by tax increases, they were defeated in both the reform commission and in Congress. The long-range problem was seen to be demographic in nature, requiring long-range adjustments in benefits. The last time Congress raised taxes in an effort to solve the long-range financing problem was 1977.

The Moynihan bill also raises the prospect of a renewed financing problem within the next decade or so and periodically thereafter. While reserves at 100% of annual outgo can withstand a reasonable recession, they can not long withstand a deep or prolonged recession, or back-to-back recessions such as experienced in the late 1970s and early 1980s. Even a period of sustained low growth would erode the reserves and leave the system vulnerable to more routine economic downturns.

Apart from the obvious undesirability of having to modify social security any more frequently than necessary, pay-as-you-go financing opens the door to additional tax increases. Each of the last two financing bills, first in 1977, and then in 1983, included hefty increases in social security taxes. According to data compiled by the Finance Committee staff, the 1977 amendments increased payroll taxes nearly $400 billion during the 1980s. The 1983 amendments increased them by another $40 billion in the 1980s (not counting the $22 billion from expanding coverage or the $30 billion from the taxation of benefits).

CONFRONTING THE THE LONG-TERM LIABILITY

The social security retirement program (excluding Medicare) is slated to spend $15 trillion, in present value terms, over the next 75 years. A disproportionate share of this liability is concentrated in the years 2010 to 2030, the period spanning the retirement of the youngest and oldest members of the baby-boom generation. In this 21-year period, the SSA actuaries project that the number of people on the benefit rolls will swell by 24 million, or just over 50%, while the number of covered workers will remain flat. Benefit costs in relation to taxable payroll are thus projected to jump 50%. Leaving the full liability implied by today's benefit promises to be met by workers at that time—without setting in place policies to increase national saving and economic growth in anticipation of that liability—seems like a risky way to secure the foundation of retirement incomes for baby-boom retirees.

In my view, it is surely worth the effort to try to make advance funding work. One way is by reforming and extending Gramm-Rudman, with the objectives of increasing the visibility of the deficit in the rest of the budget and ensuring that surplus monies are used to increase government saving, not to fund current consumption. This can be accomplished in any number of ways—with social security in or out of Gramm-Rudman, and thus with long-range surplus or zero-deficit Gramm-Rudman targets. What is essential is that the overall Federal budget move into balance in 1993, as called for under Gramm-Rudman, and that the non-social security portion of the budget move into balance shortly thereafter—and stay there. In the event social security is removed from Gramm-Rudman, new limitations (such as surplus or funding ratio targets) would have to be enacted to prevent unfunded expansions of the program.

More substantial reforms are also possible. Surplus monies could be invested in individualized retirement accounts and recovered at retirement as part of the benefits offered by social security. This option would provide a most direct mechanism for controlling the use of surplus funds and increasing national saving. Its advantage over government-directed investments in the private sector is that it would avoid the problems associated with centralizing and politicizing the investment decision; on the other hand, it may require some restructuring of future benefits to more closely align taxes paid and benefits received.

If the government is unwilling to take the steps necessary to make advance funding work, then a return to pay-as-you-go-financing is, indeed, the only option left. In that sense, I agree with Senator Moynihan. Using the payroll tax to relieve pressures on the income tax or to finance new government programs is bad economic policy as well as bad social policy. But a return to pay-as-you-go financing is an option that should be coupled with restraints on long-range spending. I, for one, am not sanguine about the likely willingness of future workers to impose on themselves considerably higher taxes than we are willing to impose on ourselves today. Relatively modest steps, such as changes in the way benefits are computed for new retirees or increases in the retirement age, would bring benefit costs back into line with available resources and help make room for the greatly increased cost of health care programs for the elderly. If, in future years, there prove to be many more workers who are more productive than now anticipated, such a decision could always be reconsidered.

A FINAL THOUGHT: WHAT WAS AND WAS NOT INTENDED IN 1983

Having served on the staff of the Finance Committee and the reform commission in 1983, I would like to comment briefly on my understanding of the decisions that were made at that time about how social security should be financed. On this, I am in general agreement with Robert Myers. The 1983 legislation was not seen as fundamentally altering the way social security was financed. The intention was to, first, make reasonably sure benefits could be met through the 1980s. To provide for a margin of error, "pessimistic" economic assumptions were used, rather than the intermediate assumptions traditionally used. When the economy performed well—indeed, better than projected with the intermediate assumptions—substantial reserves accumulated.

In addition, the intention was to restore long-range balance in the OASDI trust funds. The long-range was evaluated, as it traditionally is, using a 75-year summary statistic (based on intermediate assumptions). This showed the 1983 financing package producing aggregate income roughly equal to aggregate outgo over the period.

The 1983 financing package thus appeared minimally adequate in the short-range and, for a pay-as-you-go system, adequate over the long-range. There were no year-by-year or decade-by-decade projections (beyond 1990) which would have revealed, and helped focus attention on, the large build-up and subsequent depletion of reserves or the substantial contribution of interest to the overall financing of social security. These projections did not become available until after the legislation was enacted.

Apart from this, the prospect of sustained surpluses would have seemed very remote at the time. Social security had been running deficits for 8 straight years and was finally facing system-wide insolvency. Policymakers were coming out of a decade-long period in which the actuaries pronounced the system solvent only to find it insolvent again. Little wonder the debate over the investment and management of trust fund assets was limited to a relatively unimportant side-issue: the interest rate to be paid on special-issue government bonds.

Advance funding was thus a *by-product* of the decisions made in 1983—particularly the decision to have a level payroll tax rate after 1990 in the face of known demographic trends—rather than the outcome of a reasoned debate and conscious choice to abandon pay-as-you-go financing. Had it been more than that, Congress surely would have explored—if not resolved—some of the issues we now confront, including: how large a reserve fund should be accumulated and how quickly, what financial instruments should reserves be invested in, and who should make those investment decisions.

Apart from the question of how the system should be financed, there was also the question of how high the ultimate payroll tax rate should be. On this, there was considerable debate, and considerable difference of opinion. As mentioned above, though, the majority view was that the maximum rate established in 1977 should not be increased. The 1983 amendments simply accelerated the 1977 tax schedule.

On the basis of this, I conclude that the Moynihan bill would not alter any decisions regarding funding basis per se; it would, however, alter what was a central decision on taxes.

COMMUNICATIONS

AMERICAN BAR ASSOCIATION,
Washington, DC, March 21, 1990.

Hon. LLOYD BENTSEN, *Chairman,*
Committee on Finance,
U.S. Senate,
Washington, DC

Dear Mr. Chairman: In connection with your Committee's recent hearings on proposals to reduce Social Security taxes I am writing to share with your Committee the policy of the American Bar Association on the subject.

The ABA's House of Delegates at its February 1990 Midyear Meeting addressed the issue of proposed Social Security tax cuts and passed a resolution opposing legislation which would cut significantly current Social Security tax rates and return the financing of social Security to a "pay-as-you-go" system. The Association also took the position that the trust fund should be removed from the Federal Government's operating budget. Since the true Federal deficit is being masked by including the Social Security trust fund. The report of the ABA's Commission on Legal Problems of the Elderly that provided background to the House in adopting the ABA policy is also enclosed. The background report does not constitute ABA policy. Only our resolution is ABA policy.

The ABA has long been interested in the soundness and solvency of the Social Security system. The ABA, through its Commission on Legal Problems of the Elderly, has devoted a great deal of its time over the years to advocating improvement of the Social Security and health care systems. It is the belief of the ABA and its Commission that nothing is more important to the elderly population of the country and to those who will retire in the future than a sound and solvent Social security system in which they can have confidence. The pending legislation introduced by Senator Moynihan (S. 2016) raises serious doubts on that score and undermines the public's confidence in the system.

Thank you for the opportunity to provide you with the ABA's position on proposed Social Security tax cuts. The ABA would be pleased to present testimony should your Committee conduct additional hearings on this issue. We ask that this letter be made a part of the hearing record.

Sincerely,

ROBERT D. EVANS.

Attachments.

AMERICAN BAR ASSOCIATION COMMISSION ON LEGAL PROBLEMS OF THE ELDERLY—REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

BE IT RESOLVED, that the American Bar Association opposes legislation which would cut significantly current Social Security tax rates and return the financing of Social Security to a "pay-as-you-go" system.

BE IT FURTHER RESOLVED, that the American Bar Association, recognizing that the true Federal deficit is being masked by including the Social Security trust fund, supports legislation to remove the trust fund from the Federal Government's operating budget.

REPORT

The Old-Age, Survivors and Disability Insurance Program (OASDI)—our Social Security system is funded through a non—progressive payroll tax (FICA) on the first $51.300 in income Based on legitimate concerns that this revenue will be insufficient when the so-call "baby boomer" generation begins retiring around 2010. Congress in 1983 enacted legislation scheduling step increases in the tax to ensure the solvency of the Social Security trust fund. This was done on the basis of recommendations by a bipartisan commission that considered in 1982-83 what was required to keep the Social Security system solvent As of January 1990, the trust fund totals approximately $65 billion.

Notwithstanding the original intent behind the trust fund, the Federal Government is using these reserves for current operations rather than for debt reduction or investment. This practice masks the true Federal deficit, resulting in unsound fiscal policy and erosion of confidence in the future solvency of the Social Security system.

In response to this fiscal imbalance—as well as to the recent FICA increase—Senator Daniel Patrick Moynihan (who was a member of the bipartisan study commission) introduced legislation (S. 2016) on January 23, 1990 to cut significantly the OASDI tax rates and return Social Security financing to a "pay-as-you-go" system. Under this mechanism, the government will collect only money needed to take care of today's retirees, but not future retirees.

Nothing is more important to the elderly population of the country and those who will retire in the future than a sound and solvent Social Security system in which they can have confidence. The pending legislation raises serious doubts on that score and undermines the public's confidence in the system.

Accordingly, the American Bar Association recommends that the Association oppose this legislation for the reasons spelled out in the attached position paper developed by the Save Our Security (SOS) Coalition. The Commission also recommends that the Association adopt the position that the Social Security trust fund should be removed from the Federal Government's deficit calculation, for reasons also discussed in the SOS position paper. SOS is a coalition of over 100 national, state, local, labor, aging, disability and religious organizations that support a strong Social Security and health care system. The Coalition is chaired by the Honorable Arthur S. Fleming, former Secretary of Health, Education and Welfare, a former member of the ABA Commission on Legal Problems of the Elderly, and a foremost expert on the Social Security system. The position paper was developed with the assistance of another leading expert on the Social Security system, the Honorable Robert Ball, a long-time former Commissioner of the Social Security Administration. Many SOS member organizations have endorsed the position paper, including the American Association of Retired Persons (AARP). National Education Association (NEA), National Council of Senior Citizens (NSCS) and Families U.S.A. (formerly The Villers Foundation).

Respectfully submitted,

JOHN H. PICKERING, *Chair*,
Commission on Legal Problems of the Elderly.

POSITION PAPER ON THE MOYNIHAN SOCIAL SECURITY TAX CUT BILL

SAVE OUR SECURITY COALITION (SOS)

Senator Moynihan has raised a valid and important point about the fiscal imbalance in the Federal Government's operating budget and the fact that the true Federal deficit is being masked by including the Social Security reserves when determining the deficit. The SOS Coalition believes:

There should be *no* immediate-cut in the OASDI tax rates.

- Old-Age, Survivors and Disability Insurance does not yet have sufficiently large contingency reserves.
- Most experts believe, at a minimum, a 1 to 1½ year contingency reserve is necessary to protect the system in times of economic downturns.
- Currently the contingency reserve is at three-fourths of a year. A 1½ year's reserve will not be reached until approximately sometime between 1993 and 1995 depending on economic performance.

The Social Security trust funds should be removed from the Gramm-Rudman-Hollings deficit calculation.[1]

- If the trust funds were removed from the Gramm-Rudman-Hollings calculation, the Social Security trust funds would cease to "mask" the deficit, thereby, encouraging action to reduce the non-Social Security deficit.
- If the Social Security trust funds are not counted in calculating the size of the deficit either taxes should be increased to provide additional revenues or the Gramm-Rudman-Hollings law should be substantially revised in order to prevent serious reductions in vital domestic programs.
- SOS believes that a sizable reserve must be preserved in the Social Security trust funds in order to avert major benefit cuts or payroll tax increase in the future.
- However, the specific level of surplus and the payroll taxes necessary to support that level is a subject of legitimate debate and discussion.

If the goal of the Moynihan proposal is tax relief for middle- and low—income workers, consideration should be given to ways to accomplish that goal which will not erode confidence in the Social Security System. (For example, expansion of the earned-income-tax—credit.)[2]

- It should also be recognized that the Moynihan plan provides for reducing taxes for employers without establishing any need for such relief.
- In addition the Moynihan plan lowers the Social Security tax rates for both but does not have a plan to increase taxes in order to offset the additional deficit created by this cut.
- The Moynihan plan, by removing large amounts of revenue from the operating budget and not replacing them, could in the short-run, result in a sequester that would negatively affect vital domestic spending programs.
- The Treasury, as it has been doing since the beginning of Social Security over 50 years ago, is investing the Social Security reserves in government securities and when it does so is issuing demand notes with the same legal standing as a government bond and is making regular interest payments on these notes.
- The unsound fiscal policy now being followed by the Federal Government results in the money borrowed from the trust funds being used for current operations rather than for debt reduction or investment.
- A sound fiscal policy would result in the money borrowed from the trust funds being used, for example, to help retire the Federal debt. This, in turn, would mean that the Federal Government's financial burden of redeeming the demand notes in the trust funds would be much easier to meet when the payment of benefits begins to exceed income in approximately 2020.

Statement of the American Foundation for the Blind

This statement is submitted for the record on behalf of the American Foundation for the Blind, in the hearing on proposed cuts in the Social Security Tax.

The American Foundation for the Blind is a national nonprofit organization whose primary mission is to ensure the development, maintenance and constant improvement of services for blind and visually impaired people in the United States. Recognized as Helen Keller's cause in the United States, AFB works in partnership with more than 1,000 specialized agencies, schools and organizations of and for blind people.

The American Foundation for the Blind is in favor of a reduction in the Social Security tax now, and subsequent cuts as necessary to maintain the Social Security Trust Fund on a pay-as-you-go basis, with a one and one-half or two years reserve. Further, the Social Security Trust Fund should be removed from consideration as part of the Federal budget process that permits the fund to mask the budget deficit.

It is unfortunate that current reserves are used to mask the deficit, and if continued will make it more difficult to remove the fund from budget deficit considerations.

One of our concerns is that if the Fund is permitted to balloon and hide more and more of the actual deficit, political considerations may cause legislation to actually raid the fund by moving the excess over pay-as-you-go needs and applying that

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[1] Tampering with the Social Security System now could seriously erode the confidence of both the beneficiary and the worker populations that has been established as a result of the 1983 amendments to the Social Security Act.

[2] Allegations that the Government is "stealing" from the trust funds result in serious misunderstandings:

excess to an actual budget deficit reduction. In effect, we can see the possibility of the U.S. Government reneging on its debt to the Fund and using the trust fund for actual budget purposes.

If the Federal Government cannot now stand up and act to overcome the deficit problem by removing the Social Security Trust Fund (as well as other Trust Funds) from the general budget, how can it do so in the future when the situation will be worse?

It should be recognized that a large buildup in the Social Security Trust Fund will not alleviate the problems of taxes in the future. The money will still be "borrowed" by the general treasury and the taxpayer will have to foot the fill when payments are due. Lowering taxes now will not acerbate the problem.

The FICA tax should he lowered to give the lower income workers and employers some break. The taxes are very regressive to a low income employees and their employers. As you recognize, even at the minimum income tax level of 15%, an additional 7.65% tax on all earned wages makes a large difference in spendable income. A low income person with a 22.65% tax, plus a state/county income tax (as high as 11% in some States), property taxes and sales taxes does not have much left to pay rental or mortgage and leave much for daily living. That probably has something to do with the low savings rate in the United States.

The Foundation's concerns are for all people affected by the FICA tax problem; and in particular with people who are blind and attempting to maintain themselves in the labor market. As a general rule, earnings by blind workers are lower than the average for non-disabled workers and the tax bite has very adverse effects on them.

In summary, it is our proposal that (1) the FICA tax rate be lowered to give low income people a tax break inasmuch as the trust fund is being built up and used to manipulate deficit figures. If the tax is continued as is, the social security worker is being taxed to build up a fund that will cause greater deficit problems and then will be taxed to pay off the debt to that fund later. A pay-as-you go system is better since it represents the actual needs; (2) Remove the cap on income subject to FICA at the same time the tax rate is lowered. This will permit the trust fund to carry the benefit pay out, build a reserve of one or one-and one half years benefits; and (3) transfer more of the FICA tax into the Medicare fund. The Medicare fund can use additional funding to provide better health care services and for long term care. This will help maintain the Medicare fund into the next century.

Statement of the Brookings Institution

[By Ralph C. Bryant]

MACROECONOMIC CONSEQUENCES OF SENATOR MOYNIHAN'S PROPOSAL FOR REDUCING SOCIAL SECURITY PAYROLL TAXES

The attached charts summarize differing estimates of the likely macroeconomic consequences of adopting Senator Moynihan's proposal for reducing the social-security payroll tax.[1] I assume, deadpan, that the Congress and the Administration follow the Senator's suggestions for reducing the payroll tax, but do not make any other changes in expenditures or tax rates. This assumption does not embody a probability estimate, one way or another, of the Moynihan proposal being adopted. Rather, I merely ask the "what if" question: how would economic activity, inflation, interest rates, and the U.S. external imbalance change if Senator Moynihan's suggestions were actually implemented?

These estimates are the result of a short-cut analytical procedure for obtaining model-based predictions. The raw material for the procedure is a set of standardized simulations from several different multi-country macroeconometric models. The models are diverse—none is fully reliable—and yield predictions that differ significantly from each other. The estimates here are thus, at best rough orders of magnitude.[2]

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[1] Warwick McKibbin contributed the simulations from the MSG2 model. Henry Aaron and Robert Solomon made useful suggestions. Glenn Yamagata provided able research assistance.

[2] For details of the analytical procedures and how they are based on standardized model simulations, see Bryant, Henderson, and others (1988, chap. 4). None of the modeling groups whose simulations are inputs to the calculations have endorsed my particular use of their simulations or participated in the preparation of this note. The modeling groups should thus be absolved of any responsibility for the inferences I have drawn here about Senator Moynihan's proposal.

Despite severe uncertainty about the appropriateness of any individual model, these estimates for a variety of models are, taken together, indicative of the likely consequences of the Moynihan proposal. I know of no other analytical procedure that yields more reliable estimates.

Two sets of charts are presented. The first, labeled A, shows the effects of the Moynihan proposal on the assumption that the Federal Reserve keeps monetary policy unchanged. The second set, labeled B, makes the more realistic assumption that the Federal Reserve pursues an incrementally restrictive monetary policy to offset the stimulative effects on output and prices of the incrementally expansive fiscal policy.

The first-year macroeconomic consequences in 1990 would be small, according to most models, because the proposed 1990 changes in the Moynihan tax reductions are themselves small.[3] For the second year and thereafter, the effects on most major macroeconomic variables would be sizable.

The reduction in payroll taxes without any change in the money stock would have the typical consequences of stimulative fiscal policy. Real GNP would rise by some ¾ to 1½ percent relative to what it otherwise would have been (chart A-1). The price level, and hence inflation, would be higher (A-2). Nominal short-term and long-term interest rates would rise, perhaps by more than a percentage point (A-3 and A-4). Even real (inflation-adjusted) interest rates could rise perceptibly (A-5). The budget deficit would rise sharply (A-6), in the second year (1991) by some ⅓ to ¾ percent of GNP and increasing to some ¾ to 1¾ percent of GNP after several more years; in current-dollar amounts, this would be an increase in the deficit of some $25-50 billion in 1991 and some $60-120 billion by 1995-96. The dollar would probably appreciate by a modest amount (A-7), while the current-account deficit (A-8) would rise by increasing amounts through time (for example, to some .2 to .7 percent of GNP by 1995-96, or some $20-85 billion).

Assessment of whether these incremental changes in the economy are bad or good depend, of course, on what the performance of the economy would be in the absence of the payroll tax deductions. The consequences for inflation and aggregate economic activity would be clearly unfortunate if the economy were otherwise growing along an acceptable path. If the economy were soft, the incremental buoyancy attributable to the payroll tax deductions would not, by itself, be unwelcome. Any policy stimulus to aggregate demand necessitated by a soft economy, however, should preferably come from monetary rather than fiscal policy. Fiscal stimulus would cause interest rates and the twin deficits to be larger than with monetary stimulus, with unambiguously inferior results for national saving and domestic investment.

The Federal Reserve tries to keep nominal aggregate demand growing at a pace consistent with the economy avoiding either a recession or a resumption of higher inflation. The most plausible assumption to make about Federal Reserve policy, therefore, is that she Federal Open Market Committee would respond to enactment of the Moynihan proposal by tightening monetary policy (somewhat in the first year, by a larger amount in subsequent years). The B set of charts explore the likely consequences of a Federal Reserve policy sufficient to roughly offset the effects on real GNP of the payroll tax deductions. Such a policy would restrain price increases (compare charts B-2 and A-2). But it would lead to dramatically higher nominal interest rates, especially for short-term rates in 1991 (B-3 and B-4). Real interest rates could rise by well over 100 basis points (B-5). The added interest costs of servicing the government's debt would lead to still more ballooning of the budget deficit (compare charts B-6 and A-6), a sizable additional appreciation of the dollar in exchange markets (B-7), and still further worsening of the external imbalance (B-8).

The interest-rate, exchange-rate, and budget-deficit consequences of the Moynihan tax reductions, even by themselves but especially if heightened by the likely tightening of Federal Reserve policy, would be precisely the opposite of what the country needs to increase national saving and domestic investment. Consumption would rise and investment would be markedly lower than what would otherwise occur. If the current generation of political leaders in this country seriously cares about the future welfare of their children and their children's children (including the equity and the efficiency of the then-prevailing Social Security system), they will not be able to adopt Senator Moynihan's proposal.

Senator Moynihan is fundamentally correct in stressing the misuse of the surplus in the Social Security trust funds to mask the deficit in the rest of the Federal gov-

[3] Models that emphasize forward-looking expectations predict somewhat larger effects in the first year, since the announcement in the first year of the entire program is assumed to lead consumers and investors to anticipate the effects that occur in later years.

ernment's accounts. His frustration and anger with the President and the Congress for their failure honestly to cope with the budget deficit is justified. It has been inequitable to have payroll taxes rising sharply in recent years while personal income taxes as a share of government revenue have correspondingly fallen. Nonetheless, these trenchant points do not warrant adoption of Senator Moynihan's proposal.

It is often said that the proposal is intended merely to catalyze a better debate about budget and Social Security priorities, and that enactment of the payroll tax reductions would subsequently force the needed changes in government expenditures and other (non-payroll) tax policies. Such an outcome is conceivable. But at the least this line of reasoning is dangerous—tantamount to the argument that, when one's car is stuck in three feet of mud at the edge of a swamp, the recommended way to get out is to drive still deeper into the swamp to dramatize the seriousness of the situation.

EXPLANATORY NOTES FOR THE CHARTS

The charts are stapled in two groups. The set labeled A plots the effects of the Moynihan proposal on the working assumption that the Federal Reserve maintains monetary policy unchanged (defined as keeping the money stock unchanged on a "baseline" path). The B set of charts, in contrast, makes the illustrative assumption that the Federal Reserve pursues a more restrictive monetary policy, sufficient to keep real GNP roughly unchanged from the "baseline" path it would have followed without the Moynihan tax reductions.

The charts show deviations from a "baseline" path. The baseline is a projection of what would happen in the absence of policy changes. The baseline paths themselves are not plotted; instead, the charts concentrate on the incremental changes resulting from the Moynihan tax reductions (and, in the B set of charts, from the offsetting modifications in Federal Reserve policy). In effect, the baseline paths are the horizontal lines beginning at the zero points on the vertical scales.

Separate charts are shown for eight U.S. macroeconomic variables: real GNP, the price level (consumer price index), short-term and long-term interest rates, an inflation-adjusted ("real") long-term interest rate, the budget deficit as a share of nominal GNP, the exchange value of the U.S. dollar, and the current-account balance as a share of nominal GNP. As an indication of the effects on foreign countries, charts are also included for Japanese real GNP and German real GNP.

The most prominent curve in each chart, the heavy solid line, refers to an *average* prediction, obtained by averaging a subsample of 13 different model simulations.[4] The charts also show several other curves prominently (heavy dashed lines); these curves, intended as a measure of the variability of models' responses, define a crude "confidence" region around the average. This region was calculated by adjusting the underlying simulation responses by plus and minus one standard deviation around their means. Thus in the A charts, the curve labeled "stronger" fiscal policy represents the predicted outcome with fiscal policy assumed to be more powerful than the average response by one standard deviation, and vice versa for "weaker." In the B charts, since both fiscal and monetary policies are assumed to change, there are correspondingly four curves showing the calculated effects for "stronger" and "weaker" policies (stronger fiscal impacts combined with stronger monetary impacts; weaker fiscal impacts combined with weaker monetary impacts; weaker fiscal impacts combined with stronger monetary impacts; stronger fiscal impacts combined with weaker monetary impacts). The two of the four combinations defining the outer boundaries of the region are highlighted.

The charts also plot the predicted consequences for selected individual models (but not all those used in calculating the average and its confidence region). The individual model predictions shown are derived from standardized simulations of two differing versions of the Federal Reserve staff's Multi-Country Model (MCM1 1986 and MCM2 1988), two versions of the OECD's INTERLINK model (OECD1 1986 and OECD2 1988), the 1986 version of Data Resources Inc. international model (DRI 1986), the 1988 version of the Federal Reserve staff's MPS model (MPS 1988), the 1989 version of a rational-expectations model constructed by Warwick McKibbin and Jeffrey Sachs (MSG2 RE), and adaptive-expectations and rational-expectations versions of the INTERMOD 1.2 model constructed by a group at the Canadian De-

[4] Details of how this average was calculated, as well as information on the individual models included, are given in Bryant, Helliwell, and Hooper (1989). This average is a rough and ready measure of central tendency, but is only one of several different averages that could be calculated.

partment of Finance. A primary source document describing each of these individual models is given in the list of references below.

When making these calculations, I made the following assumptions about the tax-revenue loss that would result from Senator Moynihan's proposal:

	Year	Dollar amount in current prices	Dollar amount as percent of nominal current-price GNP	Amount in constant 1990 dollars
1	(1990)	7.0	0.124	7.0
2	(1991)	55.0	0.907	52.4
3	(1992)	59.1	0.907	53.8
4	(1993)	63.6	0.907	55.1
5	(1994)	68.3	0.907	56.5
6	(1995)	73.5	0.907	57.9
7	(1996)	79.0	0.907	59.3

The estimates of $7 billion and $55 billion for 1990 and 1991 are based on newspaper accounts of Senator Moynihan's proposal. The underlying numbers for GNP assume growth in real GNP along the baseline of 2-1/2 percent per year, baseline growth in the GNP deflator of 4.88 percent per year, and hence a growth in nominal GNP along the baseline of 7-1/2 percent per year. The implicit assumption is that the tax revenue lost from the Moynihan proposal grows proportionately with the economy after 1991.[5]

In the B set of charts, the Federal Reserve is assumed to tighten monetary policy so as to offset the effects on real GNP of the payroll tax deduction. The amount of tightening required varies, of course, across the models. As an illustrative approximation, I chose a path for monetary policy, measured in terms of deviations of the level of the money stock from baseline, that roughly keeps the average real GNP across models unchanged. This path reduces money below the baseline level by ½ percent in the first year (1990), and by 4½ percent in 1991 and each subsequent year.

The standardized model simulations for U.S. fiscal policy on which this analysis is based are available, for a wide range of models, only for changes in government expenditures. In principle, the analysis should make use of standardized simulations for changes in tax rates, including simulations differentiating between payroll taxes, personal income taxes, corporate income taxes, and excise or sales taxes. When it was possible for me to obtain direct simulation output from assumed changes in taxes (INTERMOD model and the MSG2 model), those data were used in the projections. For the other models and the averages, the effects are proxied by using the simulation output from changes in government expenditures. My use of this approximation is yet another reason why these estimates should be treated as only illustrative. For a summary of the available empirical evidence on the differential effects of alternative types of fiscal actions (including a contrast between expenditure changes and tax changes), see Bryant, Helliwell, Hooper (1989, section V).

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[5] The baseline includes, of course, the payroll tax increase that took effect on January 1, 1990 and the increase scheduled for January 1991; the simulations, following Senator Moynihan's suggestions, assume that those increases are rolled back, thereby generating the revenue losses relative to baseline.

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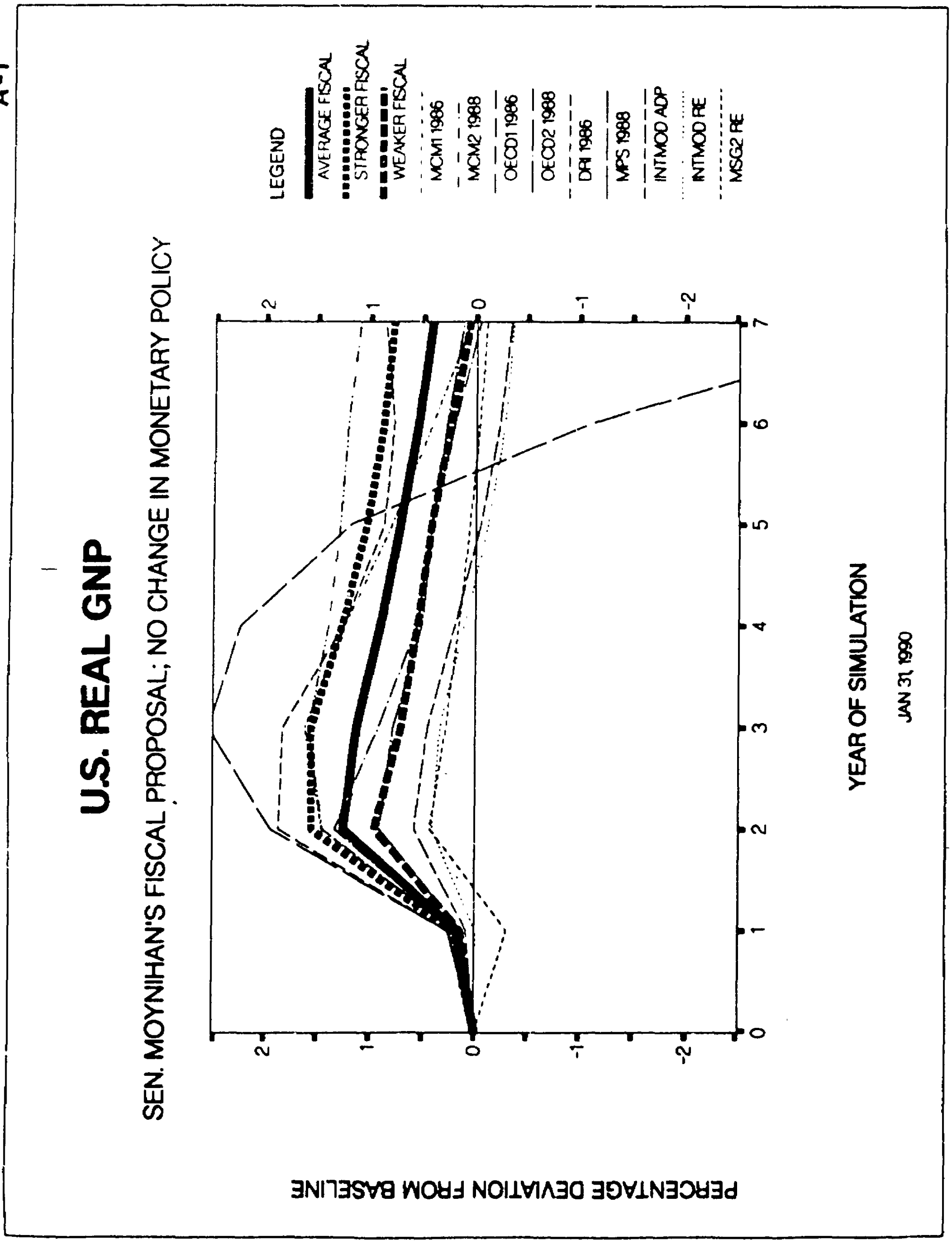
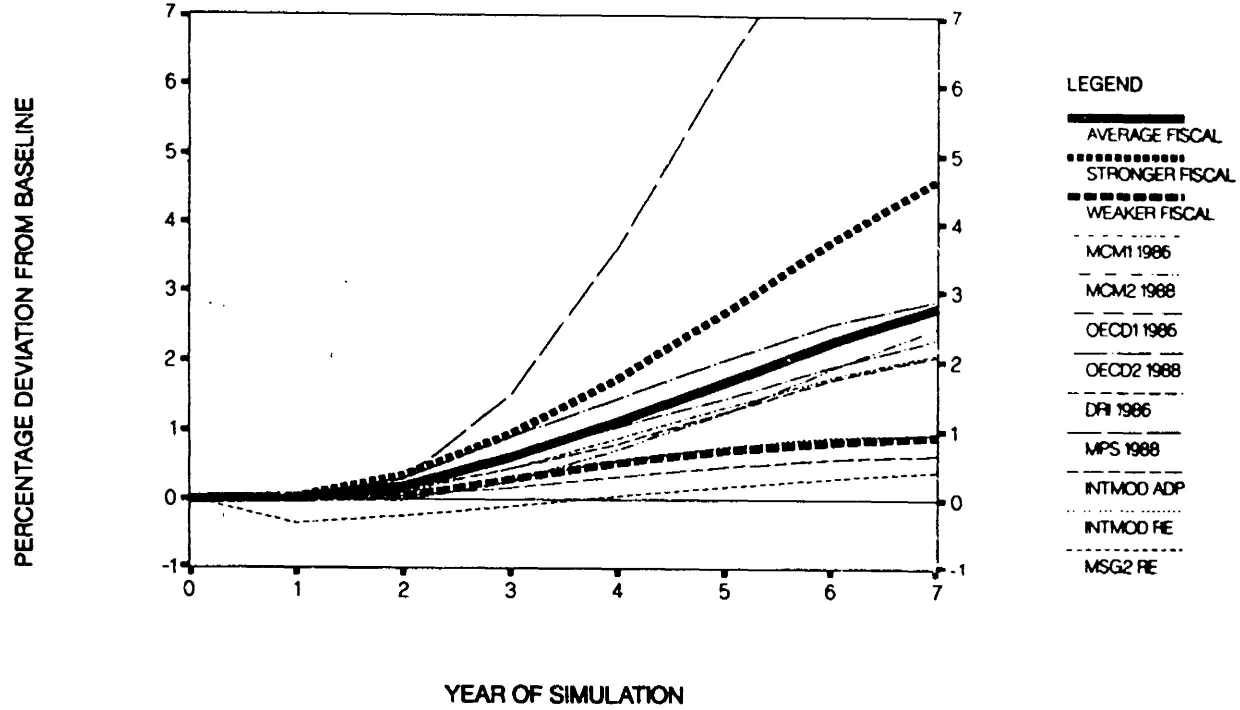
ILLUSTRATIVE CHARTS: MACROECONOMIC CONSEQUENCES OF SENATOR MOYNIHAN'S PROPOSAL FOR REDUCING SOCIAL SECURITY PAYROLL TAXES



U.S. CONSUMER PRICE INDEX

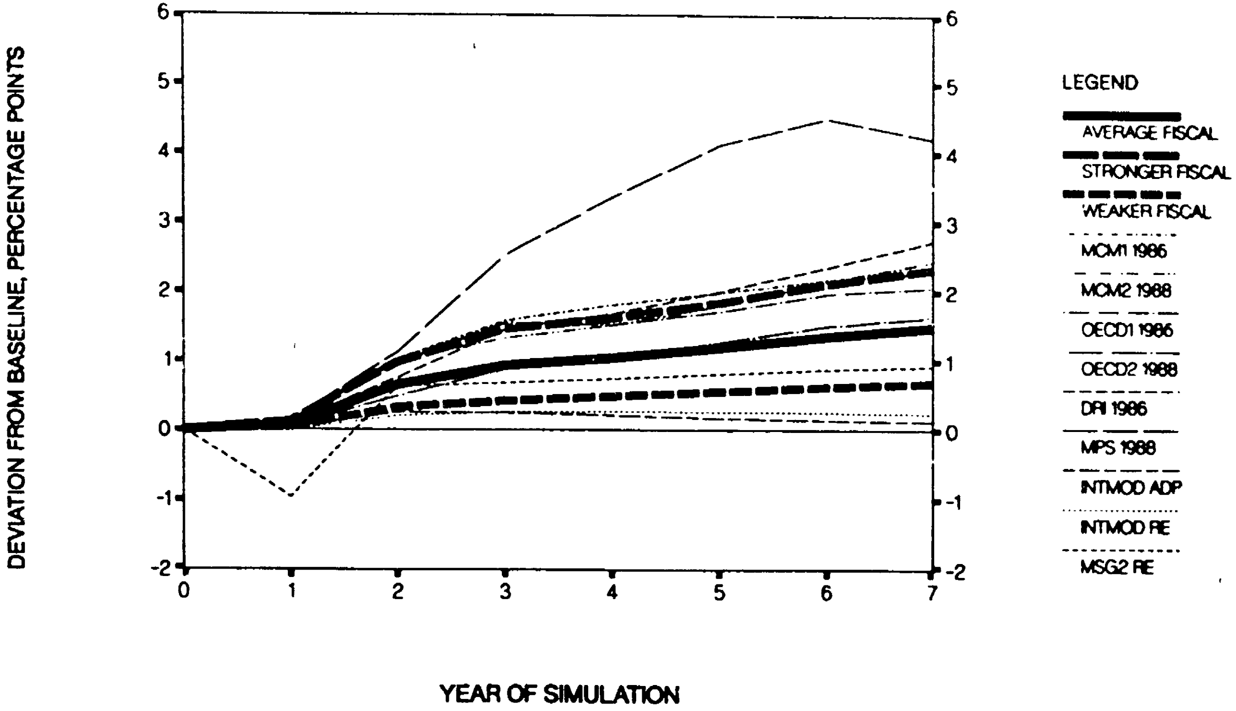
SEN. MOYNIHAN'S FISCAL PROPOSAL; NO CHANGE IN MONETARY POLICY



JAN 31, 1990

U.S. SHORT-TERM INTEREST RATE

SEN. MOYNIHAN'S FISCAL PROPOSAL; NO CHANGE IN MONETARY POLICY



JAN 31, 1990

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U.S. LONG-TERM INTEREST RATE

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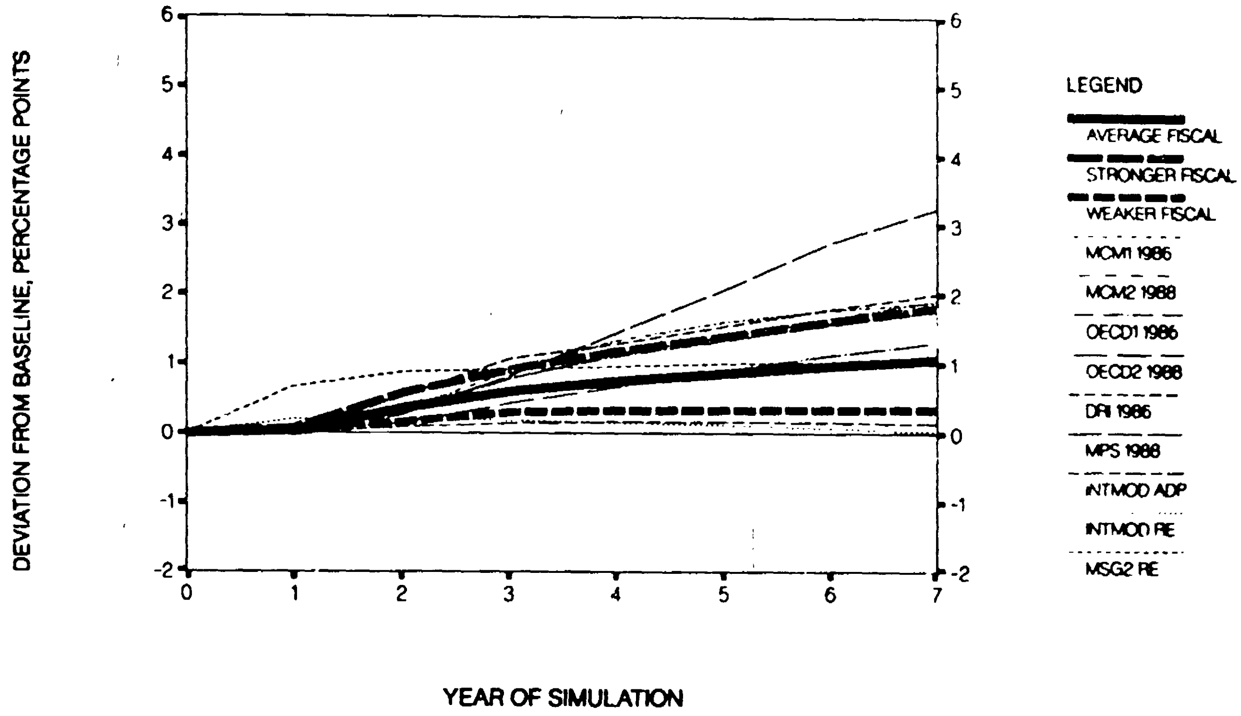
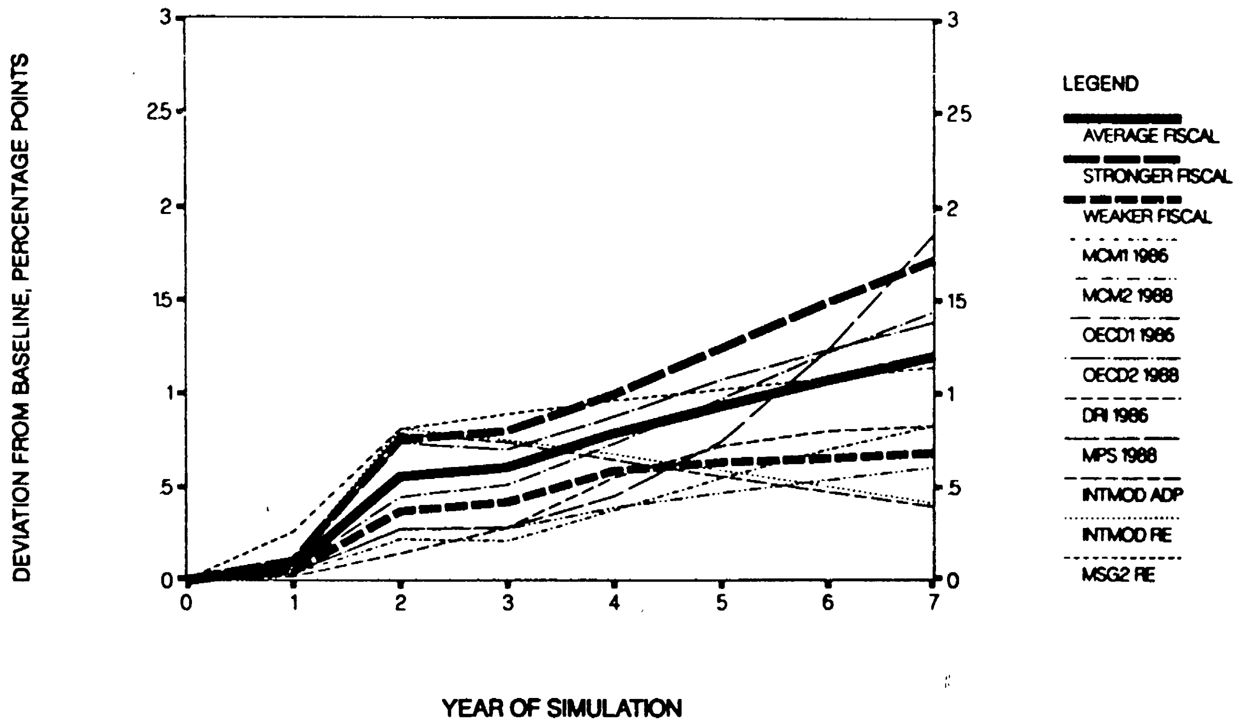


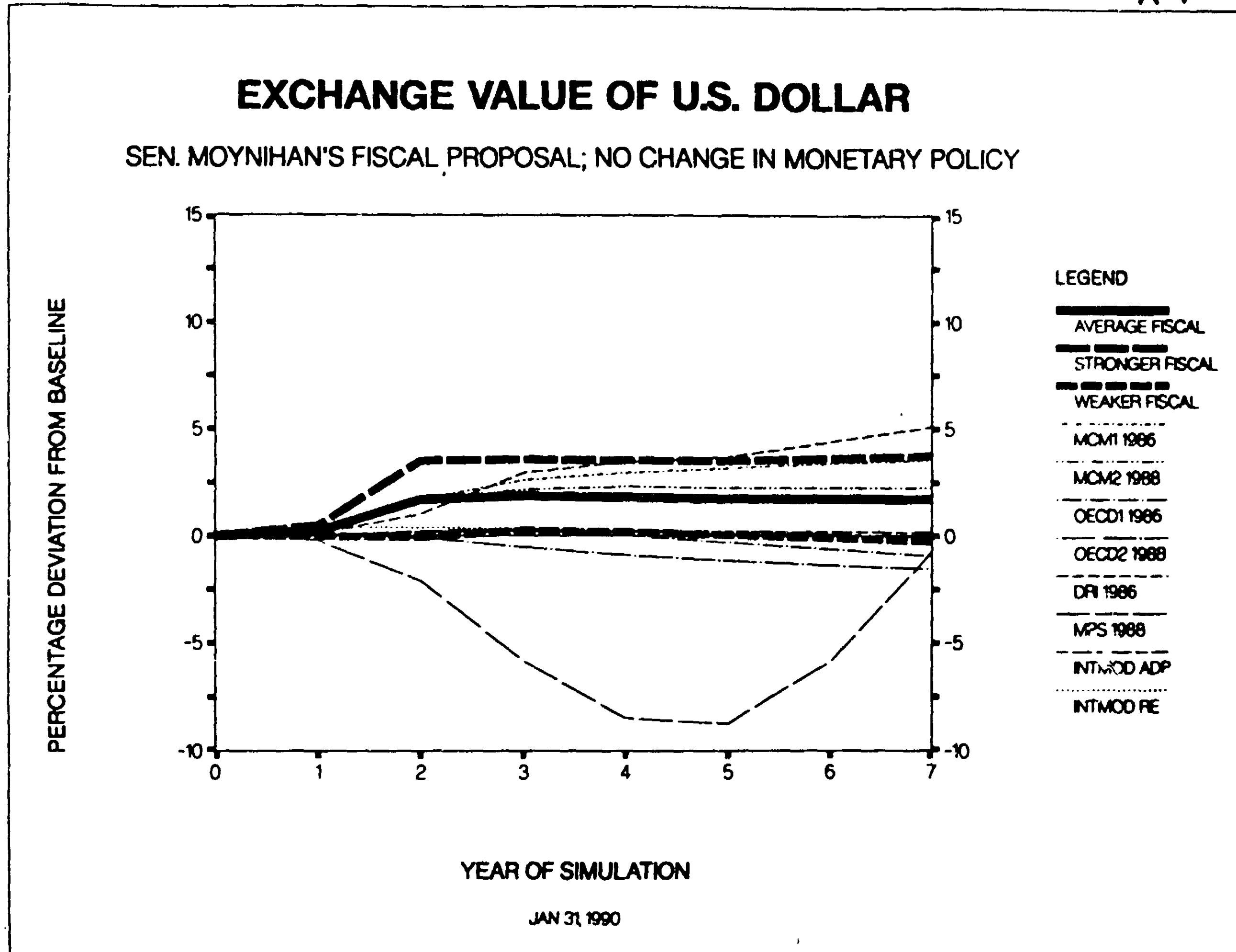
JAN 31, 1990

U.S. BUDGET DEFICIT AS SHARE OF NOMINAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; NO CHANGE IN MONETARY POLICY



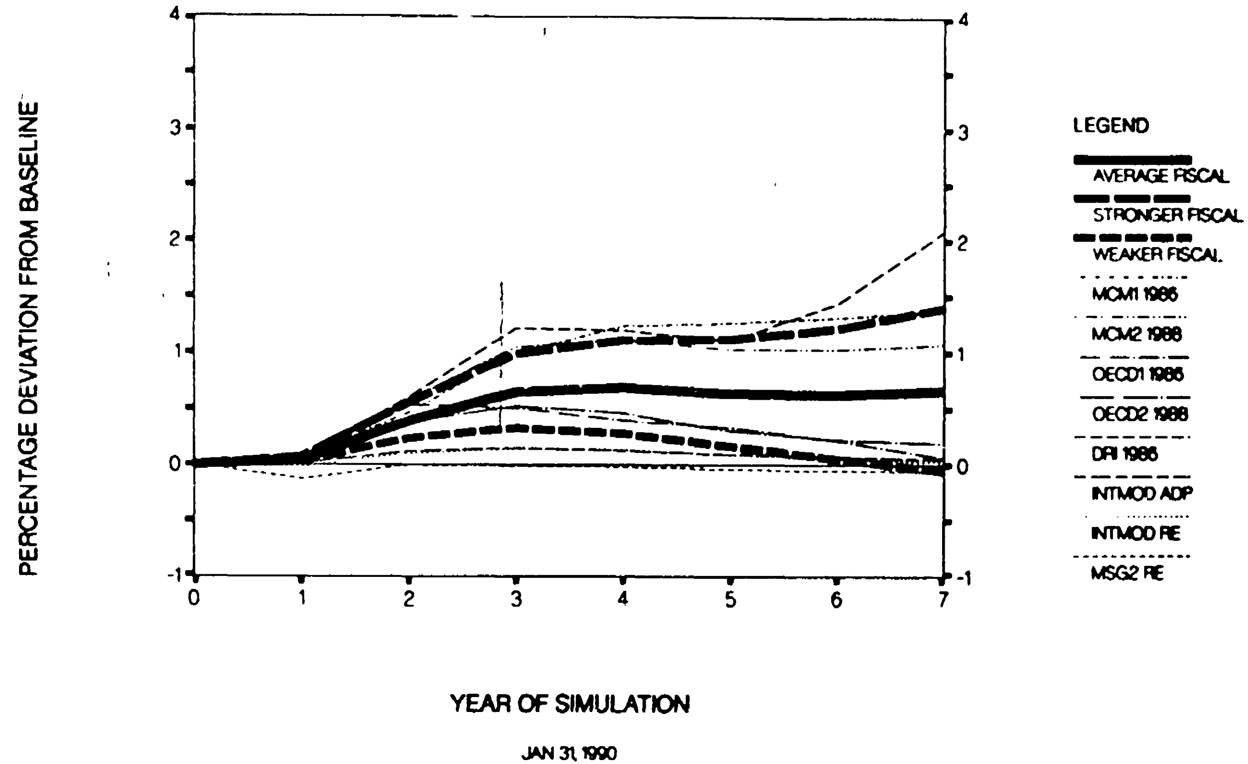
JAN 31, 1990



EXCHANGE VALUE OF U.S. DOLLAR
SEN. MOYNIHAN'S FISCAL PROPOSAL; NO CHANGE IN MONETARY POLICY
PERCENTAGE DEVIATION FROM BASELINE
15
10
5
0
-5
-10
0
1
2
3
4
5
6
7
YEAR OF SIMULATION
LEGEND
AVERAGE FISCAL
STRONGER FISCAL
WEAKER FISCAL
MCM1 1986
MCM2 1988
OECD1 1986
OECD2 1988
DRI 1986
MPS 1988
INTMOD ADP
INTMOD RE
JAN 31, 1990

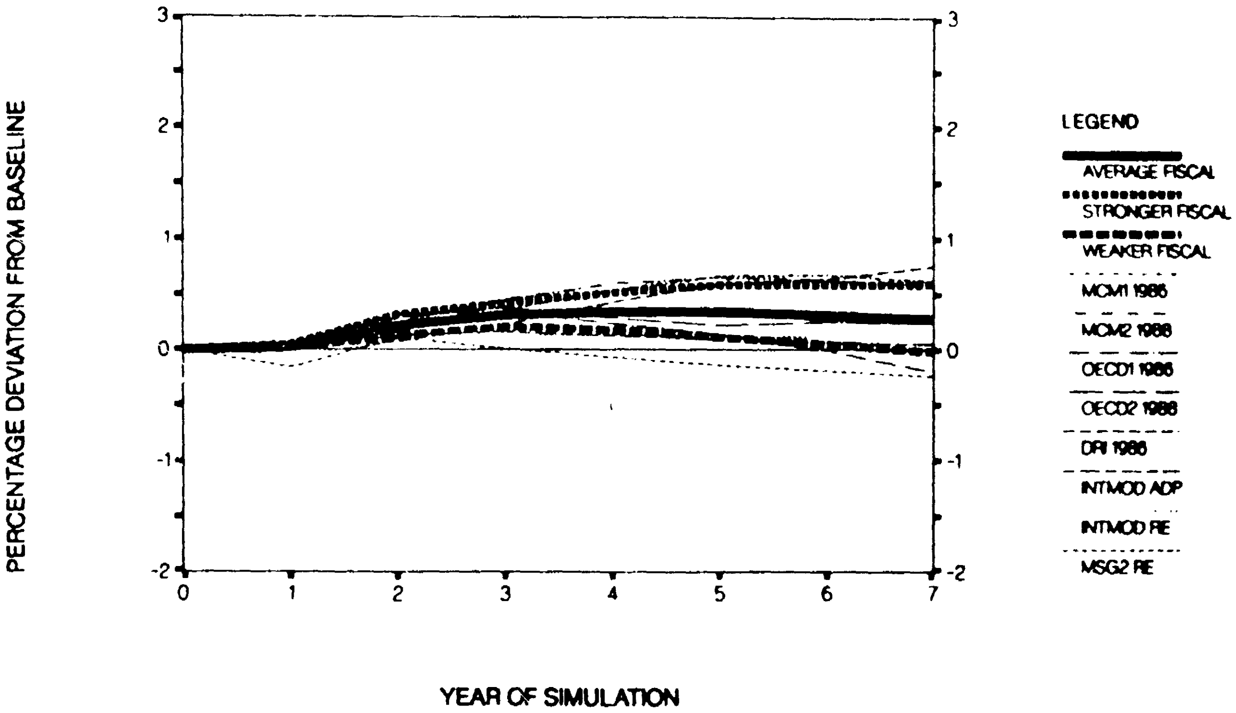
JAPANESE REAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; NO CHANGE IN MONETARY POLICY



GERMAN REAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; NO CHANGE IN MONETARY POLICY

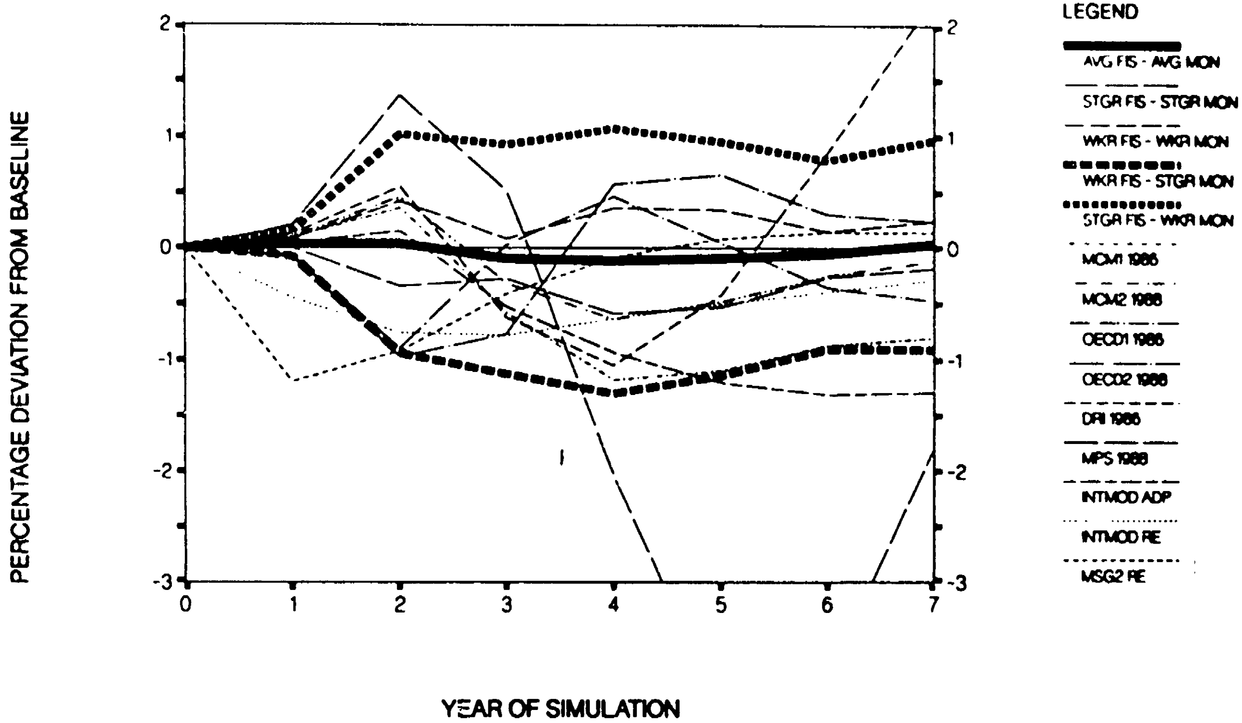


JAN 31, 1990

B-1

U.S. REAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY

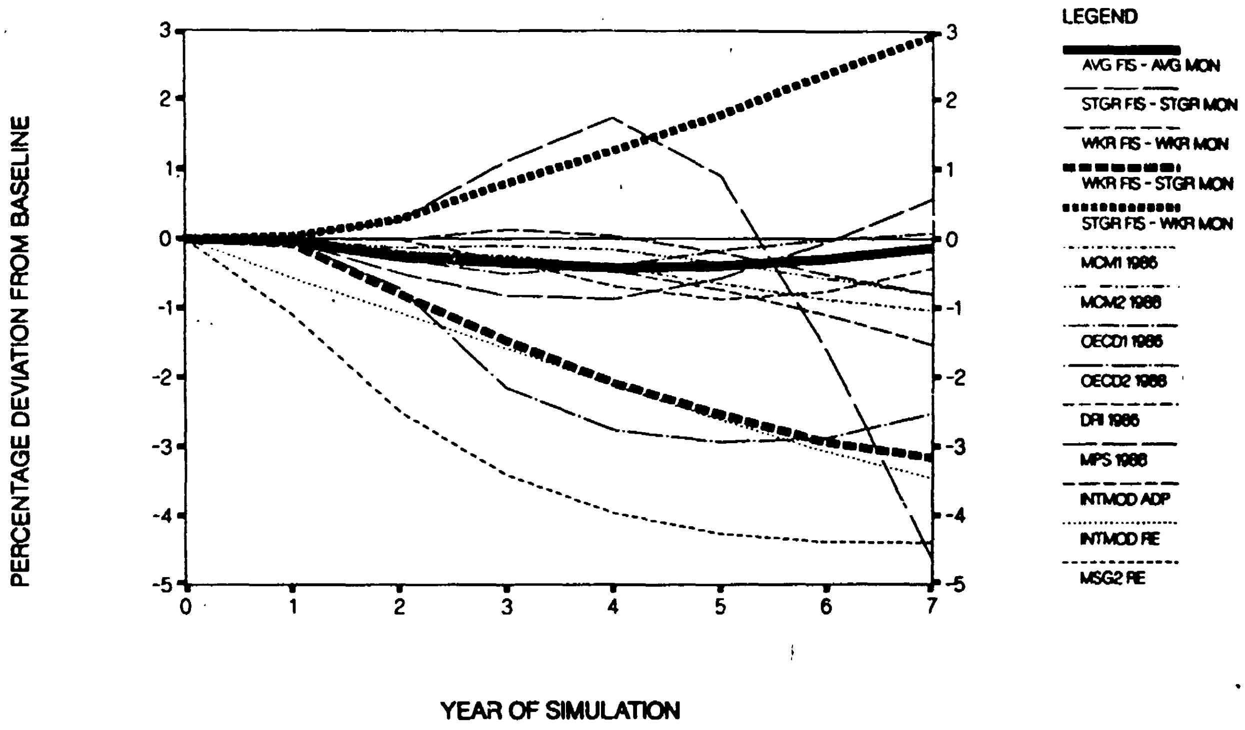


JAN 31, 1990

B-2

U.S. CONSUMER PRICE INDEX

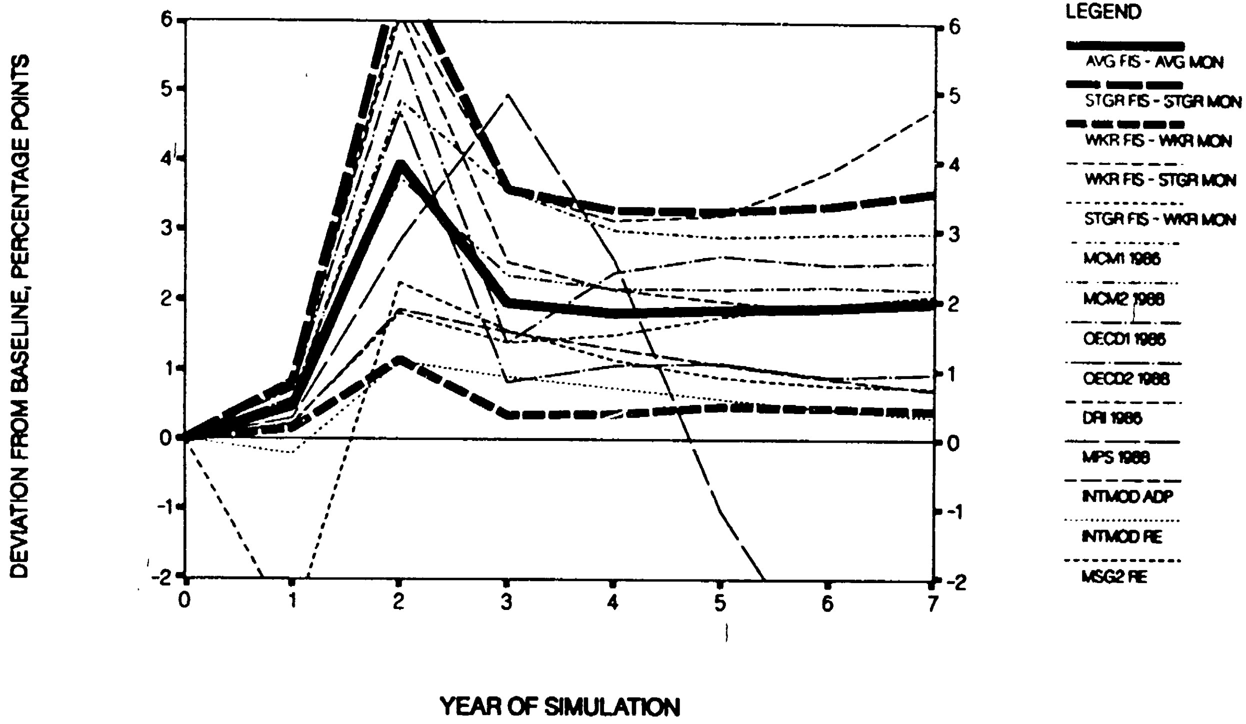
SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY



JAN 31, 1990

U.S. SHORT-TERM INTEREST RATE

SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY

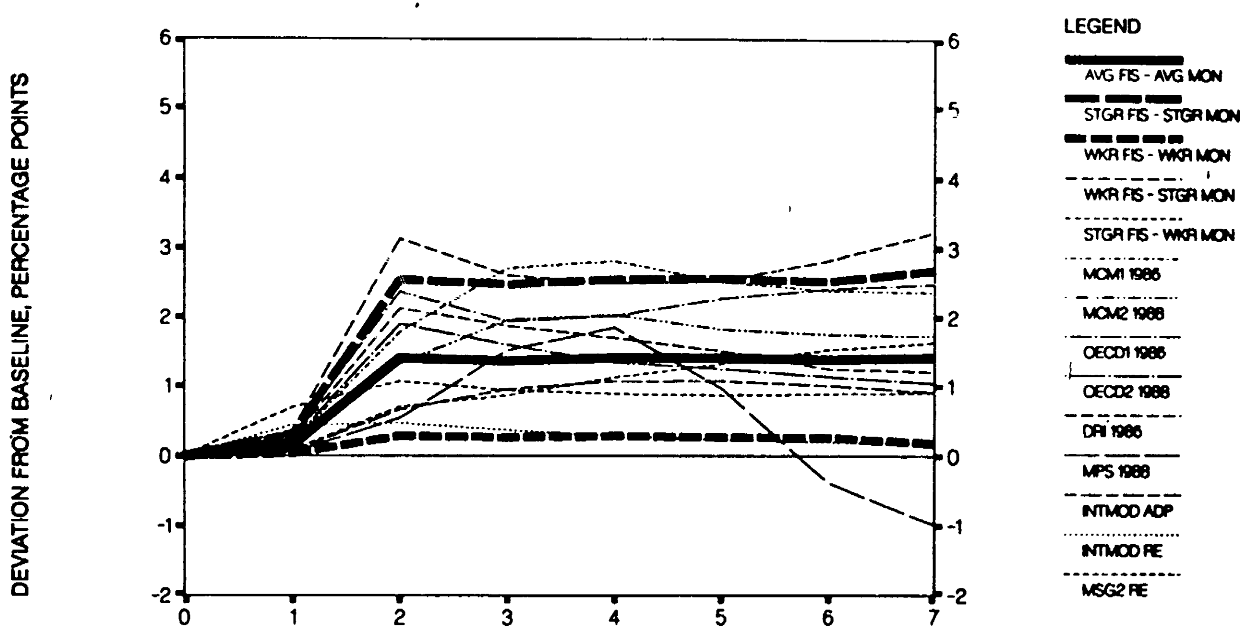


JAN 31, 1990

B-4

U.S. LONG-TERM INTEREST RATE

SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY

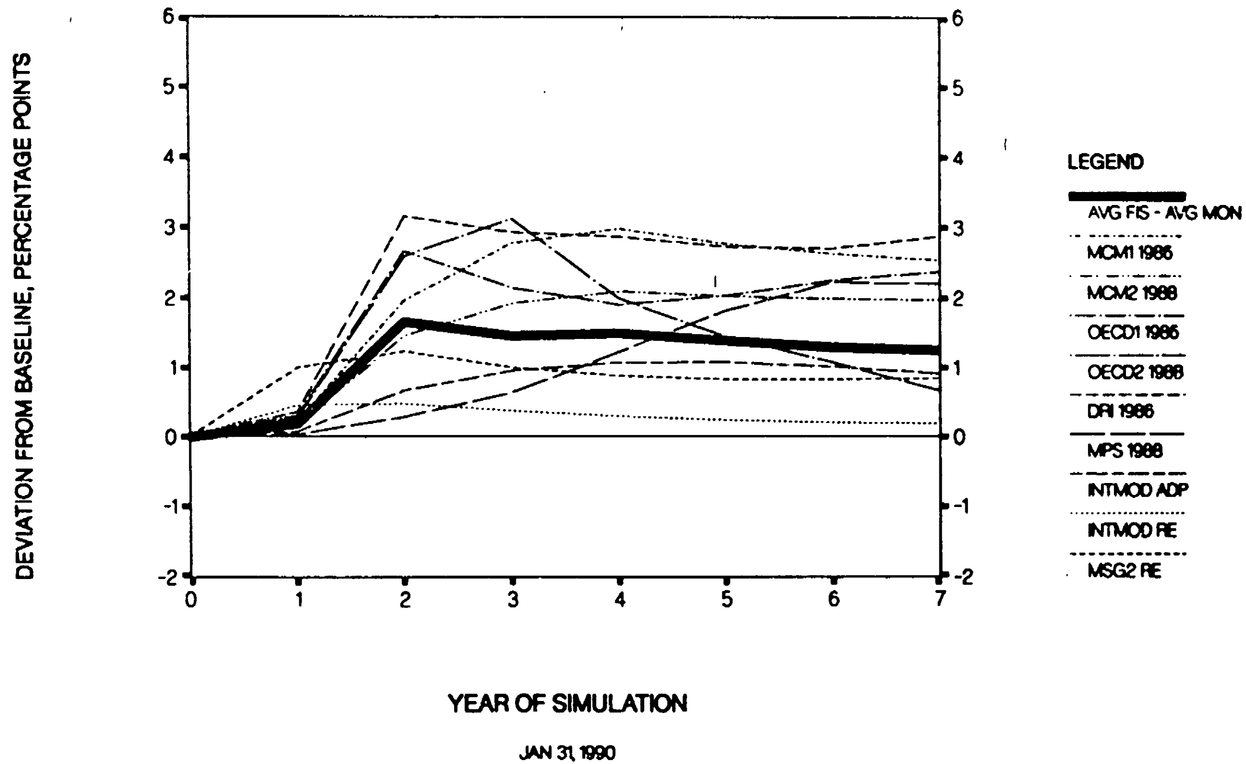


JAN 31, 1990

B-5

U.S. "REAL" LONG-TERM INTEREST RATE

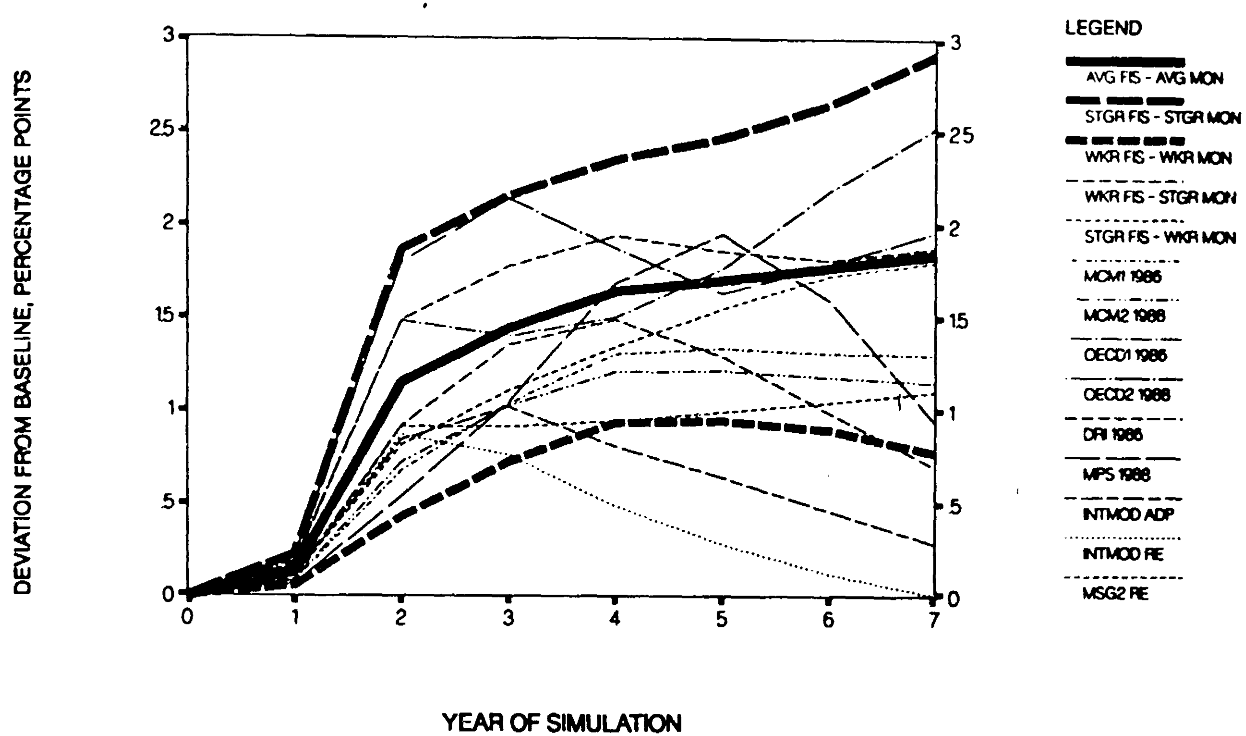
SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY



B-6

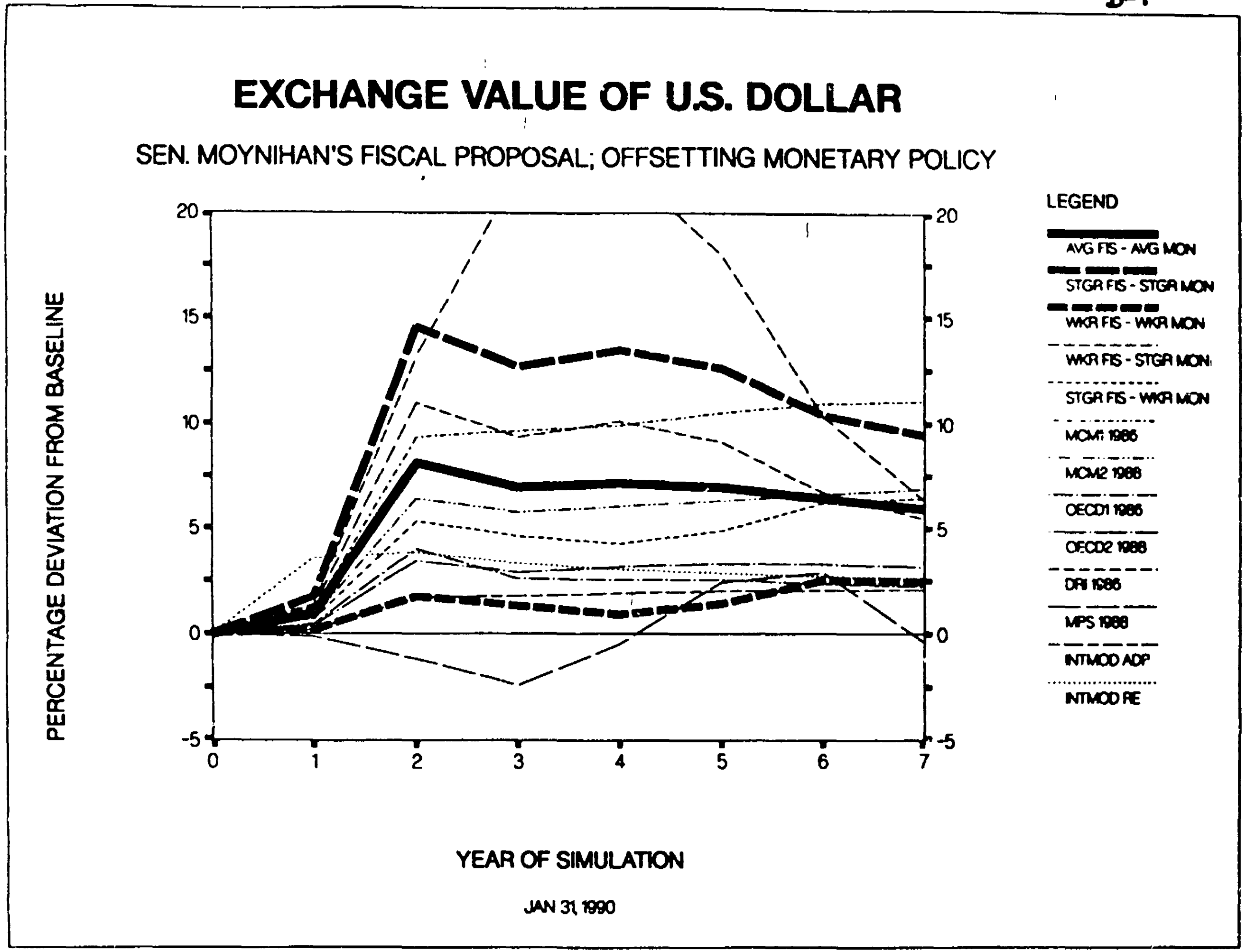
U.S. BUDGET DEFICIT AS SHARE OF NOMINAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY



JAN 31 1990

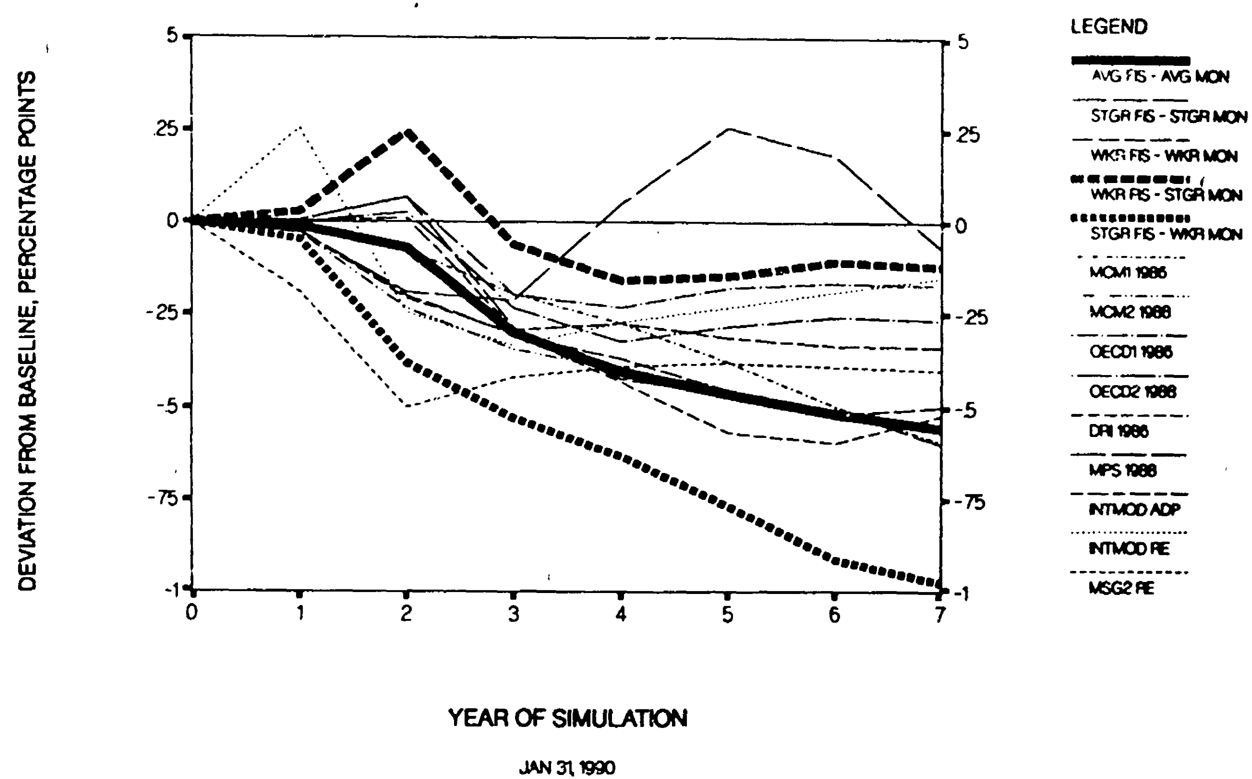
B-7


EXCHANGE VALUE OF U.S. DOLLAR
SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY
PERCENTAGE DEVIATION FROM BASELINE
YEAR OF SIMULATION
LEGEND
AVG FIS - AVG MON
STGR FIS - STGR MON
WKR FIS - WKR MON
WKR FIS - STGR MON
STGR FIS - WKR MON
MCM1 1986
MCM2 1986
OECD1 1986
OECD2 1988
DRI 1986
MPS 1988
INTMOD ADP
INTMOD RE
JAN 31, 1990

B-8

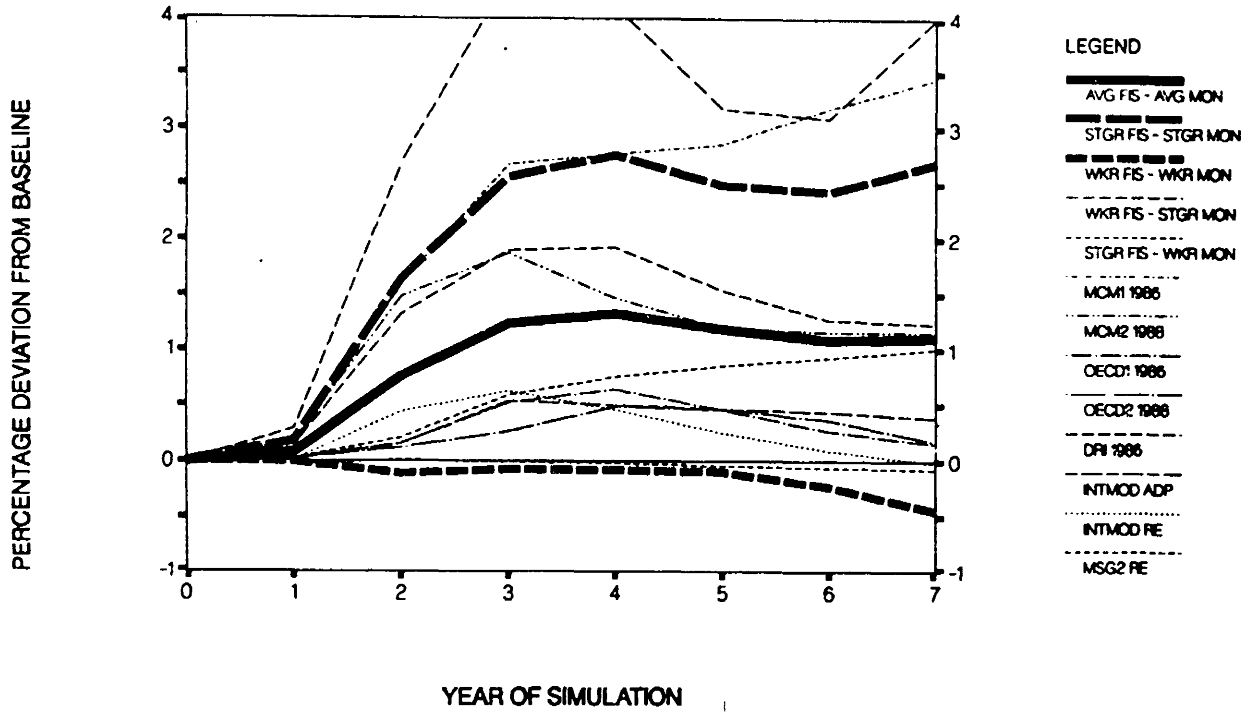
U.S. CURRENT ACCOUNT BALANCE, AS SHARE OF NOMINAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY



JAPANESE REAL GNP

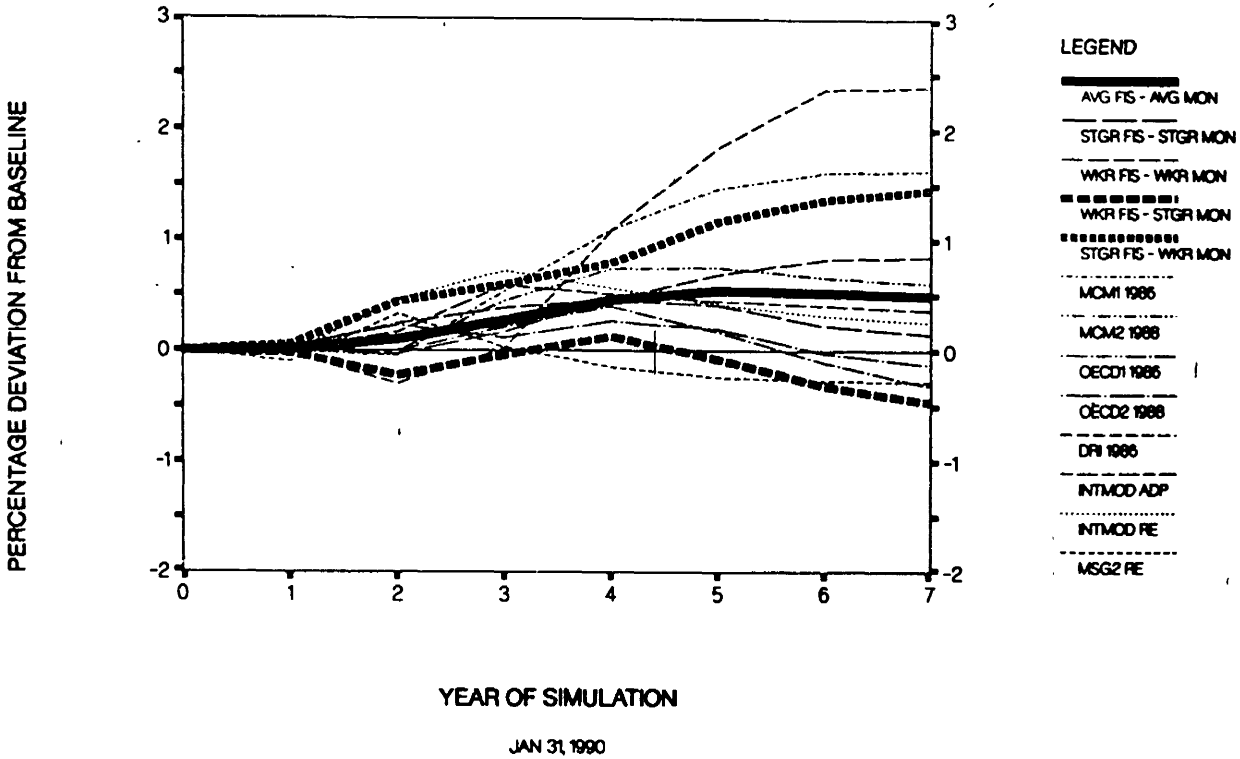
SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY



JAN 31, 1990

GERMAN REAL GNP

SEN. MOYNIHAN'S FISCAL PROPOSAL; OFFSETTING MONETARY POLICY



STATEMENT OF JEFFREY R. GATES

INTRODUCTION

Czechoslovak President Havel, in his February 21st "Family of Man" address to the Congress, advised, "As long as people are people, democracy, in the full sense of the word, will always be no more than an ideal. One may approach it as one would the horizon in ways that may be better or worse, but it can never be attained."

Similary, finding the "optimum" economic security program in a free enterprise economy represents an elusive goal, ever receding like the horizon—yet a goal toward which those in public life must necessarily strive. In Social Security we see a compassionate democracy at its best—the love of our fellow man reflected in the willing shared burden we bear in striving to take care of our own.

Yet despite this admirable intention, it is clear that this program has gone astray. Our attempt to fairly care for one group is now causing an unfair burden to another. Social Security is now the largest single tax paid by most American households, a cruel reversal of our national policy of progressivity in the levying of taxes on income.

In addition, Social Security entitlements are now the greatest form of "wealth" for a majority of American households. Thus, for most U.S. families, their most significant "asset" is an assurance that someone else will be taxed on their behalf. Surely there can be no stronger indictment of the economic policy that has thus far shaped our avowedly private property economy.

If U.S. economic policy continues to perpetuate today's concentrated pattern of capital ownership [1] and allows today's "baby boom" to become an asset-poor "senior boom," the fiscal strains we are experiencing today will seem modest by comparison.

CAPITAL OWNERSHIP IS LIKE MANURE

The only thing wrong with income-producing private property is that not enough Americans own enough of it. Personally, I am of the capital-ownership-is-like-manure school: pile-it-up-in-one-place-and-it-stinks; spread-it-around-and-it-does-some-good. The problem with Social Security finds its roots in the fact that so few Americans accumulate significant income-producing capital.

The marketplace is utterly ruthless on this point. The genius of the market is that it directs income to those who provide what the market considers to be productive "inputs." With a national economic policy that encourages the concentrated ownership of those productive inputs (i.e., in the form of income-producing assets), it should come as no surprise that income is likewise highly concentrated (i.e., absent governmental intervention such as redistributing income via Social Security taxation).

We really only have two choices. We can continue to encourage the concentrated ownership of economic "inputs" and live with the fiscal symptoms by addressing the resulting "downstream" income distribution problems. Or we can begin to focus "upstream" and utilize government incentives to encourage a steady expansion in the ownership of those income-producing assets.

Absent an ownership-expanding economic design, the nation's political design is such that those left asset-less are assured that (with a majority vote) they can instead access an income stream via the government—availing themselves of the political marketplace rather than the economic marketplace as the means by which they provide the "input" essential to generating income in a political economy.

Of course, that approach (with Social Security as its most obvious manifestation) is strictly a "downstream" approach—one that treats only the symptom while leaving the "upstream" cause intact. Widespread economic self sufficiency is the only cure. The key question is whether this Committee is willing to acknowledge the problem and begin the process of addressing it.

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[1] Of the personally-owned corporate stock in the U.S., the top 10% of wealthiest households own 89.8%, while the top one percent owns 58.4% and the top 0.5% owns 45.6%. See U.S. congress Joint Economic Committee *The Concentration of Wealth in the U.S.* (1986). This profile undoubtedly badly understates wealth concentration because it is based on 1983 research that fails to reflect the ownership-concentrating effect either of the tax incentives for investment enacted in 1981 or the subsequent dramatic increase in merger and acquisition activity (including leveraged buyouts). For example, in 1982, average wealth of the "Forbes 400" richest individuals was $200 million; by 1986 average wealth topped $550 million.

WHOSE ECONOMIC FUTURE IS IT?

The steady build up of problems that cannot be solved is a good indication of the need for a shift in the way we look at the problems, and the need for the construction of a new paradigm or a new model in order to find new possibilities for addressing the problems. The paradigm I recommend is that the Committee evaluate how it can contribute to the formulation of a national economic policy designed to promote widespread economic self sufficiency via widespread capital ownership.

In order to achieve this goal, it must be understood that "the rich get richer" not due to their inherited intellectual or moral superiority but simply because our system for financing capital assets is designed that way. To understand why that is the case requires understanding that practically all corporate funds are provided through but three sources:

1. Retained earnings—which create no new owners,
2. Tax benefits (primarily depreciation)—which create no new owners,[2] and
3. Debt—which (except via LBOs and ESOPs) is repaid for existing owners.

It is this "closed system of finance" (a term coined by the U.S. General Accounting Office) that explains why the economy's capital base expands while its capital ownership base does not and, absent policy intervention, will not. Sales of new equities are not a significant net source of corporate funds nationwide (seldom more than 3%) and are now substantially negative due to the volume of stock buybacks (more than $311 billion in 1988).

Prior to the advent of employee stock ownership plan (ESOP) financing, policy and practical restraints made this "closed system" virtually impenetrable. For example, it is difficult to access retained earnings for this purpose because, by the time those earnings are retained, they belong to existing capital owners. Similarly, the cash flow available through depreciation is available only once the asset is placed in service and, by then, the asset (as well as the accompanying depreciation) belongs to someone.

Likewise, qualifying for the debt necessary to buy assets on a self-financing basis is difficult in the absence of collateral, a scarce commodity among non capital owners. Equity purchases, of course, require cash, and it is those already within this "closed system" who can best afford to purchase those new equities with the discretionary income generated by their already-owned capital.

The point is that current national economic (and tax) policy supports this "closed system" of finance, an ownership-concentrating tendency that can be changed only if that policy begins *actively* to favor instead ownership-expanding financing techniques.

FINANCE IS A SOCIAL TECHNOLOGY

The reason the current techniques of capital finance fail to empower a broad base of citizens is simple: they are not (as yet) designed to. Like so much of our institutional life, they just sort of grew—unintentionally, incrementally, accidentally—most of them enforced not by rule so much as by common business practice.[3]

Capital finance is a type of social technology. Its practitioners even use technological terms to describe its oft times arcane workings, terms such as "leverage" (an analogy to mechanical technology) and cash "flow" (a metaphor from hydraulic technology). Although that technology is invisible and intangible, its operations are

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[2] From 1975–1985, the two primary corporate tax benefits for capital financing totalled $1,056.6 billion, comprised of $158.7 billion of investment tax credit and $1951.9 billion of depreciation deductions. (Internal Revenue Service *SOI Bulletin*, Fall, 1988). Given today's capital ownership pattern, approximately half of those tax benefits (i.e., $528.3 billion in tax savings) were used to finance *additional* income-producing assets for the already wealthiest 3-5% of U.S. households.

[3] The Federal Reserve is a partner in the process that perpetuates this "closed system"—by facilitating bank credit to fuel this system (e.g., via its discount rate operations) and by accommodating deficits incurred to finance tax benefits that feed this system (e.g., by its open-market operations). For example leveraged buyouts (LBOs) are often partly Fed-facilitated (for example, when LBO-related bank debt is presented for discount by member banks, thereby expanding the money supply). The ownership of government debt securities (another income-producing asset) is similarly concentrated. The Treasury estimates that, of those securities held by U.S. individuals, 93% are owned by 10% of the population while 71% are held by just two percent. That form of "wealth" totalled $900 billion in 1980; it now approaches $3,000 billion. The annual ownership income earned on that form of wealth (i.e., taxpayer-funded interest payments to non-government holders of U.S. securities) now exceeds $150 billion.

as real as the income-producing physical assets its operations bring into being, assets whose ownership (or lack thereof) touches each of us every day.

Financial technology is the social, contractual "software" that connects American households to this nation's productive "hardware": the technology embodied in our nation's capital instruments and means of production. Properly designed, this financial technology can represent progress of the highest order, with this culture's labor-saving, job-displacing, income-producing technology financed so as to empower a broad base of those whose culture gave rise to that technology.

The economic reality of the Social Security problem lies much deeper than any analysis offered to date. The answer lies not in a simplistic "downstream" redistribution of income (as in now achieved via Social Security taxation) nor in a simplistic "redistribution of wealth." Rather, the answer lies in a recognition that our financial technology must evolve to ensure that more American families become ownership participants in this nation's economic future.

The steady degradation of our fiscal condition stems largely from the fact that our capacity for creating income-producing capital assets has outstripped our capacity for creating income-receiving capital owners. We continue to practice our compassion "downstream" of where the problem lies. We should continue to be sensitive to the distribution of income as a social safety net (e.g., via Social Security). But, for the long-term, we should begin to focus our analysis "upstream" and begin the designing of an economic policy that better connects American households to their economy. Jobs alone are an insufficient connection; they must be connected by ownership as well.

A NEW PARADIGM FOR SOCIAL SECURITY

Social Security must, itself, begin to move from the myth of a government promise to the reality of productive assets. At the barest of minimums, any surplus should be saved by investing it in productive, private sector capital—but with an awareness that, absent an investment strategy designed to promote widespread capital ownership, such investments will inevitably fuel the "closed system of finance" described above.

It is not enough that those investments simply be invested to increase the *nation's* real wealth and that such investments stimulate economic growth and higher revenues. It is essential that those investments be made with an eye to promoting widespread economic empowerment by asking just *whose* wealth is being increased because it is only with long-term efforts to encourage *widespread* economic self sufficiency that we can reduce pressure on the Social Security system.

We need a shift in the income-redistribution paradigm of Social Security. In that model, even the right actions will not work. For example, if, as some urge, the surplus funds in Social Security are invested in the private sector—those investments (absent an emphasis on ownership-expanding financing techniques), will serve to further concentrate capital ownership. For example, if the funds are invested in corporate debt instruments, as those debts are repaid they serve to finance capital assets for those already within the "closed system" of corporate finance.

Similarly, if the excess funds are used to retire government debt (as others urge), that may well result in lower interest rates and increased investment—but for whom? If those investments are financed at lower interest rates within today's "closed system" (and there is no reason to think they would not be), the result is the similar: fueling that "closed system" of finance.

Investing without regard for the operation of this "closed system" is irresponsible, counterproductive, and inequitable. To draw a medical analogy, the Social Security paradigm has thus far represented an extreme version of symptomatic medicine by treating only the economic symptom—the lack of income, rather than treating the "upstream" cause: the lack of personally-owned assets with which to generate income.

Appropriately invested, the Social Security surplus could, itself, form the core of a "preventive medicine" approach to this economic malady. Given today's aging baby boom demographics, today's widespread lack of economic self sufficiency can only worsen unless this failure of economic policy is systematically addressed.

Our current assumptions influence the very way in which we think about the Social Security problem. For example, policy makers tend to assume that the problem is a widespread lack of income and, thus, the debate tends to focus solely on that "downstream" manifestation of the problem and to color the analysis and even the terminology of the debate. This testimony, if it is successful, will broaden the focus of the debate by altering the assumptions and thereby changing the way in which this Committee thinks about the problem.

TOWARD AN ASSET-BACKED ECONOMIC SECURITY POLICY

Currently, the Social Security trust funds represent nothing more or less than a promise by the government to tax or to borrow to provide income to Social Security beneficiaries. By investing in "phantom assets" (i.e., government I.O.U.s), the system's capability for providing that income is based not on economics but on politics. The "asset" that backs Social Security's promise is not productive assets in the economy but instead the political willingness of taxpayers to bear the burden of income redistribution in the form of taxes.

This testimony suggests that the focus of the program should be to match that economic need (for income) to economic capability—in the form of productive assets capable of generating that income. This approach would have two components, one symptomatic, the other preventive. The symptomatic component would continue as before to address the income needs of Social Security beneficiaries, but would begin the shift to the accumulation of income-producing productive assets (versus simply income redistribution via taxation) as the means by which those needs are met.

The preventive component would ensure that those productive assets are financed in such a way as to promote widespread capital accumulation by the next generation of beneficiaries. For example, a prescribed (and growing) portion of the Social Security surplus could be invested in ownership-expanding financial instruments such as notes representing ESOP-type financing or securities backed by ESOP loans. Similarly, equity investments could be targeted to companies meeting a prescribed (and growing) threshold of employee stock ownership.

By investing so as to encourage stock ownership among employees of those companies in which the funds are invested, trust fund investments could also positively impact corporate performance and spark U.S. competitiveness by improving motivation, productivity, commitment, dignity, morale, quality, creativity, entrepreneurship, labor-management relations, etc.

This investment philosophy would also promote "patient" capital by facilitating a corporate environment able to focus on the long term while also helping to "anchor" domestic capital, preserving the economy's job-creating (and tax) base.

An ownership-broadening trust fund investment policy would also update the government's role in promoting economic opportunity by helping to create widespread income opportunities not just from jobs but also from capital ownership—an inflation-dampening and competitiveness-enhancing economic policy.

IN SEARCH OF AN ECONOMIC EMPOWERMENT AGENDA

The key is to be responsibly forward looking, anticipating future obligations and putting a financially sound program in place to deal with them. That program should include a substantial measure of ownership-expanding private sector investments. By investing in support of widespread economic self sufficiency, Social Security's investments could help to relieve the out-year pressure on Social Security while also helping to relieve the fiscal strain inherent in any delay in shifting to an asset-backed Social Security funding strategy.

Of course, fiscal, tax and monetary policy are all components of an indivisible whole in thus far neglecting to design a national economic policy supportive of widespread economic self sufficiency. For example, in addition to directing government trust fund investments into ownership-expanding corporations (e.g., those with ESOPs), government's fiscal power could support widespread economic empowerment by directing its purchasing, contracting, licensing, loan guarantees, etc. to such firms.

Similarly, tax policy (a key component in corporate finance) could be comprehensively adapted to such an economic empowerment agenda.[4] Monetary policy could likewise be coordinated in support of ownership-expanding corporate financings (e.g., by preferring such financings via special reserve requirements or rediscount rates).

In closing, let me mention a subtle political point that is often missed by those who bemoan governmental intervention in the operations of our free enterprise system. The frightening fiscal dynamics of the fast-emerging "baby boom" demographics (of which I am a part) scream for government to wake up to its need to advance an economic policy designed to encourage widespread sharing in this nation's economic potential.

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[4] See suggestions at pp. 10–16 of my March 15, 1989 testimony before the Committee on Ways and Means.

If we choose to simply permit our capital financing system to operate as it currently does—and passively wait for those dynamics to emerge, we are choosing to perpetuate a growing fiscal nightmare well into the next century. The subtle political point is this: government must itself act to ensure that our free enterprise economic system does, in fact, operate to economically empower those within that system.

The evidence suggests that the system does not yet fulfill that need, and that the resulting fiscal strains are themselves endangering the operation of our free enterprise system. The analysis suggests (i.e., the "closed system" of finance) that the system as it currently operates will continue to fail to meet that need and that, absent policy intervention, this failure poses a grave danger both to the economic system and to those within it.

This testimony is not meant to suggest a specific destination but only a direction in which our economic security policy should head if the interests of the Social Security system are to be compatible with the needs of the economy and society.

Personally, I prefer widespread capital ownership over concentrated ownership. And I believe that any company can only be improved by a substantial dose of employee stock ownership. Yet, absent a comprehensive national economic policy designed to achieve those goals, neither will occur and this nation and its people will be the poorer for it.

RICHARD JOSS,
Winslow, WA, February 22, 1990.

Ms. LAURA WILCOX, *Hearing Administrator,*
Senate Finance Committee,
Washington, DC.

Mr. ED MIHALSKI, *Minority Chief of Staff,*
Washington, DC.

Re: Social Security Taxes

Dear Ms. Wilcox and Mr. Mihalski: This letter is being sent for inclusion in the printed record for the hearings on Social Security Taxes. The purpose of this letter is to request that the Senate Finance Committee change its focus on generational equity for Social Security from a benefit equity to a contribution equity.

Now that the Social Security program has matured to the point where most new benefit recipients have been contributing participants for most of their working careers, it is possible to define generational equity in terms of contributions rather than benefits. 'Under this scenario, the contribution formula would be fixed (perhaps 6.0% employee and 6.0% employer taxes up to the wage base). The duty of the Social Security Trustees and their actuarial advisors is then to ensure equitable distribution of funds through careful adjustment of eligibility criteria, cost-of-living increases, etc.

In particular, as the baby boom generation nears retirement, it would seem that prudent trustees would allow the trust fund to build up somewhat, *and* would establish later retirement eligibility criteria and smaller cost-of-living adjustments.

If these actions are taken now and communicated effectively, and the private system of retirement fund accumulation is encouraged and supported, all our citizens will have the opportunity to plan for a financially secure retirement, without projecting a heavy tax burden for our children or grandchildren.

Sincerely,

RICHARD R. JOSS.

STATEMENT OF RICHARD M. LALLY

J. BENNETT JOHNSTON (D-LA),
Senate Hart Office Building,
Washington, DC.

Dear Sir: Respectfully request I be invited before your committee to give personal testimony, present a list of witnesses and numerous documents in the matter of corruption in the Social Security Administration and the use of corrupt officials thereof by a small but significant number of corrupt surgeons and insurance companies in defrauding millions of working men and women of their Social Security taxes while disenfranching them of their legitimate right to bring lawful malpractice actions to report crime and from receiving lawful workmans' compensation benefits for life. This corrupt criminal combination is in effect using the Social Security Administration as a defrauding device which causes the disabled American worker to receive ⅓ of the lawful financial support he/she has entitlement to.[1]

Further that this corrupt criminal combination is being used by an unknown number of criminal surgeons to *intentionally* cause an unknown number of permanently disabled working men and women every year.

Further that this corrupt criminal combination is using the prestige, influence and power of this legitimate medical profession to avoid detection.

That this corrupt criminal combination is causing attempted murder, criminal assault and battery, fraud, intimidation and possibly murder and suicide and untold personal and economic suffering—its tearing at the very social and economic fabric of this nation!

That it is taking place to my personal knowledge in Syracuse, NY and Burlington. VT.

Further that this corrupt criminal combination has to be nationwide.

CORRUPTION IN THE SOCIAL SECURITY ADMINISTRATION

Who Am I And How Did I Arrive At This Conclusion.
The Corrupt S.S. Judge, The Corrupt D.D., The Criminal Surgeon, The Victim And The Insurance Company Come Together.
The Mechanics Taking Place.
That The CCC Exists.
The Corrupt S.S. Officials Make It "A Crime Waiting To Happen" And It Happens."
Democracy In Action.
Summary.

Abbreviations Used—

S.S.—Social Security.
S.S.A.—Social Security Administration.
LTD—Long Term Disability benefits (income).
S.S.D.B.—Social Security Disability Benefits (income).
D.D—Social Security District Director.
CCC—Corrupt Criminal Combination.

What you are going to read has taken place over a 4 year period. I can not reduce to writing the complete story, my personal appearance and sworn testimony is required.

It has taken me 8 months to collect, code, cross-reference, research and analyze the material involved.

This corrupt criminal combination is praying on the working men and women of this country and is being financed by their Social Security Taxes and Medicare Funds.

The crimes associated with this one almost unbelievable however, on April 29, 1945 we came upon an almost unbelievable event—*Dachau.*

Gentlemen—I would not be disabled today if there was not for corruption in the Social Security Administration.

The document is being submitted under the aegis that I have exhausted all avenues of redress and now look to my elected representatives.

WHO AM I AND HOW DID I ARRIVE AT THESE CONCLUSIONS

I am Richard M. Lally K-A 7300 Cedarpost Road, Liverpool, New York 13088, telephone 315-451-2307.

I received a Bachelor of Science degree from Drake University College of Pharmacy June 1956. While always employed I graduated 5th out of 37 and received upon graduation the Phi Delta Chi scholarship award for the graduating senior with the highest grade point average. I mention this only to give credibility to the fact that anyone with a degree of intelligence, a medical background, the presence of a library local College of Medicine and a little help can research the spine and discover why he is disabled. No one has a monopoly on medical knowledge—it is all documented in the literature—and the spine holds few secrets not documented.

On 9/89 I began an intensive study of my spine disability at Syracuse University Library College of Medicine. I researched all available surgical textbooks, medical

[1] We will find out later where the ⅔ of the financial support goes; number of witnesses 95; number of pages 200; the number of pages outstanding unknown.

journals and other relevant sources. I retrieved all my medical records, X-Rays,[2] reviewed my Social Security records and constantly referred to my diary. I am examined by 2 more surgeons—visited a few attorneys. I discovered my surgically induced disability was permanent—impossible to repair.[3] I would not walk or stand for over 1/2 hour for the rest of my life—and that this was done—*intentionally.*[4] At this time—2/90—the presence of the corrupt criminal combination is a certainty.

Now fully knowledgeable of my disability and incensed that this *1st* disability was intentional—driven by pain and some help, I go for the several documents that I now know have to exist—and will link up the corrupt criminal combination. I find my actions have not gone undetected.

I am met with a planned almost unbelievable counter attack. I am knowledgeable about everything-but the ferociousness of the response shocks and unsettles me.

I receive 3 intimidating letters from these cowards. 2 with threats about terminating my Social Security and insurance disability income.

My Social Security records arrived from storage-incrementing evidence is present—the surgeons reports—the old ones removed and new ones inserted in their place—A TAMPERED S.S. FILE!

On 3/10/90 I requested the Social Security storage area to send me documentation on the movement of my Social Security file—to date no answer.

My Registered letters go unanswered, telephone calls not returned, I find 4 suborned individuals, the insurance company, surgeon (local) sends me a contrived medical report (30 days in preparation). The insurance company stonewalls and my hospital records have been blantly tampered with.

On 3/16/90 I receive a stroking call from the local Social Security Director.

On 4/12/90 I receive a snarling intimidating call from him.

The criminal surgeon who disabled me is tampering with my Social Security file, my hospital records and suborning people. His statute of limitations for medical malpractice ran out in June 1989—What is he worried about? his statute for criminal assault and battery does not run out until November.

To the uninformed—to the disadvantaged—to the disabled American working men and women seeking to find the cause of their disability. *These acts are meant to terrorize—these acts are the ultimate tools of corruption and crime!*

This *1st* unspeakable crime would have been impossible without the unbridled corruption in our Social Security Administration and the American workers are financing this CCC with their even increasing Social Security taxes and are themselves targets of it.

To date to cover up the CCC's action Medicare has been billed $31,000.

THE CORRUPT SOCIAL SECURITY JUDGE; THE CRIMINAL SURGEON; THE VICTIM AND THE INSURANCE COMPANY COME TOGETHER

Key—"2-Paragraph" Letter "See the Judge," "W.C. Benefits"

On 11/85 I am intentionally permanently disabled by surgery. I will not walk or stand over a ½ hour for the rest of my life.

I returned to the surgeon—report the disability and he keeps me coming back to his office 7 times—he does nothing—his office notes show nothings wrong—I am crippled.

Strangely I am receiving LTD benefits from the insurance company. They are receiving the same office notes (nothing wrong) as I am. The insurance company *has* to know something is wrong.

After the 6th visit I receive from the insurance company a notice to sign up for Social Security. "I might be eligible" and to "prosecute" the case (means see the Judge).

On the 7th and final visit I request Workers Compensation Benefits—absolutely not—[5] (it is Workers Compensation Compensable) and if I live through 80 years it is worth $358,000 to me tax free and $358,000 to the insurance company. Also, after this visit this criminal surgeon sends out the "2 paragraph letter" 1st paragraph (nothing wrong) second paragraph (totally disabled (no cause given).

[2] All documents have been source, dated, coded and cross-reference by me. They cover a 4I1 year period—2 operations they require my personal appearance and sworn testimony to lead you through this maze of crimelcorruption and fraud.

[3] In 2 months I find out what happened to my spine—a spine surgeon of 35 years experience does not know—incredible—he knew.

[4] I am shown how to read my critical X-Rays on 10/89.

[5] My retrieved S.S. file from storage did not contain the cassette tape of the hearing on 7/20/87—It was to "bulky" to be sent—I assure you it will be interesting to hear.

I sign for Social Security and the 1st two actions are handled by the New York State Disability determination—commission—They call the surgeon twice, about the ambiguous letter—he refuses to comment and states, "read my office notes of 12/18/86" which is the "2-paragraph letter." CORRECTLY, I am denied Social Security Benefits

After the 2nd denial for Social Security the insurance company sends a letter "appeal" (means "see the Judge")

After the 2nd denial for Social Security the insurance company sends a letter "appeal" (means "see the Judge")

After 2 denials—next stop the corrupt S.S. Judge.

At the hearing I don't want S.S. I am almost insulting to him. I wish a postponement—NO. I get S.S. disability on the spot. I challenge the attorneys fee (reason later) the insurance company pays his fee in full.

HOW

The Corrupt Social Security Judge receives the "2-paragraph" letter, *knows why he received it* and *knows what to do with it* —he and the D.D. have seen and used it before.

A. The corrupt Social Security Judge executes a fraudulent "Favorable Decision" document: [6]

In this fraudulent document he:

1. Drops the 1st paragraph of the "2 paragraph letter" in which the surgeon states there's "nothing wrong."
2. Uses only the 2nd paragraph of the "2 paragraph letter" in which the surgeon states you are totally disabled (no cause given) in his lengthy wordy "Favorable decision."
3. This fraudulent "Favorable Decision" also states "further action necessary" and is sent forward to the next higher authority-the corrupt District Director. We now have a document with the Facade of Legality.

B. The corrupt D.D. and the Fraudulent "Award Certificate" From him I receive an "Award Certificate" which states "The Doctors and other trained personnel who decided you are disabled believe your health may improve "and further" that, therefore, in a few years we will review your case to see if you are still disabled or not! If yes they will continue—If no benefits (income) will end!

I discover what my induced disability is—and it is forever—impossible to correct. I double check—triple check—retrieve my Social Security file from storage and nothing! nothing! These people do not exist—and in view of the damning medical evidence I uncover—that recovery is impossible—it is impossible for them to exist! This document is nothing more than legal fiction.

THE MECHANICS TAKING PLACE

Key "2 paragraph letter" and "W.C. Benefits"

On the 2nd visit after the surgery the criminal surgeon checks me out to see if the disablement is indeed a fact—assured it is he takes the following *"presumptive action."*

He *calls* the insurance company—there has been an error—In return for their silence he will deny me W.C. benefits for life—worth to me as before $358,000 and to them $358,000 [7] also he will arrange for me to be placed on S.S. disability (by means of the corrupt S.S. Judge and the "2 paragraph letter") thus reducing their LTD payments to me by 50%.

To arrange this—the S.S. people are very expensive—he will need ($000.00) six weeks after the intentional disablement—the deal is cut—the ($000,000) check is sent.

NOW THE FOLLOWING ACTS TAKE PLACE

1. Out of the insurance company check the criminal surgeon keeps ($000,000)
2. The criminal surgeon gives the corrupt S.S. judge ($00,000)
3. The corrupt S.S. judge sends the corrupt D.D. ($0,000)

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[6] My case is a little more complicated because of my action. It will require my personal appearance and sworn testimony.

[7] Source; New York Life Insurance Company and Northwestern Mutual Life Insurance Company, Syracuse, NY. All values rounded off.

Using the "2 paragraph letter" with skill and experience the corrupt S.S. Judges "favorable decision" leaving out the damning 1st paragraph (nothing wrong) of the "2 paragraph letter" is sent forward to the District Director along with ($0,000).

The DD sends the intentionally disabled worker the "Award Certificate" with the previously noted statements.

At this point we can even assume the DD has been duped but, with the following statement he actually indicts himself he states "this action supersedes our previous determination and in accordance with the 2 previous denials and the now criminal "2-paragraph letter."

The award certificate is nothing but legal fiction.

WHY THIS TYPE OF "AWARD CERTIFICATE"

This "award certificate" is nothing more than legal fiction. Its sole purpose is to deter inquiry and to conceal corruption. The surgeon, the judge, the D.D. and the insurance company have been involved in a crime-an unspeakable crime-and they seek concealment. That "2 paragraph letter" is not new—it is old. It has been used before. The phrases is the "award certificate" have been carefully chosen to lead the victim to believe there is another legitimate bureaucracy existing. There is *nothing* but outer space behind the facade of the letter!

The surgeon knows about the "2 paragraph" letter—how to use it—"why to use it" and when to use it. He is 65 years old he handles that letter with cunning, knowledge and experience—he's used it before—he's a pro—but he's not greedy he doesn't do this ALL the time.

The victim is totally confused—in an unexpected foreign world—LTD, occupational W.C., S.S.D.B., pain and disability. The financial impact distracts me from the cause of the disability. My attorney informs me about occupational W.C. benefits—I begin writing other surgeons and as we shall later see—it, almost, further disables me.

THE CORRUPT S.S. OFFICIALS MAKE IT "A CRIME WAITING TO HAPPEN" AND IT HAPPENS

The surgeon decides on the evidence present that I will make a perfect candidate for "His surgery." He is not going to kill me—he is only going to disable me.

I have an exceptional life expectancy. [8]
I have a compensable occupational W.C. condition.
I have the income to receive the maximum W.C. income benefits.
I have established work record and income to receive S.S.
I have private insurance providing LTD benefits.
He has his support group in place:
He will have protection from the medical profession—he will lie to them.
I will never know what happened-every one is stupid but him.
He will use the "2-paragraph" letter.

THE CORRUPT S.S. JUDGE IS IN RESIDENCE

He has used it before.
He knows what to do with it.
He knows why it was sent.
He executes the fraudulent "Favorable Decision" document.

THE CORRUPT S.S. DISTRICT DIRECTOR IS RESIDENCE

He received all of the above.
He has received this material before.
He knows which kind of "award certificate" to issue. He uses the "award certificate" that is legal fiction—meant to deter inquiry.

The job is done—it will take awhile to arrange things—he is no magician, the office notes (nothing wrong) have to be generated—the waiting time required by S.S. regulations—the insurance company—the money—the judge—these things all take time.

I as a Pharmacist have malpractice insurance—I am human can make a mistake and cause harm. Insurance companies sell it. The surgeon has the same.

He is 65 ready to retire—his reputation can't be hurt—its an honest mistake most cases are settled out of court via mutual legal silence—there are thousands each year we all know it. What is his problem?

---

[8] My life expectancy is 79 to 81. Add to this my father is alive and well at 99, my mother died at 87 and my maternal uncle at 102.

His problem is that malpractice insurance—no insurance pays for intentional injury. He can't settle—in court or out of court. That's why he has been stalking me for 4 years. His statute for criminal assault and battery does not run out until 11/90, That is why at this late date he is tampering with my S.S. file, hospital records, etc.. Why can't I find out recent movements of my S.S. file from storage? The corrupt S.S. officials don't wish me to know. The criminal surgeon and corrupt S.S. officials don't wish anyone to know they have contempt for human life.

THE INSURANCE COMPANY ARRIVES ON THE SCENE LIKE THE FIRE DEPARTMENT—THEY KNOW ARSON WHEN THEY SEE IT—THE PRIZE W.C. BENEFITS $358,000

Split 4 ways—1—surgeon—2 S.S. Officials & 1—Ins. Co. N.Y. State W.C. Benefits $15,600 X 23 years = $358,000

The insurance company has to know what is going on—but they did nothing wrong—they were presented by a fiat accompli—why not profit from it. This victim is a faceless disabled Pharmacist—human being No. 06102 they have never seen me and don't want to see me—things happen—forget him—he'll never know.

The insurance company and its employees are not deaf, dumb and blind—they know what they are doing. They knew why they were doing it. They knew how to do it. They showed experience—They'd done it before—Those appeal letters (means to see the Judge) went out like clockwork.

THAT THE CORRUPT CRIMINAL COMBINATION EXISTS

On 11/ /85 I am criminally assaulted, battered and disabled. On my last visit I inquire about occupational W.C. he became visibly upset—animated—he over—reacted—absolutely not. I write 2 others and strangely they both deferred to him. Does he have a monopoly on the subject—of course not. He has already shook down the insurance company for his and the S.S. officials share of my W.C. benefits. That has already been taken care of (split 4 ways).

I become a threat to the Corrupt Criminal Combination.

I write a surgeon out of state about W.C.—I have shown another surgeon 2 articles from the Syr. Univ. Med. Library—I challenge S.S.—I have a medical background—(I have a compensatible W.C. case) I am an intimate threat.

On 10/87 (fraudulent documents are placed in my file in July). I will be either seriously further disabled or dead (remember my spine is impossible to repair) by proposed surgery.

I unexpectantly go out of state, while he goes on vacation, for the 2nd surgical opinion, which this surgeon states "no operation." Since that date the surgeon has he himself or induced others—to commit 18 criminal acts attempting to avoid detection and prosecution. I have the documents coded, dated and cross referenced including the names of 2 surgeons who are withholding incrementing documents. His documents will not stand up to *any* scrutiny.

On 7/88 I am criminally assaulted and battered in an effort to conceal all of the above (by this surgeon who said I shouldn't have an operation) and wake up from general anesthesia in a hospital room unattended—of the state of Vermont, the city of Burlington. Remember my spine is impossible to repair and this 2nd operation has left me in almost constant pain—requiring narcotics everyday.

Does this CCC exist—you bet it does—the surgeon who made the offer—a lawyer—who had my complete trust and respect—called and lied to me about the statute of limitations—when I found that out—it adds up. The 2nd surgeon (a recent immigrant) was pressured to at least criminally assault and batter me. When ones will possibly attempt murder—(at least felony assault), a lawyer, suborn others and an immigrant surgeon—at lease commit criminal assault and battery—it exists!

AN UNRELATED EVENT TAKES PLACE? TWO MURDERS AND ONE SUICIDE

My neighbor (unknown to me) has spine surgery the same day as I—with disabling results same thing—nothing wrong—On 11/86 he kills his surgeon—returns home kills his wife and himself. Several others are questioned by police—they don't even know about my neighbor—no medical investigation about my neighbor or the others questioned! From his partner I received an intimidating letter with a threat concerning my S.S. disability income on 2/5/90!

Did my neighbor contact the F.B.I. or the U.S. Attorney—if he did he was wasting his time—I called the U.S. attorney on 3/6/90 said I wished to meet with him about a corrupt S.S. judge and a surgeon for at least felony assault—he suggested I call the S.S. I replied for these crimes1—he said I'll have an F.B.I. agent call you—never called. Incredible!

WAS THIS MAN TO RECEIVE HIS "2-PARAGRAPH LETTER? [9]

DEMOCRACY IN ACTION

In 1950 your predecessors collectively lawfully and with wisdom called upon the youth of this nation to respond to an outside threat to this nation. We made ourselves available to make the ultimate sacrifice—many did. Like our forefathers we laid aside our plans, bore arms and became citizen solders.

I didn't realize it at the time but we responded to protect and preserve for ourselves and others to come more than our soil. It was for our form of democracy—bolted in place by our Constitution and Bill of Rights.

This nation now faces another threat—It had as its origins secretly, greed, contempt for human life, abuse of power and authority and has developed over the years into a insidious criminal corrupt combination and I have documented it in these pages. You may put any label on it you wish.

According to the results of the Harvard Study Commissioned by N.Y. State for 1984 there were 2500 cases of permanent total disability resulting from malpractice and negligence. If we have 250 million in the U.S. That translates into 37,500 cases nationwide. I will attest to the fact that *they were not all unintentional.* What makes it possible is the unblieveably of it. But, I will, also, give you sworn testimony that these criminal acts were not unknown. I was certainly not the 1st victim.

On 9/89 I realized I was a hostage to the CCC. On 11/89 I was fobbed off by an F.B.I. agent and on 3/6/90 by an assistant U.S. Attorney. They can explain themselves later. This CCC is actually a mini—corrupt pseudo—oligarchy. These people are responsible to no one—No one! The American working men and women of this nation stand naked before it—defenseless and innocent—who will be the next victim to have their life dumpstered.

This thing, disabled me, maimed me, almost killed me, defrauded me and will eventually bankrupt me. Am I the 1st? These pages show that is nonsense.

It is my inalienable right—I and millions were ready to and did die for it—and I am using it and in so doing an encouraging other to use it.

To show we have an instrument—our constitution—to rely upon when we have exhausted all other means. Our right to address our elected officials to whom we have given the right to investigate and legislate when we discover a threat to ourselves and to our form of democracy.

No where in our constitution is there a reservation for *any* form of *any* oligarchy.

SUMMARY

Gentlemen: I have wrung out all the emotions from this document.

No one will ever be able to wring out the emotion from my experience and the untold of number of individual who have been thru my experience. I have taken on the entire corrupt criminal combination and now require your assistance for myself and for those who follow.

On 11/00/85 I walked into a hospital came out disabled—go through 4½ years of crime, corruption, fraud and intimidation end up writing the Congress of the United States. This is a shame to our nation.

Society has the right to know, has to know what is going on in Syracuse, NY, Burlington, VT—and elsewhere. The "2 paragraph" letter is not new and it is a definitive threat to the American working men and women.

They should be notified of the presence of the "2-paragraph letter" (or it's equal) as soon as possible.

I have done the best with this document considering the difficult circumstances.

Respectfully,

RICHARD M. LALLY.

[9] That man was a wonderful extremely, well liked neighbor. At the hearing I will attempt to tell you why he killed that surgeon then his wife and then himself.

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NEW YORK STATE DEPARTMENT OF SOCIAL SERVICES
Office of Disability Determinations

(Rev 10/82) DF-232
Request for Medical Advice

Case Surname Richard Kelly A/N 133-30-1701

1. From: Unit x-47 Analyst (Signature) [illegible] 2/7/87
Initials Date

2. Referred to Dr. [illegible] [illegible] 1/30/87

3. Advice prepared; case file returned to originating Analyst named above in Item 1. [illegible] M.D. 2-2-87

4. Description of problem: (See notes below regarding cardiac cases)

☐ Analysis of ECG tracing, see reverse

☐ Other (Describe) 54 y o m

[illegible]

5. Advice:

[illegible]

JAN 30 1987 RFC Unlimited
TMD 12/86 Reports basically normal exam

(Signature) 2-2-87 (Date)

NOTES TO ANALYST: 1. If stress ECG's are to be reviewed tracings must be in file.

2. If bypass surgery was performed give date.

3. Is there an adequate description of heart related pain in file if it is an issue?

REPORT OF CONTACT -18-
(Use ink or typewriter)

ACCOUNT NUMBER AND SYMBOL: 133-20-1701

NAME OF WAGE EARNER OR SE PERSON: Lalley

NE MAT SE GL WN MAM

ODO DIO DOS

PERSON CONTACTED AND ADDRESS: ☐ WE OR SE PERSON ☐ OTHER (Specify)

TMD

CONTACT MADE: ☐ DO ☐ CS ☐ HOME ☐ PHONE ☐ OTHER

DATE OF CONTACT: 1/14/87

CT

Re: on last exam
gait and station
ROM extension & lateral
motor strength of L.E.'s
any reflex deficits
heel / toe walk: yes
sensory deficit? see ~~note~~ ~~[illegible]~~ 18

Result: busy
left questions with secretary, she said MD
was very busy, he may not get to it for a week.
They will contact me.

1/20/87 Result [illegible]
Result MD did not want to comment [illegible]
[illegible] He said [illegible] to office
visit of 12/18/86

OFFICE (Name, Address & Code)

☐ CR ☐ FR ☐ SR ☐ CLAIMS CLERICAL

☐ OTHER (Specify)

DATE OF REPORT: 1/14/87

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THE "2-PARAGRAPH" LETTER

12/18/86 Re: Richard M. Lally NOTHING WRONG

This patient returned to my office on December 18, 1986. He has really done very well from his decompressive laminectomy. He has no increasing neurological deficit. He can walk, stand, and bend forward and almost touchs his toes, save about 4 to 5". He has no list. His wound has healed well. He can stand on his toes and his heels. 1ST

Richard weighs 185 lbs. He finds that he can wash dishes or do some housework and he has to sit down and rest. He can't stand or walk or sit too long. I do not think he is able to return to his profession as a pharmacist. This requires long periods of standing and continuous sitting. He can't lie down and rest when he feels discomfort. I think it would be inappropriate for him to return to this type of work. He is totally and permanently disabled from his work as a pharmacist. He may not do work which requires him to sit for over 20 minutes. No lifting or bending repetitively. He can not carry objects over 15 lbs. He should not climb stairs. He has to avoid excessive twisting. 2ND

TOTALLY DISABLED - NO REASON GIVEN

Health Insurance

SOCIAL SECURITY ACT

NAME OF BENEFICIARY

RICHARD M LALLY

CLAIM NUMBER SEX

133-20-1701-A MALE

IS ENTITLED TO EFFECTIVE DATE

HOSPITAL INSURANCE 12-1-87

MEDICAL INSURANCE 12-1-87

SIGN HERE Richard M Lally

1ST PARAGRAPH DISAPPEARS FOREVER
2ND PARAGRAPH ONLY, IS USED IN
JUDGES "FAVORABLE DECISION"

THE PATIENT NEVER KNOWS WHAT IS WRONG WITH HIM

WITH THIS LETTER AND THE CORRUPT S.S. JUDGE = DISASTER FOR THE PATIENT