EXECUTIVE COMMITTEE MEETING

TUESDAY, JULY 25, 1989

U.S. Senate

Committee on Finance

Washington, D.C.

The meeting was convened, pursuant to notice, at 11:20 a.m. in Room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (Chairman) presiding.

Also present: Senators Moynihan, Danforth, and Heinz.

Also present: Vanda McMurtry, Staff Director and Chief Counsel; Ed Mihalski, Chief of Staff, Minority.

Also present: Jill Ouseley, Director, Office of Market Finances, Department of the Treasury; Joseph Humphreys, Majority Health Counsel; Rick Grafmeyer, Minority Health Counsel.

The Chairman. We will now go into Executive session for consideration of the nominees.

Senator Moynihan. Mr. Chairman.

The Chairman. Senator Moynihan.

Senator Moynihan. We have heard from some excellent candidates this morning, nominees. They are distinguished by their experience and their preparation in the field. And unless there is a desire to deal with them individually, I would propose that they be approved by the committee en bloc.

Senator Heinz. Mr. Chairman, I second that motion.

The Chairman. And that will be a voice vote unless someone requests otherwise.

The motion has been made and seconded that the nominees be hereby reported out by this committee. All in favor of that motion make it known by saying aye.

(Chorus of ayes.)

The Chairman. Opposed?

(No response)

The Chairman. So done.

We will now move to consider H.J. Res. 280, and that is the debt limit extension. Now the House version of this bill provides for a $322.7 billion increase in the permanent debt limit and that is to last until approximately September of 1990.

The Treasury has informed us that they think it is important that we move this week on this piece of legislation; that if it is not enacted by August the 1st, Treasury may be unable to fully invest the Social Security Trust Funds. And if we left for the August recess without increasing the debt limit the Government would be in the position of defaulting on some of its obligations during the recess. So we have to act quickly.

Frankly, the chair had originally considered that we do a long-term extension of it to the same period of time that the House talked about, September 1990. But it became obvious that if we did it would be a lightning rod in the collecting point for every amendment that staff or members could think of and that they can convince the appropriate member to offer. And that the August recess would be a long time coming.

So in the interest of trying to expedite the process, what I am proposing this morning is an extension to October 31st, 1989. And it is my strong hope and desire that we will not see amendments attached to this piece of legislation coming out of the committee, other than a technical amendment that has been requested by Treasury insofar as the value placed on bonds and trying to get the appropriate value.

Now that does not mean that we won't get some amendments offered on the floor of the Senate, and that we will have problems in trying to fend those off.

Now I also think any amendments that are offered are going to be a fang for effect rather than realization of whatever the objective is of that amendment, because I think that if they were successful on the floor of the Senate they would be stripped off on the House side.

And full opportunities obviously are going to be available as we bring this back up in October. So I would urge that we not try to put the amendments on it as we come out of this committee.

But with that in mind, I now defer to members of the committee for any comments they have. Senator Moynihan.

Senator Moynihan. Mr. Chairman, I want to support your position. It is the only realistic way to ensure that we have a measure in time to avoid the default of the United States Government which is out there about 20 days from now I think. It is hard to imagine, but that is the way we deal.

I would like if I can, Mr. Chairman, very briefly to make a point which members will want to consider and that is for the first time this year we are required to increase the debt ceiling, not simply to enable the Government to borrow more monies in the consequence of a deficit in the current operating accounts, but also to give the Treasury the ability to borrow money from the Social Security Trust Fund in effect to enable it to invest the monies, the Social

Security tax--the f.i.c.a. tax--in bonds that go into the Trust Fund. I s-ould make myself more clear. They don't borrow money from the Trust Fund. They borrow the monies that come in from the f.i.c.a. tax and giving bonds that are placed in the Trust Fund.

If the debt ceiling were not to be increased, the Treasury would not be able to issue bonds to the Trust funds and the Trust funds would not then be collecting the interest that is there they collect under the arrangement. They would not have the security of a bond.

This has not ever happened before, or to the degree it has it has been very marginal as we have been on a pay as you go basis. Now the Trust funds are rising by $1 billion a week. Unless we increase the debt ceiling, the Treasury will not be able to issue bonds for that $1 million and the consequent disarray would be altogether I think unacceptable to this committee and it would cause outrage in the country if it ever came about.

I think Senator Heinz is of that view as well.

Senator Heinz. Mr. Chairman.

The Chairman. I might interject here for a moment for something I did not comment on. We have checked on this date with the Administration--we have the support of the Administration--I have checked with the Ranking Member and we have his support in that regard--in trying to bring about bipartisan extension here. Senator Heinz.

Senator Heinz. Mr. Chairman, Senator Moynihan has broached the topic of the investment of the Social Security Trust funds and I would like to make two comments in that regard. The latter will refer back to the comments made by my friend from New York, Senator Moynihan. The former is that I think we are getting to the point where we will soon be unable to pass a debt ceiling extension unless we take into account in the way we do our budgeting and our accounting for the budgeting, what it is we are doing to the Social Security Trust funds.

And while the short-term extension of the debt ceiling may not be the place to fight that battle, I do want to reserve the right before this committee in which I serve to offer an amendment on the floor, which perhaps I will be able to persuade some of my colleagues to join in offering, in order to clarify for those who are interested--and there are a lot of people who are interested, at least 37 million senior citizens and all the people who will be stuck with a lot of debt, twice as much debt as we now have in 20 years from now if we don't stop this system of counting the annual surpluses in the Social Security Trust Fund as if they are deficit reduction.

If we did not owe that money in the Social Security Trust Fund to somebody else at some point in time, the baby boom generation when they retire, as both my colleagues know, I would not be raising the issue. But the fact is that we are pledging that money twice. And I was told that if you make a deal in the Senate you should make it with one person on one deal, you should not make two different deals on the same subject.

So I want to reserve the right to bring that up.

Now my colleague from New York raises an interesting point on what happens if we do not increase the debt ceiling. Will the surpluse funds that are being generated in the Social Security Trust Fund, will they in fact be precluded from investment?

And I don't normally disagree with my friend from New York. I am not entirely sure that he is wrong and I am right. But my understanding would be this, that as long as the aggregate amount of debt outstanding did not exceed the statutory limitation of roughly $2.8 trillion, the Treasury Department would be empowered--indeed I think they would be compelled by the law--to invest the Social Security surplus in expiring and renewable debt every Monday the Treasury goes to market to roll over the debt. And they will be rolling it over every Monday, and they can roll it over every Monday, a certain amount of it, without exceeding the aggregate debt limit.

So my understanding would be that even if we did not increase the debt ceiling, Social Security would, in fact, simply take into its portfolio more of the rolled over securities. The aggregate amount of debt would not change. The amount of debt held by the public would go down. The amount held by the Social Security Administration would go up.

Senator Moynihan. May I say to my friend?

Senator Heinz. Yes. As I say, I think that is the way it works, but I cannot swear to that.

Senator Moynihan. I think not. Once the debt outstanding to the public and to the Trust Fund has reached the limit, and there is no possible way to invest the Trust Fund incomes. It is like a tax. Perhaps Mr. Humphreies could settle this matter. That is what led to that $25 billion disinvestment in 1985.

Mr. Humphreies. Well it is a very difficult situation. Once you hit the debt limit you cannot invest anything that would cause you to go above the debt limit.

Now if you happened to hit it on the same day that there were expiring issues, and there were enough of them, and you had enough cash to pay them off in cash, and draw the debt down below the limit, then to the extent you had room you could invest.

Senator Moynihan. But let's say you don't have that cash. They sell and buy; they redeem and borrow on the same morning.

Mr. Humphries. I think this is the problem.

Senator Heinz. On that point, if there is no cash--since the Social Security reserves are counted as if they are part of the general fund of the Treasury, and any surplus cash generated by virtue of a surplus that is uninvested of the Social Security Fund, will be sitting in the general fund of the Treasury and will be available to purchase obligations--it seems to me that the cash problem is not a prooblem. Either there will be surplus cash to invest in something or there will not. Now is that wrong?

Mr. Humphries. That is not quite right because there isn't necessarily any surplus cash. The Social Security Trust funds get credited on the first day of the month with the cash that is going to come in during the rest of the month. So no cash has really come in at that point.

Senator Heinz. But in that sense they are getting an extra benefit. They are getting credited for cash that they have not yet received.

Mr. Humphries. That is right.

Senator Heinz. So in a sense we are kind of carrying the Social Security Administration, giving them the benefit of the doubt for that month as an accounting convenience. Is that right?

Mr. Humphries. That is right. And there are subsequently adjustments that are made.

Senator Heinz. So at the end of a month there is cash is my point.

Mr. Humphries. By the end of the month.

Senator Heinz. All right.

Well we will clarify all of that.

Senator Moynihan. Can I say that I think we really have to settle this. Is there someone from the Treasury present who could help us?

The Chairman. Yes. All right. We can have that comment, but I would like to move along, frankly, because it is an interesting argument. But by the end of the day we have to do the job.

Would you like to make a comment? Do you have a definitive statement that you would like to make? Please come forward and state your name.

Ms. Ouseley. I am Jill Ouseley. I am the Director of the Office of Market Finance in the Treasury Department.

And what Mr. Humphries has said is correct. As far as the Social Security Trust fund earnings are concerned, that what is called normalized tax transfer, is credited on the first day of the month and invested. However, over the period of interest accrual, any amounts of earnings that are in excess of the investments of actual funds would be deducted.

Senator Heinz. So that in that sense there would be no loss to the Social Security Administration if the debt ceiling was not passed in a timely fashion as long as there were expiring Treasury obligations sufficient to invest their surplus revenues.

Ms. Ouseley. As long as the debt limit impact did not exceed approximately three months. That would be the case.

Senator Heinz. Yes. All right.

Senator Moynihan. Mr. Chairman, may I suggested we get to this at another time? But let me just lay it down right now.

The Chairman. Yes.

Senator Moynihan. If we do not do what you propose there will be no Social Security checks sent out on September 1. Now is that not correct?

Senator Heinz. No.

Mr. Humphries. Yes. If the debt limit is not increased, the Government will be in default long before September 1 and the cash would not be there.

Senator Moynihan. That is all I am asking.

The Chairman. I don't think anyone wants to respond to that one.

Senator Heinz. Mr. Chairman, I have got a second question on the zero coupon bonds.

The Chairman. All right.

Senator Heinz. And what happens to the portion of the zero coupon bond, how do we recognize and account for that portion of the zero coupon bond above the discount rate and below the face value?

Mr. Humphries. Under the proposed amendment?

Senator Heinz. Yes.

Mr. Humphries. It is accounted for as it becomes an actual obligation.

Senator Heinz. Well let me give you an example. Let's say we are going to sell 30-year zero coupon bonds that mature 30 years from now at $1 billion. I go to the market. I sell that for a quarter of a billion dollars in round numbers. The difference is $750 million. At what point and how do we take account of that $750 million?

The first transction is we have received cash and incurred an obligation for $250 million. That is the discounted value. What happens to the rest and when?

Mr. Humphries. All right. On a straight-line basis each month as you move towards that 30 years from now the charge against the debt limit goes up, so that it starts out at $250 million. By the thirtieth year the charge against the debt limit is the full $1 billion.

It is really the same thing. If you took the same bond and sold it at interest with an interest-bearing bond, it would pay $750 million of interest over the 30 years.

Senator Heinz. So you would charge off as if it were interest $25 million a year?

Mr. Humphries. That's right.

Senator Heinz. And that is accounted for as in what is reported as net interest.

Mr. Humphries. No. That is not a debt limit calculation.

Senator Heinz. All right.

I just want to make sure that we know where it shows at.

Mr. Humphries. It gets to go in the debt limit as debt subject to outstanding debt subject to limit. I am not sure how it gets accounted on the interest.

Ms. Ouseley. On the budget side it would be counted as it accrues. The interest would be counted as it accrues.

Senator Heinz. Under what basis does it acfure? What is the accrual rule? Does it accrue at the end or does it accrue in increments, in equal increments, over 30 years? You have to have a rule for its accrual.

Ms. Ouseley. There are monthly accruals that are calculated by the Treasury Department.

Senator Heinz. So it accrues each --

Ms. Ouseley. Each month.

Senator Heinz. -- periodically.

Ms. Ouseley. And it would be, as Mr. Humphries has said in your example. The difference between the $250 million and the $1 billion would be on an accrual basis over that period of time.

Senator Heinz. True. Yes. And that would be a straight line accrual?

Ms. Ouseley. No. It is ex-financial.

Senator Heinz. It is ex-financial?

Ms. Ouseley. Yes. It would be compounded because the obligation is increasing in value as time goes on, so that the interest is earning interest. It is compounding.

Senator Heinz. Does that mean that you will recognize more earlier or less earlier?

Ms. Ouseley. The recognition of the interest payment would be somewhat less earlier because you do have the interest on interest as the bond reaches maturity.

Senator Heinz. Mr. Chairman, this sounds like gimmickry to me as I understand it.

Senator Moynihan. It sounds like high finance to me, but that is the difference between those who understand it and those who don't.

Senator Heinz. There may not be a big difference. Vote me no.

Senator Moynihan. Put you down as no.

Senator Heinz. Let me explain why.

Senator Moynihan. Yes.

Senator Heinz. The Chairman is in a hurry to push this through and I don't wish to detain him. Apparently he didn't wish to be detained. But it sounds like, to me, what is going to happen is that the Treasury Department is going to be able, in effect, to borrow a lot of money at what is reported as a reduced rate of interest. And that is just one way of making our books, once again, look better now with a bigger bill to be paid later. It is exactly the same subject that the Senator from New York and I are concerned about regarding what happens to the Social Security Trust funds. This looks to me like just one more gimmick to get as much money as the Government can today and recognize as little cost in doing so today as possible.

Ms. Ouseley. I think over time you would find that the cost would be the same between a zero coupon security and a coupon security.

Senator Heinz. Over time, that is quite true. It will be the same. But it will make our books look, in my judgment, deceitfully better now. Because if you had to do it the old fashion way, go out and borrow the billion dollars and pay interest on the billion dollars, you would pay the market rate of interest each year for the next 30 years.

What you have described is a rate of interest that, because you are doing a calculation ex-financially, will be substantially less, as I understand the explanation, in the early years and more later. Now if that is wrong, present us with some numbers that show us.

Senator Moynihan. Would the Senator yield?

Senator Heinz. Yes.

Senator Moynihan. The Senator has made a very clear proposition. Can we not get from you, not this afternoon but before this bill goes to the floor, a statement in response and with some numbers?

Ms. Ouseley. We can provide some mathematics for an example.

Senator Moynihan. I am sure you can. Wouldn't you want that, sir?

Senator Heinz. Yes. That would be fine.

And I will continue to vote no on this amendment to the debt limit extension. Not on the debt limit extension. I want that to get to the floor. But I will vote against the Treasury's perfecting amendment to permit the $15 billion in existing debt.

Senator Moynihan. And we will have before we go to the floor--very quickly now--we will have a full statement.

I think the Chairman would like to move this matter and I think he will be with us very shortly. As a matter of fact, if we don't do something in the next 17 minutes it might be too late. And so with that in mind --

Senator Heinz. Mr. Chairman, I move that we report the debt ceiling bill.

Senator Moynihan. And you wish to see it reported. But how do you want it recorded of a no vote on the Treasury amendment?

Senator Heinz. Well, I just want to be recorded, and the fact that I have stated that is sufficient for my purpose.

Senator Moynihan. All right. We have that motion. I think the Chairman would wish to be here at this time. And the Chairman is here.

Mr. Chairman, we have a motion to report the measure by the distinguished Senator from Pennsylvania. The Senator from New York seconds the motion.

The Chairman. Well, I am pleased to see it has moved expeditiously and all of those serious problems have been resolved in my absence.

The motion has been made and seconded. All in favor of the motion make it known by saying aye.

(Chorus of ayes.)

The Chairman. Opposed a similar sign.

(No response)

The Chairman. The motion is carried. Thank you very much, gentlemen. The meeting is adjourned.

(Whereupon, at 11:45 a.m., the meeting was concluded.)

CERTIFICATE

This is to certify that the foregoing proceedings of an Executive Committee Meeting of the Committee on Finance, held on Tuesday, July 25, 1989, were transcribed as herein appears and that this is the original transcript thereof.

William J. Moffitt

WILLIAM J. MOFFITT
Official Court Reporter

My Commission expires April 14, 1994.