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LONG-TERM STATUS OF THE SOCIAL SECURITY TRUST FUNDS

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

MAY 13 AND 20, 1988

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ADMINISTRATION WITNESS

PUBLIC WITNESSES

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LONG-TERM STATUS OF THE SOCIAL SECURITY TRUST FUNDS

FRIDAY, MAY 13, 1988

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:33 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Daniel Patrick Moynihan, Chairman, presiding.

Present: Senators Moynihan, Packwood, and Durenberger.

[The press release announcing the hearing follows:]

[Press Release H-18]

FINANCE SUBCOMMITTEE TO HOLD HEARINGS ON SOCIAL SECURITY TRUST FUNDS

WASHINGTON, DC.—Senator Daniel P. Moynihan (D., New York), Chairman of the Senate Subcommittee on Social Security and Family Policy, announced today that the Subcommittee will hold two hearings on the long-term status of the Social Security trust funds.

The hearings are scheduled for Friday, May 13, 1988 and Friday, May 20, 1988 at 10:00 a.m. in Room SD-215 of the Dirksen Senate Office Building.

In announcing the hearings, Moynihan said, "We are all very happy that current long-range projections for the Social Security program show the system to be sound, with assets growing well into the next century."

The hearings will focus on two issues: the long-range impact on Social Security and Medicare of projected demographic and labor force changes, and the implications of the projected Social Security Trust Funds surplus for the federal budget and the economy.

The Subcommittee will hear testimony from a number of government officials, as well as private economists and other experts. The witnesses will appear by invitation only.

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

Senator MOYNIHAN. A very good morning to our witnesses and our guests and colleagues.

This is an oversight meeting of the Subcommittee on Social Security and Family Policy.

We meet today for the first of three hearings on the long-term status of the Social Security trust funds.

I must say at the outset, we meet to discuss some very good news. Last week, the Social Security Board of Trustees released its annual report on the financial condition of the old-age, survivors, and disability insurance trust funds. The report includes many interesting facts, like the following: Since 1982 the Social Security cost rate—that is, OASDI expenditures as a percentage of payroll—has fallen steadily, from 11.9% in 1982 to 10.7% in 1987. A ten percent decline. The report also shows that Social Security trust fund reserves grew by some $22 billion in 1987 (more than was estimated in the 1987 report), and held a balance of about $65 billion in interest-bearing assets at the end of the year. Trust balances are estimated, under intermediate assumptions, to reach more than $1 trillion by the year 2000, and to continue their robust growth for another 35 years thereafter. Finally and perhaps most reassuring, the trustees find that under intermediate assumptions the Social Security system is in close actuarial balance over their long-range, 75-year projecton period.

The picture, of course, was not always so reassuring. It was not 7 years ago that the then newly appointed Director of the Office of Management and Budget in the newly elected administration was declaring with respect to the trust funds that "the most devastating bankruptcy in history" was months away. Now we find ourselves dealing with the propsect of reserve amounts never previously contemplated.

There was, of course, an intervening event, the Social Security Amendments of 1983. The new Congress convened on January 3 of that year. I had been re-elected and was sworn in for a new term. The distinguished Republican leader Robert Dole, then chairman of the Finance Committee, happened to be on the floor. We talked. Agreed to meet. Met again. The administration joined us. Or we them, it matters not. What matters is that in twelve days in January, beginning on the Senate floor at approximately 1:05 P.M. January 3, and concluding at Blair House at 9:30 P.M. January 15, we reached an historic compromise, the results of which are now before us in a solid surplus and settled future.

We aimed to established surpluses not only to emphasize the solvency of the system, but also public confidence in the Social Security system. As recently as 1985 the distinguished public opinion survey firm of Yankelovich, Skelly, & White did a 50-year report card on Social Security and found that a full 66%, two-thirds, of nonretired adults believed it likely or very likely that beneifts would no longer be paid when they retired - thwo-thirds. So when we put these arrangements together we wanted to see a surplus in the trust funds that people could point to as a reserve for their retirement. Today we have a reserve of more than $65 billion and growing strong. Judging from this year's trustees report, I am heartened to say that in those 12 days we may have built better than we knew. And I hope that the work might go forth from this hearing that we are in surplus, we will stay in surplus, the system is secure, and the promises made a half century ago are being kept.

The Medicare fund is not so robust, though it is perhaps unfair to measure that program, at this point, against the Social Security success story. This year's report of the Board of Trustees for the Medicare, or Hospital Insurance, program show that program to be sound through the turn of the century, but it appears that by the year 2005 or so the Medicare program will need some fixing of its own. Not to worry. There is time enough for adjustments. And it is noteworthy that combined income to the Social Security and Medicare programs would be sufficient to finance both programs for many years into the 21st century.

As I mentioned earlier, today's hearing is the first of three on the Social Security trust funds. Today we will hear testimony on the Social Security and Medicare reports, and will also consider the implications for Social Security, Medicare, and the Federal budget of projected demographic and labor force trends. In the second hearing, scheduled for May 20th, we will discuss the macroeconomic and other policy implications of building up a projected $12 trillion Security trust fund reserve. The third hearing will be field hearing in New York City where Wall Street representatives will testify on the implications of trust fund surpluses for the financial markets.

I turn to my revered friend and colleague, the former Chairman of this Committee, Senator Packwood of Oregon.

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

Senator PACKWOOD. Mr. Chairman, I thank you for the hearings that you have planned this Friday and next Friday. I think, the information that we all expect will come forward—and I don't think the Administration's is any surprise to the Chairman or to many people now—is extraordinary in terms of the fiscal policy of this country.

As we were all aware for years, Social Security has invested their surplus in government bonds—in fact, that is all they can invest their money in. But suddenly we are aware that over the next number of years, several decades, we are going to have incredible "reserves," as Commissioner Hardy likes to call them. I call it "surplus," and she says, "It is really a reserve."

I will call it a "reserve," but this reserve is going to approach $12 trillion, unless the Congress goes absolutely bonkers—absolutely bonkers—and spends it immediately, or runs up immense general fund deficits, beyond anything that I think we would regard as imaginable. It probably means that the Social Security Trust Fund will be acquiring the better portion of the Government debt, or perhaps all of it, without any change in law.

I am not necessarily saying that is bad. Government bonds, Federal Government Bonds, are still regarded I think as one of the soundest and safest investments in the world. And only if you assume that the Federal Government is going to renege on its bonds—and if it did, it wouldn't be just those the Social Security hold, unfortunately; it would be all, which would indicate national bankruptcy and national disgrace—unless you assume that, the fact that Social Security holds those Government Bonds is neither dangerous nor bad.

But it does raise an interesting macroeconomic question as to whether or not we should be considering other tax increases in addition to the existing Social Security taxes when we will already by the mid-nineties have significant surpluses, to counting all money in and all money out, perhaps we should be considering a reduction in the Social Security Tax so that the Trust Fund doesn't grow so extraordinary large, fully realizing we would have to raise the tax again 15 or 20 years out, in order to make sure the Fund was solvent.

These are genuine questions, legitimate questions, and I hope to propound some of them to some of the witnesses today. But it does present us with a situation—I don't want to say a "problem," because I don't think it is a problem—but with a situation that we have not known in a generation, and perhaps an opportunity that we may not see for another generation.

So, Mr. Chairman, I congratulate you on holding these hearings, and I look forward with eager anticipation to what the witnesses have to say.

Senator MOYNIHAN. I think it is fair to say that we don't frequently have hearings in which we discuss what do we do with a trillion dollar surplus. This is a new and novel experience to which we look forward.

In our first panel we are happy to have here the Commissioner of Social Security, the Honorable Dorcas Hardy, and Dr. William Roper, who is the Administrator of the Health Care Financing Administration, which is responsible for the Medicare program.

Dorcas, good morning. We look forward to your testimony.

STATEMENT OF HON. DORCAS R. HARDY, COMMISSIONER OF SOCIAL SECURITY, ACCOMPANIED BY CHIEF ACTUARY HARRY BALLANTYNE, BALTIMORE, MD

Ms. HARDY. Thank you, Mr. Chairman.

I appreciate the opportunity to be here, and I do have a few comments to make.

Today, the actuarial status of the Social Security program, as you pointed out, is certainly different than the situation was earlier in this decade—thanks to your efforts and efforts of others who participated on the 1983 bipartisan National Commission on Social Security Reform.

The 1988 Social Security Trustees Report estimates that Trust Fund reserves will increase in 1988 by about $40 billion, and that reserves will total $109 billion at the end of 1988.

At the beginning of 1989 the funds on hand are estimated to be enough to pay about seven months of benefits, and under the intermediate II-B Assumptions, Trust Fund reserves will increase significantly over the next several decades. They will reach nearly $12 trillion by the year 2030; and, assuming that our projections are accurate, there should be sufficient funds to pay all benefits due to current beneficiaries and to develop a substantial reserve for payment of benefits to the baby boom generation when we retire in the next century.

Over the 75 year period the trustees use to evaluate long-term financing of Social Security, the program is in close actuarial balance. The long-range actuarial balance is a deficit of .58 percent of taxable payroll, which is less than 5 percent of the long-range cost rate over the next 75 years.

There are a lot of other useful measures of the financial condition of the program as well. The assets of the combined trust funds relative to annual expenditures peak at five times annual outgo by 2015. But then, beginning in 2032, outgo is estimated to exceed tax income plus interest on the reserves, so that accumulated reserves will have to be used to meet benefit costs. And thereafter, the combined funds drop sharply until they are exhausted in 2048.

At that time, income is estimated to equal only 80 percent of the benefit costs. And clearly, if no earlier action has been taken, benefits would either have to be reduced, taxes increased, or some combination of the two; that point is, we should note, 60 years away.

The change in the ratio of workers to beneficiaries accounts for most of the variance in the Social Security financing that we can expect over the next 75 years.

That change reflects mainly the passage of the baby boom generation through the labor force and then through retirement. The projected build-up of the Trust Fund reserves will occur while the members of this generation are in their peak earning years, which fall roughly within the first 25-year segment of the long-range projection period.

During the second 25-year period, the retirement of the baby boom generation will cause that ratio of workers-to-beneficiaries to drop from 2.9 to 1 to about 1.9 to 1.

Now, there has been considerable interest lately, as Senator Packwood has commented, and people have expressed concern that the build-up of the Social Security Trust Funds will require that the Trust Funds purchase all publicly held Federal debt, and eventually have to purchase large amounts of private debt to accommodate the size of the Trust Fund reserve.

This may be theoretically possible, but the total or combined Federal Budget would have to be in surplus for a substantial period of time for this to happen. As it is, the projected Trust Fund reserves would not exceed the current Federal Debt ceiling, $2.8 trillion, until 2006.

Whether the fiscal discipline necessary to produce Federal Budget surpluses of this magnitude can be achieved is questionable. I do think it is important, however, to be aware of this possibility, along with other potential consequences of the build-up that may have important economic repercussions.

It is our responsibility, collectively as a society, to educate all of the public about these issues, and to encourage public discussion in order to provide some very useful guidance as the reserves continue to build.

I think it is also crucial to work on improving public confidence in Social Security. As you pointed out, Mr. Chairman, as we plan for the financial stability of the program in the years ahead, the public needs to be better informed about the Social Security benefits that they can expect to receive. And in this regard, SSA, in partnership with the Advertising Council, began a national public service advertising campaign in February designed to educate the public about the total package of protection which Social Security provides—disability, survivors, as well as retirement—and its value for all ages and all families.

In all of our publication efforts, I am trying to reassure Americans that we all are working hard to ensure that Social Security will be there for all of us when we retire. But we also need to continue to explain that Social Security cannot do it all, and that it was never intended to be all of someone's retirement; it was intended to be that floor of protection. But, unfortunately, I guess our successes have exaggerated our capability, and some rely on Social Security more than they should.

In this regard, I think we need to give some very careful thought to the future direction of all of our national retirement income policies and look at ways to extend pension coverage to more people through their place of work, provide better education about pension benefits to our future retirees, and do a better and more coordinated job of formulating our national retirement income policies.

So, to improve public understanding, and as a new public service for everyone, we will soon begin providing workers with a new personal earnings and benefit estimate statement that will include a year-by-year breakdown of your earnings, and your FICA tax payments, a statement of how many earnings credits you have, and an estimate of your disability, survivors, and retirement benefit.

In conclusion, Mr. Chairman, Social Security is on a sound financial footing today and into the next century, and we all need to convince the public that the support for Social Security that is imbedded in our society ensures that the program will be there to provide benefits not only for today's retirees but for future retirees as well. And we need, at the same time, to encourage people to supplement to the best of their ability their Social Security future.

So, in my view the key to achieving these goals is to resist the forthcoming pressures to spend the Social Security reserves for purposes other than that they were specifically intended.

Thank you, Mr. Chairman. I will be glad to answer any questions.

[Commissioner Hardy's prepared statement appears in the appendix.]

Senator MOYNIHAN. Thank you, Ms. Hardy.

May I just make one point here? When you said "resist the temptation to spend the reserves for purposes other than the intended purpose," of course that would be a quite indirect thing, because the Social Security Trust Funds can be spent only for Social Security benefits and expenses.

Ms. HARDY. Yes, sir, by current statute.

Senator MOYNIHAN. That is right.

Senator Durenberger, good morning. Would you like to make an opening statement?

Senator DURENBERGER. Mr. Chairman, no. I am just so pleased that I was able to be here this morning—I am actually supposed to be in another part of the country doing something with generational equity. But I think that may be one of the things we are doing here this morning. So I really appreciate the fact that I am here now.

Senator MOYNIHAN. Senator Packwood made the point that we are discussing a new kind of problem, which is: What do you do with a trust fund surplus? That is not altogether disagreeable.

I thought we would hear from Dr. Roper, and then we will question the panel.

Dr. Roper, good morning, and welcome.

Dr. ROPER. Good morning, sir.

STATEMENT OF DR. WILLIAM L. ROPER, ADMINISTRATOR, HEALTH CARE FINANCING ADMINISTRATION, DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY CHIEF ACTUARY GUY KING, WASHINGTON, DC

Dr. ROPER. Mr. Chairman, members of the committee, I am pleased to join you and my colleague, Commissioner Hardy, to talk about these important matters. I am going to address myself to the financial status of the Medicare trust funds.

The Medicare Part A and Part B trust funds serve much the same population as do the Social Security trust funds. I can assure you and the public that the Medicare Program is strong and financially sound; but, over the longer term, we face some real challenges in the Medicare Program, and that is especially what I want to talk about.

A future President and a future Congress will have to take actions to avert the insolvency of the Medicare trust fund. We are projecting the Part A trust fund will be out of funds by the year 2005. I will have more to say about that in a bit.

As you know, Medicare has two trust funds: Part A or the Hospital Insurance Trust Fund pays for inpatient hospital and related care for the elderly and disabled. It is financed primarily by payroll taxes paid by today's workers.

The Supplementary Medical Insurance Trust Fund, or Part B of Medicare, pays for physicians, outpatient and other related medical services. Premiums from Medicare beneficiaries finance a quarter of the cost of Part B of Medicare. The remaining three-quarters is paid for by general revenues.

An important point that I would like to stress repeatedly is how rapidly the outlays of the Medicare trust funds are growing. We continually try to draw comparisons to give you an impression of this. One that I find useful is: From 1981 to our projection for 1989, the Defense Department spending will have grown by 87 percent. During that same period, 1981 to 1989, the Medicare payouts will have increased by 115 percent. So, Medicare is growing substantially larger, substantially faster than the Defense Budget. That is out of variance with the conventional view, which speaks to cuts in the Medicare program, which are not true, and rapid growth in the Defense Budget. This comparison makes an important point to bear in mind.

Demographic factors that affect the soundness of Social Security financing also affect Medicare. There is a major demographic shift underway that will occur as the baby boom generation retires, so that, by the middle of the next century, there will be only two workers to support each beneficiary, in contrast with today's 4:1 ratio.

The demographic changes are not our only concerns. In fact, a major concern is the historical trend in this country with respect to spending on health care. Outlays for health care are mounting rapidly and are consuming an ever-larger share of our gross national product.

Two decades ago when Medicare and Medicaid were begun, health care spending represented 6 percent of GNP; now the figure is more than 11 percent.

Price inflation for health care goods and services is a substantial part of that growth, as also is the growing utilization, or volume of services that we and others are paying for.

The Medicare Hospital Insurance Trust Fund last year paid out slightly more than $50 billion. Under the intermediate set of assumptions, the Board of Trustees for the Hospital Insurance Trust Fund projects that this fund will be solvent until at least the year 2005, perhaps until 2008. But the Board cautions that, and I quote, "any significant adverse deviation from these projections could result in the inability of the fund to meet its obligations much sooner than projected."

There is a need, then, to begin debate now on how to address the financing of the Hospital Insurance Trust Fund over the long term.

Important steps have been taken by the Administration and by the Congress, especially to change the way we pay hospitals under the Hospital Insurance Trust Fund with the implementation of the Prospective Payment System.

There is no cause for alarm—let me be clear about that. I want to reassure you and the public. But there are challenges ahead. As things stand now, the Hospital Insurance Trust Fund will need either an infusion of revenues of 16 percent, or a decrease in spending of 14 percent to assure the financial soundness of the Fund through the next 25 year period. My point is that things have got to change over that 25 year period.

That is the subject of thoughtful and deliberate debate that we seek.

Last year the Medicare Supplementary Medical Insurance Trust Fund, Part B, paid out nearly $31 billion. The Board of Trustees quite rightly notes its concern with the rapid growth in the cost of this program that resulted in the doubling of outlays over the last five years. I would be hardpressed to name another Federal program that has doubled its outlays in five years' time.

The Board recommended to the Congress and to the Administration that we continue to work together to curtail the growth of Part B spending.

I testified last Fall before the Ways and Means Committee about the Medicare Part B premium increase that we were forced to put into place because of the rapid growth in outlays. That premium this past January went up 38.5 percent. We are forecasting another 14 percent growth in outlays for the Part B program during Fiscal Year 1988, and that long-term pattern is going to continue unless we are able to come to grips with the growing volume of services, in particular.

Physician expenditures drive Supplementary Medical Insurance spending, accounting for about two-thirds of the program. One way of explaining that growth is to say that spending for physician services was $400 per enrollee in 1982; it was about $700 per enrollee last year, 1987.

The need to control spending under Part B of Medicare is clear. We have got to give appropriate incentives to control volume, not just deal with individual services and prices.

We have initiated several incremental reforms, such as intensified utilization review. We seek to launch a demonstration project later this year which will test preferred provider organizations, PPOs, in the Medicare program. And most importantly, we believe we need to begin investing in and helping others conduct research into things that work in the practice of medicine, to make sure we are spending these precious dollars on effective medical practice.

We believe it is necessary, though, to make an even more fundamental reform in the Medicare program. A long-run solution is to make a single payment per beneficiary to a private health plan of the beneficiary's choice. Such managed care systems will control costs and ensure beneficiaries get the quality of care they need without the added risk of care that is not needed.

Finally, Mr. Chairman, let me say we are talking about the stability and viability of the Medicare trust funds over a 25-year period. As you know, the Congress is now in conference on major legislation put forward by the President to provide catastrophic health insurance as a part of Medicare. This new benefit will be largely financed by beneficiaries through supplemental premiums, thus avoiding the need for inter-generational transfers.

But as we are in the middle of this debate, there is a debate beginning on financing long-term care, surely an important issue that deserves full debate.

Let me just make a careful point: If long-term care financing is established through Medicare, as some are seeking, it will radically affect the stability of the Medicare trust funds. Long-term care financing deserves full substantive hearings and full debate before the Congress takes action.

Let me conclude by again saying that Medicare is strong and on a sound basis. We are committed to continuing the important discussions over the longer term that will preserve its financial stability.

Thank you.

[Dr. Roper's prepared statement appears in the appendix.]

Senator MOYNIHAN. Thank you, Dr. Roper. And thank both of our witnesses.

May I say—and I ought to have invited them to join, and I will do so.

Mr. Harry Ballantyne, you are here, aren't you?

Mr. BALLANTYNE. Yes, Senator.

Senator MOYNIHAN. Won't you come forward, sir?

And Mr. Guy King? There you are, Mr. King.

These are the Chief Actuaries of our Social Security Administration and the Health Care Financing Administration, respectively. We want to welcome you and tell you how much we appreciate your important work.

I would like to thank our witnesses, in the first instance for their long-term perspective. We have very solid circumstances in our Funds right now; but life goes on, and things can force the imminent need for attention, and the sooner you know about them, the more likely you are to do it in a sensible way.

I like to recall that in her book, "Roosevelt I Knew," which was published in 1946, Frances Perkins of New York, Secretary of Labor under President Roosevelt, who was responsible for putting together the Social Security legislation, said, "There will be some problems with the Trust Funds in around 1980." Now, that's a public servant. That is my idea of someone who has a little perspective. [Laughter.]

But the kinds of problems we foresee now are good problems. In the case of health care they basically reflect a question the Nation is beginning to address, which is how much ought we do? What is useful? What is necessary?

I noted in Dr. Roper's testimony that researchers have found that residents of New Haven, Connecticut, are twice as likely to undergo coronary bypass surgery as residents of Boston, without clinically meaningful differences in health outcomes.

Dr. ROPER. Yes, sir. If I could elaborate on that a minute, one of the major unresearched areas in medicine these days is getting information on what works in the practice of medicine.

We have a very sketchy knowledge about how effective various treatments are. Distinct areas of the country like the Yale/New Haven area and Boston, differ widely as to how doctors in those areas practice.

As Dr. Jack Wennberg has recently written, "If the rest of the country practiced medicine the way Boston does, we would be spending 16 percent of our Gross National Product on health care. If the rest of the country practiced the way New Haven does, we would be spending 9 percent of our Gross National Product."

I think we should take a lesson from that, among others, and decide whether we wish to emulate the way Boston is practicing.

Senator MOYNIHAN. But may I ask, that wouldn't be the case with respect to heart bypasses. If you go to New Haven, they apparently grab you and toss you on the operating table.

Dr. ROPER. There are differences in both directions. But the Boston practice is much higher.

Senator MOYNIHAN. Yes. Sure.

Dr. ROPER. And last week we published a notice in the Federal Register indicating our intention shortly to make available to researchers and the public the Medicare database. We have a gold mine of information on 30 million admissions to hospitals each year that will allow researchers to analyze information on medical practice.

Senator MOYNIHAN. Good. That is good information. That is what we need to know. I mean, can it be that there are twice as many people who need heart bypasses in New Haven as in Boston? Or are there more interns that need practice—to use the phrase. And we look to find out.

Could I ask Dorcas Hardy two things? One: I noted that in your report—you are Secretary of the Board of Trustees—that the proportion of payroll going to Social Security benefits is declining, dropped 10 percent inside a decade. That is sort of different from the public perception, wouldn't you say? And what do you or Mr. Ballantyne say?

Ms. HARDY. Mr. Ballantyne can elaborate; but, primarily you take those differences that you commented between the early eighties and to now, we are looking at more revenue coming in, people participating more in the economy, unemployment down, all of those kinds of figures on the economic side that I think have substantially contributed to that.

Mr. BALLANTYNE. Yes, that is correct. Commissioner Hardy is correct. The economy has been growing during these last five years, and the automatic benefit increases have been lower, too, than they have been in the early 1980s.

Senator MOYNIHAN. That is an inflation effect.

Mr. BALLANTYNE. Correct.

Senator MOYNIHAN. I will get back to you if I can. We have plenty of time.

Senator Packwood.

Senator PACKWOOD. Let me publicly thank you, Mr. Ballantyne, for some of the information you have given me by phone. I appreciate it. You do an excellent job.

First, I want to go down, Commissioner Hardy, the Alternatives 1, 2A, 2B and 3, so that for the record we understand the different alternatives you are working from. Alternative 1 would be the most optimistic alternative.

Ms. HARDY. Yes, sir.

Senator PACKWOOD. 2A would be the next most optimistic. 2B is what I would call the next most pessimistic. And 3 would be the most pessimistic.

Ms. HARDY. Yes. And 2A and B are similar except for the economic assumptions in there.

Senator PACKWOOD. Right. But I want to set forth the economic assumptions that you are using, because I think they are about as rational as you could get, so that people don't think that this Trust Fund surplus is coming because of outlandish economic projections.

You use the terms "short term" and "long term." Could you tell us for the record what "short term" means and what "long term" means?

Ms. HARDY. Short term is the first 10 years, and long term is over the entire 75 year projection.

Senator PACKWOOD. Now, for the short-term projections on Gross National Product on 2B—and I am only going to ask about 2B, you have got 2.2 percent to 2.9 percent real GNP growth.

Mr. BALLANTYNE. Yes, sir.

Senator PACKWOOD. I think that is reasonable. And long-term, 1.9. That is actually a rather cautious projection in my judgment.

Mr. BALLANTYNE. That would be below the experience in recent quarters.

Senator PACKWOOD. Yes, far below our historic performance. But that is fine; I would rather they be cautious in these projections than unduly uncautious.

On wages covered by Social Security, short-term, 4.8 percent to 5.7 percent. What do you mean by "wages covered"?

Mr. BALLANTYNE. That is the percent increase in the average wage of those workers who are covered under Social Security in their jobs.

Senator PACKWOOD. Now, you lost me on that one.

Mr. BALLANTYNE. Okay—4.8 percent, for example, is the increase in the average wage for all workers in that year, 1988. For those workers who work in Social Security——

Senator PACKWOOD. In other words, these are—I see what you are saying.

Mr. BALLANTYNE. That is practically all workers.

Senator PACKWOOD. This is an average increase in wages. Or is it a total increase in the wages of the country?

Mr. BALLANTYNE. No, it is an increase in the average wage.

Senator PACKWOOD. I have got it. So, short term, 4.8 to 5.7 percent; long term, 5.4 percent?

Mr. BALLANTYNE. Right.

Senator PACKWOOD. And for the Consumer Price Index, short term 3.9 to 4.5; long term 4 percent.

Mr. BALLANTYNE. That is right.

Senator PACKWOOD. Annual interest rate, short term 6.0 to 9.1 percent; long term 6 percent?

Mr. BALLANTYNE. That is correct.

Senator PACKWOOD. How anybody can guess, considering the long term is beyond 20 years, what the interest rate will be? I think we do them an undue service when we insist they make projections over a 75 year basis.

Senator MOYNIHAN. I think you feel comfortable at 50, but 75?

Senator PACKWOOD. Lastly, the unemployment rate, short-term 5.7 to 6.2 percent; long-term, 6 percent?

Mr. BALLANTYNE. Yes, sir.

Senator PACKWOOD. I would make you a bet on short-term that you may be even actually high on that. I was looking at Commissioner Norwood's statistics, when she comes on. I would predict over the next decade that an average would be 5.5 percent. But, again, you have guessed on the conservative side, which is fine.

I just wanted to set that out for the record, so that anybody that looks at this will not think that you have reached your conclusions by outlandish assumptions.

Now, Commissioner, again, just for the record:

Over the next 30 years—and I will refer to them as the Social Security Trust Funds; I realize they are OASDI—they are projected to run annual surpluses through about 2030.

Ms. HARDY. Yes.

Mr. BALLANTYNE. That is right, 2031.

Senator PACKWOOD. Okay. And that in several of those years the annual surpluses will exceed $400 billion a year. They come close to $500 billion a year. And that is annual surplus, more money in than out that year.

Ms. HARDY. Yes, sir.

Senator PACKWOOD. And the maximum projected accumulated surplus under the 2B assumption, which is the next most pessimistic assumption, is $11.8 trillion—trillion dollars.

Now, when the Social Security Funds run a surplus, you invest them in Government Bonds. In fact that is all you can invest in, Government Bonds.

Ms. HARDY. By statute. Yes, sir.

Senator PACKWOOD. Now, you used the year 2026; I am more inclined to use the year 1995. For Fiscal Year 87, the Federal "ongoing deficit" was $170 billion, while the Social Security surplus was $19.6 billion. Is it true, therefore, that the $19.6 billion of the Federal Budget deficit of $170 billion was provided by borrowing from the Social Security surplus, or the investment of the Social Security surplus?

Ms. HARDY. Yes. The bonds are invested short term during the year and rolled over long term.

Senator PACKWOOD. Right.

Ms. HARDY. And we gain interest from that. And the other side of the house, if you will, can borrow and use that. They are borrowing. We are investing into their bank account, like we would invest into something.

Senator MOYNIHAN. I wonder if I could just ask Senator Packwood if he would think again about the term "borrow."

Senator PACKWOOD. Yes. "Investment" is a better term. The "investment" of the Social Security Reserves in Government Bonds.

Senator MOYNIHAN. When Social Security has a surplus, it is invested in a Government bond, and the Government doesn't have to go to the market for investors.

Senator PACKWOOD. Now, let us assume that Congress and the Administration, whoever that next Administration might be, continues to reduce the level of the Federal on-budget deficits, assuming we come close to hitting our Gramm-Rudman-Hollings targets. I honestly think we are going to come close to hitting them this year. I think the early projections that we were $20-25 billion off may prove to be wrong this year. Is it true that the Social Security surplus or reserves will, in about 1994 to 1996, give or take a year, exceed the Federal on-budget deficit if we continue on the projected path for the on-budget deficit that we are on now?

Ms. HARDY. Yes, sir, if the deficit projections are absolutely accurate.

Senator PACKWOOD. OK. That would mean that from that year onward the Federal Government general fund deficit—I will phrase it that way—could be funded entirely by the investment of the reserves in Social Security if—and this is an interesting "if"—as a matter of policy we chose to sell no bonds in the private marketplace.

And the reason I say "as a matter of policy," there are many pension funds in this country, Mr. Chairman, that like to buy Government Bonds. I am not sure that as a matter of policy we want to say, "No, that is it. You can't buy them. We are only going to sell them to the Social Security Trust Fund." But if we chose to sell them only to the Social Security Trust Fund, by the year roughly 1996, give or take a year, the Social Security Trust Fund could fund the entire general fund deficit.

Ms. HARDY. Well, we would have to assume—theoretically I think that is correct, and that is what I was saying in my comments to you—we would have to assume that the on-budget, the other side of the house, stays in balance for a significant period of time.

Senator PACKWOOD. Or continues on the path that we now have it on. No guarantee it will, but if it continues on the Gramm-Rudman-Hollings path that we have it on—theoretically it gets to zero. But even assuming it gets to a $100 billion deficit, rather than zero by 1995 or 1996—that would be less than the projected Social Security reserves in that year.

Ms. HARDY. Yes.

Senator PACKWOOD. Then you made the statement, and I think it bears raising in a different fashion, by the year 2025—excuse me.

Ms. HARDY. I was just reminded that we need to clarify that the combined budget has to be in surplus, which I think is what you said, before we can retire any of this other debt; so that we do have to have——

Senator PACKWOOD. Any of the past debts?

Ms. HARDY. Right.

Senator PACKWOOD. Yes. I am just talking about the annual deficit at the moment.

Ms. HARDY. OK.

Senator PACKWOOD. And you made the statement that by the year 2006, the accumulated reserves of Social Security would be big enough to buy the accumulated past deficit of the United States. That really is an interesting statement.

Ms. HARDY. Assuming that the current debt is not increased. Right.

Senator PACKWOOD. Everything goes on the path that is now projected. That means that over the next 17 years—and that is not a very long time; that is short-term, as a matter of fact, in your projection—the Social Security reserves will be big enough to retire the debt that the United States has taken 200 years—at that stage 219 years—to build up.

Mr. BALLANTYNE. Senator Packwood, it is true I think that by about 2006 the assets of the Trust Funds would be large enough to have all the current debt. But if the increase in the trust funds from today until then is used to finance the increasing debt——

Senator PACKWOOD. Oh, I agree.

Mr. BALLANTYNE [continued]. Then there won't be any money left to buy the debt that already exists.

Senator PACKWOOD. I can foresee two dangerous problems, because our principal obligation is to make sure that there is money to pay the beneficiaries. You very wisely projected the benefits that need to be paid, and I am delighted you have done that.

I can see a terrible temptation—"$12 trillion?"

Ms. HARDY. Right.

Senator PACKWOOD. "Why, the temptation would be to start an immediate program not the long-term care program starting at retirement; instead, a long-term care program starting at 25, and fund it out of this immense surplus." Or, "Why worry about the general fund deficit?" I can see people saying that. "A $400 billion surplus annually, coming in the year 2000, or 4 or 5 or 6? Why worry?" That is a dangerous assumption.

But I am simply saying, if cautiously we reduce the general fund deficit, and if cautiously your projections are right and the Social Security reserves are growing, those lines are going to cross—first, in terms of annual deficits, about 1996; and then in terms of the entire accumulated past debt of the United States, about the year 2006, give or take a year.

Therefore, a legitimate question we do want to ask, and I mentioned it in my opening statement in terms of macroeconomics, government policy, money-in, money-out, is the issue of whether or not we will be running immense surpluses, an issue to which we should address ourselves now in terms of thinking about the possibility of reducing the Social Security Tax; or, an issue we want to address ourselves to if we don't do that, in saying, "Do we want to increase any other taxes, whether they be corporate taxes, individual taxes, excise taxes, consumption taxes," knowing that that would even further heighten the surplus that the Government will have, and what the effect of doing that might be on the economy?

Ms. HARDY. Mr. Packwood, the question has clearly been raised—and I know you all are thinking about it—about the 1990 tax rate increase on our side of the house.

I asked recently what would that mean in terms of the date of exhaustion for the long-range period of the Trust Funds, and I am told that, given the assumptions we have just talked about, we are looking at about six or seven years earlier in terms of exhaustion. But even not putting that in in 1990 and holding where we are now doesn't necessarily get to the answer that I think you are working toward.

Senator PACKWOOD. You are right. I don't want to change it; I don't want to touch it; I don't want to reduce it. I think the issue is going to be raised.

Ms. HARDY. Absolutely.

Senator PACKWOOD. But my position would be that we should not touch it.

Mr. Chairman, thank you. It has been most illuminating answers.

Senator MOYNIHAN. Yes, indeed. And let me reaffirm my view that we will not touch that 1990 provision.

Could I just ask Ms. Hardy, as of today we still have only a four-month reserve, don't we?

Ms. HARDY. By the end of this year, Senator, it will be about seven months. We do spend $20 billion a month.

Senator MOYNIHAN. So let us put some more money in the bank, all right?

Senator Durenberger.

Senator DURENBERGER. Mr. Chairman, I found both the presentations by the panelists and the questions by both of you extremely interesting. But I wonder if, for the rest of our viewers, it is not a little bit confusing. But I think this is a wonderful place to start in terms of realizing how it is we are financing what it is we want to have today. And I think, in particular the questions raised by my colleague Senator Packwood hits at that point.

I came here in 1978, which is the year that you all saved Social Security. It was also the year that we began to finance an incredible amount of our having out of inflation. As I recall, by the end of 1980 we had adjusted Social Security's outgo by 24.8 percent because of the inflation of 1979 and 1980. And by the time I was up for reelection in 1982, the cry was out that Social Security was bankrupt, and the Social Security System was going to be bankrupt, the Medicare Trust Fund was going to be bankrupt in I think 1986 or 1987, and it was all my fault. [Laughter].

Because I was up for reelection or because I was here when all of this was happening.

And now, as we listen to the responses to the questions by my colleague Senator Packwood, I wonder why I have yet to meet a person under 30 who believes there is going to be any Social Security there when they retire.

Ms. HARDY. I think you are absolutely correct, Senator, and I have taken my informal polls. As I travel around the country, the hotel clerks are always the ones who are under 30. I say I am from Social Security, and they say, "Well, that's nice. It won't be there when I get there."

I think our public education efforts to say to them, "This is the benefit that you can expect, in today's dollars, an estimate, both in retirement and survivors and disability insurance. If you need the survivors and disability, family insurance, we will be there for you." And that kind of knowledge is really going to help in that area.

But you are absolutely correct, and the Chairman noted the formal polls that have been taken. I think one of the reasons is clearly that the gloom and doom headlines of the early eighties that you have alluded to—$10,000 more a minute we were spending than we were taking in—that was clear.

Fortunately, we had a little sum in the bank.

Now we are to a situation where I think that has turned around to $76,000 more a minute "in" than we are paying out. So, those kinds of things are helpful.

Senator MOYNIHAN. Stop there. Say that again. Seventy-six thousand dollars a minute?

Ms. HARDY. Given your excellent efforts, Mr. Chairman, and the Bipartisan Commission, the $10,000 more a minute that we were spending in the early 1980s has been reversed to taking in $76,000 more a minute than we are spending.

Senator DURENBERGER. I don't think any of those hotel clerks are going to understand that one, either.

Ms. HARDY. They are going to understand $76,000 a minute.

Senator DURENBERGER. But it is quite a change, and Bill wants to comment on that in a second.

I wanted to observe, though, that in addition to the fears expressed by Senator Packwood about all of this, the one that is bothering me a great deal is that we seem to be financing all of this out of work. This is not the time to debate the payroll tax versus other sorts, but I wonder if part of the concern of the young in this country isn't that they are going to work for less. Their incomes are not increasing as their parents did, and they are paying this 15 or whatever-it-is percent into this system right off the top, with the very first dollar; and part of that, I think, is a deep concern that people have about the future.

Dr. Roper.

Dr. ROPER. I just wanted to add, the 30-year-old today retires, if I calculate it right, in the year 2023, and that is several years beyond the date when we are in trouble in Medicare. I want to continue to remind you that, for two reasons, the Medicare Program will have to be dealt with over the coming years.

Senator DURENBERGER. I wonder if I have time, Mr. Chairman, for just one question?

Senator MOYNIHAN. All the time you want, sir.

Senator DURENBERGER. If either Dr. Roper or Guy King wouldn't take us through. I don't have in front of me what Bob had here on the Social Security Trust Fund. But I wonder if, Dr. Roper, you might take us through the premise section of the year 2005 projection on Medicare?

Dr. ROPER. Sure.

Senator DURENBERGER. What are the data in terms of dollars out, and that sort of thing?

Dr. ROPER. To illustrate it, in my testimony there is this graph that was part of the Trustees Report that depicts the short-term status of the Hospital Insurance Trust Fund. Most instructive is the Alternative 2B assumptions—as Senator Packwood said, the next most pessimistic assumptions—which show that Trust Fund out of funds by the year 2005.

The key point to bear in mind is, while the balance in that trust fund is now growing and will grow substantially in the period of the 1990s, when it begins to decline, about the turn of the century or shortly thereafter, it declines rapidly. And that is the period of time we need to focus attention on. It is why we or subsequent Congresses and Administrations will need to take action on the Medicare Program.

An important step that I think the Congress is about to take in connection with Medicare acute coverage of catastrophic illness is the principle of existing retirees paying for that benefit themselves through a fair mechanism. That is a different way of financing this benefit than increasing the payroll tax, which would have today's workers paying for a retiree's enhanced benefit. And that step in financing, self-financing, is a very important one.

Senator DURENBERGER. But for those of us—and it is everyone in this committee—who have been engaged in reforming the way we finance the Medicare System, what premises do you use in terms of how much money is being paid out to the hospitals of America, for whom, and at what particular dollar level in order to get to your outgo figures?

Dr. ROPER. What are our assumptions about outlays from the Hospital Insurance Trust Fund?

Senator DURENBERGER. Right. Are you using a certain medical price index, or a hospital price index?

Dr. ROPER. Yes.

Senator DURENBERGER. Are you also using the demographics about the frail elderly or about the increase in certain kinds of diseases? Or what is some of that premise behind that projection?

Mr. KING. The basic inflationary increase per unit of service for hospitals is the Hospital Input Price Index, which is similar to a CPI for hospitals, except in the early years where Congress has already enacted legislation establishing what the update factor will be.

The demographic projections do take into account the aging of the population, in the sense that as the population ages there will be somewhat of an increase in the number of admissions per capita and the average case mix.

Senator DURENBERGER. Can you tell us what you are using for a Hospital Price Index from now through the year 2005? Or "Input Index," or whatever it is?

Mr. KING. For 1987, it is 3.9 percent. For 1989 it is 5.2 percent, 5.2 percent in 1990, and then for various years through 2012 it is between 4.5 and 5 percent.

Senator DURENBERGER. What was reality in 1988 in the Hospital Input Index, or whatever it is called?

Mr. KING. It was 4.6 percent.

Senator DURENBERGER. Four-point-six?

Mr. KING. That is our best estimate of 1988 now, calendar year 1988.

Senator DURENBERGER. Mr. Chairman, I think I have used enough time.

Senator MOYNIHAN. Thank you.

Dr. Norwood has arrived, and so I don't want to keep either this panel or delay the other.

But I do want to ask—let me get one thing clear: This word "bankruptcy." It begins, the term, with Mr. Stockman's statement, and I repeat it, that he came into office in 1981 and said within months there would be "the most devastating bankruptcy in history." Now, this was never in prospect.

A "bankruptcy" suggests, you know, the whole thing collapses and disappears. But what that term is being used to describe is that point in time when savings have been used up and you are living on the current income.

Now, with respect to Medicare, if in the year 2005 you have used up your reserve, we have three trust funds. We have Old Age and Survivors Insurance; we have Disability Insurance; and we have Hospital Insurance. Right? Does everybody agree?

[No response.]

Senator MOYNIHAN. Three Trust Funds.

We take FICA tax revenue and allocate it to these three trust funds, which is just three checking accounts, right? Does anyone think otherwise? Just say no.

[No response.]

Senator MOYNIHAN. I will take silence to confer assent.

Now, if in 2005 we have a big surplus in one trust fund, and we have used up our surplus in another, we could, if nothing else, reallocate the moneys as between our three checking accounts. We don't go bankrupt.

Ms. HARDY. No, we don't go bankrupt, Mr. Chairman. But the reallocation of reserves from one fund to another is clearly a policy decision that will have to be addressed. But I would hope that that would not be the case, given that I am concerned about the young people who want to know that those reserves will be there for them upon their retirement.

Senator MOYNIHAN. Right. But the term—you know, that they are running short. I mean, the worst danger we faced in 1982 was that checks would go out a day late, or something like that. We fixed it. Bringing in your phrase, $76,000 a minute more than we are spending. We have some very interesting questions about what to do with this accumulation, as Senator Packwood mentioned.

But when we use words like that, we should not be surprised that persons take it literally. It is an image we use; it is not true; there is no prospect of this system going bankrupt. To the contrary, we are asking ourselves what do we do with the ever increasing amounts of money. By the year 2006, as Senator Packwood mentions, the trust funds could hold the entire national debt.

Ms. HARDY. If the rest of the budget stays in balance each year.

Dr. ROPER. If I could just respond, the Congress could in this future year choose to reallocate funds from the Social Security trust funds into the Medicare trust funds. You are right, that could be done.

But the point I would make is that the year 2005, under current intermediate projections, the problem is not a lack of revenue; it is a problem of continued growth in outlays. And if my personal bank account goes to zero, there is always the option that my brother can give me money. But if I am spending more than I am taking in, I ought to worry about how much I am spending. And that is the problem.

Senator MOYNIHAN. And that goes to the question of how much do we wish to spend on medical care in our country.

Dr. ROPER. Yes.

Senator MOYNIHAN. It is a large question, and we will be addressing it; but for the moment, let us discard the notion of fiscal insolvency. That is not our question. We have good long-term questions in your area, and in the area of old-age, survivors, and disability insurance.

At any given moment the Committee on Finance is the ward of one child in six in this country. One child in six is supported either by Survivors Insurance or AFDC, which is also part of the Social Security Act. We have to attend to those issues as well.

But for the moment, we have interesting problems. We are ahead of this curve in thinking about them, and they are a better sort of problem than we have had in recent years.

I thank you very much. It is a particular pleasure to see Mr. Ballantyne and Mr. King before us. We know what extraordinary public servants you are and how well you have served.

I should note that Mr. Robert Myers is in the room, who is the actuary of them all.

Thank you very much.

We now have a very special treat for our committee. We rarely see the distinguished Commissioner of the Bureau of Labor Statistics, in this case the Honorable Janet Norwood; nor yet do we often see Mr. David Walker, who is the Assistant Secretary for Pension and Welfare Benefits Administration in the Department of Labor.

Dr. Norwood, we very much welcome you, and I am going to ask you to wait just a moment until we have sped our parting guests.

[Pause.]

Senator MOYNIHAN. We have your statement. You can read it in full or place it in the record and summarize it as you like—and of course, Mr. Walker, too.

Good morning, Doctor.

STATEMENT OF HON. JANET L. NORWOOD, COMMISSIONER, BUREAU OF LABOR STATISTICS, DEPARTMENT OF LABOR, WASHINGTON, DC

Dr. NORWOOD. Good morning. It is a great pleasure to be here.

I think that in the interests of time it would be wise to ask that my statement be inserted in the record.

Senator MOYNIHAN. Without objection. Of course.

Dr. NORWOOD. I will summarize the major points as briefly as I can.

What I have tried to do is to focus on two aspects of the labor force that I think are important for Social Security and for the policymakers who have to make decisions about it.

First, of course, is the overall size of the labor force, which forms the base of workers who are paying into the Social Security System; and the second is the size of the labor force nearing retirement age, and the decisions that these people make about whether to continue working or to retire, which of course affects the number of recipients.

Now, we have completed at the Bureau of Labor Statistics a set of projections to the year 2000. As is generally known, the labor force will grow more slowly in the future than in the past.

We project that the older population, which will grow as a share of the overall population, will have reduced labor force participation by the year 2000.

Labor force participation rates for older men have fallen steadily and dramatically since labor statistics were first collected in the late forties. This trend has resulted almost entirely from improvements in the financial resources available to older workers which have allowed them to retire at earlier and earlier ages.

In general, until about age 62, the first year of eligibility for Social Security benefits, the employment patterns of older workers are similar to those of younger ones. Employed men in their late fifties and sixties work in similar occupations for about the same number of hours a week as younger men.

Social Security eligibility increases the lure of retirement. At 62, many workers leave the labor force. Those who continue to work often move away from full-time year-round employment to alternative schedules that are less demanding.

What are the conditions facing retirees today? Most of those who are out of the labor force report to our interviewers that they do not want a regular job, either full-time or part-time. In fact, only about half a million of the 30 million people who are age 60 and over and not in the labor force indicate any interest in work; and even of those, personal factors and home responsibilities keep a lot of them from working.

Well, why do so many choose the non-work option? To answer that, I think we need to examine what happens once someone takes a pension or applies for Social Security Retirement Benefits.

Once the link with a person's long-time employer has been broken, a mismatch often exists between the kinds of jobs that older persons might accept and the types of offers being made to them.

Earnings for available part-time jobs may be quite low compared to what they had been earning. Moreover, even the types of jobs and the work schedules may not be what the retired worker had in mind.

But I think it is important to recognize that this situation may be changing. Some employers, especially in retail trade that are now facing shortages because of their dependence on youngsters, have specifically targeted older workers, particularly retirees, to fill part-time and peak-load schedules.

We also know that workers in the rapidly growing "upscale" occupations—managerial and professional occupations—often remain in their jobs longer than others.

Over the last few years there has been some stabilization in the participation rates for older men. I do not believe that this means a reversal of past trends, at least for the next decade, assuming no change in retirement laws.

We saw something similar to this in the late 1970s, which was also a period of economic expansion and rapid employment growth. While the labor force projections prepared by BLS do not extend beyond 2000, it is important to consider the changes that are likely to occur in the early part of the next century, since they need to be taken into account in developing long-range retirement funding decisions.

As the baby boom generation reaches early retirement age, which will begin about the year 2007 and continue for the succeeding 20 years, very large numbers of people retiring can be expected.

One way to look at the demands on the Social Security System is to examine the dependency ratio, the ratio of those retired and outside the labor force to those who are working or looking for work.

In 1986 there were 22 persons 65 and over outside the labor force for every 100 persons in it. That ratio has been increasing steadily. In 1972 there were only 18 older nonworkers for every 100. By the year 2000, the ratio increases to just over the 1986 level, 23 older non-workers for every 100 workers. And we can calculate a rough estimate for the year 2025. There could be almost 40 non-working persons 65 and over for every 100 workers.

Now, what will these people live on? Currently, more than half of all Social Security recipients age 65 or older receive no other pension. Some of them do have other sources of income, about three-fifths have some asset income—interest or dividends—and nearly one-fifth have some wage and salary income.

Our labor force survey showed that in 1985, 43 percent of all civilian employees were covered by employer or union pension plans. Of course, larger firms are much more likely to provide retirement coverage. The BLS Employee Benefits Survey shows that about 90 percent of the full-time workers in private medium or large size firms are covered. But of course, we have to remember that about half of the work force is working in smaller firms; that is, 100 or less.

In 1987, BLS studied employee benefits in State and local government for the first time. Virtually all of them provided for full-time State and local government workers some kind of retirement plan. Many of these were defined benefit pension plans—and I am going to leave all the discussion of pensions to my colleague, Assistant Secretary Walker.

We know, of course, that when people retire, their incomes are reduced considerably. What do we know about their expenses? The BLS Expenditure Survey shows that older Americans consume fewer goods and services than the non-elderly, and they spend a larger proportion of their incomes on essentials.

Housing—which includes utilities—food, and medical care account for about two-thirds of the elderly's expenditures. Older households consume less than younger ones, partly because they tend to have smaller incomes, but also because they have fewer household members and different needs.

For example, the older age group is less likely to be paying off a mortgage, and on average they have fewer automobiles.

It is also important to recognize that older people do not constitute a homogeneous group. The characteristics and the expenditures of those people age 65 to 74 are very different from those 75 and over. Medical care, for example, accounted for 15 percent of the expenditures for those 75 and over, 9 percent for those 65 to 74, and less than 5 percent for all consumer units in urban areas in the country.

So, in conclusion, let me say that I believe that the issues this committee is looking at are extremely important ones, and we at the Bureau of Labor Statistics are prepared to help in anyway we can.

Thank you.

[Dr. Norwood's prepared statement appears in the appendix.]

Senator MOYNIHAN. Thank you, Dr. Norwood.

And as is our practice, Mr. Secretary, would you now give your paper? Then we will query you both.

STATEMENT OF HON. DAVID M. WALKER, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS ADMINISTRATION, DEPARTMENT OF LABOR, WASHINGTON, DC

Mr. WALKER. It is a pleasure to be here with you, Mr. Chairman, and Senator Packwood and Senator Durenberger who join you today, and also to share this panel with my distinguished colleague Commissioner Norwood.

I appreciate the opportunity to share with you the progress and the state of our current private pension system, and its relationship with Social Security.

I do have a statement that I would like to submit in its entirety for the record, if I can, Mr. Chairman.

Senator MOYNIHAN. Without objection.

Mr. WALKER. Thank you.

Now I would like to summarize the highlights of that statement for you.

As you know, our retirement income policy in this nation is based upon a so-called "three-legged stool" concept, in which we have Social Security, private pensions, and personal savings, all three of which form a pool of capital available to Americans in their retirement years to provide for their economic security, whether it be in the form of monthly income, for health, long-term care, or whatever purpose.

Social Security represents the foundation of this retirement income. As you know, it has almost universal coverage, full portability, mandatory preservation for retirement purposes, and is targeted to lower and middle income Americans, as to the percentage of their income that is replaced.

It is therefore extremely important, I believe, that the integrity and the financial soundness of the Social Security System be maintained, and that public confidence in this system be fostered.

I noted in Commissioner Hardy's testimony the Social Security Administration's efforts to try to make people more aware of the improved soundness of the system today. I think that is very important and should be continued.

But Social Security cannot stand alone. It should be supplemented by personal savings and by private pensions. Again, together, the three will provide the pool of capital necessary to assure economic security in retirement.

Social Security provides a foundation, and I would submit that the existence of the Social Security System has given us the flexibility to have a voluntary private pension system, a flexibility which I think is very important, because it enables employers to have the flexibility to design their plans to meet their needs, and to also meet the needs of their workers, either through the collective bargaining process or through other informal means.

Our private pension system, the voluntary pension system, is not perfect by any means, but it is clearly the most successful private pension system on earth, bar none. And much progress has been made.

From a statistical standpoint—about which I had an attachment to my formal testimony—I will review, if I can, a few of the highlights:

I will review our progress since the passage of ERISA, because I think that was the real turning point—as you know, the Employee Retirement Income Security Act of 1974, signed into law on Labor Day of 1974. Since the beginning of 1975, total plans have increased approximately 530,000 or 156 percent. Most of this growth has come in the area of defined contribution plans. Their growth has far outpaced the growth of defined benefit plans. As well, most of the growth has come in so-called "single employer plans," where you have one employer that is covering its workforce. They could be collectively bargained arrangements, or they could be salaried workers.

There has been very limited growth in multi-employer plans, and that growth has basically been non-existent since the passage of the Multi-Employer Plan Amendments Act of 1980, MEPPA.

I think you have to view this with some caution, however, while there has been an explosion of growth in defined contribution plans, many defined contribution plans represent supplemental plans to a base defined benefit plan. That footnote is very important.

The number of active participants has increased approximately 26 million, up approximately 68 percent, to a total of approximately 65 million as of 1987. Net covered workers are up 36 percent, to approximately 42 million. Retirees receiving benefits have increased 88 percent to approximately 9 million. The average benefit payment has increased 117 percent to approximately $5200. Total annual benefit payments are up 400 percent to approximately $95 billion.

Importantly, the financial soundness of the private pension system: The total assets in private pension plans are up 417 percent to approximately $1.5 trillion, the largest pool of capital in the world, which is extremely important, not only for retirement security but also for our nation's economic growth and prosperity.

The total annual contributions are up approximately 150 percent, to $95 billion per annum. And the relative funding status of the plans, which I think is a key benchmark for benefit security, as to whether or not people can rely upon these promises being meaningful and actually receiving them in their retirement years, has improved markedly.

In 1975, fifty-nine (59) percent of the single-employer plans were underfunded—they did not have enough assets to meet accrued benefit obligations that the plan then terminated. Seventy-six (76) percent of multi-employer defined benefit pension plans did not have enough assets to meet their obligations. These have been markedly reduced, especially during the last seven years, due to this nation's tremendous economic growth.

Now there are only 20 percent of single-employer plans that don't have enough assets to immediately meet their accrued benefit obligations, down 66 percent, and 33 percent of multi-employer plans, down 57 percent.

I might add, there is a significant percentage of plans that are significantly overfunded. We estimate total net surplus appears at the present time to be about $230 billion.

In addition, through working with Congress on a bipartisan basis, as I think it should be in this important area, much progress has been made, especially over the last seven years, to improve entitlements, equity, security, and the financial integrity of the PBGC Insurance Program, which backs up these promises for defined benefit plans.

This has not, however, come without a cost. That cost has been frequent legislation, which, candidly, has caused a degree of instability and a degree of uncertainty, and I think we need to move towards providing more stability in order to foster coverage.

While we have the most successful system on earth, while we have made much progress, several challenges remain of which the following represent a few highlights:

Coverage. As Dr. Norwood noted, while coverage has increased significantly as to the number of workers covered, the percentage of the full-time workforce covered has been relatively stagnant or flat since ERISA's passage. It has only gone up one percent. Of the full-time workforce, it is 53 percent. This is a challenge for the future.

As Dr. Norwood also noted, we have broadbased coverage in the middle and larger employer sector, but we have a real problem in the small business sector—which, as you know, is where most of our workers are employed and where the growth is projected to be between now and the year 2000.

Less than 20 percent of workers who work for firms with less than 25 employees are covered by a private pension plan. Clearly, this is a challenge for the future. We at the Department of Labor are making a number of efforts to try to meet that challenge, through encouraging the use of simplified arrangements such as SEPs—Simplified Employee Pensions—minimizing regulatory burdens, and trying to do other things that would help to foster growth and improve the reach of the private pension system.

Portability. Given our more mobile workforce, we need to enhance portability of pensions in meaningful and constructive ways.

Preservation. Given our aging society, it is extremely important that our laws be structured so as to encourage individuals to preserve retirement savings for retirement income purposes.

And there are a few other areas, such as corporate governance, the need to assure for meaningful employee ownership, and the need to decrease the incentives in our laws for employers to terminate their pension plans as a means of accessing surplus assets.

In summary, our voluntary private pension system is not perfect, but it is clearly the most successful on earth, and much progress has been made. It is an important supplement to Social Security, and we must work together to expand the reach and address the other issues that I mentioned.

It is important, I believe, that it remain a voluntary system, and it is also important that we move to try to provide more stability in order to foster additional coverage in the future.

That would conclude my brief remarks, Mr. Chairman. I would be happy to answer any questions you might have.

[Secretary Walker's prepared statement appears in the Appendix.]

Senator MOYNIHAN. We thank you, Mr. Secretary.

I for one found this illuminating and thoughtful. Characteristic of your labor statistics, they project things for 12 years and leave it to others to go to three-quarters of a century.

Dr. NORWOOD. That is right. It is safer that way, Senator.

Senator MOYNIHAN. On the question of Social Security and private funds, Secretary Walker notes that, since ERISA was enacted, the proportion of the full-time labor force with pension coverage has not budged—probably not statistically accurate, but 52 or 53 percent, it is the same number; it is not moving.

We have 9 million persons who are now receiving benefits, as against about 23 or 24 million for Social Security retirement benefits. So you have a measure of this.

You estimate that the present pension assets have grown very considerably, to $1.5 trillion. Well, the reserves in Social Security will be $1.5 trillion in the year 2001, and more than twice that in 2007. So, Social Security is going to be the principal source of retirement benefits in the foreseeable future.

Dr. Norwood and Mr. Secretary, would you agree to that? That the bulk of retirement income will come from Social Security?

Secretary WALKER. Clearly it will be the foundation, but it is a foundation on which we need to build. And yes, I think it will be the bulk.

Senator MOYNIHAN. Dr. Norwood.

Dr. NORWOOD. Yes, indeed.

Senator MOYNIHAN. And the supplement tends to be in occupations with higher incomes, does it not? What is the phrase you used to use? The "dual economy"? Some people are in systems where there are pensions, and other benefits, and other people work intermittently at jobs that don't have that quality to them.

Secretary WALKER. Mr. Chairman, Commissioner Norwood may have a comment on this, but my feeling is that there is a good cross-section of income levels that participate in the private pension system.

Really, the problem is in the size of firms. In other words, for large firms we have, as you know, a number of non-discrimination rules and rules designed to assure that, to the extent an employer is having a tax-favored employee benefit plan, that it has a broad cross-section of coverage that meets not only middle and upper income workers but lower paid workers. The challenge is in small business.

But I would say there are more lower income jobs probably in that sector, in the aggregate.

Senator MOYNIHAN. That is clear. And where you pick up most of them, I suspect, is in State and local employment.

Dr. NORWOOD. That is right.

Senator MOYNIHAN. They are lower income, and they are all covered.

Could I ask Dr. Norwood one question?

I was struck, and I think my colleague Senator Packwood was, that you are projecting that by the year 2000, 47 percent of the labor force will be female.

Dr. NORWOOD. Yes.

Senator MOYNIHAN. So you have, for practical purposes, equal labor force participation rates.

Dr. NORWOOD. Almost. We are at 45 percent now.

Senator MOYNIHAN. Forty-five percent—45 percent now?

Dr. NORWOOD. Forty-five percent of the labor force now is female.

Senator MOYNIHAN. Well, there you are, a representative sample. [Laughter.]

Dr. NORWOOD. That's right.

Secretary WALKER. A modern panel.

Dr. NORWOOD. And the importance of that I think for the future is that today many women in the labor force have not yet earned very many retirement benefits. But when we look ahead 10 or 20 years and beyond, they will have earned those benefits, so they will be retiring, we believe, somewhat earlier than they now do.

Secretary WALKER. If I can add to that, Mr. Chairman, I think it is important to note that our private pension system has not matured yet, and that we have made a number of recent changes in the law which should serve to increase the number of people who have pension entitlements and increase the amount of benefits they will have, especially women.

For example, vesting. For most workers, minimum vesting has gone from 10 years to five years, which means that more people will have a pension, and that they can therefore move that with them.

In addition, the ability of employers to offset or reduce the pension that an individual would get through a private pension plan, based on Social Security, was recently limited to 50 percent; whereas in the past they could have eliminated the entire thing.

So we have made a number of changes that I think will serve to assure that the average benefit level will go up and more people will get it.

Senator MOYNIHAN. Could I just ask one last question of Dr. Norwood?

I would suppose that the early actuarial forecast of Social Security assumed a much lower labor force participation rate for women. There were more single-earner households.

Dr. NORWOOD. Yes.

Senator MOYNIHAN. And one of the reasons we have such dramatically changed outlooks for Social Security is that we suddenly have two-earner households. Isn't that right?

Dr. NORWOOD. That is right. More than the majority of all married-couple families are two-earner households.

Senator MOYNIHAN. More than the majority?

Dr. NORWOOD. Yes, more than half. Well over half are two-earner households.

Senator MOYNIHAN. And in 1935 that would not have been foreseen.

Dr. NORWOOD. Oh, no. Actually, I don't have 35, but I can tell you that in 1986 the one-earner household family was only 24.7.

Senator MOYNIHAN. Wow. Thank you.

Thank you.

Dr. NORWOOD. There is a big difference.

Senator MOYNIHAN. Senator Packwood?

Senator PACKWOOD. Commissioner, it is good to have you here again. You were always a fount of accuracy, which I appreciate.

Dr. NORWOOD. Thank you, Senator.

Senator MOYNIHAN. Not a "quarter of households," but "24.7 percent." [Laughter.]

Senator PACKWOOD. That is the "fount of accuracy."

Senator MOYNIHAN. That is right.

Senator PACKWOOD. I wanted to rephrase something. I think you have said it, but I want to phrase it in a slightly different fashion, because I use it in speeches, and I want to make sure I am on sound ground.

You had the baby boom from 1945 to 1965, and people go to work roughly 20 years after they were born. So we were putting them to work from 1965 to 1985.

Dr. NORWOOD. That is right.

Senator PACKWOOD. Then, as best as I can tell—and maybe your statistics on this are better than mine—women started going into the labor force, in numbers disproportionate to those previously in about 1960. I don't know why, but the numbers become disproportionate. And it would seem to me your figures would bear out the fact that, if from 1972 to 1988 they went from 39 to 45 percent and from 1988 to 2000 they are going to go to 47 percent, that their coming into the labor force in numbers disproportionate to what they have done before is slowing down a bit.

Dr. NORWOOD. Yes. We expect that the rate of labor force participation for women will increase between now and the year 2000, but that it will increase at a somewhat slower rate. And that is because we had really an almost revolutionary change in the sixties and the seventies. Not for all women, by the way. Many women have always worked, and they worked because they had to work. And that is why women work now, in any case.

But there a lot of reasons for the increase in labor force participation of women, including, of course, the Women's Movement, but also rising standards of living, the attempt to keep up the standard of living, which in many cases is based upon two earners in the household these days.

Senator PACKWOOD. Now, if my figures are right, the labor force grew annually at an average of about 2.1 percent between 1965 and 1985.

Dr. NORWOOD. That is roughly so.

Senator PACKWOOD. Roughly. And from 1985 to the year 2000 it will, if the average is up, grow about 1.2 percent a year. And this is not because there is a shortage of jobs; it is a shortage of people.

Dr. NORWOOD. That is right.

Senator PACKWOOD. It is literally going to be a buyers' market for people looking for work from now to the end of the century.

Are there shortages of some skills? Yes. I understand the mismatch; but if you mean just on average, we are going to be in a tight labor market.

Dr. NORWOOD. We have that possibility, certainly.

And I believe the other important element here is that it should be much easier to maintain lower unemployment rates in this country, because there may be a sort of downward pull on the unemployment rate.

Senator PACKWOOD. That is the next thing I was going to come to. I have made this statement. On average—I mean, in recessions things will go up, and in tremendous booms they will go down, but on average—there is no reason why the unemployment rate shouldn't be 5.5 or 5.4 percent between now and the end of the century—on average. Six and a half or 7 percent in terrible times, and maybe 4.7 percent in good times.

Dr. NORWOOD. Well, I think there are a few things very specific that we do know. First of all, young people always have very high unemployment rates, and there are going to be fewer of them. There are fewer of them now, and there are going to be fewer of them in the labor force of the future, in the next decade, than there were in the past. That should mean lower unemployment rates, on average.

However, that is somewhat balanced by the fact that we anticipate that a large part of the increase in the work force will come from minorities, both Blacks and Hispanics, who have in the past had difficulty in the labor market, and who for one reason or another have not had the opportunities for education and training that bring about a more successful labor market experience.

So you have got things on both sides of this equation.

Senator PACKWOOD. But here is the irony, and I suppose it will accrue to whichever party is in power. I told Senator Moynihan that I remember the wonderful statement he made several years ago which put me on to this whole thing. He said, "If I were running for President"—I can't imitate his lilt, but he said, "If I were running for President in 1988, I would promise to bring the unemployment rate down as low as it has been in two decades, teenage rates down." And I said, "Pat, what would you do?" He said, "Nothing. Nothing." [Laughter.]

It is going to happen.

Dr. NORWOOD. It is going to be much easier.

Senator PACKWOOD. Here we sit, with the situation where the unemployment rate ought to be low. Here we have this absolute cornucopia of surplus coming from the Social Security Fund in terms of national savings—I am not talking here about spending, but national savings—and people are saying "We have to increase our savings rate."

Here we sit with a tax rate infinitely lower than any other industrialized country. It is no wonder that money is pouring into this country from overseas to invest—it is the best rate of return they can find any place in the world—and normally when you repatriate capital home overseas, it isn't even taxed.

So this country is going to be awash in capital. It is going to be a buyers' market for labor. There is no reason why the nineties should not be an extraordinary period of growth.

Dr. NORWOOD. I would only make one qualification, Senator, and I am only referring now to the issue of shortages and the supply of workers, and that is that we have got to see to it that we do better in the future than we have done in the past to train our workers to be able to support the kind of jobs that are going to be created.

Senator PACKWOOD. And do you know where that may come? If you look back at the greatest training program we ever had in this country, in terms of effectively training people at least for jobs at the time, it was probably during World War II, when Henry Kaiser was taking people out of Oklahoma and Arkansas—that couldn't read—took them out to Los Angeles and Portland and taught them. What did we have, a 2 percent unemployment rate during World War II? He taught them to do something that was relevant to their job.

I will be willing to wager—if you and I can get this employer tuition extension that has run out, Pat—that you are going to see a great deal of that done by employers in the next decade, and it is going to be done in conjunction with community colleges.

This is not all training at Harvard to get a Ph.D. in business; a great deal of it can be done at community colleges, and it can be done in a year or a year and a half. The ideal reason for doing it that way is that the community colleges are wonderfully attuned to the labor needs of the local area, and what Newport, Rhode Island, needs is probably not what Newport, Oregon, needs. And if we give any kind of incentives or even a decent break to employers, they are going to do a good portion of this education, because they have no choice. They need the people. If we don't foul it up.

Senator MOYNIHAN. I would note, sir, that in Dr. Norwood's testimony the words "labor shortages" appear. Labor shortages are already upon us in certain parts of the country and for certain occupations. And that is a very careful statement.

We thank you both, Secretary Walker and Dr. Norwood. It is most thoughtful of you to come, and we do very much appreciate it and value it.

Dr. NORWOOD. Thank you, Senator.

Secretary WALKER. Thank you.

Senator MOYNIHAN. And now we have the concluding panel of authorities of various sorts, all most distinguished, who are going to give us a longer perspective on the demography of the subject, and we are going to get some charts. Good. Good.

We welcome to the committee Mr. William Butz, who is Associate Director for Demographic Programs at the Bureau of the

Census; Mr. Paul Van de Water, who is Chief of the Projections Unit of the Budget Analysis Division of the Congressional Budget Office; and—a very special privilege for the Chairman this morning—Mr. Ben J. Wattenberg, Senior Fellow of the American Enterprise Institute for Public Policy Research, and author of the recent, much noticed volume, "The Birth Dearth."

As is our practice, Mr. Butz, you are the first on the list, and you will commence, sir.

STATEMENT OF WILLIAM P. BUTZ, ASSOCIATE DIRECTOR FOR DEMOGRAPHIC PROGRAMS, BUREAU OF THE CENSUS, DEPARTMENT OF COMMERCE, WASHINGTON, DC

Mr. BUTZ. Thank you, Senator. It is a privilege to be here representing the Census Bureau at this hearing. I have submitted testimony that I request be entered in the record, since I might deviate from that.

Senator MOYNIHAN. Without objection. Yes.

Mr. BUTZ. Thank you.

I am here to provide the subcommittee with information on our demographic projections and the implications of the results of these projections for the Social Security System.

But before I present them—which I will do graphically over here to the left—I want to point out that the Bureau makes no claim that its projections are inherently superior to any other projections. In fact, as you know, all projections of the sort that we are discussing here today are really only the mathematical extension of assumptions about fertility, mortality, and net immigration.

Now, I believe that our assumptions and results are reasonable. But alternative plausible scenarios based on other assumptions are also possible, and can be constructed.

For example, the projections that I will be presenting here in a moment differ somewhat from those produced by the Social Security Administration because of differences in the covered populations and in the underlying demographic assumptions.

However, the main demographic trends projected by each agency are still quite similar.

The demographic assumptions upon which we base our main series that I am going to be talking about are as follows—there are three:

First, future fertility will be roughly the same as it has been for the last decade—not much increase, not much decrease.

Second, future mortality improvements will be moderate. Mortality improvements will continue, but they will not be large compared to the recent past.

Third, legal immigration will continue at recent levels, while undocumented immigration will be sharply reduced within 10 years.

For illustrative purposes, I am going to show you, also, information from two alternative scenarios.

The first alternative will be labeled on the graphs: "Lowest Working Age to Elderly Ratio Series"—which just means, basically, that there are fewer working age people and more elderly people in these projections. It shows what would happen if women averaged only 1.5 children, instead of the 1.8 that we assume in our middle projection, if net immigration were only half its current level, and if life expectancy rose rapidly. Now, clearly, this scenario is one, if you will, that is the "worst case" scenario for the Social Security System.

The other alternative will show what would happen if women had 2.2 children, a considerable increase from current levels, if we had almost 1 million immigrants each year, and if life expectancy did not improve at all during the next 20 years. This, one might say, is the "best case" scenario for the Social Security System's future.

I will focus on future trends in the 65 years and older population. Of course, some people join the Social Security System before that age and some join after it, but that seems a reasonable proxy for the eligible population; otherwise, I would probably have 27 or 35 lines on the slides rather than just 3.

There is a very sharp contrast between the past and future growth patterns of this age group. The 65-and-over population grew by more than 3 percent a year during the 1930s, 1940s, and 1950s. Since 1960 it has grown a little more slowly, but still more than 2 percent a year. Now, this is important—this is a high rate of growth that has occurred in the recent past in the United States, we will see when we compare it in a moment to the future.

Now on Chart 1 according to the middle projection series, the pattern of growth of this population—65—during the next 50 or 60 years is likely to fluctuate widely. Three distinct stages of growth are apt to occur.

The first stage is during the next 20 years or so, when the 65-and-over population will probably increase more slowly than it has in many decades. This will occur because those becoming 65 will be the survivors of the very small groups born between the mid-1920s, and World War II.

From 1988 to the year 2008 the 65-and-over population will grow only 8 million—that is just about 1 percent a year. By comparison, remember, from 1968 to 1988, this 65+ population grew 13 million or 2.2 percent a year. It has grown faster in the recent past.

Senator MOYNIHAN. Mr. Butz, would you say that once more? The period in which the 8 million will be?

Mr. BUTZ. Yes. From 1968 to 1988, the last 20 years, the population 65+ has grown about 2.2 percent a year.

Senator MOYNIHAN. All right.

Mr. BUTZ. In the next 20 years, from 1988 to 2008, this population will grow about 1 percent a year.

Senator MOYNIHAN. Thank you.

Mr. BUTZ. The growth during the next 20 years in fact will be so slow that the percent of the population over age 65 only rises from 12.5 percent in 1988 to 13.6 percent in the year 2008.

In comparison, again, during just the eight years from 1980 to 1988, the elderly share of the total population grew nearly as much in just these eight years, from 11.3 percent in 1980 up to 12.4 percent in 1988.

Now, that is stage one, the next 20 years.

The absolute increase in the 65-and-over population from 2010 to 2030, stage two, will be of an unprecedented size. This is the result of the entrance of the baby boom cohorts born into this age group—that is, people born after about 1945.

The 65+ population may be 39 million in 2010 and reach 66 million by 2030, when the last of the baby boomers turn 65.

The net addition of 26 million elderly people in only 20 years would be a remarkable event. For example, as recently as 1980 there were fewer than 26 million elderly in our population, and it took our country more than 200 years to reach an elderly population of this size. But it will take the survivors of the baby boom generation only 20 years to match that earlier growth.

Senator MOYNIHAN. All right.

Mr. BUTZ. I have been talking about the growth in absolute numbers, but during this period, between 2010 and 2030, the proportion of the nation's population which is over 65 will also rise dramatically, and you can see in this next chart.

In 2010, about 14 percent of the population will be over age 65, and the equivalent figure will be about 22 percent in 2030.

Now, in spite of these figures, it is important to realize that the rate of growth of the 65 population during the 2010 to 2030 period is not unique. From 2010 to 2030 the aged population may grow about 2.6 percent a year. As I mentioned earlier, from 1930 to 1960 it grew about 3.2 percent a year.

Stage Three: After 2030, the population over age 65 will resume the pattern of very slow growth, which is likely to occur during the 1988 to 2008 period. In fact, the growth after 2030 may be the slowest ever recorded in this country. The number of people age 65 and older is projected to increase only from about 66 million, in 2030, to about 70 million in 2060. The percentage of the population age 65 would slowly rise during this period from about 21.8 percent in 2030 to about 23.7 percent in 2060—a much smaller rate of increase than we saw in the earlier period, Stage Two.

Having described these three stages in the future growth of the elderly population, I will now discuss the changing relationship between the future working-age population and the future elderly population, which of course is the crux of the matter here.

What makes the 2010 to 2030 period so exceptional is not the growth of the aged population, but that this growth is not likely to be accompanied by a growth in the population of working age. The unusual nature of the relationship of the working-age population to the elderly population during the 2010 to 2030 period is illustrated in the following comparison:

From now to 2008, the 65+ population will grow about 1.1 percent a year, or 8 million people. During this same time, the population aged 18 to 64 years, the working-age population, will grow 27 million, or 0.8 percent a year. These two percentages are close together—1.1 percent and 0.8 percent—so that the average number of people of working age per elderly person does not change too much during the next 20 years.

However, during the 2010 to 2030 period, the working-age population actually declines by nearly 8 million. This decline contributes significantly to the fall in the working-age to elderly ratio between 2010 and 2030.

The ratio of working-age people to people over age 65 will diminish during the next 50 years, as we see here on this final chart which brings all of these projections together into what really matters for the subject today.

In 1980, there were 5.4 persons aged 18 to 64 for every person aged 65 and over. By 1988, that ratio will already have fallen to 4.9. The ratio of working-age people to persons age 65+ will remain at about this level until 2008. Now, this occurs because the elderly population will grow so slowly during this period.

But from a level of 4.6 in 2010, this ratio will plummet to 2.6 in 2030—from a ratio of 4.6 to 2.6 in 20 years. After that time, the ratio of working-age persons to elderly will stabilize at about 2.5.

There are three implications:

One, the ratio of working age people to the elderly drops dramatically in the alternative series also. This is very important. Even under alternative assumptions that would tend to raise this ratio quite high or lower it quite low at any period of time, this change in the 20 years from 2010 to 2030 remains there. This indicates that such a pattern is likely to occur even under quite different demographic assumptions.

Two, the rapidity of the decline in this ratio during the 2010 to 2030 period may require adjustments in the way society cares for the elderly, simply because it is such a dramatic change.

And three, even though the 65+ population grows very slowly after 2030, it is important to realize that the ratio of working-age persons to elderly persons is not likely to rise back toward its present level. This means the social service needs of the elderly population may continue to be high after the year 2030.

Although I have confinend these remarks and these numbers to strictly demographic measures, the issue is more complex than just the total number of elderly and their relationship to the size of the traditional working-age population. Changes in health status, overall economic wellbeing, labor force participation, and retirement and savings patterns could have dramatic effects on the actual social service needs of the elderly. Census Bureau data might be of help in examining these aspects, as well.

Mr. Chairman, this concludes my remarks. It is a pleasure to be here. I look forward to hearing what my fellow panelists have to say and to answering any questions.

Senator MOYNIHAN. We thank you so much, sir. And we may ask you to leave those charts behind, they are so impressive.

[Mr. Butz' prepared statement appears in the appendix.]

Senator MOYNIHAN. Mr. Van de Water, good morning, sir.

STATEMENT OF PAUL N. VAN DE WATER, CHIEF, PROJECTIONS UNIT, BUDGET ANALYSIS DIVISION, CONGRESSIONAL BUDGET OFFICE, WASHINGTON, DC

Mr. VAN DE WATER. Thank you, Mr. Chairman, Mr. Packwood. I am pleased to be here this morning to discuss government budget trends and their relation to projected demographic and labor force changes.

Like Mr. Butz', my statement is long, and I would like to summarize it, if you have no objection.

Senator MOYNIHAN. Without objection. Of course.

Mr. VAN DE WATER. The role of the Federal Government in the economy has grown substantially over the past 25 years, as Figure 1 on page 2 of my complete statement will indicate. At the same time, as shown in Figure 2 on page 4, substantial shifts have occurred in the components of Federal spending.

The first panel in Figure 2 shows that the ratio of defense spending to gross national product has been on a downward trend, interrupted only by the Vietnam War and the defense buildup of the early 1980s.

Entitlements and other mandatory spending nearly doubled their share of GNP between 1962 and 1976, but except for the 1982-1983 recession, entitlements have not grown as a share of GNP since the late 1970s.

Senator MOYNIHAN. Right. And you project it flat, don't you?

Mr. VAN DE WATER. Yes, sir.

Nondefense discretionary programs have borne the brunt of budgetary restraint during the 1980s, declining from almost 6 percent at the start of the decade to less than 4 percent at present.

Finally, the rapid rise in Federal borrowing and relatively high interest rates during the 1980s have caused net interest on the public debt to be the fastest growing spending category in the Federal budget.

Turning to page 6, Table 1 provides further details on Federal fiscal activities in recent years. Almost 95 percent of Federal spending for the aged is accounted for by just a few entitlements—Social Security, Medicare and Medicaid, and programs providing benefits for retired and disabled Federal employees, coal miners, railroad workers, and veterans. Between 1965 and 1985, these entitlement programs more than doubled, growing from 3.7 percent to 8.8 percent of GNP. Over this same period, the number of Americans age 65 and over grew by a little more than half, so that you can see from that comparison that, more important than the demographic shift, decisions were made over this period to pay for an increasing share of the needs of the elderly through public programs. Notably, Medicare began operation in 1966, and Medicaid of course was greatly expanded, and Social Security replacement rates were increased substantially during the early 1970s.

Now, during this past 25 years, Federal spending, and revenues of course, have been influenced by events such as the Great Society, the Vietnam War, OPEC oil shocks, and what have you. But our projections inevitably lack this richness that history shows.

It is very hard to look ahead and see anything other than smooth trends, even though we can be quite sure that the future will be just as variable as the past.

Our baseline budget projections for 1989 to 1993 show Federal spending rising at a rate somewhat slower than GNP. This occurs principally because spending in defense and non-defense discretionary programs is assumed—and I emphasize that is by assumption—is assumed to grow only at the rate of inflation.

Revenues under current law are anticipated to increase modestly as a share of GNP and stabilize at around 19.5 percent. As a result, the baseline deficit falls to 2.1 percent of GNP by 1993.

The non-Social Security portion of the budget, of course, shows deficits of about $230 billion per year, or roughly 4 percent of GNP.

By the mid-1990s, as you have heard, the elderly population will be growing less rapidly, and its share of the total population will stabilize at around 13 percent. Concurrently, the working-age population—again, as you have heard—will become a larger proportion of the total.

Under these relatively favorable demographic conditions, to which Senator Packwood alluded, a straightforward extension of our five-year projections might suggest a lessening of the fiscal pressures on the Federal Government. In fact, some analysts have argued that the deficit will disappear by turn of the century as a result of the Social Security financing structure now in place. But this does not seem likely.

Table II on page 10 shows three alternative budgetary paths for the 1990s. Under only one of these paths does the deficit disappear.

The three budgetary paths differ only with respect to the assumptions we have made about discretionary programs. In Path Two, the case on which the testimony focuses——

Senator PACKWOOD. Say that again. The assumptions are different only as to the discretionary spending?

Mr. VAN DE WATER. Yes, sir.

Senator PACKWOOD. Of non-discretionary on all three paths, you assume the same?

Mr. VAN DE WATER. We have assumed essentially an extension of current law. That is right, Senator.

Our assumption for these defense and non-defense discretionary programs in Path Two is that after 1993 they are held constant as a share of GNP. Under this assumption, the deficit in the year 2000 would be about 2 percent of the Gross National Product. Thus, even with what might be considered a fairly tight lid on discretionary spending, Federal deficits are likely to remain at relatively high levels through the 1990s, absent of course legislative tax increases or further spending cuts.

Senator PACKWOOD. I don't understand your Path One projection.

Senator MOYNIHAN. Where it disappears.

Senator PACKWOOD. Where it disappears, but under Path One you assume a growth in the discretionary programs of at least the rate of inflation, do you not?

Mr. VAN DE WATER. Yes, sir.

Senator PACKWOOD. So you are presuming, in Path Two, expenses in those programs, or expenditures, above the rate of inflation?

Mr. VAN DE WATER. Yes, sir, that is exactly correct.

Senator PACKWOOD. Mr. Chairman, let me ask another.

Senator MOYNIHAN. Sure.

Senator PACKWOOD. Do you mean to say—for the moment, exclude the non-discretionary programs: Medicare, Social Security. Assume we do nothing to put any 2-percent lid on Social Security, that it just continues right along—Medicare and all of those. If we did nothing else but let the discretionary programs increase at the rate of inflation, we would grow ourselves to a balanced budget by the turn of the century.

Mr. VAN DE WATER. That is correct, Senator.

I think the point we make in the statement, however, is that while that is possible as a matter of logic, one implication of that policy would be that both defense and non-defense discretionary spending would then reach what is essentially, historically low levels as a percentage of GNP. So, that would in fact----

Senator PACKWOOD. Well, actually, over the next five years wouldn't defense do better under that assumption than it is going to do under the present assumption?

Senator MOYNIHAN. Yes. It is going down now.

Mr. VAN DE WATER. Of course, none of us knows what is going to happen, so that is why we have the alternatives.

Senator PACKWOOD. But for the last 3 years it has gone down.

Mr. VAN DE WATER. Oh, yes. Definitely.

Senator PACKWOOD. It hasn't even kept up with inflation.

Mr. VAN DE WATER. That is correct, Senator.

Senator PACKWOOD. And you are assuming that we can get to a balance even if defense turns and goes back up to the rate of inflation.

Mr. VAN DE WATER. Yes, sir.

As you have seen, even in these projections to the year 2000 there is an incredible amount of uncertainty, and alternatives that can be made with respect to assumptions. Beyond the year 2000, projecting the course of the Federal Government is truly a matter of speculation.

Demographics, of course, will play a major role. The Social Security actuaries project, as we have heard, that with the retirement of the baby boom generation, expenditures for cash benefit programs will rise from 4.4 percent of GNP in the year 2000 to 5 percent of GNP in 2015 and 6.5 percent in 2030. Including hospital insurance, costs would rise from 6 percent to 9.2 percent of GNP over that same 30 year period.

Now, an increase of two to three percentage points in Government spending is neither unprecedented nor unmanageable. When the baby boom started school, for example, State and local spending for education rose from 2.5 percent of GNP in 1950 to over 5 percent in 1970, a span of only 20 years.

One of the factors most critical to these budget projections, as you discussed with Dr. Roper, is the growth in the cost and use of medical care services.

In CBO's 5-year baseline projections, increases in Medicare and Medicaid spending per enrollee more than offset the slowing of the growth in the elderly population. Medicare and Medicaid benefits in our projections rise from 2.5 percent of GNP in 1988 to 3.1 percent of GNP in 1993. In our extrapolations, these health programs account for nearly 18 percent of the budget and about 4.1 percent of GNP by the year 2000.

Now, compound interest and common sense tell us this rate of increase could not continue forever, but no one obviously can now predict when or why that rate of increase would come to a halt.

Another point is that, because they are an extrapolation of recent tendencies and not a forecast of budget outcomes, the projections presented here do not assume any overall budgetary targets. In particular, of course, they do not incorporate the targets contained in the Balanced Budget Reaffirmation Act of 1987.

In the short run, fiscal policy will obviously continue to be dominated by questions of economic stabilization. Thus, the Balanced

Budget Act targets might have to be modified again, as they were in 1987, if economic developments were to again put them out of reach.

In the longer run, the choice of fiscal targets turns on questions of national saving and investment, both domestic and foreign. One possible long-run target is a balanced total budget, as incorporated in the Balanced Budget Act. By itself, achieving this target would be a substantial improvement over the past 25 years, when deficits averaged 2 percent of GNP.

A more stringent target would be to balance the part of the Federal Budget that does not include Social Security. The implication of this latter target is that the Federal Government would save an amount equal to the Social Security surpluses.

Your committee, of course, will be exploring the issues involved in choosing a long-term deficit target, as I understand it, at next week's hearing.

In conclusion, Government budgets depend on far more than demography; they also reflect political judgments about the shape of the American economy, economic and military developments abroad, and domestic social needs. These other factors have had a much greater effect on budget developments over the past 25 years than have changes in the age structure of the population, and it is likely that they will continue to dominate the course of the Federal Budget into the next century.

Thank you, Mr. Chairman.

[Mr. Van de Water's prepared statement appears in the appendix.]

Senator MOYNIHAN. Mr. Van de Water, we continue to be so proud of the work that gets done in the CBO. Our Congressional Budget Office has been extraordinary.

Good testimony, as was that of Mr. Butz.

And now, to wrap up our panel and our morning, Mr. Benjamin Wattenberg—Ben Wattenberg. If you would proceed, sir, we look forward to hearing your assessment of all of this.

STATEMENT OF BEN J. WATTENBERG, SENIOR FELLOW, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH, WASHINGTON, DC

Mr. WATTENBERG. Thank you very much, Mr. Chairman.

I have no prepared statement this morning, other than—if appropriate—chapters 6 and 12 of my recent book.

Senator MOYNIHAN. That's fine. Please proceed.

Mr. WATTENBERG. Normally, as you know, I write optimistic books, and I would usually applaud the air of euphoria that I have heard during some of the testimony this morning.

I hate to be a Cassandra, but I must say I am deeply concerned about one aspect of the situation you are talking about.

I would like to quote something from the jacket of this book, which says: "A major and threatening demographic change in America has escaped public attention," and that was a quote about the book written by you, Senator Moynihan, for which I was very grateful.

I think it is true. A major and threatening demographic change in America has escaped public attention. The problems and issues that you all are dealing with, the elderly, is surely one of the major issues of our time. What is not always appreciated is that the fate of the elderly in a modern society, almost as much as in primitive tribal societies, is determined by the non-elderly. In those traditional societies, the support is direct from the non-elderly to the elderly. In ours, we run the money through the Social Security Administration, and a variety of other government agencies, and private agencies, but it is the same basic idea.

Now, the United States today has a total fertility rate that has never been so low for so long. With an occasional blip here and there, this has been a 200-year trend.

The first census in the United States was taken in the year 1790. We had a total fertility rate of about seven children per woman, and it just fell and fell and fell. There was a blip during the baby boom, which we see in the chart up there, but it has continued to fall, and it is now—from the latest data we have, which has held constant for about the last 13 years—at 1.8 children per woman over the course of her childbearing years. It takes 2.1 children per woman merely to keep a population stable over an extended period of time.

This is a quite remarkable development. It is happening not only in the United States but in every single country of the modern industrialized world.

The recent Social Security projections, until this year—and I just got a look at the Trustees Report—for about 10 years after the total fertility rate fell to 1.8, the Social Security Administration was using middle-range projections of 2.1.

When the Bipartisan Committee met, I gather there was an attempt to get the facts together, and they dropped the 2.1 to 2.0, which was still 10 percent above a 15-year trend of 1.8. And 10 percent of our current number of births runs about 400,000 births a year. If you project that for 25 years, you are talking about an extra 10 million people. The amount of receipts coming into Social Security on that differential alone, I gather, can differ by hundreds of billions of dollars per year.

I am happy to see that the Social Security Administration this year, for the first year, has lowered their middle-range projection to 1.9, and the Center for Vital Statistics says there may have been a little up-tick for 1987, which in fact for the first time would raise the 1.8 to 1.9.

But the fact is that, at least until now, these estimates have been starkly understated.

Moreover, most of the Social Security projections and the sorts of things that I have heard here today about tight labor markets, which everybody seems to take for granted, because there are now fewer teenagers, and you drive down a highway, and you see Wendy's and Burger King and MacDonalds, and they are all saying, "We'll pay $4 an hour, $4.50 an hour," because there is in fact a shortage of teenagers, and everybody thinks this is going to mean, as Senator Packwood was saying, a low unemployment rate in the 1990s. I am not so sure about that.

What you are going to have in the 1990s is a stunning drop in the number of young adults because of this birth dearth. The number of young adults from age 25 to 34 from 1990 to the year 2000, the absolute number of young adults, the people who are the trigger to our economy, who go out and get jobs and buy houses, is going to fall by 18 percent.

New housing construction in the United States, with all of its ancillary activities, represents 10 percent of our Gross National Product. So you are going to have an 18 percent drop in just one industry, an 18 percent drop in 10 percent of our GNP, and a lot of people—the carpenters, the plumbers, the masons, the foundation layers, the people who put the sod in, and everybody else—are not going to have houses to work on.

So you are going to have at least some turbulence and distortion and structural unemployment. I am not predicting disaster, but the idea that there will automatically be tight labor markets, it seems to me, is by no means certain.

I want to talk for just a very quick minute about what we ought to do about it, because, as I say, I think it is a serious problem.

I think first we ought to consider raising the immigration levels in this country. I think that would be good for us for a variety of reasons.

Second, concentrate on fertility in the United States. It is not true that the low fertility in the United States today is entirely voluntary—young men and women just saying, "Well, we don't want to have any children."

When I came out with this book, I was on radio shows and television programs around the country, and the more you talk to young people you find out that, sure, some of them just don't want to have children, but many of them tell you, "It's so much harder to have children these days." People are marrying late, there are two-earner families, their incomes and their expectations are keyed to two-earner families. And then, if they say, "Let's have two or three children, it turns out to be extremely difficult."

So I would suggest that we ought to be looking, in terms of policy, towards two goals: One is to make it easier for people who want to have children, and who will be good parents, to be able to have children. And the second thought is—and I know that both the Senators have been deeply involved in this and understand it—we must do something to help poor children in the United States. It is surely the number-one social problem in America. Twenty percent of our children are in poverty today, and a third will be in poverty at some point before their eighteenth birthday, which is a scandal.

There are two basic strategies. One is sort of a services strategy child care—maternal leave, tax credits for child care. I approve of that. I would support most of the bills that are now being proposed. They help the working mother.

Strategy B seems to be a more plenary idea, and I think that may be the key to doing both of the things we are talking about—making it easier for people who want to have children to have children, and to help poor children—and that would be to raise the personal tax exemption.

The personal tax exemption in the United States until 1986, as you all know far better than I, was $1080, and now it is scheduled to go to $2000.

Suppose, in that golden year of 1986, the plan was to freeze the $1080 for everybody and use that saved money to raise it—the personal tax exemption for children—to $5,000 or $6,000 per child until age 18? It wouldn't be an on-budget expenditure; it would just be taking from some and giving to others. That would yield per child, for 18 years, depending on how you worked it out, somewhere between $1000 and $1500 in cash per child. That is $27,000 for 18 years. That is $81,000 if you have three children.

Now, that money, it helps working mothers—and here you get into the politics of it, because there is a split between people who say we ought to help working mothers, and other people say, no, we ought to help women stay at home with their children. Cash is a remarkably fungible product; you can use it for anything you want. The cash would help working mothers, for child care, or the equivalent for maternal leave. It helps mothers or fathers, for that matter, if they so choose to take care of their children at home. And moreover, it tends to eliminate the free-rider aspect of Social Security for people who never have children.

Now, it seems to me if you go down that second track, it is a track that helps adults who want to have children to have children, it helps poor children; and by doing that, it helps the elderly, because it provides younger people to support them in the future.

A last word, if I might. We have, for the last 50 years, certainly in the Democratic Party, followed a philosophy that says: There must be some at least moderate redistribution of wealth from rich to poor.

What I am suggesting is that perhaps we might consider changing that goal. It would have the same general effect, but if we said, instead of attempting to redistribute wealth from rich to poor, we ought to redistribute wealth from the childless to the child-rearing. That can be done with no on-budget costs through a lower exemption for childless people and a higher exemption for child-rearing persons. It would help people who want to have children, and help poor children.

It seems to me that is the one grandaddy plan. All the other ones—maternal leave, day care—make a lot of sense. But that is the basic way to go about solving the essential structural problem that you see on the charts up there. Because if our fertility rates and our immigration rates went up starting now, those curves would start changing very rapidly.

Thank you, sir.

Senator MOYNIHAN. We thank you for, as always, an exceptionally thoughtful and creative set of ideas.

I am going to ask our two very distinguished demographers here what they think of what Mr. Wattenberg said, and put it in this context:

There is a very considerable amount of pro-natalist efforts by governments over the last century, almost a century. About a century ago, France became determined to produce enough soldiers to overwhelm Bismarck and the Germans. In the 1930s, the Swedes were convinced they were going to disappear, and began a very extensive program.

Yet, I don't think much happened. To the contrary, there is almost an inverse relation: The more they try, the less they succeed.

What is the professional judgment on these matters? Because I think Mr. Wattenberg raises an exceptionally important question.

Mr. BUTZ. Well, both of you discussed earlier with Commissioner Norwood the prospects for a tighter labor market during the next 15 years of so in this country. To the extent that that occurs, there are several safety valves that could take place that could loosen the labor market somewhat if unemployment gets really low and real wages begin to rise really quickly, and there are strains in the production system.

Ben Wattenberg has referred to two of those: one is the immigration rate; another is fertility.

Now, as to the immigration rate, because the numbers of people immigrating into this country are such a small proportion of the total population, the numbers immigrating into this country can double, in fact, making a noticeable but not a substantial change in those graphs we see to the left.

For example, our middle assumption on immigration is that there will be about 660,000 total immigrants into our country——

Senator MOYNIHAN. Which is about level, about where we are right now.

Mr. BUTZ. About level, that's right, 100,000 illegals. Or let us say you get triple that, for some reason. That is a drop in the bucket as far as these trends go. It may be very important for other reasons.

So it seems to me that it would take a substantial increase in immigration, documented or undocumented, to change the trends we see here.

Senator MOYNIHAN. How many people are born in this country every year?

Mr. BUTZ. How many people are born in this country every year? Three point seven million.

Senator MOYNIHAN. Well, if immigration reached 1.8, there would be a 50 percent increase.

Mr. BUTZ. If immigration reached 1.8, which is a long way above the assumption we are making——

Senator MOYNIHAN. Immigration is now about 20 percent of population growth?

Mr. BUTZ. No, immigration is not that large a proportion.

John, do you know?

VOICE. Six hundred thousand, to 3.7.

Mr. BUTZ. Oh, of growth. I am sorry. Yes, of growth.

Senator MOYNIHAN. As a former chairman of this committee said, "Even a blind hog finds acorns, sometimes." And I got it right, 20 percent. [Laughter.]

Could I just interrupt to say that some young people, a large number of them, have just arrived in our hearing room. I asked if I could know who they were, and to my great pleasure it turns out that they are eighth graders from the Trinity School in New York City.

We welcome you.

Proceed.

Mr. BUTZ. I would just conclude my reactions by saying that there are other safety valves as well. One of them occurs around the retirement age. If labor markets really do tighten, it may be that we would see rising retirement ages, or more people working part-time.

And as Commissioner Norwood also indicated, we might see increases in female labor force participation rates, and in the particicipation rates of other groups, who traditionally——

Senator MOYNIHAN. Not much left, for female, though. At 45 percent they project it will go to 47.

But we do, of course, provide for a very slow increase in the retirement age in our existing, the 1983, Social Security law.

Mr. Wattenberg?

Mr. WATTENBERG. Yes. I just wanted to respond to your question about the efficacy of pro-natalist planning.

It is true that there has been for many years within the demographic community the idea that was sort of a mantra: people said pro-natalism doesn't work, pro-natalism doesn't work, pro-natalism doesn't work, pro-natalism doesn't work. In recent years I think there has been some new attention paid to it.

In the 1960s the lowest total fertility rates in the world were in Eastern Europe. I remember I went there then, to Hungary, in 1965 to look at this country that was so low—it was below the replacement rate.

A lot of people went there and said, "Oho! Look at these Communist countries. You know, they are so spiritless, they won't even have children. They are going to go out of business." And the Eastern European countries, which are not normally the countries that I look to as my models, decided to do something about it. They were obviously very concerned that if you have a below-replacement fertility rate, sooner or later you just go out of business; there aren't any folks around.

They started throwing money at the problem. I mean, big money, in terms of a children's allowance, housing allowance, school allowance, the whole shooting match.

And the Eastern European countries are spending somewhere around four to five times as much relative to their GNP on pronatal activities versus Western Europe, and Western Europe is even higher than we are.

What happened was, Western Europe had a higher total fertility rate than Eastern Europe. Eastern Europe started spending substantial amounts of money, throwing money at that problem in a variety of ways. And now Eastern Europe has a substantially higher total fertility rate than Western Europe. The total fertility rate of Eastern Europe is now 2.1, and of Western Europe it is 1.6.

So, again, no one knows for sure exactly how this works. Senator Moynihan, you can't even use Sweden and France. I mean just sort of epistemologically you can say, "Well, they are at 1.8." But suppose they hadn't spent that money? Maybe they would be down at that 1.4 that Italy and Germany are at. It is very interesting.

I just got some figures from the Population Reference Bureau. The lowest total fertility rate in the world today is in Italy. In a Southern European Catholic country that everybody used to make good-natured jokes about—how large the Italian families are—it is 1.4 children per woman. In West Germany it is just a tad higher than that.

So it seems to me that there is at least some general evidence that pro-natalism, when you do it seriously, with big dollars can work. As you know, I used to work for President Johnson, and we sort of believed in that idea of throwing money at problems. I still do.

If you want to make poor kids into non-poor kids, the best way to do it is to throw money at them. And I think that an ancillary effect of it would be, at the margin, to somewhat increase fertility rates, because it would make it a little easier for, typically, a woman to stay out of the labor force for another couple of years to have that second child. It seems to make a certain degree of sense.

So I think that is just the general state of knowledge. There is still a lot of dispute about it—granted. But there does seem to be some evidence coming in that way.

Senator MOYNIHAN. That is fascinating. And on that note, of throwing money at problems, I think we have to turn the microphone over to Senator Packwood.

Senator PACKWOOD. Ben, instead of going through all of these convoluted pro-natal policies, why not just end the immigration restrictions, short of hard-core felons and lunatics, and say,"Come"?

No wonder Eastern Europe had to try it; nobody wants to go to Eastern Europe. But my hunch would be we could probably take in 4 to 5 million people a year.

Mr. WATTENBERG. I am for it. I don't know about 4 or 5 million, but I would surely be for it; I think immigration has been great for this country.

I think you will have a lot of difficulty. If you look at the public opinion polls and you poll your colleagues, I think you will have a lot of difficulty passing such legislation.

But there is one other problem. That solves part of the macroproblem; it does not really solve the social problem that you have among young couples today who would like to have more children and, because of the way we have structured our society, find it very difficult to do that.

Senator PACKWOOD. That is a second problem.

If all you want is more people to pay the Social Security Taxes so that we can take care of this dip, we can do that by immigration.

Mr. WATTENBERG. Well, that is the cheapest way, because often somebody else pays for their education and up-bringing. I mean, you are just bringing in payors. Absolutely.

Senator PACKWOOD. Mr. Van de Water, let me ask you a question. It is not in your testimony, and if it is beyond your ken, don't worry about it.

Do Japan and Germany have higher per capita annual deficits than we do, and a higher per capita accumulated deficit in relation to their GNPs?

Mr. VAN DE WATER. I think their annual deficits have been somewhat variable, and I am afraid I do not have statistics on that.

Senator MOYNIHAN. But they do have deficits.

Mr. VAN DE WATER. They do. Yes, sir.

Senator PACKWOOD. Do you know about their accumulated debt in relation to the total GNP?

Mr. VAN DE WATER. I am sorry, I do not, Senator.

[The material appears in the appendix.]

Senator PACKWOOD. Thank you.

I have no other questions, Mr. Chairman.

Senator MOYNIHAN. I would then ask, on that point, on the question of savings—the most distinctive point about the German and Japanese countries is that they have had deficits but they have had high savings rates.

Now, think of yourselves as economists and not demographers right now. If we were to reach the point where the flow in of the Social Security revenues would allow us to begin retiring debt, that, in our national accounts, becomes "net saving," does it not?

Mr. VAN DE WATER. Yes, Senator.

Senator PACKWOOD. Except, ironically, in that term that is normally called, Pat, "savings," Social Security is not counted. Pensions are, but Social Security isn't.

Senator MOYNIHAN. But if the Social Security trust funds began buying up privately held debt, then there is money in the market that would otherwise have been acquired by the Federal Government. That money goes into other imvestment. Savings and investment would be increased.

Now, if we started increasing our national savings rate, which is at an incredibly low 2 percent of net national product—the Japanese, have a savings rate of about 18 percent of net national product—might we not begin to get a more productive economy, which would not require those two-earner households just to maintain the level of family income? We still haven't got real family income back to the 1973 level.

So, Mr. Wattenberg's concerns might fall away as people found they didn't have to postpone childbearing in order to maintain income levels.

What do you think?

Mr. VAN DE WATER. Senator, you have focused, on the fundamentals of Senator Packwood's question. The issue is not how much saving the Government is doing, but how much saving is being done in the total economy—the private and public sectors together.

Certainly, these economies that Senator Packwood mentioned—Germany's and especially Japan's—are much more high-saving economies, and ours is a very low-saving one.

More saving has a lot to recommend it; although, with regard to Social Security, it is not a panacea. If you think, as real incomes go up, people of working age will be earning higher Social Security benefits for the future. And that means, when they hit 65 or whatever, that their retirement benefits will also be correspondingly greater. .

So, in relation to the total size of the GNP, the cost of Social Security may not be much smaller than it would have been in a lower-saving slower-growth economy.

On the other hand, since the economy as a whole would be richer, it is quite reasonable to think that those who would be of tax-paying age might feel somewhat better about paying, albeit the same relative share of their earnings, to support the retirement-age population.

Senator MOYNIHAN. Well, good.

I am afraid the hour of noon has come, and under the Senate rules we would have to have unanimous consent, which we didn't have the foresight to request, to stay in session.

I want to thank this panel for some extraordinarily useful thoughts.

I want to instruct the young people from the Trinity School: You have heard what was said. We need every one of you. We want you to graduate and learn lots of things, so you can help your country and yourselves when the time comes.

And we thank our staff who have put all of this together.

Next week we will hold a yet more speculative session and learn more about the macroeconomic issues related to the build up of a large trust fund reserve.

Thank you, gentlemen.

This hearing is closed.

[Whereupon, at 11:59 a.m., the hearing was concluded.]

LONG-TERM STATUS OF THE SOCIAL SECURITY TRUST FUNDS

FRIDAY, MAY 20, 1988

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY,
Washington, DC.

The hearing was convened, pursuant to recess, at 10:03 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Daniel Patrick Moynihan (chairman) presiding.

Present: Senators Moynihan, Daschle, Packwood, and Durenberger.

(Senator Moynihan's prepared statement appears in the appendix.)

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

Senator MOYNIHAN. A very good morning to our distinguished panelists, and our guests.

Senator PACKWOOD. Good morning, Mr. Chairman.

Senator MOYNIHAN. Good morning to you, sir.

This is the second of three hearings, oversight hearings on the condition of the Social Security Trust Funds. The first, which was held a week ago, Senator Packwood and I surely found to be a matter of greatest interest and led to considerations and thoughts which really hadn't been much in play for some while hereabouts.

We had very specific testimony last time as to the condition of the Trust Funds. Dorcas Hardy testified to the 1988 Report of the Social Security Board of Trustees, that the Social Security system is in close actuarial balance for the 75 years ahead.

We learned that from a low point in the early eighties when the funds were paying out $10,000 a minute more than they were taking in, they are now taking in $76,000 a minute more than they pay out. This translates into mind-boggling numbers if you start multiplying—it would take you about a half hour to get yourself started, much less a weekend.

Now we have three most eminent scholars to talk to us about the larger implications. We heard about the Medicare Funds, we heard about pension funds, we had very able testimony from within the Government, and now we turn outside to our three distinguished witnesses: Mr. Robert Myers, being an insider who is now outside, the most distinguished Chief Actuary of Social Security for the longest while; Mr. Barry Bosworth, a scholar of great repute; and Ms. Alicia Munnell—everything—Central Banker, scholar, economist, and all that, as well.

I have a statement I would like to place in the record, and also a long and good letter from Robert Roosa who was Deputy Secretary of the Treasury, of course, under President Kennedy, and who cannot—owing, as he puts it, "to the instructions of a couple of doctors"—come down but has some very strong views on this matter which I think are very compatible with some that we will hear from our panelists.

[Robert Roosa's letter appears in the appendix.]

Senator MOYNIHAN. Senator Packwood?

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

Senator PACKWOOD. I know Mr. Myers was here last week also and watched the hearings. I think the thing that surprises the Press more than the Chairman and myself, because we have looked at these figures for a while, is the fact that the surplus is building in Social Security—absent any change of laws—assuming we don't spend it, or assuming we don't lower the Social Security Taxes. Neither the Chairman nor I think we should do that.

The money is coming in. So, the question becomes: What do you do with it? Buy Government debt? Do you change the law and invest it in Texas real estate? What do you do over this period of time when there is going to be an immense surplus?

And then the ancillary question is: If you take Social Security, de facto, off budget—not just legally off budget where you continue to buy bonds, which in essence practically makes it "on budget" from a macro standpoint—if you take Social Security de facto off budget and say it cannot be used to buy Government Bonds or cannot be used to finance the deficit, and we attempt to narrow the deficit with other taxes or other spending cuts, what is the effect on the economy of then having, in essence, from the standpoint of all Government funds, an immense surplus? Would that be a drag on the economy? Is that something that we should avoid?

These are questions which the Chairman said very clearly last week we just have never discussed before, because this surplus, the size of it, this coming surplus, is frankly, to most members of Congress and the press and the public, a new issue that we had not foreseen before.

Thank you, Mr. Chairman.

Senator MOYNIHAN. And an issue which we raise with a certain circumspection. We are not sure how many people we want to know. [Laughter.]

Senator Daschle, good morning, sir—another distinguished member of our committee. Would you like to make an opening statement?

Senator DASCHLE. I have no statement, Mr. Chairman.

Senator MOYNIHAN. In that case, we will go right to the business at hand.

I think, in the pattern of the committee, we will hear each of our witnesses in series; but if anyone likes to comment, won't you feel free to do? Because we know you know each other, and you know each other's work.

Dr. Munnell, good morning.

STATEMENT OF DR. ALICIA H. MUNNELL, SENIOR VICE PRESIDENT AND DIRECTOR OF RESEARCH, FEDERAL RESERVE BANK OF BOSTON, BOSTON, MA

Dr. MUNNELL. Thank you, Mr. Chairman.

I am delighted to be here. I think the subject of today's hearings is an important one, and I am pleased to be able to discuss it with you.

The United States currently has a unique opportunity to augment its low level of national saving by accumulating assets in the Social Security Trust Fund. That is, the possibility exists for Federal Government saving to increase the national saving rate. The difficulty is that this will not happen automatically.

Whether or not Government saving actually occurs will depend on how the assets in the Social Security Trust Funds are used. If the reserves are used to finance current consumption—that is, to pay for current outlays in the rest of the budget—no real saving will occur. On the other hand, if the Government alters its spending and taxing patterns to produce surpluses at the Federal level—at the Federal level, not just in the Social Security Trust Funds—the nation will enjoy higher saving and investment.

Hence, we as a nation face an important economic choice. I would like to review some of the considerations that might enter into making that choice, and discuss some of the practical problems associated with the Federal Government's saving through a Social Security Fund buildup.

The 1977 Amendments to the Social Security Act assured some short-term buildup in the Social Security Trust Funds. This was really done by moving a tax rate hike that was scheduled for 2011 down to 1990, so that you had higher revenues coinciding with lower costs.

But the 1983 amendments greatly increased the size and the duration of these surpluses. Currently, as you heard last week in detail, I'm sure, tax income to Social Security's Old Age and Survivors Disability Insurance Trust Funds is projected to exceed outgo for the next 30 years.

These annual surpluses will produce Trust Fund reserves equal to roughly 30 percent of GNP in the year 2018, or $2.6 trillion in 1988 dollars.

These accumulated reserves are currently scheduled to be drawn down to cover annual deficits in the years between 2018 and 2048.

What are the economic effects of building up and then drawing down Trust Fund reserves? Because that is the proposal we are looking at right now, building them up and then drawing them down.

Let us first assume that the buildup in the Social Security Trust Fund actually does result in positive accumulation of resources at the Federal level. The simplest way of thinking about this is to assume the Federal budget, exclusive of Social Security, is brought more or less in balance, while the Social Security Trust Funds run surpluses.

In this case, the surpluses in the Social Security Trust Funds represent net saving by the Government and imply that a higher proportion of current output will be devoted to capital formation.

If the current level of national saving is too low, and if monetary and other non-fiscal policies assure full employment—which goes to Senator Packwood's comment—surpluses at the Federal level will lead to greater long-term growth in the supply of capital and higher future levels of output and income.

As a result of the surpluses, then, future generations will have a relatively higher standard of living from which to contribute taxes to redeem the debt when the time comes to pay the benefits.

Now, the discussion so far has focused on the accumulation of reserves between now and 2018. But what happens after 2018 under the current plan?

During this time, the foregoing analysis works in reverse. After 2018, benefit commitments will exceed tax revenues so that the fund will have to use interest on the assets and eventually redeem its holdings of Government Securities in order to provide pensions to beneficiaries.

The redemption of the Government Bonds and the transfer of these funds to the public will represent a dissaving by the Federal Government. This means that a lower portion of current output will be devoted to capital formation.

Thus, the projected pattern of Trust Fund activity over the next 60 to 75 years would involve an element of forced saving between now and 2018, which, if invested productively, will increase capital accumulation, future income, and consumption. After 2018, the relative value of the assets in the Trust Funds will decline, creating a dissaving at the Federal level, which will reduce the share of future output devoted to capital formation and thereby future levels of per capita output.

The important question is: What is gained by the accumulation and subsequent depletion of Social Security reserves over the next 60 to 75 years, and when do the gains occur?

The answer is that the exercise is primarily one of shifting the pattern of consumption from the early half of the period to the later.

Now, the rationale for such a shift in consumption patterns is that the people contributing during the period of accumulation are part of the baby boom generation. This very large cohort would place a significant burden on the following generation if all its retirement benefits were financed on a pay-as-you-go basis.

Because of the magnitude of this potential burden, the argument goes, this generation should pay for some of its retirement in advance by accumulating surpluses in the Social Security Trust Funds.

The other side of the argument, of course, is that because of its large size the baby boom generation has already had a very hard time. These people attended overcrowded schools, experienced difficulties finding jobs, and found slow advancement once on the job.

The mere size of this group has contributed to the virtual freezing of wage growth in the last decade, and has made it almost impossible to find affordable housing. Whether or not this generation should be the one to contribute towards its own retirement in addition to financing benefits for current retirees is an issue that should be part of the debate.

Another factor that should be considered is the wisdom of drawing down the Trust Fund reserves once they have been accumulated. The discussion surrounding this part of the proposal seems to imply that we are facing a temporary blip in the cost of Social Security as the baby boom generation passes through. I used an analogy of a rat being digested by a snake, but I have now become more upscale with "a pig being digested by a python."

In other words, the implication is that the number of beneficiaries per hundred workers will go from its current level of 30 beneficiaries per hundred workers up to 55 beneficiaries per hundred workers, and then come back down. This is not the case. We are facing a permanent increase in the ratio of beneficiaries to workers. The reason is that the fertility rate, which has been reduced by nearly half since 1960, is expected to remain around its current level. That means that the number of beneficiaries per hundred workers is going to go gradually up to 55 and is going to stay there, and the pay-as-you-go costs of the Social Security program will increase proportionately.

Hence, if the decision is made to pre-fund some Social Security benefits, it may make more sense to build up the fund and keep it as a permanent source of funding, rather than drawing it down. This would require a tax increase around the year 2018, and this issue should also enter into the debate.

Whether the fund is eventually drawn down or not, accumulating surpluses in the Social Security program may be the most effective way of raising the nation's saving rate over the next 30 years. Accomplishing this goal, however, involves surmounting some practical problems.

The most crucial is making sure that the trust fund surpluses are not simply offset by deficits in the rest of the budget. If payroll tax revenues earmarked to pay future retirement benefits are loaned to the Treasury, and the Treasury uses these monies to cover current outlays in the rest of the budget, then the surpluses will have contributed nothing to overall capital accumulation. The full burden of supporting the beneficiaries will come from the taxpayers in the second half of the period, just as if we had been on a pay-as-you-go basis all the time.

The evidence from other countries that have tried to fund their public pension systems is not entirely encouraging. Canada, Japan, and Sweden in particular have accumulated large public pension trust reserves in order to augment private savings. But as I read the evidence, only Sweden appears to have been successful. Japan seems to have run large deficits in the overall federal budget, and in Canada the money was lent to the Provinces for investment, but they spent it on current consumption; so, really, there was no additional capital accumulation there.

I mentioned the international evidence, not to argue that Federal Government saving is impossible but only that it is difficult. If we choose to proceed along this path, it appears that we could learn quite a lot from both the successes and failures of other countries.

We have time to take a look at the experience of other countries. We do not have to determine today the course of fiscal policy for the next 75 years, or even the next 25 years. Regardless of what we decide to do for the long run, our short-run agenda is already set. Whether or not we decide ultimately to continue with a plan to pre-fund the Social Security program, prudence tells us to continue building up Trust Fund assets at least until we have an adequate contingency reserve. We never want to have happen again the repeated Social Security crises that we experienced in the late Seventies and early Eighties.

My calculations indicate that a reserve equal to 150 percent of annual outlays would be required to weather the kind of back-to-back recessions that we experienced in the 1970s. This level of contingency fund will not be reached until 1995. Long-run funding decisions can be postponed until we near that time.

The desired path for the non-Social Security portion of the budget is equally clear to me. Fiscal responsibility demands that our tax and spending activities be brought more in line. Continued deficits produce a large burden for our children and make our own welfare dependent on the good will of foreign governments. Hence, at the same time that we are accumulating a contingency reserve in the Social Security Trust Funds, we should be reducing the deficits in the rest of the budget.

And during this time, we can debate whether we want to try to increase our national savings rate by continuing to accumulate surpluses in the Social Security Trust Funds.

It is a very complicated task. An important factor, however, to keep in mind while the debate takes place is that the Social Security program itself will function perfectly well under either the funding or the non-funding scenario.

If a fund is built up, current tax rates should be adequate to finance benefits for the next 60 years. If OASDI reserves are not accumulated during the period from now to 2018, then OASDI taxes will have to be raised in 2018 to finance annual deficits on a current cost basis.

It is important to note, however, the magnitude of the required tax increases. It doesn't require a doubling or tripling of the tax; it would require a tax increase of one to two percentage points each of taxable payrolls, for the employee and for the employer. These are not small numbers, but they are manageable numbers.

In short, we are not faced with another Social Security crisis, but rather with an opportunity to increase national saving and investment. This is good news, not bad news.

Thank you.

[Dr. Munnell's prepared statement appears in the appendix.]

Senator MOYNIHAN. Dr. Munnell, yes, exactly. It is not every day here in this committee that the Japanese have just blown their surplus while we are saving ours.

Dr. MUNNELL. It is nice to know they can't do everything.

Senator MOYNIHAN. What do you think about that, Senator Packwood? Have you heard that lately (laughing)?

Senator PACKWOOD. I have heard that, Mr. Chairman.

Senator MOYNIHAN. Barry Bosworth is a Senior Scholar at the Brookings Institution. We welcome you again to the committee, sir.

STATEMENT OF BARRY P. BOSWORTH, SENIOR FELLOW, THE BROOKINGS INSTITUTION, WASHINGTON, DC

Mr. BOSWORTH. Thank you.

I have a written comment.

Senator MOYNIHAN. We will place it in the record, and you speak to it as you would like.

Mr. BOSWORTH. Since that is available, I will not try to go over all of it. And since Alicia Munnell has covered many of the same issues, I would like to make just a few brief comments, perhaps highlighting some areas of disagreement though they are few.

Senator MOYNIHAN. Good.

Mr. BOSWORTH. I think it is very important, to start with, to remember why Social Security is running a surplus. It has a surplus because of a sharp demographic change that is occurring in the U.S. population: We are growing old. And anybody anticipating that would prepare by raising their saving rate.

One of the things that is most remarkable in the United States is that during this period, rather than increasing our national saving rate, we have dramatically reduced it in the 1980s. We can forget about the surplus of Social Security for a moment and think about the national savings rate, and realize that this country is now consuming 98 percent of all its income.

Senator MOYNIHAN. Just so you can help us, you must have put that somewhere in your paper—I remember reading that. Where is that, the 98 percent figure?

Mr. BOSWORTH. I really don't remember, either (laughing).

Senator MOYNIHAN. So our national saving rate is 2 percent today?

Mr. BOSWORTH. Our national savings rate today is 2 percent. We have a private saving rate equal to 6 percent of income but two-thirds of all private savings in the United States is currently being used to finance the government budget deficit.

The new projections of the Congressional Budget Office indicate that the U.S. budget deficit has declined to about $160 billion for fiscal year 1988, and it is projected to fall further to about $140 billion annually by 1993.

That has led to an increasing number of comments by individuals that the U.S. budget deficit problem is well on its way to solution. "Yes, the budget deficit it too big, but it's coming down."

What this testimony today I think does is highlight the fact that we are reducing the budget deficit in the United States only because we are running an ever-growing surplus in the Social Security Fund. And the intention under present budgetary policy is to run a surplus in Social Security, and then turn around and borrow it to finance our own consumption. That will do absolutely nothing to offset the burden on future workers.

It is true that under current law they will not face dramatic increases in employment taxes. Instead, what they will be faced with is enormous increases in income taxes when the Social Security

Fund begins to turn back to the Treasury, and say, "Give us our money back."

And so, future generations face the problem of having to repurchase all this debt that is being issued to the Social Security Fund. Their employment taxes will remain low; their income taxes will skyrocket.

The burden of trying to pay for a retired generation will be completely unaffected, because the real issue is not an issue for the Social Security System at all—the Social Security System is in good shape. The issue, instead, is for the rest of the Federal Budget: What are we going to do with the surplus?

If we set it aside, if we save it, if we allow it to pass through in the increased levels of capital formation, it turns out there is no increased burden of Social Security on future workers, because with a higher level of national saving we will provide them with a larger capital stock and an increased level of income in the future, out of which the Social Security benefits can be paid. In fact, under that sort of a scenario, which is exactly what I tried to present in the last table of this testimony, there is no increased burden on future workers.

However, under current plans what we are doing is borrowing the surplus, using it to finance general fund expenditures of the Federal Government. The magnitude of that is today about $40 billion a year. And just five years out, the Social Security surplus will be right around $100 billion a year.

Now, if you remove the Social Security Fund and say, "How is the General Fund doing? How is the part of the budget that finances normal day-to-day expenditures—defense spending, welfare, et cetera?" That budget deficit is in fact almost $200 billion today, and it is not going down; it is going up. The situation is steadily getting worse.

In effect, the appearance that the overall budget deficit is being reduced in the United States is simply financial gimmick of borrowing from one fund to finance ever-growing deficits in other funds.

In effect, the United States is substituting a very regressive employment tax on middle and low income workers to pay for national defense, welfare, other government expenditures, and reducing income taxes.

It seems to me as a method of financing day-to-day government expenditures, the idea of substituting an employment tax for an income tax is absurd. And in fact, future generations will have to make all this back up in the form of increased income taxes.

Now, Alicia mentioned that in fact all this is introducing is just a big cycle in the Social Security Fund. "We'll run a big surplus, and then we'll run a big deficit and run it back down again." But in fact, under current plans that would not happen, because the Social Security Trustees are required to report to the Congress actuarial balance of the Fund and its actuarial condition 75 years out.

For the next few years, the Fund is in great shape. At the end of the period it is in terrible shape. Just the pure passage of time means that about 1992 you are going to get a report that the Social

Security Fund is in a long-run imbalance, and you will be forced to increase taxes or cut benefits.

Under that projection, if you just keep the Fund in actuarial balance, we build up a big surplus in the Social Security System and we keep it. If we allow that to pass through into higher capital formation, we will forever offset any increased costs of Social Security on future workers.

But the major issue that has to be addressed today, and is not an issue for 75 years out but an issue immediately, is: Is the Congress and the President going to simply borrow the surplus of the Social Security System, or are we going to save it? If we borrow it, it is just a financial gimmick, to make it "appear" that the budget deficit is temporarily low. If we save it, set it aside, reduce the deficit in the rest of the Government accounts, this provides an opportunity for the United States to offset a very significant future burden of trying to provide for our retired.

Let me close with just one final point. That is, there is probably too much focus on Social Security—it's got a big surplus. But I would remind you that under current tax rates the Medicare program will have a deficit equal to the surplus in the Social Security account in future decades. And this just means that we are postponing a very serious problem, that there is a very large increase in the burden on future workers coming of trying to prepare for pensions and Medicare expenses of the elderly. And I think the way to deal with it is to set the Social Security surplus aside and save it.

If in fact that is impossible to do, then I think the Congress would be well advised to abandon the whole attempt to build up a reserve, and return back to the old system of pay-as-you-go; because all we are doing is setting this country up for an enormous debate 20 and 30 years from now, when my generation is going to turn around and say, "Give me back my money in the Social Security surplus. It's mine," when in fact, it is not; all we have done as a generation is put money into one fund and borrow it to finance expenditures in another fund.

[Dr. Bosworth's prepared statement appears in the appendix.]

Senator MOYNIHAN. We thank you very much, Dr. Bosworth.

I would like just to record for the panel a future question, which is: Did we not in 1983 in effect change our policy from one of pay-as-you-go to one of acquiring a surplus, a reserve, as you like?

Now, no one person could provide a more authoritative answer than our next distinguished witness, Mr. Robert Myers, who was the Chief Actuary of the Social Security Administration for so many years and was Executive Director of the National Commission on Social Security Reform, which in the end made the proposals, the aftermath of which we are just beginning to understand as we have had four full years of the experience.

I would like to record, if my colleagues would permit me a statement, that there is a saying around Washington, or ought to be, that everybody is entitled to their own opinion but not to their own facts. And the great achievement of Bob Myers in the year 1982 was simply to set forth the facts—patiently, patiently, patiently—until they sank in. And it could be seen in attendance at Commission meetings. In the first meeting, everybody came, and one by one those people got it straight in their heads what the facts were and stopped coming, until finally Mr. Myers was testifying before one member of the Commission plus Alan Greenspan. But in the end there was a realization, as Mr. Greenspan himself said, that, "When you first hear about this it sounds impossible, and then when you get to know the facts, it is really not that difficult. We can do it."

Mr. Myers, we welcome you, sir.

STATEMENT OF ROBERT J. MYERS, FORMER CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, SILVER SPRING, MD

Mr. MYERS. Thank you, Mr. Chairman, for those very fine words. I might say that I have used your well-coined expression quite a number of times, "Everybody is entitled to their own opinions but not to their own facts." It is a great statement.

First, before beginning my prepared remarks, I would like to comment on the question that you raised, that in 1983 was it considered that we were setting up a new financing basis the OASDI program, as compared with the previous one?

The answer is a little murky on that matter. But, in my prepared testimony, I have a whole section on that, which goes into this in some detail.

In summary, I would say that, in 1983, when we were very much concerned with the iceberg ahead of July 1983, when the checks would not go out on time, the Commission, in order to get a consensus, focused on two things: First of all, to get through the 1980s; and second, over the long range, on the average, to have the system in actuarial balance or be fully financed. The Commission just did not have the time to realize what the long-range financing method adopted actually did, that it did build up these large funds which would then be used up over the long run.

Senator MOYNIHAN. But wouldn't you say—and this is a large point, Bob—that prior to that it had been sufficient to make sure that as you went from year to year you would be able to pay the bills and have a little cushion, but the rates we put in place in 1983 meant that after you got through the Eighties there would in fact be a very large reserve?

We had testimony last week that from now to the year 2000 the reserves increase by $1.4 trillion. That is almost exactly equal to the total assets of all private pension plans.

So I think there was kind of a discontinuity as you economists say.

Well—thank you.

Mr. MYERS. Thank you.

I would like to comment on one point that Mr. Bosworth made, where I see it a little different, that if nothing were done five or six years from now, or perhaps even sooner, the system would be shown to be out of actuarial balance, and then you would have to raise taxes. Well, actually, this could be handled very easily and perhaps not too queerly to the public, that the point you would have to raise taxes would be a tax raise in the year 2040 or so. And that would put the system in great shape without preventing the buildup of funds now, but rather taking care of the situation when the fund is exhausted.

Now, for my prepared testimony, I am very happy to report, as you realize, that the OASDI system is currently in excellent financial health, and far more than it was estimated to be at this time in 1983.

The Trust Fund balance at the end of last year was $69 billion, which was three times as high as under the pessimistic estimate on which the financing package in the Consensus Agreement was based. The Fund now is even twice as high as in the intermediate or best-guess estimate.

There is one problem that the Trustees Report points out that I think is perhaps overlooked, that the allocation of the OASDI tax rate between OASI and DI should be changed. The DI Trust Fund is slowly going down hill, and in a few years it may well run into difficulties.

What was done, as you recall, in 1983 was that the DI allocation was reduced by about 45 percent relative. There should have been a reduction, but this was a little too much; so there should be some reallocation, I think, as soon as possible back to the DI Trust Fund.

As to the long-range actuarial situation, so far the OASDI Trust Funds are in good condition. Of course, nobody can be sure what is going to happen in the long period like 75 years; but things still seem reasonably favorable.

This year's Trustees Report has a revised method of measuring long-range actuarial balance, which it so happens—we have gone around the circle—is the same as was used before 1973, and I think quite properly so, to take into account the Fund balance at the valuation date, and particularly the interest earnings. This is only proper to do over time.

Senator MOYNIHAN. When you have gone into a reserve mode, so that interest becomes a very consequential portion of your income, Bob.

Mr. MYERS. That is correct, Mr. Chairman.

Another interesting point that people have noted is the cost of OASDI relative to taxable payroll has been slowly decreasing in the past five years. Thus, in 1983 the cost was 11.5 percent of payroll, now it is down to 10.7 percent. This, however, is not surprising; it is just what was estimated in 1983, though the decline has been slightly more. So this is something that we expected, and it is a favorable sign for probably the next 10 or 15 years. The cost, if anything, will be going down slightly.

Senator MOYNIHAN. The burden is not rising but going down.

Mr. MYERS. Now, as far as the Hospital Insurance Trust Fund, it currently is in excellent shape as compared with before the 1983 Amendments, which introduced the diagnosis-related group method of reimbursement of hospitals. It was thought there was going to have to be another national commission—heaven forbid—in 1987 or 1988 to take care of the HI Trust Fund that was going to go bankrupt then.

Well, with the new method of reimbursing hospitals, the Trust Fund really is in quite good shape. It is now $54 billion as against an estimate of $33 to $45 billion at this time that was made back in 1983.

Nonetheless, the Fund will peak in a few years and then be exhausted at least by the early 2000's.

The SMI Trust Fund, that people don't pay a great deal of attention to, I think deserves a look. It is in reasonably good condition; but it should be noted that at the end of last year, although it had about $5.5 billion in it, from an actuarial standpoint it had a 1.5 percent relative deficit. This resulted from holding down the premium rate in 1987 to a low figure to use up the fund. Unfortunately, the failure to raise it very much was a little optimistic, so the fund declined. But with the sharp increase this year the fund will get back into the black, and at the end of this year it will probably have a 2 percent relative surplus.

Interestingly, one point that is not brought out in the SMI Trustees Report that I think should be is that the SMI premium next year is going to take another rather sharp jump—not as much as last year, but it is going to take an estimated 11 percent increase.

According to the Trustees Report, as a previous witness has said, the OASDI Trust Funds will build up to a very high size in the next three decades and will then become exhausted in about three more decades. As I will discuss later, I think this is a very undesirable situation. Instead, true pay-as-you-go financing should be adopted. If this were done, this would mean lower tax rates than currently scheduled until about the year 2020, and then somewhat higher ones for the next three decades, but about the same thereafter.

I show my suggested tax schedule on this reduced basis in Table 4 of my prepared testimony.

In 2050 and thereafter, the tax rates under my proposal would be slightly lower than would be required under present law. People do not realize, I think, what it means when you say the "fund is going to be exhausted at some time." At that point, you are going to have considerably higher tax rates or else reduced benefits.

It has been proposed by some that we should build up and then maintain a large fund. If so, you would need a substantial tax increase in 2020 to 2030 that would be almost as large as those under my proposal.

Again, if this proposal were adopted, we would have come full circle back to the financing basis of the original 1935 Act, when it was proposed to do exactly that—namely, to build up a large fund, in that far distant future year 1980, namely $47 billion, and then hold it level thereafter. Now, $47 billion does not sound like much money today, but it should be realized that the national debt in 1934 was only $32 billion, and people were then wondering, "How are you going to have a $47 billion fund when the national debt isn't even that large?"

Building up large fund balances under OASDI is undesirable for three reasons:

First, such balances would, in my view, cause almost irresistible pressures for benefit liberalizations now. This would increase the long-range cost of the program and make future financing problems just that much more difficult.

Second, the ready availability each year of the large excesses of OASDI income over outgo would make general governmental borrowing seem much easier, and therefore I think would not create sufficient pressure to really get the general budget in line.

Third, if the future balance is to be drawn down to zero some 30, 40, or 50 years from now, as contemplated under present law, this would make at that time terrific financing problems for the general treasury.

Finally, another point. Turning back to the Medicare system, I believe that at the very least, the tax rate schedule for the HI program should be changed so as to bring the system into closer long range balance. If there is to be some benefit reduction without affecting current beneficiaries, in lieu of increasing tax rates, as much, I would suggest that what should be done is that the minimum age for non-disabled beneficiaries follow in tandem the increase in the normal retirement age for OASDI—in other words, gradually increase, beginning in the year 2003, until it would be age 67 in the year 2027.

As to public confidence in the program, unfortunately many younger persons believe that the OASDI program will not be around when they retire. As the preceding discussion indicates, the chances are excellent that the program will have a perpetual life. Of course, no actuarial estimates can be all that precise, no matter how accurately made.

However, if the experience some years hence is adverse and financing problems arise, solutions can be achieved by making relatively small and painless changes, as was done in 1983.

President Reagan, in signing into law the 1983 Amendments, said it very well: "This bill assures us of one more thing that is equally important—it is a clear and dramatic demonstration that our system can still work, when men and women of good will will join together to make it work. There has been one point that has won universal agreement: the Social Security system must be preserved." And I think that same thing will hold true in the indefinite future.

I would like to pay great tribute to the distinguished Chairman and Ranking Minority Member of this Subcommittee, who played such an important role in the 1983 legislation. At one time, when it appeared that the torch had irretrievably fallen to the ground, and no legislative action would be taken, these two distinguished statesmen picked up the torch, and it was carried triumphantly to the finish line.

Thank you, Mr. Chairman.

Senator MOYNIHAN. Mr. Myers, you are our kind of witness. [Laughter.]

We thank you so much, sir. I said earlier what we owe you as a Nation and as a committee.

[Mr. Myers' prepared statement appears in the appendix.]

Senator MOYNIHAN. I am going to have to tell our panel that happily we have 45 minutes. But at 11:30 we commence five votes in a row on the INF Treaty, and they are 10 minute votes; so it just wouldn't make much use to try to get back. So let us get this very important panel together.

Senator Packwood, won't you start the questioning?

Senator PACKWOOD. I want to ask both Dr. Bosworth and Dr. Munnell a question, but I will start with Dr. Bosworth:

In the end of your testimony you have got that chart, "The Economic Effects of Saving the Surplus of an Actuarially Balanced OASDI Trust Fund," and so forth. Then you have got, under "General Economy" four categories, "Capital Stock, Net National Product, Real Wage Rate, and Nominal Interest rate."

Does that mean in improvement from baseline if we save the entire surplus, so that in terms of net national—what is "net national product," by the way?

Dr. BOSWORTH. The same thing as GNP, but deduct off depreciation.

Senator PACKWOOD. OK. So, does that mean that, if we save it all, in the year 2000 the net national product will be 1.8 percent better than it would otherwise be by baseline projections?

Dr. BOSWORTH. Yes.

Senator PACKWOOD. And that real wages would be 3.1 percent higher than we otherwise project, and that interest would be .14 percent lower?

Dr. BOSWORTH. Yes.

Senator PACKWOOD. OK. And can I assume that any combination of saving part of the surplus would have a slightly more salutary effect on the future economy than spending it all immediately? It wouldn't be as good as saving it all, but it would be better than spending it all.

Dr. BOSWORTH. As a first approximation it would be strictly proportionate.

Senator PACKWOOD. Yes. Because I can foresee this happening.

As you are well aware, under the Gramm-Rudman law now, in theory, we are to get to a balanced budget in 1992 counting the surpluses; and then, bam, in 1993 we say, "Now you can't count the surplus anymore," and we are back, under the best of projections, to a $100 billion deficit right away in the general funds.

But what I can foresee happening after that, if we have any restraint at all, is partial savings and partial use of the surplus to offset the deficit by buying Government Bonds. My hunch is, we would then use the rest of the annual surplus to purchase past government debt, assuming people will sell it to us.

Senator MOYNIHAN. As it expires.

Senator PACKWOOD. Well, as it expires, yes. Yes, as it expires we could buy it up; but I am thinking of buying back the debt that hasn't expired, if those who hold it would sell it.

Would that count, in your judgment, as savings? Buying up past government debt? Would it have a salutary effect?

Dr. BOSWORTH. There is a little bit of confusion here, I think. It doesn't really matter from an economic point of view what financial assets Social Security buys. For example, we normally assume they are going to buy Treasury securities. Suppose Social Security decided not to buy Treasury securities, but bought corporate stock? Then the Treasury securities that would have been purchased by Social Security would have to be sold in the private sector. But the corporate stock that used to be bought in the private sector would now be in Social Security. You would rearrange the ownership, but it doesn't make any difference what Social Security buys.

Senator PACKWOOD. I understand that.

Dr. Bosworth. What is important is what happens to the budget deficit as reported of the other, what we would normally call the "general fund" of the Federal Budget.

Senator Packwood. Well, let me give you a scenario, then, and you tell me if this would help in terms of savings: Let us say we reach 1993 and we are still not doing very well in the General Fund deficit, and it is still running $100–$200 billion a year or more; but the Social Security surplus gradually even starts to get bigger than $200 billion a year.

So, given the worst case—I hope it is the worse case—a $200 billion General Fund deficit and $300 billion Social Security surpluses, assuming we fund $200 billion of the deficit with the $300 billion annual surplus, if we take the $100 billion and use it to buy a past debt, is that savings? Does that have a salutary effect?

Dr. Bosworth. Yes.

Senator Packwood. We are not spending it for current consumption, we are eliminating—in essence—the cost of past consumption that we borrowed to spend.

What I am trying to figure—we are at what? A $2.7 trillion national debt now?

Dr. Bosworth. Uh-huh.

Senator Packwood. Let us say by 1995 it is $3.7 trillion, almost four. If Social Security gradually started to buy up that debt, by the year 2005 or the year 2010, assuming they finally now have bought it all up, would that have a sufficient salutary effect on the economy, that the economy would grow faster than it would otherwise grow, and justify the investment in first the current debt and then the past debt, so that the accumulated surpluses in the Social Security Trust Fund might be $17 billion instead of $11 billion, simply by the faster growth of the economy, by the savings imposed by buying up the past debt?

Dr. Bosworth. Now, we tried to take account of that as well, the fact that if you invest the Social Security surplus, you have a larger economy; therefore, Social Security in fact will have a larger surplus.

Senator Packwood. A larger surplus.

Dr. Bosworth. Right.

Senator Packwood. Is that too much of a bootstrap argument?

Dr. Bosworth. No, it is perfectly valid. It turns out that, of the gains in national income, the Social Security surplus itself will benefit to the extent of about 5 percent of that in the short run.

But there is something often overlooked about the Social Security system, the way it operates, that in the long run will eliminate this, and that is: If the economy grows faster, initially that is good for Social Security, because it collects more taxes. But, the higher level of wages ultimately means benefits have to go up, right?

Senator Packwood. Right.

Dr. Bosworth. So in the long run, variations in the level of GNP have a neutral effect on Social Security.

Senator Packwood. On the Social Security payments. Or are you saying——

Dr. Bosworth. The taxes and the benefits will rise by equal proportions. There will be no long run effect on Social Security.

Senator PACKWOOD. Why would that be true if the Gross National Product or net national product grew faster than the rate of inflation?

Dr. BOSWORTH. Well, if you always grow faster, then the tax increases run ahead of the benefiting.

Senator PACKWOOD. Yes.

Dr. BOSWORTH. But if you think of going up to a new, higher level of national income and then flattening back out again, the benefits catch up to the taxes, and Social Security has to pay say 3 percent more in benefits, it collects 3 percent more in taxes.

Senator MOYNIHAN. That was a problem we got into in the late Seventies.

Dr. BOSWORTH. Yes.

Senator DASCHLE. I am curious about that. It would seem to me that if you have a recession, and businesses failed and employees lost their jobs, and you were not collecting the revenue, the benefits are still going out. And as the benefits continue to go out with regularity, and less and less comes in because of the recessionary impact on the trust fund, I can't help but think that the volume of trust fund dollars, the availability of those dollars, will shrink, and ultimately have an impact.

Dr. BOSWORTH. In the short run, you are absolutely right.

Senator DASCHLE. But you never make up that little bit, do you? How do you make up the loss of income going into a recession?

Dr. BOSWORTH. If the economy recovers from the recession and goes back to a full employment expansion, you have made it up, right? If it doesn't recover, you never make it up.

Senator DASCHLE. But have you made up that pool of funds that never went into the trust fund? How do you make that up?

Dr. BOSWORTH. But the benefits will never come back, either because of the wage history on which people receive benefits. If you are unemployed for a year, you don't get any benefits for that year in the counting up of your wages.

Senator MOYNIHAN. Senator, I wonder if Mr. Myers couldn't help by saying, when we make these projections, and we normally take the mildly pessimistic projection, we assume a business cycle, isn't that right?

Mr. MYERS. Yes, that is true. It is a very complex matter. If you just have one bad year, that isn't going to hurt your benefits one bit, because over the long run your retirement benefits are computed over your best 35 years. And if you have two or three bad years in your individual earnings record, it is not going to hurt you one bit.

So I think the point the Senator makes is well taken, that business cycles can raise the cost of the program; but, hopefully, the actuaries have taken this into account in their projections. They don't predict that a business trough will occur in the year 2022, because nobody can do that; but in their methodology they do take into account this feature that you can omit a number of bad years from your earnings record.

Senator MOYNIHAN. Senator Daschle.

Senator DASCHLE. Go ahead.

Senator PACKWOOD. Well, it just seems to me, unless we spend it all now, which is a temptation—and I don't mean just defense, I can see long-term care and expansion of benefits, and everything else coming down the line. But if we don't spend it all now, and if the savings rate—although, am I told Social Security does not count in the national savings rate, in what we normally call "the savings rate"?

Dr. BOSWORTH. Sure. It would reduce the government budget deficit and add to national savings.

Senator MOYNIHAN. It does count.

Senator PACKWOOD. It doesn't count in that figure that you normally see printed in the paper about "the savings rate is—"

Dr. BOSWORTH. Sure it does. The national savings rate I gave you of 2 percent includes any savings that would be accumulated in the Social Security Trust Fund.

Senator PACKWOOD. In the Social Security Trust Fund? I did not realize that.

Dr. MUNNELL. It doesn't count in the personal savings rate, which is what you often see in the newspaper.

Senator PACKWOOD. Is that what I see in the paper?

Dr. MUNNELL. Yes.

Senator PACKWOOD. However, private pension funds that you have a vested interest in count.

Dr. MUNNELL. Yes.

Senator PACKWOOD. But not a Social Security reserve that, in theory, you have a vested interest in?

Dr. MUNNELL. It is counted as government savings.

Senator PACKWOOD. Government savings.

Dr. MUNNELL. Yes.

Senator PACKWOOD. It comes out the same total in the end, in other words; it is just shifted from one side of the ledger to the other, but it is all savings.

Dr. MUNNELL. Yes.

Senator PACKWOOD. I was noticing Mr. Jardenies predictions the other day of personal savings going up to a rate of 8 to 10 percent by the mid-Nineties, simply based upon demographics, as the rat moves through the snake, as Dr. Munnell said. [Laughter.]

The rats save more when they are 35 than when they are 25, and save more when they are 45 than when they are 35.

What do you think about that?

Dr. MUNNELL. Can I make a comment about savings generally?

Senator PACKWOOD. Uh-huh.

Dr. MUNNELL. This is a little risky on my part, because to even question just going ahead and accumulating more savings in the Social Security Trust Fund is almost heresy.

Economists do exercises like Barry's, and they look and see that if we put aside more money now, we would have an enormous payoff in the future. And it is so frustrating for us, as a profession, that people do not save more.

Senator PACKWOOD. Do you mean an enormous economic payoff?

Dr. MUNNELL. An enormous economic payoff.

Senator PACKWOOD. By forced savings now?

Dr. MUNNELL. Right. If we really did it, we would have more machines, we would have more factories, we would have more production.

Senator PACKWOOD. Uh-huh.

Dr. MUNNELL. And so, economists look at these tables, and they just wring their hands. "If you only would save more, people, we would have all these good things in the future."

My concern is that you could take Barry's table around to every household in America and say, "Look, if you did this now, look how much better things would be in the future." And every household in America could say, "I don't really care. I like saving just what I am saving now."

What I am worried about is that the exercise that we are doing in the Social Security Trust Fund is saying, "Okay, but we, who know better than all of you, are going to save at the Federal level." And I bet people undo any effort that we make to accumulate at the Federal level, that they are as likely to adjust their individual saving. That is, if we can accomplish saving at the Federal level.

Senator PACKWOOD. Is that right? It is interesting.

Dr. MUNNELL. And I am concerned that we won't be able to accomplish increased saving at the Federal level and that we will be setting ourselves up for failure, and the credibility of decisionmakers will be brought into question.

Senator MOYNIHAN. Could I say something here about this?

Dr. MUNNELL. Yes. Sure.

Senator MOYNIHAN. It is very clear. We are at a large decision point in our country: Are we going to bet on democracy?

We did change the funding basis of Social Security from pay-as-you-go to a surplus; we are going to acquire this great surplus. It is already rolling in. It makes possible a huge increase in saving, which we greatly need.

Dr. MUNNELL. That is right.

Senator MOYNIHAN. It also makes possible an irresponsible increase in consumption. And are we going to bet that we, as a people, are capable of doing it?

I see Dr. Munnell, Dr. Bosworth, Mr. Myers—we all agree. That is part of the bet we are making here, aren't we?

Dr. MUNNELL. That is right.

Senator MOYNIHAN. And I wonder if you wouldn't agree that there are two ways you can do this: Keep it secret—nobody believes it, so nobody will know—or bring it up front and spit it out and say to the presidential candidates, "What are you going to do?"

Senator DASCHLE. Or say to the Congress, "What are you going to do?"

Senator PACKWOOD. Do you mean, force them to say, "We are going to save it"? Because they don't dare say, "We are going to spend it."

Senator MOYNIHAN. That is right. But then say, "All right, but remember what you said," and hold hearings every year.

What do you think, Senator?

Senator DASCHLE. I know what I would say.

Senator MOYNIHAN. But don't you think this is a decision point?

Senator DASCHLE. Oh, absolutely.

Dr. MUNNELL. Yes.

Senator MOYNIHAN. But do you all agree?

Dr. MUNNELL. I agree. And this is the time to think about it, because, as I said, the course is sort of set for the next five or ten years.

Senator PACKWOOD. But I am intrigued with what she said.

Let us assume we make the decision to save, but the public says, "You bet. We are not going to spend it on two more aircraft carriers; we are going to save it now." What Dr. Munnell is saying is that somehow the public is going to get around us by decreasing the savings that they are now making privately, and we are not going to end up with any more net savings anyway.

Do I hear right what you are saying?

Dr. MUNNELL. That is what I said. It is not clear to me exactly what the mechanism is going to be. But it is hard, also, to think how the government is going to make individuals as a group do something that they don't want to do.

Dr. BOSWORTH. But come on, Alicia. [Laughter.]

We have just been through an episode in the 1980s of this. The federal budget deficit went from a small amount up to $200 billion. Now, did the American public sit back and say, "Oh, the government's dissaving; I had better save more"? No. The private savings rate has gone down by a third in the United States in the same decade. I as an individual am not going to make these corrections and save more for my children because the federal budget deficit is larger.

This issue has been raised, but I think the economic research on it has been overwhelming: there is no evidence in American historical experience, or in the international experience of other countries, that people will raise their savings rates to offset government budget deficits. No.

We have been through it in the Eighties. If it was true, I wouldn't worry about today's budget deficit. But as I told you, when the government budget deficit went up, the national savings rate in the United States went down dramatically. We are consuming almost everything we produce today. And to suggest that these things will be offset is contrary.

Senator MOYNIHAN. I think that asks more of people than should be asked of them, that they spend their time reading the monthly economic indicators, that when they get home at night they sit down and take off their shoes and say, "Now, what is the Council of Economic Advisors telling us today?" [Laughter.]

And, "Liz, have you seen that new report that Munnell did for the Board of Governors of the First District of the Federal Reserve Board? Wow!" You know. [Laughter.]

Dr. MUNNELL. Can I just make one point on that, in terms of the international evidence? The place where you really do see a build-up in public reserves is in Sweden. And of course it is not fair to compare Sweden, the United States, Canada and Japan, because they all have such different economies.

What happens in Sweden is, you have a very high level of saving at the government level; you have zero saving at the personal level.

Senator MOYNIHAN. Zero.

Dr. MUNNELL. In Japan, they have large budget deficits, but they have had very high personal savings.

Senator MOYNIHAN. You have huge taxes in Sweden. In Sweden you have very high rates of taxes. Do I take it that they put their reserves into the securities market?

Dr. MUNNELL. They are invested indirectly. They have three funds, and they sort of divvy it up.

Senator MOYNIHAN. And they spread some into stocks and bonds.

Dr. MUNNELL. Yes.

Dr. BOSWORTH. Sweden's national savings rate is far higher than that of the United States, the national savings rate.

Senator MOYNIHAN. Senator Daschle?

Senator DASCHLE. Thank you, Mr. Chairman.

Dr. Bosworth, you had said something that I would like to begin by clarifying. You said that if the Trust Fund was invested in capital formation, we would not require any change in payroll taxes for the foreseeable future, for "all perpetuity" I think is the sentence. Is that what you said?

Dr. BOSWORTH. No. Under the current one, if you just hold the tax rates constant, at current levels, as the Trustees Report shows, you go to a surplus, then you run it all right back down again. And in fact, the Fund will ultimately go in the deficit.

However, if you assume as you go through time that the Trustees keep doing what they have been doing, they look out 75 years ahead and they raise or propose increases in taxes or cut benefits, as necessary, then you get a small series of tax increases for Social Security over the next 75 years. The total is about 2 percentage points on the tax rate, when we have simulated the effects with Social Security.

At that point the Trust Fund never runs down. It is like saying the current generation of workers will pay for a portion of its own retirement by building up the fund. But then our children make the same decision, they will pay for a portion of their retirement by maintaining the fund.

Senator DASCHLE. But assuming, just from a strict, Trust Fund investment point of view, that the Trust Fund is invested in government securities as opposed to any other concept in capital formation, wouldn't the rate of return on investment be approximately the same?

Dr. BOSWORTH. Yes.

Senator DASCHLE. And if it is approximately the same, you are assuming that the government will not have the revenue necessary to make good on that investment at some point in the future. Is it the difference in rate of return that concerns you?

Dr. BOSWORTH. No. The government would earn a rate of return equal to the financial rate of interest in U.S. capital markets. Right?

Senator DASCHLE. Right. Which is what?

Dr. BOSWORTH. To be paid into the Social Security Fund that it earns on its securities. Right?

Senator DASCHLE. That is right.

Dr. BOSWORTH. So, it is receiving interest income. In fact, one of the major reasons this fund looks so good is these tremendous interest income receipts it is going to be receiving in the future.

So, it gets its share of the benefits of higher rates of capital formation.

Senator DASCHLE. OK.

Now, from the point of view of the taxpayer, a dollar borrowed from that trust fund is no less expensive than it is from any other source, is that correct?

Dr. BOSWORTH. Right.

Senator DASCHLE. And over a 30-year period of time I am told that that cost to the taxpayer per dollar borrowed is about $13. Is that your understanding?

Dr. BOSWORTH. Well, it sounds about right.

Senator DASCHLE. Somewhere in there?

Dr. BOSWORTH. Yes.

Senator DASCHLE. So in other words, we are not borrowing a dollar. In a 30-year timeframe, in my generation, we are going to be paying the cost of that borrowed dollar as $13.

Dr. BOSWORTH. Uh-huh.

Senator DASCHLE. Senator Packwood had an amendment about 3 or 4 months ago dealing with the Airport Trust Fund that said: If we don't use the dollars for that particular trust fund, we will cease collecting the money. I voted for that. I think it makes sense. Certainly from the point of view of that person paying into the Trust Fund it would make sense.

The concept of not paying into the Trust Fund for dollars not being used appeals to me. What do you think of that, any one of you?

Dr. BOSWORTH. I would agree with the Chairman's statement that he had before. You have a tremendous opportunity. It doesn't mean you will use it. You have an opportunity to use the surplus in the Social Security system to reduce the burden on future workers when the baby boom retires.

I also agree with Mr. Myers: If it turns out that it is just politically impossible to set these funds aside and save them, and you are just going to end up consuming them for other purposes, borrowing them say, I would agree with him, I would prefer to stop the facade and go back to a pay-as-you-go system. But be aware, there is going to be a big argument about 30 years out about the cost of Social Security.

Senator PACKWOOD. Let me partially answer that, also, Tom.

Senator DASCHLE. Sure.

Senator PACKWOOD. I would apply that to the other trust funds but not to Social Security, for this reason. Although I would agree with Barry that if we are going to have a $300 billion deficit, we should have a $300 billion deficit. Then I would rather go to a pay-as-you-go and force us to use rationality on some other basis.

But the other trust funds are really collected to be spent over a relatively short period of time—not 50 years, but 5 years. And if Administrations—and both Republicans and Democrats and liberals and conservatives do it—if they, for the picayune purpose of trying to make their deficit look $4 billion or $5 billion better this year, are not going to spend the money for the purpose for which the taxes were imposed, then we ought to give up on the tax. I think that will cause the money to be spent for the airports and the sewers and the other purposes that we intended.

But I think Social Security is slightly different in a sense. I don't mind not spending it now and building up this reserve—if we don't just in essence spend the reserve on something else—because this is the only program we have where we are looking at the necessity for saving money over 25 or 30 or 40 or 50 years.

The Highway Trust Fund? You know, I don't mind if we run a $3-4 billion surplus this year because we didn't quite spend it, so long as we are rationally spending it over 5 years.

Senator DASCHLE. But your argument was well taken. You said that really the money that was being used was used to mask the deficit, and the concept is the same here. The funds being collected are really masking the deficit.

Senator PACKWOOD. It is. I would agree. If we use it to mask the deficit, then we ought to quit kidding ourselves. I am hoping we don't use it to mask the deficit. But I do distinguish between funds which if collected are meant to be paid out 30 years from now or 40 years from now and funds which if collected, even if they were rationally impounded—and I mean it in a good sense—might mean that we would spend it next year rather than this year, or two years out rather than 1 year out. And I find that significantly different than funds that you might otherwise spend 30 years out or 40 years out, where you, hopefully, have to amass them and not spend them for current consumption.

Senator MOYNIHAN. And there is the question of size, too. We are moving towards a reserve in the trillions.

Sir? I am sorry. Mr. Myers.

Mr. MYERS. On this point, in favor of current-cost financing, that besides this danger of misuse of the Fund, I would argue that, although you will need higher tax rates eventually, they are no higher than you would need under present law after the fund is used up. So, in essence, if you shifted over to current-cost or pay-as-you-go financing now, you would have lower tax rates up to about 2025, you would have higher tax rates for the next 20 years, and then you would have about the same as under present law.

I just do not think, from an actuarial standpoint, that it makes good sense to fund a pension plan or a social insurance system by building up a big fund and then using it up. Either you should have current-cost financing (pay-as-you-go financing) or you should do as Alicia Munnell suggested, build up a fund and then maintain it, which, as I have said, was what was proposed in the original Social Security System in 1935.

My only difficulty with that is the great political temptation that, with all that money there, there are going to be people who come and say, "With all that money, you surely can increase benefits somewhat," and we are already seeing that in this notch problem difficulty. [Laughter.]

People come in and say, "Let's spend the money. It is there. Another $6 billion a year, what's the difference?"

Senator DASCHLE. Let me just ask one last question, if I could.

We had a fairly significant debate a month or so ago on the floor with regard to a Sense of the Senate Resolution relating to all of these trust funds. The original proposal was to unmask the deficit by removing the Social Security Trust Fund from any calculation of the deficit. I think virtually everyone voted for it.

But then came subsequent proposals—next, Civil Service, then airports, and then highways, and then a military trust fund, and everyone was making the case that if we are going to begin with the Social Security Trust Fund, why not have all these other trust funds and include them as part of the pool that ought to be taken off budget, as we were just discussing.

Do you differentiate at all between Social Security and these others? And can one, on the floor, make an argument that the Social Security Trust Fund, other than the size, which I don't find very convincing, as a reason why Social Security could not be used to mask the deficit? Does anyone wish to address that?

Dr. BOSWORTH. I think it is the point that Senator Packwood made. It is the question of whether or not the fund has a liability in the future. With Social Security you are building up a surplus; but, corresponding to that is a known liability out in the future that you have to meet.

Senator DASCHLE. But, Barry, if this is true, can't you say that about airports?

Dr. BOSWORTH. No. Just a minute. The same is true of Medicare, and the same would be true of the Civil Service Employee Retirement Fund. For example, State and local governments move their pension funds off budget. And then, as I say, they don't spend it. They have consistently saved it. Their budget deficits on the other accounts have not gone up.

What is the difference? A Highway Trust Fund is meant to be spent right now; it is just a mechanism of tying a user fee to the subsequent benefits of it. It is just the justification to the public of, "Look, isn't it easier to understand programs when I tell you there is a connection between the taxes you pay and the benefits you get?" So we adopted this as a way to tie things in.

Who benefits from highways? People who use cars. Therefore, why shouldn't the gasoline tax pay for it? That is not an argument to move it off budget. You could, but what would be the point? It wouldn't make any difference.

Now, Senator Packwood does have another issue. He says, "I don't like collecting revenues under false assumptions here," and so he wants to force you to either spend it or cut it, you know, within a reasonable time period. Fine.

But there is a difference between a fund that is being built up to meet a future liability, a commitment you have made to workers who work today and who expect to get their Social Security benefits, and a trust fund where the money was intended to come in and go right back out again.

Senator PACKWOOD. Well, and technically, you can carry it further. We do appropriate those other trust funds. We might have a \$50–\$40–\$30 billion surplus in the Highway Trust Fund, but there is no legal obligation to spend it in the future. I don't like the idea of building it up, but we have not built into it a liability in addition that is an absolute, iron-clad liability on the Federal Government.

Senator DASCHLE. Thank you, Mr. Chairman.

Senator MOYNIHAN. Well, unfortunately we are getting to our last quarter hour. I would like to make one general request first.

Mr. Myers, you suggested that we probably should adjust the Disability insurance percentage, and that is exactly as far as I think this committee is willing to go on the subject for quite a number of years now. We have a system in place, we want to keep it in place, we like it, and we want people to know it is there. But we, as you know, have free checking accounts, and you might want to move a little money more into one and out of the other. It doesn't make any difference in the total amounts, but just for appearances sake——

If you could have the great courtesy of giving us a memorandum on that, would you do that? On what your advice would be?

Mr. MYERS. I would be glad to do that, Mr. Chairman, for the record.

[The memorandum appears in the appendix.]

Senator MOYNIHAN. And we will think about that in the next Congress or maybe the Congress after that.

But could I ask the panel, and I guess perhaps particularly our two economists: In this morning's Washington Post, John Akers, who is Chairman of IBM, has a series of things we have to do. He makes a point I found interesting.

We have talked about the great increase in employment since 1973, and we have had about 27 million jobs—half of the population of France, he makes the point. He says, "Don't take that as necessarily a very good sign; that may mean your productivity is falling behind, that you need more people to do work which more machines could do better."

And he says we now have a savings rate at 4 percent. He says he wants to get the savings rate up from less than 4 percent, our lowest in 40 years, to a rate closer to Germany's 12 or to Japan's 17. The Japanese are saving four times what we are, and they are investing. In the end, that gets at you.

I have learned one thing from Bob Packwood—I have learned many things, but the salient thing I have learned is, never hesitate to say you don't understand something. That way, over the years your saving rate and understanding both go up. [Laughter.]

Would you explain, how do we distinguish personal savings, national savings, and corporate investment? There must be kind of a mix there. Where do we get these numbers? When John Akers says, "less than 4 percent," where will we find printed that 3.8 or whatever?

Dr. BOSWORTH. Those numbers are printed in U.S. National Income Accounts which are prepared by the Commerce Department, the Bureau of Economic Analysis. So, when you feed the figures about GNP growth and things for the current quarter, imbedded in that in more detailed tables—this is the information on the national savings and investment rate—the numbers that Akers mentioned were roughly right; although, if he wants to know how far below 4 the number is, it is 2 in 1987 for the nation.

Now, what that consists of is three parts:

First is the savings of individuals in the United States, "households" is the term given, which is just their income minus their consumption.

Then there is corporate saving. That is saving that corporations hold in the form of retained earnings—profits not paid out to the stockholders in dividends but held as retained earnings.

And the third one—it is kind of funny to refer to it this way these days—is government saving. Now, government saving for the Federal Government has been negative since 1969.

Senator MOYNIHAN. But there have been States, certainly.

Dr. BOSWORTH. Yes. But the States in their general funds averaged zero in the post-war period—neither a saver nor a borrower be—and they run a surplus of about $50 billion a year in their employee retirement programs. So, in the aggregate, they are a source of savings.

On the other side, what do we do with this national saving? We can invest it in home building. Right now that is very high because the baby boom generation would like a chance to buy a house, along with the rest of us. That takes about 3 percent of our national income.

The second thing we can invest it in is in business, plant and equipment. That takes about 3 percent of our national income as well. That adds up to 6 percent of our national income that the United States invests.

As I said earlier, well, we only save 2 percent. How can you save 2 and invest 6? You borrow 4 percent of your income every year overseas. That is that Japanese investment that Americans get so mad about. But in fact, we have to have it in order to support our current standard of living. If we couldn't borrow that 4 percent, we would see interest rates here in the United States go through the roof, and the baby boomers would be shoved out of the housing market, because, the truth is, as a nation we don't save enough to finance the little bit of investment we now do.

Senator PACKWOOD. Barry, can I ask a question? How on earth—you look at the historic savings rate of this country. It may have hit 9 percent once; 8 would have been good for 2 or 3 years, but 7 or 7.5 would be about average. How on earth did we ever expand in the fifties and the sixties, with a relatively modest saving rate in comparison to the rest of the world?

Dr. BOSWORTH. People say, "If we save so little, how come we're so rich?" And there is a simple answer to that. We have not had a war on our shores in over a century. Europe and Japan back at the turn of the century were fully comparable in most respects to the United States standard of living. But they lost all of their assets in two world wars. Since World War II they have been saving at two to three times the rate to have to catch back up.

If you take a trip to Europe, or you take a trip to Japan, you will find that today in many respects they have caught back up.

Senator PACKWOOD. Can we expect their savings rates to go gradually down, then?

Dr. BOSWORTH. So far, not very much. Right now the world seems to have a bargain. Americans love to consume, and the Japanese love to save, and so we made a deal.

Our savings rate has been going down in the 1980's dramatically. The Japanese and Europeans' savings rates have declined a very little bit; they continue to save at incredible rates.

Senator MOYNIHAN. Do you mean, our budget deficit at the national level simply reflects the national mood?

Can I ask this question, to pursue Senator Packwood's point? We have a law in place, known as the Gramm-Rudman-Hollings law, which says that we will reach zero deficit in the total budget.

Dr. BOSWORTH. It will borrow Social Security surplus, if that is your preference.

Senator PACKWOOD. Zero in the total budget, by 1992, or 1993 if we extended it, at the earliest.

Senator MOYNIHAN. I have got a problem there. That zero budget in 1993, will it include about $40 to 50 billion in Social Security?

Dr. MUNNELL. One hundred.

Senator MOYNIHAN. One hundred. Oh.

When we reach zero on the operating budget, then we can use all of the surpluses to buy up the debt. Which translates into an increase in economic growth and wages.

Dr. MUNNELL. "Operating" means the unified? Social Security and the rest of it together?

Senator MOYNIHAN. No, we will separate out Social Security. We have already agreed to that in the 1983 Amendments. It comes in 1993, does it, Bob?

We will call "operating budget" just what we take in and pay out apart from Social Security.

Senator PACKWOOD. General funds.

Senator MOYNIHAN. Yes, general funds.

Dr. MUNNELL. So if you reach zero in that, and you have a surplus of a hundred in the Social Security System, then you are running a hundred at the federal level, and you can buy up a hundred—this is Senator Packwood's point—a hundred of past debt, which frees up individuals in the private sector to go and buy other private securities that will lead to more——

Senator MOYNIHAN. Right. The process is, I suppose basically—well let me ask you, Dr. Munnell, you are a Central Banker.

Your debt matures all the time, your short-term T-bills and your 10 and 20 and 30 year bonds. So really, when debt matures, you pay the holder and don't roll it over and issue new debt.

Dr. MUNNELL. Right.

Senator MOYNIHAN. So it would be an easy exercise.

Dr. MUNNELL. Right. You take it from the public, and you don't issue anything else.

Senator MOYNIHAN. Yes. And the moment we get that general fund to a zero deficit, we begin saving the whole of the trust fund surplus. But there will come a time sooner, somewhere in the Nineties, I would hope, when the Social Security surplus will be larger than the deficit; so that you will begin buying debt with the remainder.

Dr. MUNNELL. Right. If you just kept the general fund deficit at $200 billion, and you would have this automatic buildup in Social Security, eventually you will get surpluses.

Senator PACKWOOD. Shortly after the turn of the century.

Senator MOYNIHAN. Shortly after the turn of the century, right.

Dr. MUNNELL. The thing that you have to worry about is that you get a behavioral reaction and you don't keep your general fund deficit at $200 billion, but that goes up to $300 billion or $400 billion.

Senator MOYNIHAN. And that is what Robert Myers is worried about.

Dr. MUNNELL. Right.

Senator MOYNIHAN. We are approaching the hour when our bells are going to ring on us, so I wonder if we could have one last round of questions.

Or is there something you want to tell us? Is there a question that we should have asked? You can write it down and send it up. [Laughter.]

Dr. MUNNELL. I think that your questions have been very good. I would like to restate, without Barry jumping on me, my concern. [Laughter.]

My concern is that I don't think we want to say we are going to do something and fail. I think it will look bad, undermine the credibility of Congress, and it will be a serious loss.

So, before we do it, I think we should look and see how other countries do it, what the problems are, what you invest in, what kind of disciplines you need in place, like taking Social Security out of the budget, to try to make this exercise successful. It is a tricky thing to do. It is not easy. So we are going to have to do a lot of planning to carry it off.

Thank you.

Senator PACKWOOD. I do have one question. Let assume we actually are responsible, and we do not balloon the general fund deficit up to \$200—\$300, \$400 billion. Is there an economic danger to the government, in terms of its total budget, running \$200-\$300 billion surpluses year after year for a decade?

Dr. MUNNELL. I think this always depends on the speed at which you increase your surpluses. But if you do things gradually, and I think the numbers in the projections are gradual enough, you should be able with good monetary policy keep the economy operating at full employment.

Senator MOYNIHAN. Uh-huh.

Mr. MYERS. Mr. Chairman?

Senator MOYNIHAN. Please, sir.

Mr. MYERS. I might say I am delighted that the Committee on Finance has addressed this subject. I felt like the little boy crying "wolf" for the last 2 or 3 years, talking about these big surpluses down the road, with nobody paying any attention. Now that a great many people are paying attention, I am sure that we will come forth somehow or other with a good solution to this problem in the next few years.

Senator MOYNIHAN. Well, if we keep you at our side, we are more likely to do that than not. And I certainly want to thank you.

Dr. Bosworth, did you have some comments?

Dr. BOSWORTH. No.

Senator MOYNIHAN. Senator Daschle?

Senator DASCHLE. Mr. Chairman, could I just clarify one last thing? There seemed to be a little bit of a difference of opinion between Mr. Myers and Dr. Bosworth with regard to when this crunch comes, at what time do we actually begin this raising of personal income tax to offset this run on the trust fund.

Now, Mr. Myers, I thought you said it was going to be decades hence. Dr. Bosworth, I thought you said it could be in five or six years.

Dr. BOSWORTH. No.

Senator DASCHLE. Did I misunderstand you? You both share the same view that at no time in this century will we have to begin considering the increase in personal taxes to offset this, just for the trust fund purposes?

Okay.

Senator MOYNIHAN. We built better than we knew in 1983.

I think we will now close the hearing, as we are about to go to the floor.

I want to thank our distinguished panel. I want to thank our staff. I want to particularly thank Mr. Eduard Lopez, who is a Fellow with us here, on loan from the Social Security Administration.

And I would like to say that Senator Packwood and I think—and Senator Daschle might want to join in saying this—that maybe we ought to produce a committee report on this subject.

Senator PACKWOOD. I normally don't think committee reports are very important; but in this case, the magnitude of this subject is so extraordinary that I would hope we would produce and widely disseminate a report.

Senator MOYNIHAN. And with that, with the collective sigh you have just heard from the staff behind us——

[Laughter].

Senator MOYNIHAN [continuing]. I want to thank everybody, and we will close this oversight hearing.

[Whereupon, at 11:30 a.m., the hearings were concluded.]

APPENDIX

Alphabetical List and Material Submitted

Statement of

Barry P. Bosworth

The projections of a large surplus in the social security system over the next several decades is an issue that has suddenly attracted considerable attention. But the interest in that surplus comes from two widely divergent perspectives. On the one side are those who see it as the result of a decision taken in the 1977 and 1983 Social Security Amendments to attempt to fund a portion of the increased costs of retirement that the United States will face when the baby-boom generation begins to retire. Others see it as the solution to the budget deficit problem or a means of financing a growing list of desirable new government programs.

As emphasized in the latest trustees' report the social security system itself is itself in quite good financial condition. Because of a large bulge in the age distribution of the population -- the baby-boomers -- the system will, under current tax rates, accumulate a large surplus, totaling about $2 trillion in 1988 dollars, over the next several decades. As the number of retired persons begins to rise in the years after 2025, however, that reserve will be rapidly drawn down; and the fund will actually fall into a deficit near the end of the 75-year projection period, unless taxes are raised or benefits reduced in the future. The issue that is being raised today is what to do with the surplus in the meantime. Should we simply borrow it to finance programs in the rest of the budget, or should we save it in anticipation of the increased costs in the future? Clearly, under current budget procedures the intention is to simply borrow it?

Historically, the United States has relied on a pay-as-you-go system to finance Social Security under which current taxes are used to pay for current benefits. The 1977 and 1983 social security amendments have moved the system in the direction of a partially funded system to offset some of the increased costs to future workers of a rise in the proportion of the population that will be retired. Through tax payments in excess of current outlays, the current working population will fund a portion of its own retirement costs, much like a private pension system.

At the Brookings Institution we are completing a research study that examines several issues surrounding the management of a large Social Security surplus in future decades and the economic implications of the alternative uses that might be made of the surplus. We have concentrated on the following major questions: If the fund were set aside from the rest of the budget and the annual surpluses used to increase national saving, how much difference would it make? What would be the impact on domestic rates of capital formation and productivity growth and the rate of return to capital? How would the Social Security System itself be affected? And what would be the impact on the cost to future generations?

We believe that these issues, which might seem of relevance in the distant future, are actually of great importance today because of their impact on current fiscal policy decisions. The economic impact of the Social Security reserve buildup will depend critically on the uses to which the reserve is put. If the current population simply borrows from the social security fund to finance its own consumption -- say, to finance other outlays in the federal budget -- the burden on future workers will not be reduced. It is true that their employment taxes will not increase. Instead, they will face much higher income taxes to finance the repurchase of the Treasury debt transferred to the social security fund in prior years. The combined level of income and employment taxes would be roughly the same as under a continuation of a strictly pay-as-you-go system.

Alternatively, the reserve could be used to augment the nation's critically low level of national saving and capital formation. In that case the current generation would finance a portion of its own retirement by supplying future generations with a larger capital stock. Future workers would benefit both from the funding of a portion of the costs from capital rather than labor income, and because their own wages would be higher as a reflection of their increased productivity -- increased capital per worker.

Which of these approaches is followed will depend not upon the decisions of the Social Security System, but the decisions of the Congress and the President with respect to the rest of the budget. Currently, discussions of the budget and the appropriate targets for fiscal policy are discussed with no distinction between Social Security and other parts of the budget. Thus, implicitly the surplus of Social Security is available to finance other programs.

For example, if one simply focused on the overall budget deficit projections of CBO and the Administration (shown in table 1), the impression would be that, while the current budget deficit is still large, at least it is headed in the right direction -- down. However, that conclusion assumes that it is appropriate to borrow from social security to finance today's consumption. If, instead, the social security surplus is set aside to augment the nations' saving, it is clear that the basic budget deficit is getting worse not better. Without social security the budget deficit is $198 billion in FY 1988, rising toward $236 billion in 1993. In effect, the United States is simply substituting a highly regressive system of employment taxes for income taxes as a means of paying for the day-to-day costs of government. If we focus on the whole period of 1980 to 1993, the intention is to finance a $163 billion increase in the general fund deficit, in part, by borrowing $ 98 billion a year from the Social Security Trust Fund.

I cannot discuss all the aspects of our study in this brief testimony, and I will limit my remarks to a few summary points that seem most relevant to the Committee's interests. Most of our analysis is the result of the construction of a small model of U.S. economic growth that has been adjusted to match, as a baseline, the intermediate II-B projections of the Social Security Trustees. Although their projections can be criticized as being overly optimistic or pessimistic in some respects, there is, in fact, very little basis for making accurate projections as far into the future as is required to fully evaluate the system over a person's full work and retirement life.[1] Since we are primarily interested in the incremental effects of alternative policies, the baseline projections are not in most cases critical to our conclusions.

1. The intermediate II-B projections of The Trustees indicate that there will be a very large annual surplus, averaging 1.5 percent of NNP, for the next three decades followed by an even larger deficit. In comparison, the current total national saving rate is only 2 percent of NNP and it has averaged only 6-7 percent in the post-World War II period. From the point of view of Social Security the future is clearly divided into alternating periods of feast and famine.

2. The most frequently suggested means of insuring that the Social Security surplus is invested for the future, rather than being used to finance today's consumption, is to totally remove the fund from the budget -- as mandated in the 1983 reforms -- for purposes of establishing appropriate budget targets. As a result, the annual surplus would automatically be passed through to national saving and private capital formation.

3. Actually, the simple suggestion of saving the surplus projected by the Trustees is not particularly attractive because for the 75-year period as a whole the fund has a deficit not a surplus: the average rate of national saving would be reduced, not increased. In addition, the pattern of surplus and deficit would simply introduce a large cycle into the national saving rate with most of the benefits of high saving occurring in the period before the rise in the number of beneficiaries.

3. Analysis based on the current OASDI projections is deficient in one critical respect, however, because it incorporate a future fund deficit that will not occur. Under current legislation, the trustees each year undertake a 75-year projection of the fund and judge it to be in "close actuarial balance" whenever income is, on average over the full period,

within 5 percent of outlays. As those projections are extended in the future, the need for further tax increases, or benefit cuts, will become more noticeable. If we assume that future Congresses will act to maintain the fund's solvency, the large deficits at the end of the projection period will not occur and the fund's contribution to national saving will remain positive through-out the period.

- We evaluated this decision rule in our simulation by simply assuming that tax rates are increased whenever the fund moves into an actuarial deficit.
- The additional tax rate increases would total 2.3 percent of taxable payroll -- an increase in the tax rate from 12.4 to 14.7 percent -- with the first increase occurring in the 1990s.
- A summary of the results are shown in table 2.
- The increment to national saving is positive throughout the period 1990-2060.
- If the surplus is passed through into national saving, the nation's income is increased in every year of the projection period and the percentage gain reaches its peak in about the year 2030.
- The policy also completely eliminates any increased burden on future generations. They do pay a higher tax rate and a larger magnitude of benefit payments are transfered to future retirees; but the after-tax incomes of future workers are increased by more than the increased cost of OASDI benefits shown in the current trustees' reports.
- It is in this sense that the current generation can, through higher saving, pay for the added cost of its own retirement.

In summary, I believe that the larger future costs of providing for an aging population argue in favor of a greatly expanded rate of national saving today. The failure to plan for these needs will imply dramatically higher burdens on the future working population. Furthermore, I believe that a collective approach to the problem is far preferable to attempts to dismantle Social Security and rely on private retirement schemes. We know that many individuals will not make adequate plans, and I find it hard to believe that future generations will simply ignore the problems of poverty that will develop.

Fortunately, the 1983 reforms in Social Security provide an ideal vehicle for generating the required buildup of national saving. To a first approximation, the surplus generated by an actuarially-balanced OASDI fund is a good measure of the required increment to national saving. The most serious threat to generating the required saving is the perception of the current generation that the Social Security reserve is simply a pool of funds that can be fully borrowed to finance other government expenditure programs. That perception is perpetuated by the current practice of lumping the Social Security reserve together with all other programs in defining the budget deficit and the appropriate budget deficit targets. We are not, in fact, saving the Social Security surplus. We are simply using a system of regressive wage taxes to finance general fund outlays that were formerly financed with the personal and corporate income taxes.

I favor a separation of Social Security from the overall budget and its operation in a fashion similar to that of private retirement systems, with public trustees. I believe that the separate treatment would increase the likelihood that the surplus would, in fact, be saved; and it would increase public attention to the enormous gulf between current government consumption and the taxes required to support it. At present, the United States is living far beyond its means -- particularly, in the public sector. Unless this problem can be addressed, future generations will face an overwhelming burden of trying to finance our debts and our retirement needs.

If we cannot bring ourselves to set aside the surplus and save it, I would agree with those would argue for a reduction in current tax rates and a return to a pay-as-you-go system. The running of a surplus in one account which is simply borrowed to finance expenditures in others is a fake form of accounting which will set of an enormous debate in the future when current workers attempt to reclaim a reserve that does not exists. It would, however, mean the passing up of an opportunity to solve a very foreseeable problem.

I am aware that my testimony seems to reflect an atmosphere of unreality. At a time of enormous budget deficits on the conventional measures and a national saving that has plummeted far below the historical norm, I am arguing that the historical norm is far too low. Just in terms of the budget deficit issue, the general fund deficit (exclusive of Social Security) that should concern us is $198 billion in FY 1988 and rising toward $236 billion in 1993, not $157 billion and falling as suggested by the latest CBO projections.

It is also difficult to interest people in distant future events. But, if we ignore the implications of the demographic changes, it is difficult to visualize how the current retirement and health care system for the retired can be kept intact.

The fundamental problem, however, is that the public finances got way out of balance in the 1980s and the gap between our expenditure commitments and the tax revenue to support them has been steadily growing over time. The longer we wait, the more painful the adjustment will be.

Federal Budget Deficit With and Without Retirement Trust Funds, Fiscal Years 1980-1993.

	1980	1987	1988	1989	1993	Change: 1980-93
TOTAL FEDERAL DEFICIT	-74	-150	-161	-177	-139	-65
Less Surplus in:						
Social Security (OASDI) (off-budget)	-1	20	37	46	97	98
ON BUDGET DEFICIT	-73	-170	-198	-223	-236	-163
Less Surplus in:						
Medicare (HI)	1	12	15	17	16	15
Fed. Employ. Retirement	10	31	32	34	43	33
GENERAL FUND NONRETIREMENT DEFICIT	-94	-213	-245	-274	-295	-201

Source: Numbers for 1980 and 1987 are actual. Numbers for 1988 through 1993 are the Congressional Budget Office baseline projections.

The Economic Effects of Saving the Surplus of An Actuarially Balanced OASDI Trust Fund

Percent deviation from baseline value

	General Economy				Social Security			Incremental Burden	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Year	Capital Stock	Net National Product	Real Wage Rate	Nominal Interest Rate[a]	Social Payroll Taxes	Benefits	Trust Fund Reserve[b]	Baseline[c]	Higher Saving[c]
1990	0	0	0	0	0	0	0	-0.1	-0.1
2000	9.4	1.8	3.1	-0.14	8.8	0.4	4.3	-0.4	0.3
2010	19.6	3.6	6.1	-0.49	12.0	2.5	9.2	-0.4	-1.1
2020	23.5	4.2	7.1	-0.74	20.2	5.0	14.3	1.0	-1.3
2030	21.0	3.9	6.3	-0.79	19.3	6.2	19.2	1.9	-1.2
2040	16.2	3.2	4.9	-0.64	17.7	6.0	22.9	1.8	-0.8
2050	13.4	2.6	4.1	-0.51	23.8	5.3	28.4	1.5	-0.2
2060	12.4	2.5	3.8	-0.46	23.5	4.6	25.9	1.3	-0.3

a. Expressed as the simple difference from the baseline in percentage points.

b. The difference is expressed as a percent of NNP in the baseline.

c. The burden is measured as the increase in the ratio of OASDI benefits to baseline NNP from the 1986-90 average minus the increase in consumption from the baseline level.

Mr. William P. Butz

Associate Director for Demographic Programs

U.S. Bureau of the Census

Introduction

Mr. Chairman, I appreciate the opportunity to provide the Subcommittee with information on the implications of the results of our demographic projections for the Social Security System.

Before I present these results, I would like to emphasize that the Bureau of the Census makes no claim that its projections are inherently superior. Our projections simply represent the mathematical outcome of assumptions we have made about future trends in fertility, mortality, and net immigration. We believe both our assumptions and our results are reasonable. Certainly, we recognize that alternative plausible scenarios can be constructed. For example, these projections differ somewhat from those produced by the Social Security Administration because of differences in the covered populations and in the underlying demographic assumptions. The main demographic trends projected by each agency are still quite similar.

The demographic assumptions upon which we base our main series are as follows: First, future fertility will be roughly the same as it has been for the last decade. Second, future mortality improvements will be moderate. Third, legal immigration will continue at recent levels while undocumented immigration will be sharply reduced within 10 years.

For illustrative purposes, I am also providing you with information from two alternative scenarios. These series indicate what the population might be if future fertility, mortality, and net immigration were all either well below or well above our middle series trends.

Results

Today I will focus on future trends in the 65 years and older population. Some people join the Social Security system before that age, and some join after it, but 65 and over will suffice as a reasonable proxy of the eligible population. There is a very sharp contrast between the past and future growth patterns of this age group. The 65 and over population grew by more than 3 percent a year during the 1930's, 1940's, and 1950's. Since 1960 it has grown a little more slowly, but still more than 2 percent a year. According to the middle projection series, the likely pattern of growth of this population during the next 50 or 60 years will fluctuate widely. Three distinct stages of growth are apt to occur.

Stage 1. During the next 20 years or so, the 65 and over population will probably increase more slowly than it has in many decades. This will occur because those becoming 65 will be the survivors of the very small birth cohorts born between the mid-1920's and World War II. From 1988 to 2008 the 65 and over population will grow only 7.7 million, or about 1 percent a year. By comparison, from 1968 to 1988 the 65+ population grew 13 million or 2.2 percent a year. The growth during the next 20 years will be so slow that the percent of the population over age 65 only rises from 12.4 percent in 1988 to 13.6 percent in 2008. In comparison, during the 8 years from 1980 to 1988, the elderly share of the total population grew nearly as much--from 11.3 percent to 12.4 percent.

Stage 2. The absolute increase in the 65 and over population from 2010 to 2030 will be of an unprecedented size. This is a result of the entrance of the baby-boom cohorts into this age group. The 65+ population may be 39.4 million in 2010 and reach 65.6 million by 2030 (when the last of the baby-boomers turn 65). The net addition of 26.2 million elderly people in only 20 years will be a remarkable event. For example, as recently as 1980 there were fewer than 26 million elderly in our population. It took our country more than 200 years to reach an elderly population of this size, but it will take the survivors of the baby-boom generation only 20 years to match that earlier growth.

During this period between 2010 and 2030 the proportion of the Nation's population which is over 65 will also rise dramatically. In 2010 about 14 percent of the population will be over age 65. The equivalent figure may be 17.7 percent in 2020 and 21.8 percent in 2030.

In spite of these figures, however, it is important to realize that the rate of growth of the 65+ population during the 2010 to 2030 period is not unique. From 2010 to 2030 the aged population may grow about 2.6 percent a year. As I mentioned earlier, from 1930 to 1960 it grew about 3.2 percent a year.

<u>Stage 3</u>. After 2030 the population over age 65 will resume the pattern of very slow growth which is likely to occur during the 1988 to 2008 period. In fact, the growth after 2030 may be the slowest ever recorded. The number of people aged 65 and older is projected to increase from 65.6 million in 2030 to 70.3 million in 2060. The equivalent percentage of the population aged 65+ will rise from 21.8 percent to 23.7 percent.

Now that I have described these three stages in the future growth of the elderly population, I will discuss the changing relationship between the future working-age population and the future elderly population.

What makes the 2010 to 2030 period so exceptional is not the growth of the aged population, but that this growth is not likely to be accompanied by growth in the population of working age. The exceptional nature of the relationship of the working-age population to the elderly population during the 2010 to 2030 period is illustrated by the following comparison. From now to 2008, the 65+ population will grow about 1.1 percent a year or 7.7 million. During the same time, the population aged 18-64 years will grow 26.7 million or 0.8 percent a year. Thus the average number of people of working age per elderly person does not change too much. However, during the 2010 to 2030 period the working-age population actually declines by nearly 8 million. This decline contributes significantly to the fall in the working age to elderly ratio between 2010 and 2030.

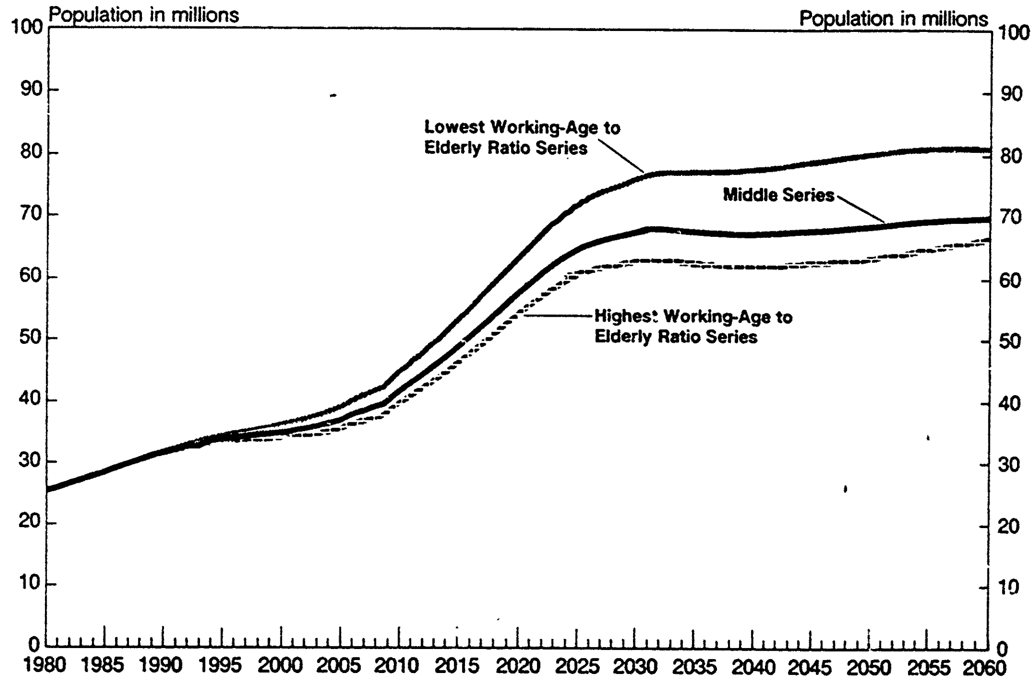
The ratio of working-age people to people over age 65 will diminish during the next 50 years. In 1980 there were 5.4 persons aged 18 to 64 for every person aged 65 and over. By 1988 that ratio will already have fallen to 4.9. The ratio of working-age people to persons aged 65+ will remain at about this level until 2006. This occurs because the elderly population will grow so slowly during this period. But, from a level of 4.6 in 2010, this ratio will plummet to 2.6 in 2030. After that time the ratio of working age persons to elderly will stabilize at about 2.5. There are two implications:

1. The rapidity of the decline in this ratio during the 2010 to 2030 period may require adjustments in the way society cares for the elderly;

2. Even though the 65+ population grows very slowly after 2030, it is important to realize that the ratio of working-age persons to elderly persons is not likely to rise back towards its present levels. This means the social service needs of the elderly population may continue to be high after 2030. Although I have confined my remarks to strictly demographic measures, the issue is more complex than just the total number of elderly and the relationship to the size of the traditional working-age populations. Changes in health status, overall economic well-being, labor force participation rates, and retirement and savings patterns could have dramatic effects on the actual social service needs of the elderly. Census Bureau data may be of help in examining these aspects as well.

Mr. Chairman, this concludes my remarks. We thank you for the opportunity to present this information about this important topic. I look forward to hearing the testimony of the other witnesses and to answering any questions.

Chart 1.
U.S. Population Age 65 and Over: 1980 to 2060



Source: U.S. Bureau of the Census.

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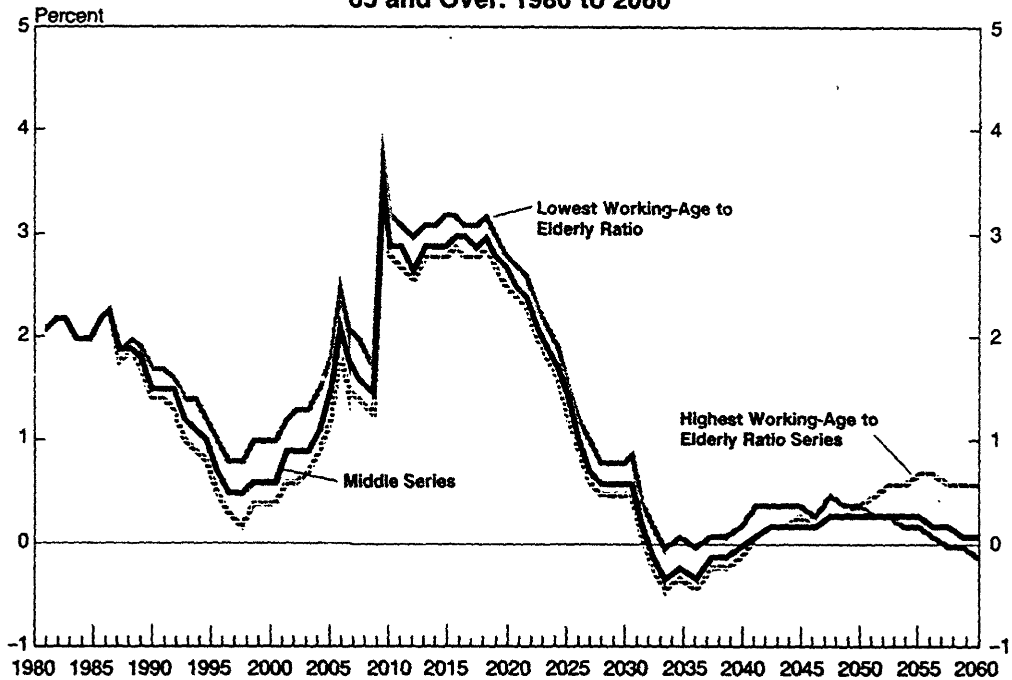
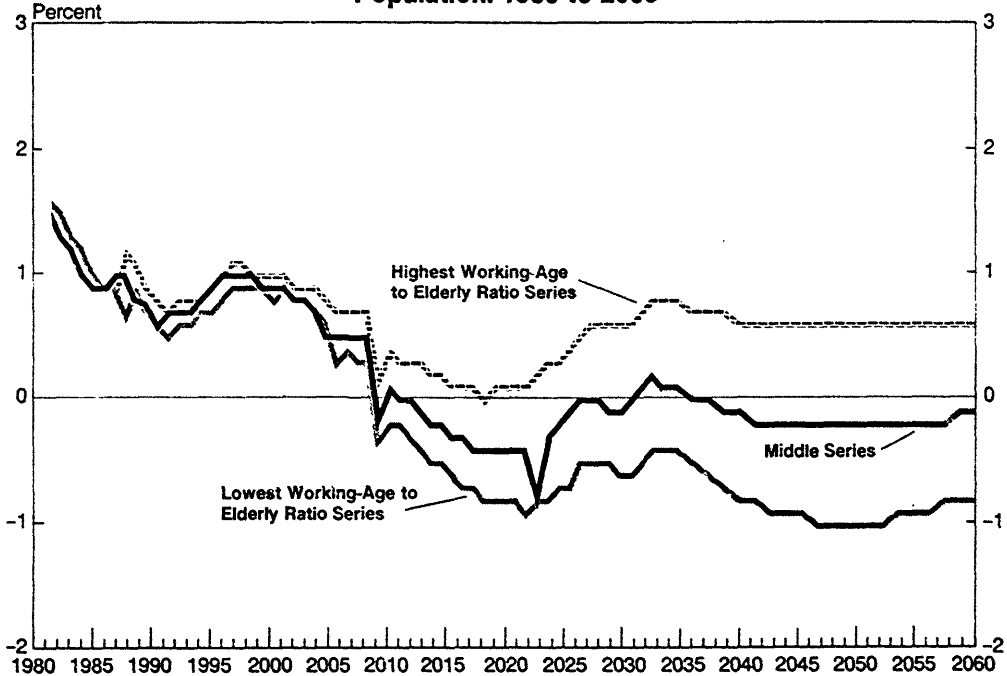
Chart 2.
Annual Growth Rate of the Population Age 65 and Over: 1980 to 2060



Source: U.S. Bureau of the Census.

Chart 3.
Annual Growth Rate of the Working Age Population: 1980 to 2060



Source: U.S. Bureau of the Census.

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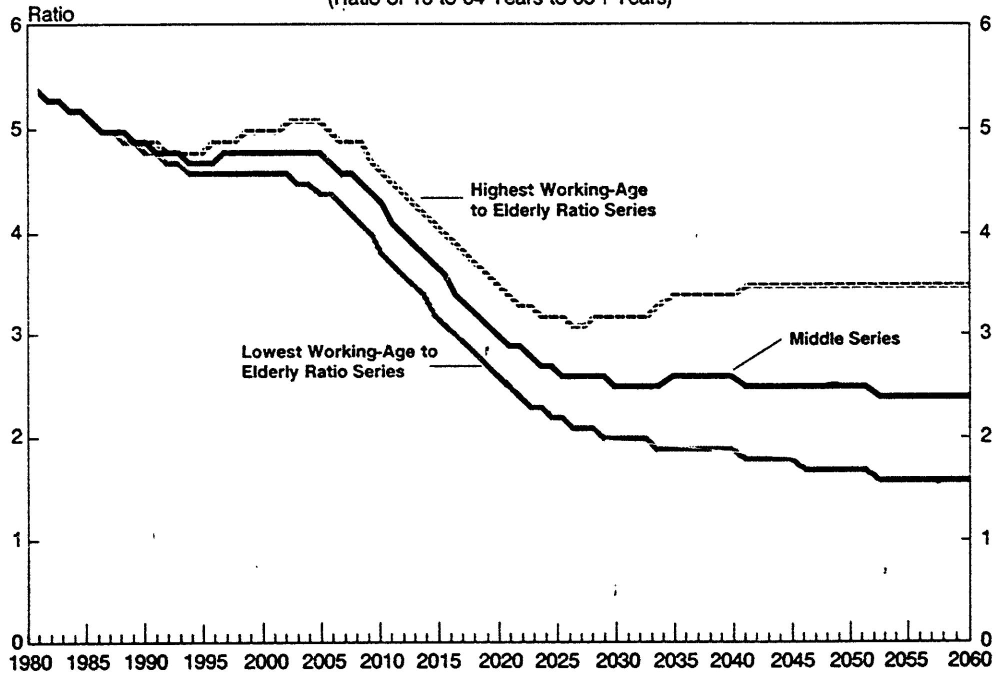
Chart 4.
Ratio of Working Age to Elderly Population: 1980 to 2060
(Ratio of 18 to 64 Years to 65+Years)



Source: U.S. Bureau of the Census.

STATEMENT
BY

DORCAS R. HARDY
COMMISSIONER OF SOCIAL SECURITY

Mr. Chairman, I am pleased to appear before you today to discuss the financial status of the old-age, survivors, and disability (OASDI) program--which I shall refer to as Social Security.

Introduction

From the beginning of my tenure as Commissioner, I have been convinced that maintaining the fiscal integrity of the Social Security program, educating the public as to what they can expect in future benefits, and providing the best possible service to our customers are critical ingredients in building confidence in and satisfaction with Social Security.

Public confidence in the program was badly shaken by the financing problems Social Security faced in the late 1970's and early 1980's. As a result, the financial condition of the program continues to be the key factor in rebuilding public confidence in Social Security.

Mr. Chairman, as a result of the courageous bipartisan actions taken in 1983 by President Reagan, by you and your fellow members of the National Commission on Social Security Reform, and by the Congress, Social Security is now in sound financial shape for many years into the future. The program's current financial well-being has been made even more secure by the good economic performance of the last 5 years.

Actuarial Status of the Program

The 1988 report of the Social Security Board of Trustees, submitted to the Congress last week, confirms the system's health. The estimates show that trust fund income this year will total $263 billion and outgo will total $222 billion. Thus, the Social Security trust fund reserves are estimated to increase in 1988 by $40 billion, and the trust funds are estimated to have total reserves by the end of 1988 of $109 billion. At the beginning of 1989 the funds on hand are estimated to be enough to pay about 7 months of benefits.

Under the Intermediate II-B assumptions in the Trustees Report--which is the set of assumptions underlying the information I will be providing--trust fund reserves will increase significantly over the next several decades, reaching $1.4 trillion by the year 2000 and nearly $12 trillion by the year 2030. Thus, if these assumptions prove to be accurate, there will be sufficient funds to pay all benefits due to current beneficiaries and to develop a substantial reserve for payment of benefits to the Baby Boom generation when it begins to retire in the next century.

Over the complete 75-year period the Trustees use to evaluate long-term financing of Social Security, the program is in "close actuarial balance." The long-range actuarial balance of the OASDI program is a deficit of 0.58 percent of taxable payroll, which is less than 5 percent of the long-range cost rate over the next 75 years.

However, the financial condition of the Social Security program cannot be measured solely by the estimated long-range actuarial balance. Other measures are also useful. The assets of the combined trust funds, relative to annual expenditures, reach a peak of 5 times annual outgo by 2015. But by 2019, annual outgo is estimated to exceed tax income, and interest on the reserves will be needed to help pay benefits.

Thirteen years later, in 2032, annual outgo is estimated to exceed tax income plus interest so that we will have to begin using the accumulated reserves to meet benefit costs. After that point, the combined funds drop and are exhausted in 2048. Annual income at that time is estimated to equal only 80 percent of benefit costs.

Factors Affecting Program Financing

Three factors largely explain the Social Security program's financial outlook over the years ahead: the tax rate, future economic performance, and the changing ratio of workers to beneficiaries. Under current law, the combined Social Security tax rate for employers and employees will be increased in 1990 to 12.4 percent of taxable payroll--the level at which it is scheduled to remain. And under the 1988 Trustees Report intermediate assumptions, the economy is projected to perform well, with earnings growing on average at about 1.4 percent more each year than the cost-of-living. However, the third factor--the change in the ratio of workers to beneficiaries--accounts for most of the variance in Social Security financing that we can expect over the next 75 years.

Demographic Changes

I should note that the intermediate demographic assumptions in the 1988 Trustees Report were revised somewhat to reflect additional experience. The ultimate fertility rate assumed to be reached in 2012 was reduced from 2.0 children per woman to 1.9. We made this change because the total fertility rate has been below 2.0 children since 1972, usually falling between 1.7 and 1.8 children per woman during the 1970's, and between 1.8 and 1.9 in the 1980's. Based on provisional data the estimate for 1987 is 1.87.

Death rates are assumed to be slightly higher overall than in last year's report, producing a slight decrease in the overall life expectancy in the future. A third demographic assumption that was revised is the rate of immigration, which was increased from a net rate of 400,000 to 600,000 immigrants annually. Although these changes in demographic assumptions have a significant impact on Social Security financing, they largely offset each other. Thus, the long-term demographic future facing Social Security has not substantially changed.

The major demographic event of the current long-range projection period is the passage of the Baby Boom generation through life and retirement. The projected buildup of the trust fund reserves will occur while the members of this generation are in their peak earning years, which comprise roughly the first 25-year period of the long-range projection period (1988 through 2012).

During the second 25-year period of the long-range projection period (2013 through 2037) the Baby Boom generation retires, causing the beneficiary population to increase rapidly. At the same time, the working age population will be declining, causing a drop in the worker-to-beneficiary ratio from 2.9 to about 1.9.

Early in the third 25-year projection period (2038 through 2062), the Baby Boom generation passes from the scene and is replaced by lower birth rate generations of retirees. This might be expected to result in an improvement in Social Security's financial condition. However, at this point increasing longevity exerts a predominant influence. Longer lifespans offset the effect of the passing of the Baby Boom generation, leaving the ratio of workers-to-beneficiaries constant at about 1.8 to 1.9.

Thus, the projected outgo of the Social Security program remains steadily larger than income during the third 25-year period, an imbalance which reduces the assets of the trust funds until they are projected to be exhausted during the year 2048. At that time, if no earlier action has been taken, benefits would have to be reduced, taxes increased, or some combination of the two.

Clearly there is ample time to deal with the long-range financing situation and, of course, projections that far into the future should be used only to give some sense of what the situation might be.

Educating The Public

While it is crucial to public confidence that we plan for the financial stability of Social Security in the years ahead, I believe that the Social Security Administration can also increase public confidence by educating the public about the benefits they can expect to receive from the program. People can neither fully appreciate Social Security nor evaluate their plans for personal financial security without such information. For this reason, the Social Security Administration, in partnership with the Advertising Council, undertook in February a national public service advertising campaign designed to educate the public about the Social Security program and its value for workers of all ages and their families. The campaign will also stress the financial solvency of the program that has resulted from the Social Security Amendments of 1983.

Surveys conducted by a variety of private organizations over the last few years have indicated that many Americans have little knowledge about the protection they have under Social Security or the financial stability of the program. A 1985 survey sponsored by the American Council of Life Insurance indicated that only 41 percent of the public considered itself to be fairly well informed about Social Security. Its 1986 survey indicated similar findings.

I believe it is absolutely essential that we provide workers with the Social Security information they need to help them plan for their financial future. That is why I am about to inaugurate a new public service. Within a few weeks we will provide workers with a new personal earnings and benefit estimate statement which will include:

- A year-by-year breakdown of earnings and FICA tax payments;

- A wider range of benefit estimates, including disability and survivors estimates, and more realistic retirement estimates at age 62, full retirement age, and age 70 that use the worker's own projected future earnings; and

- The number of earnings credits the worker needs for all three types of benefits, and the worker's current number of credits.

Because the new statement offers so much more information, we have also redesigned the form a worker must use to request the statement. We have been testing the new form and statement in a number of ways prior to national implementation; the exact date--and it will be soon--will be decided based on these test results.

Planning For The Future

In addition to educating the public as to what they can expect from Social Security, it is vital that we plan ahead to meet the demands that demographic, societal, and technological changes over the next decade will place on the services the Social Security Administration provides.

To do this, in 1986, I established an Office of Strategic Planning reporting directly to me. I was convinced that looking ahead is an essential aspect of good management, and the GAO had earlier noted a deficiency in SSA's long-range strategic planning. Over the last 18 months SSA managers and staff all over the country have worked with the Office of Strategic Planning to define what SSA needs to do to meet the challenges and opportunities the next 10-15 years will bring. Perhaps most important, we must assure that our programs and the quality of services we deliver to all Americans keep pace with the expectations and needs of our society.

The result of our efforts is a strategic plan for the year 2000, which we published in January. This plan will undoubtedly have to be revised many times in the future, but it provides a start for dealing with the changes that will undoubtedly come. For example, the public increasingly is conducting business by telephone, and to make our service more convenient, this fall we will begin implementing a nationwide toll-free 800 telephone number for all general incoming calls. Callers will receive personal service weekdays from 7 a.m. to 7 p.m. At all other times, 7 days a week, 365 days a year, automated answering units will allow callers to leave information and be called back the next workday to complete their business.

Another example of the kind of change we envision in our strategic plan is allowing new parents the opportunity to obtain a Social Security number for their child as soon as the baby's birth is recorded at the hospital. We have tested this idea in three States--Indiana, Iowa, and New Mexico--and it has proved to be such a success that we plan to extend the service to other States.

Conclusion

Mr. Chairman, I would like to emphasize again the fact that Social Security is on sound financial ground--today and well into the next century. We are embarking on a period of stability, during which the income received by the Social Security trust funds will be sufficient to pay all benefits and to develop the reserves needed to pay benefits well into the next century.

We should, I believe, use this period of stability to solidify public confidence in the durability of this important American institution. At the same time, we need to plan for the future needs of the program and to engage in a national dialogue on how those needs can best be met.

OPENING STATEMENT OF SENATOR JOHN HEINZ (R-PA)

HEARING ON THE LONG-TERM STATUS OF THE SOCIAL SECURITY TRUST FUNDS

May 20, 1988

MR. CHAIRMAN: I commend you for calling these hearings on the long-term status of the Social Security Trust Funds and I thank you for allowing me to sit in with the Subcommittee on Social Security and Family Policy today to hear this distinguished panel of witnesses. I am pleased that today we will be focusing on the relationship of the Trust Funds to the budget process, and particularly on the effect of the Trust Funds on the Federal deficit problems we are currently facing.

In my view, including Social Security surpluses in the Federal budget threatens the integrity of the Social Security System and is an irresponsible approach to deficit reduction. We need Social Security surpluses to pay for future benefit obligations to today's workers. Borrowing these funds today to obscure and cover profligate spending on other programs will only tie us to a future that includes higher levels of spending than we can afford at the same time that we are repaying large loans from Social Security. We are condemning today's taxpayers to a dangerous struggle with their children over the financing of Social Security unless we begin today to treat these surpluses as true budget surpluses.

Right now Social Security is technically 'off-budget." But in reality, the Trust Funds are very much on-budget. For example, the deficit calculation under Gramm-Rudman-Hollings for fiscal year 1989 is $136 billion. This includes adding in Social Security's estimated FY89 surplus of $45 billion. We are therefore kidding ourselves if we think we have a deficit of only $136 billion in our fiscal year 1989 budget projections. The honest estimate ofthe deficit should be $181 billion. Why? Because we will spend $181 billion more on our "on-budget" programs than we will raise in general revenues to pay for them.

All of this borrowed money must be paid back in the future -- this is not a free ride. In the case of funds borrowed from Social Security, we know exactly when that day of reckoning will be. The actuaries tell us that in 34 years, we will begin to draw down the accumulated surpluses to pay the benefits we have promised to today's workers. To do this we will begin cashing in the Trust Fund securities, and we must raise taxes or raise the debt to pay this money back, plus interest. Our children and grandchildren will need to dig deep into their pockets to bail the country out of the financial hole we are digging today.

And this problem is only getting worse. Four years from now, we will borrow $92 billion a year from Social Security, and by the time Social Security is totally removed from the budget deficit calculations in 1994, we will have borrowed more than $400 billion from the program to mask our deficit spending. This is the extent of the problems that we will face if we do not get a real dose of reality on this issue.

Again I thank the Chairman for calling these hearings, and I look forward to reviewing the testimony. I hope that we can continue to work together to address our budget deficits, so that the Social Security program we leave for future generations will not come with a "past due" notice and the threat of foreclosure.

FROM THE OFFICE OF

Senator Daniel Patrick Moynihan

New York

FOR IMMEDIATE RELEASE
Friday, May 20, 1988

Contact: Matt James
202/224-4451

SOCIAL SECURITY TRUST FUNDS II

Statement by

Senator Daniel Patrick Moynihan

Senate Finance Committee

Subcommittee on Social Security and Family Policy

SD-215, Dirksen Senate Office Building

May 20, 1988

OPENING STATEMENT

We meet this morning for the second of ~~two~~ three hearings on the long-term status of the Social Security trust funds.

At last Friday's hearing we heard some very good news. Social Security Commissioner Dorcas Hardy reviewed the recently released 1988 annual report of the Social Security Board of Trustees. The trustees find the system to be actuarially sound for the next 75 years. They estimate that Social Security trust fund reserves will build to more than $100 billion by the end of this year and continue to grow to $1.4 trillion by the year 2000. Trust fund assets are projected to peak at about $12 trillion in 2030.

This bright financial outlook is the result of the Social Security Amendments of 1983.

In brief, in twelve days in January that year, a half dozen people in Washington put in place a revenue stream which is just beginning to flow and which, if we don't blow it, will put the Federal budget back in the black, pay off the privately-held government debt, jump start the savings rate, and guarantee the Social Security Trust Funds for a half century and more.

It all began on a Monday morning, January 3. Bob Dole of Kansas had an op-ed article in the Times which insisted that things would soon be looking up for the Reagan administration -- there was a near depression on -- and that Congressional Republicans were behind him. Nothing special, save for one paragraph. Having said that the issues confronting them presented as much opportunity as peril, he went on:

> Social Security is a case in point. With 116 million workers supporting it and 36 million beneficiaries relying on it, Social Security overwhelms every other domestic priority. Through a combination of relatively modest steps, including some acceleration of already scheduled taxes and some reduction in the rate of future benefit increases, the system can be saved. When it is, much of the credit, rightfully, will belong to this President and his party.

Oh? Not twenty-four months earlier David Stockman had foretold that the "most devastating bankruptcy in history", that of the Social Security Trust Funds, was months away. Which wasn't so, but in the main Republicans didn't know this. What Sylvia Porter called "a scare campaign of vicious proportions" had been going on. The new breed of conservatives seemed to detest the program even more than the old breed. And the funds were going down, the result of an interval in the 1970s (the first since World War II) when prices ran ahead of wages, such that Cost of Living Adjustments were not being offset by increased payments into the funds.

The White House wanted to scrap the system. (Make it voluntary.) Senate Majority Leader Howard Baker knew better. He worked up a bi-partisan National Commission on Social Security Reform. Dole and I were appointed. Alan Greenspan was made chairman. A year went by with no seeming movement from either side. Then of a sudden this signal from Dole. He and Greenspan had come to understand that the

System's problems really were temporary and that in the long term it could be made heroically solvent.

At noon I was sworn in for a second term. I went over to Dole who happened to be on the floor. If he thought that, shouldn't we make one last try? Two days later, he and I and Barber Conable from the House were secreted out to Jim Baker's in Northwest Washington. Negotiations began.

Word got out, and without too much effort at concealment we began meeting at Blair House. Agreement was reached at about 9:30 Saturday night, January 15, and promptly endorsed by a hastily summoned Commission. The President signed the legislation in April.

A familiar story, so far. Here is what is not generally understood. Almost everyone involved knew -- by then -- that the administration had got the public finances in terrible shape. Stockman who joined us has written this in great detail. $200 billion deficits "as far as the eye could see." We would in fact triple the national debt in eight years. Nor was Ronald Reagan going to do anything to prevent it

And so we would. We would put in place a revenue stream that after first taking care of the short term needs of Social Security would commence to produce a series of ever-increasing surpluses. This was perfectly defensible in terms of saving for the needs of the System in the next century. But we could have put that off. We didn't because we had this one chance to redeem the 1980s. They would end in a mess. But all would turn around in the 1990s.

We have now had four full calendar years of the new revenue base. The Trustees have just reported. The Social Security Trust Funds are increasing at the rate of $109,440,000 per day and rising.

This income stream money must be deposited with the Treasury, which issues a special Social Security bond. (It never falls below face value.) The Treasury must accept this money first. If at the end of the day it has more money on hand than it needs, it simply retires privately held debt. This can sound arcane but isn't. Every week some millions of Treasury bonds and bills "mature," and are cashed in. At present, the Treasury "rolls over" the debt, issuing new bonds or bills to get the cash to pay off the old ones. But if it isn't short of cash it needn't do this. The national debt begins to shrink.

Our present deficit "path" takes us, in theory at least, to a zero deficit by 1993. If that happens the revenue stream from Social Security will be sufficient to begin retiring debt by 1994. As public debt declines, private savings increase. The money is invested in -- what? -- General Electric bonds. Whatever. This is standard national accounting.

If not in 1994, then surely 1995, or 1996.

By 2010 the Social Security reserve is projected to be \$4.5 trillion. (\$4,460,600,000,000.00.) If we wanted to go all the way, we could probably have zero national debt by that time. The first time, incidentally, since 1836. (When we were down to $38,000.)

Now this needn't happen. We might blow the opportunity. We could start to "spend" the Social Security surplus, rather than using it to retire debt, and so get rid of the deficit. (Which for practical purposes now consists almost entirely of debt service.) But we needn't. Surely we should "save" it. Put aside the fiscal mess of the '80s. Our real economic problem is that we don't save enough. Of twenty-four OECD members, we rank 20, followed only by Iceland, and a few such. Yet, as one witness at last week's hearing put it, by the next decade we could be "awash in capital." This is the one sure way -- saving and investment -- to make certain the Social Security funds are still ample when the baby boom retires. So why not?

Two further points. In the near term the proportion of retired persons in the population is quite stable: the depression babies. Today there are 21 persons retired for every 100 working age. This rate stays stable through 2010. (Social Security payments as a percent of payroll are declining.) Moreover, after a generation of having to absorb enormous numbers of new workers, the economy faces a true labor shortage. From now to the year 2000 the Bureau of Labor Statistics projects labor force growth of a bare 1.2 percent. The others weren't born!

There you have it. Hard to believe? Yes. But within our grasp.

All done in twelve days in January.

And now I turn to our panel of experts this morning for further discussion of these and other issues related to the buildup and investment of the trust fund reserves. We have with us Alicia Munnell, Senior Vice-President and Director of Research, Federal Reserve Bank of Boston; Barry Bosworth, Senior Fellow, The Brookings Institution; and Bob Myers, former Chief Actuary, Social Security Administration.

ROBERT V. ROOSA
59 WALL STREET
NEW YORK, N.Y. 10005

May 13, 1988

Dear Senator Moynihan,

I am delighted to see that the Finance Subcommittee which you chair is investigating the Social Security Trust Funds. Having been continually frustrated by the misleading and ambiguous manner in which the Trust Funds' cash flows in the federal budget statistics are presented in the "Treasury Bulletin," I enthusiastically endorse your efforts to take a fresh look at the full picture. The many articles appearing in the press about the so-called social security surplus and its implications for the federal budget deficit are evidence of the general confusion surrounding the relation between the Trust Funds and the operating budget.

My own feeling (consistent with the way we did things in my Treasury days in the early 'sixties) is that the revenues, disbursements and net surplus or deficit of the Social Security Trust Funds should be kept out of the federal operating budget. It is important separately to clarify the revenues and costs of the social security program, and to protect that splendid system from the ongoing debate on how to cut the federal government's deficit. The proponents of combining social security trust accounts with the federal operating budget argue, correctly of course, that such a consolidated deficit or surplus most accurately reflects the overall impact of federal government inflows and outflows on the economy.

There are, however, better ways to identify needed action than just lumping everything together. A start would be made in the right direction if both the net operating budget and the net position of the Trust Funds were reported side by side. If there were a clear separation in accounting treatment, the implications of a deficit in the operating budget, for example, would then be to cut expenses somewhere and possibly to raise taxes, but there would certainly be no compelling necessity to affect the social policy embedded in the schedule for social security disbursements and the actuarially determined employment tax rates required to support the social security system. With proper segregation, a straightforward measure of the impact of a deficit in the operating budget on the economy should not carry any implication for curtailing social security or medicare benefits, nor for impairing the traditional "self-financing" principle. Let me explain.

In any current year, the surplus or deficit in the Trust Funds could be held fiscally neutral (as we did in the early '60s) insofar as the macroeconomic aspects of the net overall cash flow impact of the operating budget on the national economy are concerned. The relevant procedure is simply to have any surplus generated by the Social Security Trust Funds invested in ordinary Treasury securities of the same maturities and interest rates that are available to the public. When a deficit in the operating budget requires the Treasury to add to the public debt, the Trust Funds can put current surpluses (if they have them) into a preferred allotment at the terms determined by the public auction of the Treasury securities being publicly issued. Alternatively, the Funds can use surpluses to buy marketable Treasury debt in the market if for any reason at some time acquisition on original issue is not feasible. Looked at the other way around, if instead of running surpluses the Trust Funds have disbursements exceeding current inflows, such deficits or shortfalls of the Funds can be met either by selling in the market some of the Treasury securities held in the Funds or by redeeming maturing securities when the Treasury is replacing them through refunding in the public market.

The steps in this neutralization become even clearer by tracing through the net cash flows. When more cash is coming into the Trust Funds from employment taxes than is currently being paid out in benefits, the resulting net inflow "from the public" would be fiscally neutralized in one of two ways: either the net inflow would replace an equal amount that would otherwise be directly withdrawn from the public by Treasury borrowing in the market, or the Funds would put that amount back into the market by buying already outstanding government securities, and that amount would eventually be available to be reabsorbed by Treasury borrowing when the operating deficit required added borrowing. Shortfalls in the Trust Funds would be met either by drawing funds from the market through selling Governments, or an equal amount would be drawn directly from the Treasury whose borrowing needs from the market would be correspondingly increased. Either way, the public would end up holding as many more government securities as would be needed to cover a shortfall in the Trust Funds. And the outstanding total of government securities would still be whatever emerged from the surplus or deficit in the operating budget.

What this means, then, is that the magnitudes of the Treasury marketable debt outstanding will always represent the net effect of past deficits in the operating budget. There would be no obscuring of the government's actual operational borrowing needs by merging them inconspicuously into the net inflows or outflows of the Trust Funds. Moreover, future beneficiaries of the Trust Funds could have the assurance that interest-bearing Treasury securities constitute a clearly identifiable asset base on which they can rely for their future benefits. In fiscal policy terms, neither surpluses nor deficits in the Trust Funds would then have any effect on the net flow of funds from the public into the Treasury to finance the operating budget (i.e., what the British call the "public sector borrowing requirement").

I hope that your committee will find this approach both meaningful and consistent with the principles expressed by the Greenspan Commission a few years ago.

Sincerely,

Robert Roosa

Senator Daniel P. Moynihan
United States Senate
Washington, D. C. 20510

Alicia H. Munnell

The United States is currently faced with a unique opportunity to augment its low level of national saving by accumulating assets in the Social Security trust funds. Tax income to the funds is projected to exceed outgo for the next 30 years. Assuming that the rest of the federal budget is brought more or less into balance, then Social Security surpluses could increase our supply of capital and lead to higher future levels of output and income. The accumulated reserves are currently scheduled to be drawn down to cover annual deficits in the years between 2018 and 2048.

We have time to explore this possibility for increasing the national saving rate. Experience in other countries suggests that it will be a complicated task. Meanwhile, prudence tells us ~~to continue~~ now to build up the Social Security trust fund assets until we have a contingency reserve equal to 150 percent of annual outlays. This level will not be reached until 1995, and long-run funding decisions can be postponed until we near that time. The desired path for the non-Social Security portion of the budget is equally clear. Fiscal responsibility demands that we bring our tax and spending activities more in line. Meanwhile, we should also be debating whether we want to try to increase our national saving rate by continuing to accumulate surpluses in the Social Security trust funds.

The Social Security program will function perfectly well under either scenario. If a fund is built up, current tax rates should be adequate to finance benefits for the next 60 years. If OASDI reserves are not accumulated during the period from now to 2018, then an increase in OASDI taxes of 1 to 2 percentage points will be required in 2018--a manageable increase. In short, we are not faced with another Social Security crisis, but rather with an opportunity to increase national saving and investment.

Mr. Chairman and members of the Committee, thank you for inviting me. The subject of today's hearings is an important one and I am pleased to be able to discuss it with you.

The United States is currently faced with a unique opportunity to augment its low level of national saving by accumulating assets in the Social Security trust funds. That is, the possibility exists for federal government saving to increase the national saving rate. This will not happen automatically, however.

Whether or not government saving actually occurs will depend on how the assets in the Social Security trust funds are used. If the reserves are used to finance current consumption--for example, to pay for current outlays in the rest of the budget--no real saving will occur. On the other hand, if the government alters its spending and taxing patterns to produce surpluses at the federal level--not just in the Social Security trust funds--the nation will enjoy higher saving and investment.

Hence, we as a nation face an important economic choice. I would like to review some of the considerations that might enter into making that choice and discuss some of the practical problems associated with the federal government saving through a Social Security fund buildup.

I. Where Did the Surpluses Come From and How Big Will They Be?

How did the Social Security system, which for the past three decades has been financed more or less on a pay-as-you-go basis, become slated to accumulate large surpluses? Although the 1977 amendments to the Social Security Act created some relatively small surpluses in the program, the 1983 amendments are the major source of the large projected buildup in the Social Security trust funds.

As you remember, in order to strengthen the financing of the program, the 1977 legislation extensively revised both the benefit and the revenue provisions. Most of the additional revenue for the long run came from increasing a rate hike already planned for 2011 and making it effective in 1990. This meant that the rate hike, which was originally scheduled to coincide with rising benefit costs as the baby boom retired, would take effect while, for demographic reasons, costs were declining as a percent of payrolls. The combination of increased revenues and lower costs was projected to produce annual surpluses in the Social Security program through the year 2010. Even so, the 1977 amendments left a significant estimated deficit in the last 25 years of the 75-year projection period.

The 1983 amendments, which were designed to relieve a short-term financing crisis and to remove the long-term deficit left by the 1977 amendments, significantly increased the size of the surpluses and extended their duration. This was accomplished primarily by increasing revenues somewhat through the taxation of benefits and reducing costs significantly through a six-month freeze on the cost-of-living adjustment and the extension of the retirement age. As a result of the 1983 legislation, the intermediate cost estimates indicate that tax income to Social Security's old-age, survivors, disability insurance trust funds is projected to exceed outgo for the next 30 years. These annual surpluses will produce trust fund balances equal to roughly 30 percent of GNP, or $2.6 trillion in 1988 dollars, by the year 2018. These accumulated reserves are currently scheduled to be drawn down to cover annual deficits in the years between 2018 and 2048.

It is important to note that the proposal in question now is one of building up and then drawing down reserves, so that the economy will more or less be in the same position in 2048 regardless of whether or not we pursue a policy of building a large reserve. Although I will discuss another option later, the current issue under consideration, then, is how individuals and the economy will be affected during the intervening period between now and 2048. This is not a trivial question, however, since the intervening 60 years is a very long time.

II. Economic Effects of Building Up and Drawing Down Reserves

In assessing the potential impact of the scheduled accumulation and subsequent depletion of trust fund reserves, let us first assume that the buildup in the Social Security trust funds actually does result in a net positive accumulation of resources at the federal level. The simplest way of thinking about this is to assume that the federal budget, exclusive of Social Security, is brought more or less in balance, while the Social Security program is experiencing annual surpluses. In this case, the surpluses in the Social Security trust funds represent net saving by the government and imply that a higher proportion of current output will be devoted to capital formation. If the current level of national saving is too low and if monetary and other non-fiscal policies assure full employment, surpluses at the federal level will lead to greater long-term growth in the supply of capital and higher future levels of output and income. As a result of the surpluses, then, future generations will have a relatively higher standard of living from which to contribute taxes to redeem the debt when the time comes to pay benefits.

The discussion so far has focused on the accumulation of reserves between now and 2018, but has not referred to the drawdown that is slated to occur later in the forecast period. During this time, the foregoing analysis works in reverse. After 2018, benefit commitments will exceed tax revenues, so that the Trustees of the fund will have to use interest on the assets and eventually redeem their holdings of government securities in order to provide pensions to the beneficiaries. The redemption of the government bonds and the transfer of these funds to the public will represent dissaving by the federal government. This means that a lower portion of current output will be devoted to capital formation.

Thus, the projected pattern of trust fund activity over the next 75 years would involve an element of forced saving between now and 2018, which, if invested productively, will increase capital accumulation, future income and consumption. After 2018, the relative value of assets in the trust funds will decline, creating dissaving at the federal level, which will reduce the share of future output devoted to capital formation and thereby future levels of per capita output.

The important question is: what is gained by the accumulation and subsequent depletion of Social Security reserves over the next 75 years, and when do the gains occur? The exercise is primarily one of shifting the pattern of consumption from the early half of the period to the later. That is, people living during the period of accumulation would have lower per capita consumption than they would have otherwise. During the period of drawdown, on the other hand, consumption will receive a boost from two sources. First, the increased saving and capital accumulation from the buildup of the trust funds will start to pay off in the form of higher levels of national output and consumption. Second, the drop in savings brought on by the drawing down of the trust fund assets could create a consumption binge similar to the one we have just experienced.

III. The Rationale for a Large Reserve

The rationale for such a shift in consumption patterns, of course, is that the people contributing during the period of accumulation are part of the baby boom generation. This very large cohort would place a significant burden on the following generation if all its retirement benefits were financed on a pay-as-you-go basis. Because of the magnitude of this potential burden, the argument goes, this generation should pay for some of its retirement in advance by accumulating surpluses in the Social Security trust funds. The other side of the argument, of course, is that because of its large size, the baby boom generation has had a difficult time. These people attended overcrowded schools, faced severe competition getting into college, experienced difficulties finding jobs, and found slow advancement once on the job. The mere size of this group has contributed to the virtual freezing of real wage growth for a decade and has made it difficult to find affordable housing. Whether or not this generation should be the one to contribute towards its own retirement in addition to financing benefits for current retirees is an issue that should be part of the debate.

Another factor that should be considered is the wisdom of drawing down the trust fund reserves once they are accumulated. The discussion surrounding this part of the proposal seems to imply that we are facing a temporary blip in the cost of Social Security as the baby boom generation passes through--a rat being digested by a snake. In other words, the implication is that the number of beneficiaries per hundred workers will go from its current level of 30 up to 55 and then back down. This is not the case; we are facing a permanent increase in the ratio of beneficiaries to workers, because we expect the fertility rate, which has been reduced by nearly half since 1960, to remain around its present level. The number of beneficiaries per hundred workers will rise from the present level to 55 and remain there, and the pay-as-you-go costs of the Social Security program will increase proportionately. Hence, if the decision is made to pre-fund some Social Security benefits, it may make more sense to build up the fund and keep it as a permanent source of partial funding rather than draw it down. This would require a tax increase around the year 2018. This issue should also enter the debate.

IV. Difficulties with Saving through Social Security

Whether the fund is eventually drawn down or not, accumulating surpluses in the Social Security program may be the most effective way of raising the nation's saving rate over the next 30 years. Accomplishing such a goal, however, involves surmounting some practical problems.

The most crucial is making sure that trust fund surpluses are not simply offset by deficits in the rest of the federal budget. If payroll tax revenues earmarked to pay future retirement and disability benefits are loaned to the Treasury and the Treasury uses these monies to cover current outlays in the general fund, then the surpluses will have contributed nothing to overall saving and capital accumulation. The full burden of supporting the beneficiaries will come from the taxpayers in the second half of the period--just as if the system had been financed on a pay-as-you-go basis all along. The only effect of accumulating Social Security surpluses would be to alter the composition of federal revenues over time. General government expenditures during the first half of the period would be financed by the relatively regressive payroll tax rather than the more progressive income tax, and future benefit payments would be financed in part by general revenues.

The evidence from other countries that have tried to fund their public pension systems is not entirely encouraging. Canada, Japan and Sweden in particular have accumulated large public pension trust reserves in order to augment private savings, but only Sweden appears to have been successful. Since the inception of the Swedish program in 1959, large annual surpluses have usually swamped the relatively small deficits in the general accounts. (The exception is the period 1979 to 1986, when a weak economy led to overall negative numbers.) By 1986, the fund had amassed assets equal to 46 percent of GDP and accounted for over one-third of the stock of assets in organized financial markets. Thus, the Swedish public pension plan appears to have contributed to national saving.

The Japanese experience seems to have been quite different. Japan developed a partially funded public pension system in 1954, and by 1986 total assets in the trust funds accounted for 17 percent of GDP. The key difference between Sweden and Japan, however, is that, for most of this time, Japan has run deficits in the overall federal budget. That is, the deficits in the non-Social-Security portion of the budget more than offset the surpluses in the pension system.

The Canada Pension Plan is also a partially funded system, which has accumulated assets equal to 6 percent of GDP. The original idea was that the funds would be lent to the provinces for use as investment capital. The

Canada Pension Plan had the potential to increase substantially the flow of private investment capital out of provincial securities and into the private capital market, while supporting an increased level of capital investment. As it has turned out, private capital investment has not increased as a result of the Canada Pension Plan surpluses, and provincial governments have allocated a large share of these surpluses to current consumption expenditures. Hence, neither the Japanese nor the Canadian funding efforts appear to have augmented national saving.

This brief international excursion has not been to argue that federal government saving is impossible, but only that it is difficult. If we choose to proceed along this path, it appears that we could learn quite a bit from both the successes and failures of other countries.

V. Implications for Immediate Action

We have time to undertake such explorations. We do not have to determine today the course of fiscal policy for the next 75 years or even 25 years. Regardless of what we decide to do for the long run, our short-run agenda is already set. Whether or not we decide ultimately to continue with a plan to pre-fund the Social Security program, prudence tells us to continue building up trust fund assets at least until we have an adequate contingency reserve. My calculations indicate that a reserve equal to 150 percent of annual outlays would be required to weather the kind of back-to-back recessions that we experienced during the 1970s. The most recent projections by the Social Security Administration indicate that this level of contingency fund will not be reached until 1995. Long-run funding decisions can be postponed until we near that time.

The desired path for the non-Social Security portion of the budget is equally clear. Fiscal responsibility demands that we bring our tax and spending activities more in line. Continued deficits produce a large debt burden for our children and make our own welfare dependent on the goodwill of foreign governments. Hence, at the same time that we are accumulating a contingency reserve in the Social Security trust funds, we should be reducing the deficits in the rest of the budget.

We should also be debating whether we want to try to increase our national saving rate by continuing to accumulate surpluses in the Social Security trust funds. It is a complicated task. An important factor to keep in mind while the debate takes place, however, is that the Social Security program will function perfectly well under either scenario. If a fund is built up, current tax rates should be adequate to finance benefits for the next 60 years. If OASDI reserves are not accumulated during the period from now to 2018, then OASDI taxes will have to be raised in 2018 to finance annual deficits on a current cost basis. It is important to note, however, that the rate increase required would be between 1 and 2 percent each for the employer and the employee--or roughly $60 billion in terms of today's programs. This is a large sum of money, but it is manageable.

In short, we are not faced with another Social Security crisis, but rather with an opportunity to increase national saving and investment.

STATEMENT BY ROBERT J. MYERS

Mr. Chairman and Members of the Subcommittee: 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.

This testimony will deal with the present financial status of the Social Security program -- Old-Age, Survivors, and Disability Insurance (OASDI) -- and the Medicare program, as shown by the 1988 Trustees Reports. 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.

Present Financial Status of OASDI

The OASDI system is currently in excellent financial health. The assets of the OASDI Trust Funds at the end of 1987 amounted to almost $69 billion. This, as shown by Tables 1 and 2, was $48 billion higher than was estimated for that date in the pessimistic (or 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 as much as $35 billion for the intermediate (or Alternative II-B) estimate.

However, when the experience for the OASI and DI Trust Funds is examined separately, a small problem appears. The actual DI Trust Fund balances have been decreasing since 1983, even though both estimates predicted a more or less level trend. This has resulted from unfavorable disability experience as compared with the estimates -- both somewhat more awards and somewhat fewer terminations. It would seem desirable to reallocate once again the OASDI tax rate between OASI and DI, so as to give the latter a little more. It will be recalled that the 1983 Amendments reduced the DI allocation by 47% relatively for 1988-87, by 44% for 1988-89, and by 45% for 1990-99. Evidently, this was somewhat too much of a decrease, and a portion of it should be restored, beginning in 1989.

The favorable short-range experience differs significantly from the estimates of the long-range actuarial balance in the successive Trustees Reports. These have shown larger and larger actuarial lacks of balance -- in part, due to the aforementioned unfavorable disability experience. Nonetheless, the program is still in "close actuarial balance", although I believe that the method of measuring that significant element is in need of thorough re-examination and improvement.

The 1988 OASDI Trustees Report contained a number of changes in assumptions and methodology. I particularly agree with the change to take into account the current balance in the fund and future interest earnings, because it is the essence of actuarial science to recognize the time value of money, as had been done in the reports before 1973. In addition, I believe that it would be desirable to include a cost item for building (and subsequent maintenance) of a fund balance of one year's outgo -- as was formerly done for the HI system.

From a cost standpoint, these various changes were approximately counterbalancing, so that the long-range actuarial lack of balance remained about the same as in the 1987 report. Such balance is just within the "accepted" limit of 5% of the level-cost rate.

We often hear concern about the rapidly rising cost of OASDI. Interestingly, when such cost is considered in relation to taxable payroll -- as it should be -- rather than in dollars, the recent trend has been slowly downward. Thus, the cost rate (total outgo relative to taxable payroll) dropped from 11.5% in 1983 to 10.7% in 1987 -- see Table 3. However, this was not unexpected, because the 1983 estimates indicated that this would occur, although not to quite as great an extent as occurred. This downward trend is estimated to continue for about the next two decades, but then a significant upward trend will begin as the baby-boomer population enters the retirement ages.

Present Financial Status of Medicare

The Hospital Insurance program (HI) is currently in excellent financial health. The trust-fund balance at the end of 1987, amounting to $54 billion, is $41 billion higher than the pessimistic estimate for that year which was made in 1983, and $33 billion higher than the corresponding intermediate estimate -- see Table 2. Similarly, the cost rate has been slowly decreasing over the years -- rather than increasing as was anticipated in 1983; however, this favorable trend is expected to last for only a short time, and then significant increases will occur each year.

The favorable recent trend for HI, which in 1983 was expected to have its trust fund about exhausted by now if conditions were pessimistic, has been due, in large part, to reducing reimbursements to hospitals and controlling utilization of services. How much this can be augmented in the future without endangering hospitals' financial conditions or providing inadequate services to patients is a question.

The Supplementary Medical Insurance program (SMI), when considered on a 1-year term insurance basis -- as it should properly be -- is in good condition. On an incurred basis, the fund balance at the end of 1987 ($5.5 billion) was 9% less than its liabilities. However, this small deficiency will be more than eliminated in 1988, as a result of the large increase in the enrollee premium rate (and thus in the matching payments from the General Fund); in fact, this deficiency was a major reason why the premium rate was increased significantly.

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 portion 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.

Under current law, the funding basis of OASDI is not -- as is often erroneously said -- pay-as-you-go financing. Rather, very large fund balances will be built up during the next four decades under the intermediate estimate. The fund ratio -- which is the fund balance expressed as a percentage of the next year's outgo -- peaks at 531% in 2015, when it is estimated at $6.8 trillion in current dollars, or $2.3 trillion in 1988 dollars. After 2015, the fund balance continues to grow in terms of current dollars, reaching a peak of about $12 trillion shortly after 2030. Even under the pessimistic assumptions, the fund balance in 2015 would be $3.4 trillion in current dollars, or $0.9 trillion in 1988 dollars.

After the end of the build-up period, the assets of the trust funds will be drawn upon, and they will be exhausted shortly before 2050. At that time -- if the benefit provisions are left unchanged -- additional financing, higher payroll tax rates, will be necessary. These increases in the tax rate would, on the basis of the intermediate-cost estimate, have to be 1.8% for both the employer and the employee over the rate now scheduled 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.

How the Present Funding Basis for OASDI Came About

One might well ask why the National Commission on Social Security Reform, when it developed recommendations that led to the enactment of the 1983 Amendments, did not consider the manner in which the long-range financing of the OASDI program would unfold. While the members of the National Commission were aware of this situation, there was the much more pressing matter of developing a solution to the short-range financing problem -- through the 1980s. The OASI portion of the OASDI Trust Funds was estimated to run out of money in mid-1983, so that -- if no action were taken -- benefit checks would not go out on time. Accordingly, the National Commission devoted its major efforts to the financing problems of the 1980s, although at the same time attempting to assure that, on the average, the program would be financed adequately over the next 75 years.

The National Commission thus developed its recommendations by assuring, 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 we know, the use of averages can, at times, be deceptive. It 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. I think that it is fair to say that the National Commission knew that, once the short-range problems were definitely solved -- as they certainly have been -- then a closer look should be given to the long-range situation. This definitely should be a major function of the statutory Advisory Council on Social Security, that is to be named after next January.

Currently, there is a widespread myth about the financing of the Social Security program as provided in the 1983 Amendments. Specifically, many believe that the intention was to "prefund" by saving enough money over the next 10 to 20 years to pay for benefits to the huge generation of post-World War II baby boomers that will retire 25 to 40 years from now.

This was by no means the thinking of the National Commission when it made its recommendations, or the intention of Congress when it enacted the legislation -- as indicated previously. Accordingly, the building up of a huge fund that would peak in the midst of the baby boomers' retirement period was merely a coincidence.

What Should Be Done About the Funding Basis of OASDI?

I believe that OASDI should be financed on close to a current-cost basis. Income should, on the whole, slightly exceed outgo each year, in order to build up a fund which is about equal to one year's outgo -- and certainly no more. This should be accomplished by changing the future tax-rate schedule so as to more nearly match the trend of outgo. In the near future, the tax rate should be a little higher than this, so as to build up the fund balance to the desired goal of one year's outgo.

My proposed tax schedule to accomplish this result, developed on the basis of the intermediate-cost estimate, is shown in Table 4, along with the present one. The tax rate for 1989 would be reduced from the 6.06% rate now scheduled, which went into effect this year, and would be rolled back to the 5.7% rate that prevailed in 1984-87, and then would be held at that level through 1994 (thus eliminating the increase to 6.2% scheduled for 1990). Thereafter, the rate should be decreased by 0.6% in 1995, after an adequate fund balance had been accumulated. The rate would need to be increased in 2015, and then again in 2020 and 2025.

These proposed tax rates would be lower than presently scheduled in 1989-2019, higher in 2020-48, and slightly lower thereafter (as a result of having available the interest earnings on the trust-fund balance that has been accumulated -- as against none at that time under present law). If some object to the higher rates for 2020-48, note that they are not as high as would ultimately result under present law if the benefit structure were left unchanged.

Under my proposal, the trust-fund balance would slowly, but steadily, build up over the years. It would reach about $400 billion in 2015 (in 1988 dollars), as compared with a relative peak then of $2.3 trillion under present law -- and as compared with $69 billion at the end of 1987. Then, in 2048, the fund balance under my proposal would be about $900 billion, as against bankruptcy under present law. The "roller-coaster" effect under present law would be replaced by slow, but steady growth.

A good way of looking at the situation under both present law and my proposal is to consider the fund ratios for OASDI. Under present law, the ratio grows from 41% at the beginning of 1988 to a peak of 531% in 2015 and then falls to zero 34 years later. On the other hand, under my proposal, the ratio would slowly increase to about 100% before the turn of the century and would remain at that level thereafter. Once again, the stability of my proposal is evident.

Some might argue that future experience may not follow the intermediate-cost estimate, and then what of my proposal and its revised tax schedule? The answer is that the tax schedule should be reviewed from time to time as the experience unfolds, and as new estimates of the future experience are prepared. Congress could then legislate different scheduled tax rates or changes in the benefit provisions. But this would also have to be done if the present tax schedule and funding method were to be continued, and is done, in any case, in the annual reports of the Board of Trustees.

A procedure that might be used in lieu of revising the tax schedule in order to accomplish the desired result of pay-as-you-go financing would be to have automatic adjustment of the tax rate so as to maintain approximately the desired fund ratio. A description of such a procedure was contained in a staff memorandum furnished to the National Commission on Social Security Reform ("Methods to Assure Adequate Financing of OASDI Program Through Loans or Through Automatic Adjustment of Either Benefits or Taxes", Memorandum No. 63 (Revised), November 22, 1982).

What Should Be Done If It is Desired to Build Up and Then Maintain A Large OASDI Fund?

As indicated previously, it is extremely illogical to plan to have the OASDI Trust Funds build up huge balances during the next 20-25 years so as to "take care of the high cost for the baby boomers" and then be drawn down to exhaustion about 60 years from now. The situation is not that the cost of the program will drop sharply, to a much lower level, after the baby-boom cohort has passed from the scene. The cost of the program, expressed as a percentage of taxable payroll, will increase from the current 10.7% to 15.9% in 2030 (when all those born before 1965 will have reached age 65), according to the intermediate estimate, but will rise slowly thereafter, reaching 16.8% in 2060.

If the OASDI Trust Fund is to be maintained at its peak (in current dollars) of $11.8 trillion, which is reached in 2030 under the intermediate estimate, the tax rates would have to be increased sooner than under present law (see Table 4). The increases in 2030 and thereafter, as compared with the rates in present law, would be almost as large as those under my proposal. Thus, the higher tax rates in the near future under this proposal as against those in my proposal are not very advantageous from a financing standpoint.

What Should Be Done About the Funding Basis for HI?

There is no question that, over the long range, the HI program is significantly under-financed. I believe that, as soon as possible, at the very least a tax-rate schedule should be legislated that will adequately finance HI over the 75-year valuation period according to the intermediate estimate. If it is desired to solve the financing problem by some benefit reduction, without affecting current and near-future beneficiaries or reducing the scope of benefit protection, I suggest that the minimum age for non-disabled beneficiaries should be set at the Normal Retirement Age for OASDI -- so that the two programs move in tandem; a correspondingly lower tax-rate schedule would then be necessary.

I fully realize that the future experience of HI is subject to great variability -- more so than OASDI.. As a result, any tax-rate schedule established now will undoubtedly need to be altered as future experience unfolds. But certainly, a revised basis along the lines indicated will present a more accurate picture to the general public and will allay the fears of "certain bankruptcy".

Certain Comments and Suggestions about 1988 Trustees Reports

I have certain comments and suggestions about the several 1988 Trustees Reports. The measurement of long-range actuarial balance for OASDI and HI should be on the same basis -- namely, taking into account the existing fund balance and future interest earnings, along with allowance for building up (and maintaining)

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Certain Comments and Suggestions about 1988 Trustees Reports

I have certain comments and suggestions about the several 1988 Trustees Reports. The measurement of long-range actuarial balance for OASDI and HI should be on the same basis -- namely, taking into account the existing fund balance and future interest earnings, along with allowance for building up (and maintaining) a balance of one year's outgo, which generally amounts to only a small adjustment. In the past, this procedure was followed for HI, but -- over the objection of the Chief Actuary -- has been dropped, while this year all but the allowance for building the fund balance was incorporated for OASDI. Consistent, logical treatment is needed as between the two programs.

The Statement of Actuarial Opinion in the 1988 HI report not only expresses concern about not using the allowance for fund build up, but also does not contain the usual "opinion" that "all the assumptions used and the resulting cost estimates are in the aggregate reasonable". It would be interesting to know whether the Chief Actuary believes that the results place the HI program in a better or worse light than he believes to be the case.

The HI report does not contain an interesting bit of information -- namely, the payment from the General Fund for the cost of the benefits for the relatively small number of federal employees who were covered under HI when such coverage was extended in January 1983 and who are eligible for benefits only on the basis of credit for federal service before 1983 (authorized by Section 278(d)(3) of TEFRA). Presumably, these payments are combined with some other item in Table 2 of the HI report.

Desirably, the SMI report should show the assumed enrollee standard premium rates for 1989 and 1990 on which the cost projections of its Tables 5 and 6 are based -- just as the OASDI report does for the various promulgated items in that program. As it so happens, by simple actuarial analysis of the data in the report, these rates can be derived -- $27.60 for 1989 (or 11% higher than the 1988 rate of $24.80) and $28.60 for 1990 (or 4% higher than the 1989 rate).

Relationship Between OASDI Program and National 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 trust funds have been out of the Unified Budget, so that any excess of income over outgo of the trust funds does not reduce the Budget deficit. However, anomalously, it was provided that 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 the 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.

At times, individuals propose that the Budget deficits should be reduced by making long-term permanent reductions in OASDI benefits. As indicated previously, because OASDI is not included in the Budget, such effect would not actually occur, although the Budget targets would be more readily met. Again, this seems to be a matter of deceiving ourselves. Perhaps even more importantly in this respect, because OASDI is financed on a completely self-supporting basis, any reduction in long-range benefit costs should correspondingly produce reductions in the tax rates required to support the system. The net effect of this action and reaction is essentially counterbalancing, so that, insofar as the Budget is concerned (even including the Gramm-Rudman-Hollings targets), nothing would really be achieved.

If the financing basis of the OASDI program is restructured along the lines that I have proposed -- so that its funding is on a pay-as-you-go basis -- not only would OASDI be on a sound and more desirable basis, but also the Budget picture would be clearer and more realistic. The short-range deficit situation insofar as the Budget is concerned would be portrayed vividly and honestly. Also, there would not arise the onerous situation that, under present law, could be placed on the Secretary of the Treasury for several decades following about 2025. Such situation is that, in the absence of huge increases in general taxes, the Secretary would have to sell huge amounts of government-debt obligations each year to the general public, because the assets of the OASDI Trust Funds would then have to be liquidated to meet the excesses of benefit outgo over tax income.

Public Confidence in Long-Range Future of OASDI

Unfortunately, many -- if not most -- younger persons believe that the OASDI program will not be around when they retire. As the preceding discussion of the 1988 Trustees Report has indicated, the chances are excellent that the program will have a perpetual life. Of course, no actuarial estimates for the long-range future can be completely precise, no matter how accurately made.

However, if the experience some years hence is adverse, and financing problems arise, solutions can be achieved by making relatively small and painless changes, as was done in 1983. President Reagan, in signing into law the 1983 Amendments, said it very well -- "This bill assures us of one more thing that is equally important. It's a clear and dramatic demonstration that our system can still work when men and women of good will join together to make it work. There has been one point that has won universal agreement: the Social Security system must be preserved."

I would like to pay great tribute to the distinguished Chairman and Ranking Minority Member of this Subcommittee, who played such an important role in the 1983 legislation. At one time, when it appeared that the "torch" had irretrievably fallen to the ground, and no legislative action would be taken, these two distinguished statesmen picked up the torch, and it was carried triumphantly to the finish line.

Table 1

COMPARISON OF ACTUAL OASI AND DI TRUST FUND BALANCES AT END OF YEAR WITH THOSE ESTIMATED IN 1983

(Figures in billions)

Calendar Year	Actual Net Balance a/	Estimated Net Balance a/ Alt. II-B	Estimated Net Balance a/ Alt. III	Excess of Actual Over Estimated Balance Alt. II-B	Excess of Actual Over Estimated Balance Alt. III
		OASI Trust Fund			
1983	$2.2	$3.8	$3.1	-$1.6	-$.9
1984	9.6	6.1	2.1	3.5	7.5
1985	20.1	11.7	5.3	8.4	14.8
1986	39.1	16.4	8.1	22.7	31.0
1987	62.1	22.6	10.6	39.5	51.5
		DI Trust Fund			
1983	$10.3	$11.1	$11.1	-$.8	-$.8
1984	9.1	10.5	10.1	-1.4	-1.0
1985	8.8	10.3	9.7	-1.5	- .9
1986	7.8	10.4	9.8	-2.6	-2.0
1987	6.7	11.2	10.2	-4.5	-3.5

a/ The net balance of the OASI Trust Fund is the total assets, minus the outstanding loans (if any) from the DI and HI Trust Funds. Similarly, the net balance of the DI Trust Fund is the total assets, plus the outstanding loans (if any) to the OASI Trust Fund.

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Source: Estimated data are from "Actuarial Cost Estimates of the Effects of Public Law 98-21 on the Old-Age, Survivors, and Disability Insurance and Hospital Insurance Programs, Committee on Ways and Means, House of Representatives, WMCP:98-13, September 8 1983

Table 2

COMPARISON OF ACTUAL OASDI AND HI TRUST FUND BALANCES AT END OF YEAR WITH THOSE ESTIMATED IN 1983

(Figures in billions)

Calendar Year	Actual Net Balance a/	Estimated Net Balance a/		Excess of Actual Over Estimated Balance	
		Alt. II-B	Alt. III	Alt. II-B	Alt. III
		OASDI Trust Funds			
1983	$12.5	$14.9	$14.2	-$2.4	-$1.7
1984	18.7	16.6	12.2	2.1	6.5
1985	28.9	22.0	15.0	6.9	13.9
1986	46.9	26.8	17.9	20.1	29.0
1987	68.8	33.8	20.8	35.0	48.0
		HI Trust Fund			
1983	$25.3	$24.1	$24.0	$1.2	$1.3
1984	28.1	23.2	22.1	4.9	6.0
1985	31.1	22.5	19.2	8.6	11.9
1986	40.0	22.8	15.8	17.2	24.2
1987	53.7	20.5	8.0	33.2	45.7
		OASDI and HI Trust Funds			
1983	$37.8	$39.0	$38.2	-$1.2	-$.4
1984	46.8	39.8	34.3	7.0	12.5
1985	60.0	44.5	34.2	15.5	25.8
1986	86.9	49.6	33.7	37.3	53.2
1987	122.5	54.3	28.8	68.2	93.7

a/ The net balance of the OASDI Trust Funds is their total assets, minus the outstanding loans (if any) from the HI Trust Funds to the OASI Trust Fund. The net balance of the HI Trust Fund is its total assets, plus the outstanding loans (if any) to the OASI Trust Fund.

Source: See Table 1.

Table 3

COMPARISON OF ACTUAL OASDI AND HI COST RATES[a/] WITH THOSE ESTIMATED IN 1983 (ALTERNATIVE II-B)

Calendar Year	OASDI Actual	OASDI Estimated	OASDI Ratio[b/]	HI Actual	HI Estimated	HI Ratio[b/]
1983	11.50%	12.00%	96%	2.67%	2.78%	96%
1984	11.24	11.37	99	2.64	2.79	95
1985	11.13	11.34	98	2.65	2.89	92
1986	10.98	11.40	96	2.58	3.01	86
1987	10.69	11.35	94	2.53	3.14	81

a/ Cost rate is total outgo for benefit payments and administrative expenses expressed as a percentage of taxable payroll.

b/ Actual cost rate as percentage of estimated cost rate.

Source: See Table 1

Table 4

PRESENT AND PROPOSED SOCIAL SECURITY TAX RATES[a/] FOR EMPLOYERS AND EMPLOYEES (each)

Period	Present Law	Proposal	Difference
1984-87	5.7%	5.7%	--
1988	6.06	6.06	--
1989	6.06	5.7	- .36%
1990-94	6.2	5.7	- .5
1995-2014	6.2	5.1	-1.1
2015-19	6.2	6.0	- .2
2020-24	6.2	6.8	+ .6
2025-48	6.2	7.6	+1.4
2049 and after	8.0[b/]	7.7	- .3

a/ These rates do not include the tax for the Hospital Insurance portion of Medicare -- currently, 1.45% (and so scheduled for all future years). Also, in 1984, the employee rate was reduced by a tax credit of 0.3%.

b/ Rate necessary to finance scheduled benefits.

May 27, 1988

MEMORANDUM

FROM: Robert J. Myers

SUBJECT: Proposed Future Allocation to the DI Trust Fund from OASDI Taxes

In my prepared testimony, I suggested that the allocation of the OASDI rate to the DI Trust Fund, as contained in present law, should be increased. The reasons why such action should be taken are that the DI fund balance (on a "net" basis, including as an asset the loan to the OASI Trust Fund, which was fully repaid in 1986) has been decreasing steadily since 1983, and that the DI system is not in close long-range actuarial balance. Further, under the pessimistic estimate (Alternative III), the fund is shown to be exhausted in 1996. On the other hand, the OASI portion of OASDI is in much better financial condition, both short-range and long-range.

The long-range actuarial balance status of the OASDI program on the 75-year "level-financing" basis is shown by the 1988 Trustees Report as follows (for the intermediate estimate):

Trust Fund	As Percent of Taxable Payroll: Income Rate	Cost Rate	Balance	Imbalance as Percent of Cost Rate
OASI	11.53%	11.98%	-.45%	3.76%
DI	1.40	1.53	-.13	8.50
OASDI	12.94	13.52	-.58	4.29

The above figures show that both OASI and OASI-DI combined are in close actuarial balance, because their imbalances are less than 5.00%.

I suggest that the DI allocations from the OASDI tax rates be increased such that both OASI and DI separately have imbalances exactly the same as OASI and DI combined. If this were done, the "level-financing" income rate for DI would be 1.46% of taxable payroll (1.53%, times 100% minus 4.29%). As it so happens, such an income rate would result if the present allocation schedule to DI (as to the employer-employee tax rate, 1.06% in 1988-89, 1.20% in 1990-99, and 1.42% in 2000 and after) were a uniform rate of 1.42% in all future years (i.e., the same as the ultimate rate currently scheduled).

STATEMENT OF
DR. JANET L. NORWOOD
COMMISSIONER
BUREAU OF LABOR STATISTICS

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before the Subcommittee on Social Security and Family Policy to discuss the statistics and projections of the Bureau of Labor Statistics and their implications for the Social Security System.

Two aspects of the future labor force are crucial to the Social Security System. The overall size of the labor force furnishes the working base from which revenues are derived. The size of the labor force that is nearing retirement age, coupled with the decisions of the individuals within that group to stay in the labor force or retire, affects the number of Social Security recipients.

The Bureau of Labor Statistics projects that the labor force will reach 139 million by the year 2000. This represents the addition of 21 million persons between 1986 and 2000, well below the 31 million added between 1972 and 1986--a period of the same length. This slowing of labor force growth reflects a number of factors, but the most important of these is the large baby-boom generation which was entering the labor force in the 1972-86 period. Beginning in the early 1980's, and continuing throughout most of the remainder of this century, the much smaller population group--the baby bust group or those born between 1965 and 1978--will be entering the labor force.

Some trends in the projected labor force--the expected growth in the share of the labor force attained by women and the drop in the share of the labor force for workers 55 and older--are the result of projected changes in labor force participation rates. Women were only 39 percent of the labor force as recently as 1972; by 2000, they are projected by BLS to be 47 percent of the labor force, because of the increases in workforce participation. On the other hand, the older population, which is projected to grow as a share of the overall population, is expected to have reduced labor force participation in 2000 and, as a consequence, constitute a smaller share of the labor force.

Prime age workers--25 to 54 years old--are projected to comprise 73 percent of the labor force in the year 2000, up from the 67 percent they represented in 1986. This increasing share reflects underlying demographic changes: (1) the baby-boom generation will still be in the central working ages over this period, (2) the share of the youth labor force (16-24 years) is projected to continue to decline until the "echo" of the baby boom (the children born to women of the baby-boom generation) begin entering the labor force between 1995 and 2000, and (3) the share of older workers (55 and older) is projected to shrink between 1986 and 2000 by about one-and-a-half percentage points. This reflects a BLS projection that men in this age group will continue to retire at an earlier age. In developing the projections for older workers, BLS analyzed the trends for detailed age-sex-race groups in the 55-and-over age group and found no convincing evidence of any turn-around in the tendency for a smaller and smaller share of the older labor force to continue working. Nonetheless, there are a number of emerging developments that bear watching. (Of course, these projections assume no change in the underlying legislation which could affect the retirement decisions.)

Labor force participation rates for older men have fallen steadily and dramatically since labor statistics were first collected on a regular and consistent basis in the late 1940's. This trend has resulted almost entirely from improvements in the financial resources available to older workers, allowing them to retire at earlier and earlier ages. These improvements come from expansion of the coverage and benefits under the Social Security retirement and disability programs, expansion of private pension programs, and a general increase in the financial resources of the older population.

In general, until about age 62, the first year of eligibility for Social Security benefits, the employment patterns of older workers are similar to those of younger ones. Employed men in their late 50s and 60s work in similar occupations for about the same number of hours per week as younger men. Social Security eligibility increases the lure of retirement; at 62, many workers leave the labor force. Those who continue to work often move away from full-time, year-round employment to alternative schedules that are less demanding. For some, reducing their work schedules may require a job switch, as part-time work opportunities are unusual in some industries but common in others, such as retail sales and services.

Nevertheless, significant numbers of people continue to work considerably beyond age 62. On average in 1987, there were 3.1 million men and women age 65 or over in the labor force. The decision to continue working reflects the impact of many factors, including health, earnings, retirement income, self-employment, part-time opportunities, job satisfaction, and the availability of jobs in general. For women, marital status also plays a large role, as unmarried women are far more likely to work than are women with a husband present.

What are the conditions facing retirees today? Most of those who are out of the labor force report to interviewers for the monthly Current Population Survey that they do not want a regular job, either full or part time. In fact, only about half a million of the more than 30 million persons who are age 60 and over and not in the labor force indicate any interest in work. And even of those, personal factors and home responsibilities keep many from working. Although a minority of older people do obtain work after retiring from a long-term job, once an older person is out of the labor force for any extended period of time, retirement generally becomes permanent--in actual behavior as well as in mindset.

Why do so many choose the nonwork option? To answer that we need to examine what happens once someone takes a pension or applies for Social Security retirement benefits. Once the link with a person's long-time employer has been broken, a mismatch often exists between the types of jobs older persons might accept and the types of offers being made. Earnings for available part-time jobs may be quite low compared to what the retired worker had previously earned at the peak of his career. Moreover, even the types of jobs and the work schedules may not be what the retired worker had in mind. However, the situation is beginning to change. Labor shortages are already upon us in certain parts of the country and for certain types of occupations. Some employers, especially in retail trade, already facing shortages, have specifically targeted older workers, particularly retirees, to fill part-time and peak-load schedules. While we have anecdotal evidence, such efforts are not widespread enough at this point for us to see their effects on aggregate employment data. But, we need to watch the trend.

We also know that people are living longer. At 65 years of age, a man can expect to live another 14 years and a woman, 18 years. According to the most recent BLS estimates, the man who at age 65 is still working will spend about one-quarter of those additional years at work; the woman, one-fifth.

We also know that workers in the rapidly growing "upscale" occupations--managerial and professional occupations--often remain in their jobs longer than those in other lines of work. This is because 1) these workers often are in better health than those in more physically demanding jobs, 2) the jobs are easier for older persons because they demand less physically, and 3) they may offer, in general, more psychic satisfaction than, say, repetitive factory jobs.

As we move further into the 21st century, therefore, we may find that more people physically able to perform the types of jobs the economy provides will be in jobs that will still interest them. Others could find part-time opportunities in the growing service sector, which is generally where older retirees and job switchers work.

Over the last few years, there has been some stabilization in the participation rates for older men. I do not believe that this means a reversal of past trends-- at least for the next decade, assuming no change in retirement laws. We saw something similar in the late 1970's, which was also a period of economic expansion and rapid employment growth. Last year, the economy created 3 million jobs, and, obviously more employment opportunities for workers of all ages. It is unlikely that job growth will continue at such a rapid pace, especially since growth in the labor force is expected to slow.

While the labor force projections prepared by the Bureau do not extend beyond 2000, it is important to consider the changes likely to occur in the early part of the next century since they need to be taken into account in developing long-range retirement funding decisions. As the baby-boom generation reaches early retirement age, which will begin about 2007 and continue for the succeeding twenty years, very large numbers of people retiring can be expected. We know from the Census Bureau projections, for example, that the 65-and-older age group will grow from 16 percent of the civilian noninstitutional population 16 years of age and over to 24 percent in 2025. Moreover, during this period workers who will be paying into the Social Security System, will be primarily from the baby bust group.

One way to look at the demands on the Social Security System is to examine the dependency ratio--the ratio of those retired and outside the labor force to those working or looking for work. In 1986, there were 22 persons 65 and over outside the labor force for every 100 persons in the labor force. That ratio has been increasing steadily; in 1972 there were only 18 older nonworkers for every 100 workers. By the year 2000, the ratio increases to just over the 1986 level--23 older nonworkers for every 100 workers. However, using the Census Bureau population projections and holding BLS participation rates at the year 2000 mark, we can calculate a rough estimate of the ratio for the year 2025. At that time--and again emphasizing that it is a very rough estimate--there could be almost 40 nonworking persons 65 and older for every 100 workers.

What will these older persons live on? Currently more than half of all Social Security recipients age 65 or older receive no other pension. Some of them do have other sources of income--about three fifths have some asset income (e.g., interest or dividends), and nearly one-fifth have some wage and salary income. The presence of these other sources of income is very important because it greatly decreases the likelihood of poverty.

Lack of pension coverage and failure to have vested in a pension benefit due to short or discontinuous service can be a serious problem for older workers, especially women. Women who are working today tend to have fewer years of continuous work experience than men, are often employed in industries with low wages, and frequently have no pension coverage at all. This situation may improve in the future as more covered workers retire and as more women develop continuous work histories.

The Current Population Survey showed that in 1985, only 43 percent of all civilian employees were covered by an employer or union pension plan. However, this level of coverage is much higher than in the past. The Department of Labor's Pension and Welfare Benefits Administration maintains a series which calculates pension coverage by comparing information reported to the Internal Revenue Service with CPS labor force data. According to this series, the proportion of workers covered by pensions doubled from 22 percent in 1950 to 44 percent in 1975, although there has been little change since then. In recent years, there has been an increase in the proportion of plans supported by defined contributions and a corresponding reduction in the proportion that provide defined benefits.

Of course, larger firms are much more likely to provide retirement coverage. The BLS Employee Benefit Survey shows that about 90 percent of the full-time workers in private medium or large firms are covered. In 1987, BLS studied employee benefits in State and local government for the first time. Virtually all (98%) full-time State and local government workers were covered by retirement plans, the vast majority in defined benefit plans.

In 1986, 62 percent of defined benefit pension plan participants in medium and large firms were in plans that were coordinated (integrated) with Social Security benefits. This figure has increased gradually since 1983, when 55 percent were in integrated plans. (The definition of integration was changed by BLS in 1983, so data from earlier years are not comparable.)

The incidence of Social Security integration was much lower among State and local government pension plan participants. One reason for this: some governments are not covered by the Social Security System. In 1987, 73 percent of the pension plan participants studied in the Employee Benefit Survey were employed by State and local governments covered by Social Security; but even among these participants, only 25 percent were in plans with integrated formulas.

We know, of course, that when people retire, their incomes usually are more limited than during their working lives. What do we know about their expenses?

The BLS Consumer Expenditure Survey shows the older Americans consume fewer goods and services than the nonelderly and spend a larger proportion of their incomes on essentials. Housing (including utilities), food, and medical care account for two-thirds of the elderly's expenditures.

Older households consume less than younger households partly because they tend to have smaller incomes, but also because they have fewer household members and different needs. For example, the older age group is less likely to be paying off a mortgage and they average fewer cars.

It is also important to recognize that older persons do not constitute a homogeneous group. The characteristics and the expenditures of those aged 65 to 74 are quite different from those 75 and over. Medical care, for example, accounted for 15 percent of the expenditures for those 75 and over, 9 percent for those 65 to 74 years, and less than 5 percent for all consumer units.

In conclusion, let me emphasize how important I think these issues raised by the Subcommittee are. The extent to which retirement age individuals will remain in the labor force is a critical variable for future labor supply as well as the demands on the Social Security System. As I indicated, BLS projections to the year 2000 indicate continued reductions in the participation rate of older persons. Forecasting the situation beyond that time period is more problematic. Changes in the economic and personal situation of older persons are hard to anticipate so far into the future.

STATEMENT OF WILLIAM L. ROPER, M.D.

ADMINISTRATOR

HEALTH CARE FINANCING ADMINISTRATION

I am William L. Roper, M.D. Administrator of the Health Care Financing Administration (HCFA), and I am pleased to be here today to discuss the financial status of the Medicare trust funds.

INTRODUCTION

It is always a pleasure to testify before this Committee, and especially when I can assure the American public that their Medicare system is strong. The legislative reforms enacted in 1983 that secured the financing of the cash benefits programs well into the next century have once again affirmed that neither the Administration nor the Congress will fail to act in a responsible manner when the soundness of the system is threatened. I am pleased, Mr. Chairman, that you are holding these hearings which will begin to focus attention on the need to look closely at the Medicare program. For reasons I will detail later in my statement, a future President and a future Congress will need to take action to ensure its continued strength.

Commissioner Hardy has set forth those demographic and economic factors which determine the financial soundness of the cash benefits portion of the Social Security program. I will address the unique features that are of particular concern to the Medicare program.

THE MEDICARE TRUST FUNDS

The Medicare program is financed through two trust funds. The Hospital Insurance (HI) fund pays for inpatient hospital and related care for the elderly and the disabled. It is financed primarily by payroll taxes paid by today's workers. The Supplementary Medical Insurance (SMI) fund pays for physicians, outpatient and other related medical services. Premiums from Medicare beneficiaries account for one-quarter of the SMI fund's financing; the balance is paid by general revenues. Since 1981 and projected through 1989 Medicare spending will increase by about 115 percent; in contrast defense spending will increase about 87 percent.

The Board of Trustees in the 1988 annual report project that (using the intermediate sets of assumptions) the HI fund will remain solvent until shortly after the turn of the century. The Board urges prompt attention to the financing of this program while we have time to take remedial action that is not precipitous.

The soundness of the SMI fund is appropriately assessed on an annual basis, as one would assess private group insurance. Each year HCFA actuaries determine the premium levels and general revenues needed to finance the SMI program for the coming year. The Trustees find that the SMI fund is sufficient to cover the projected expenditures for 1988, and thus the fund can be said to be actuarially sound. But, the Board sounds a note of caution -- with which I agree -- about the rapid growth in the cost of the SMI program.

FACTORS AFFECTING THE MEDICARE TRUST FUNDS

The demographic factors that affect the soundness of Social Security financing also affect Medicare. A major demographic shift will occur as the Baby Boom generation retires, so that by the middle of the next century there will be only two workers to support each beneficiary. This contrasts with today's ratio of about 4 to 1.

The aging of the population has important implications for the soundness of the Medicare trust funds. Data from the Census

Bureau indicate that today the percentage of the population over age 65 is about 12 percent. By the turn of the century the proportion will reach 13 percent and will increase to slightly over 21 percent by the year 2030.

The aging of the elderly population also will have an impact, although a more limited one, on the Medicare program. Because lifespan has increased, the population over age 85 will grow at a faster rate than the age 65-and-over group as a whole. Today nearly 10 percent of the elderly population is over age 85. By the year 2000 the number of the "old elderly" will nearly double and will constitute over 14 percent of the elderly population.

This percentage will grow steadily, with a temporary respite between the years 2010 and 2030, as the Baby Boom group reaches age 65 but not yet 85. Thereafter, the age 85 and over population will increase steadily until it comprises nearly 25 percent of the elderly. Our analysis suggests that the aging of the elderly population is a relatively minor factor in projecting expenditure for Medicare, but would become a significant one if Medicare were to provide a long term care benefit.

We must not fail to recognize the historical trend in this country with respect to spending on health care. National expenditures for health care in the United States have been mounting rapidly and consuming an ever larger portion of the GNP. At the inception of the Medicare program, health care spending represented about 6 percent of the GNP. This rate has consistently increased since that time, and now accounts for 11 percent of the GNP.

We must be alert to another component of health care financing -- that of prices. Price inflation for medical goods and services has been higher than for non-medical items -- and we have no reason to believe that the future will depart from the past.

Between 1965 and 1987, the consumer price index for medical care increased at an average annual rate of 7.8 percent -- almost two percentage points higher than the rate for other goods and services in the economy. Had health care prices grown at the lower rate, our 1987 national bill for health care would have been some $140 billion less than we actually paid.

Medicare must be considered in the context of the larger health care spending arena. To the extent that there is increased and unbridled demand as well as unrestrained prices, the Medicare program will shoulder a significant portion of the spending. Today Medicare pays for nearly 29 percent of the hospital care in this country. Likewise Medicare pays for over 20 percent of physician services. While Medicare has significant purchasing power in the medical market place, we are subject to the same economic forces as the overall environment of the health care economy.

THE HOSPITAL INSURANCE TRUST FUND

In 1987 Medicare paid out slightly more than $50 billion from the HI trust fund. Under the intermediate sets of assumptions, the Board of Trustees projects that the HI trust fund will be solvent until at least the year 2005 and perhaps until 2008. But, the Board cautions that, "... any significant adverse deviation from these projections could result in the inability of the fund to meet its obligations much sooner than projected."

Clearly there is a need to begin the debate now on how to address the financing of the HI trust fund. The Board "...notes that promising steps..." have been taken by this Administration "...to begin reducing the rate of growth in payments to hospitals...including the implementation of prospective payment and diagnosis related groups..."

From fiscal year 1973 through 1983, prior to the implementation of the prospective payment system (PPS), payments from the HI trust fund were increasing at an average annual rate of 19 percent. But, the reforms we have taken have dramatically slowed the rate of growth of HI payments per enrollee from a growth rate of 16.4 percent in fiscal year 1982 (prior to the implementation of PPS) to 0.5 percent in fiscal year 1987.

Surely these payment reforms have strengthened the financial solvency of the HI trust fund. And, while there is no cause for alarm, we must begin to face up to the challenges that still lie ahead. The debate needs to begin now. Time and again since the beginning of the Social Security program in 1935, Presidents and Congresses have demonstrated their commitment to the program that enjoys the support of the American people. Elected officials have made the commitment to address its financial soundness, to make difficult decisions regarding its financing, and to build public consensus for such actions.

As things stand now, the HI fund will need either an infusion of revenues of 16 percent or a decrease in spending of 14 percent to ensure the financial soundness of the fund through the next 25 year period.

Mr. Chairman, as you know better than anyone, discussions of the solvency of the Social Security and Medicare programs can easily alarm the public, and this is something we want to avoid. We have time to address the issue in a thoughtful and deliberate fashion and should listen to the Board of Trustees who urge Congress to "...take early remedial measures to bring future HI program costs and financing into balance, and to maintain an adequate trust fund against contingencies."

THE SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND

In 1987 Medicare paid out nearly $31 billion from the SMI trust fund. The SMI trust fund is financed primarily through general revenues, with the balance from beneficiary premiums. Its solvency is determined each year when HCFA actuaries project the balance of assets over liabilities for the period. The Board finds the SMI fund secure through December 1988.

But, the Board quite rightly notes their concern with "...the rapid growth in the cost of the program" that has resulted in a doubling of outlays in the last five years. The Board goes on to note that "...for the same time period, the program grew 40 percent faster than the economy as a whole..." and that the growth "...shows no sign of abating despite recent efforts to control the cost of the program." Again, the Board recommends that Congress continue to work to curtail the growth of SMI spending.

I could not agree more. Last September I appeared before the Ways and Means Committee to explain why it was necessary to increase the SMI premium to $24.80 per month in 1988 -- a 38.5 percent increase. This premium is required to accommodate a nearly 14 percent increase in SMI spending projected for 1988. We expect SMI program outlays to grow at least 90 percent over the next five years -- 4.2 times as fast as the cost of living adjustment projected for Social Security benefits.

Physician expenditures effectively drive SMI spending, accounting for about two-thirds of SMI spending. Physician payments were responsible for the lion's share -- 63 percent -- of the 1988 premium increase. Historically Medicare physician spending has increased very rapidly, particularly relative to growth in the general economy as measured by the GNP. Between fiscal years 1975 and 1987 it increased 615 percent -- the GNP increased only about 181 percent during the same period. SMI spending for physician services was about $404 per enrollee in 1982, but jumped to about $711 per enrollee by 1987.

The need to control SMI spending is clear. Without some control beneficiary premiums and out of pocket spending will become exorbitant and create pressure for greater general revenue financing of the program.

SMI PROGRAM REFORMS

To control costs successfully, any reform of the SMI program must include appropriate incentives to control volume not just prices of individual services. Much of the dramatic increase in SMI expenses has gone to provide real benefits for patients --clearly we can do more for patients today than we could 15 years ago. But, we also know from various research projects and our own analysis that a considerable amount of unnecessary services are provided -- more lab tests, more office visits, and more fragmentation of billing to maximize payments. To the extent that these practices are inappropriate, we waste valuable, and limited, resources.

We have initiated several incremental reforms which attempt to deal with the volume of service problem. Our fiscal 1989 budget request includes an additional $50 million for increased carrier claims review. We plan to intensify pre-payment and post-payment claims review and increase medically trained personnel by 10-15 percent. In addition, we will require carriers to employ a physician to serve as a liaison between the carrier and the medical community to facilitate physician understanding of the medical review process.

Related to the issue of unnecessary services is the issue of ineffective services. We have begun a series of discussions with leading medical researchers on the subject of effectiveness of medical interventions. Mr. Chairman, you are aware of recent research findings that suggest that many commonly used, and often expensive medical treatments, may be ineffective and in some instances harmful. One study found that 32 percent of carotid endarterectomies were unnecessary, as were 17 percent of coronary angiograms and upper gastrointestinal endoscopies. Other studies suggest that there are wide variations in practice patterns for specific diagnoses. For example, researchers have found that residents of New Haven, Connecticut are twice as likely to undergo coronary bypass surgery as residents of Boston -- without clinically meaningful differences in health outcomes.

In light of these findings and our goal of fostering quality in the Medicare program, it is time for Medicare to assume a leadership role in providing physicians with information on what works in the practice of medicine. We believe that most physicians want such information and would gladly act on it. For reasons that are not yet clear, it appears that some practice patterns evolve based on local consensus rather than sound scientific evidence. We have available within the Medicare data system sources of clinical information which will permit us to look at actual outcomes of various medical procedures. This information can be made available to physicians for educational purposes. Quite simply, Medicare ought to spend its dollars on what works.

To support greater research activity, last week we published in the Federal Register a new routine use notice which will permit outside researchers access to a file containing detailed information on about 11 million inpatient Medicare records. Although the identity of patients will be encrypted, it will be possible to track individual patients over time to determine certain health outcomes. This file also includes zip code information that will permit small area analysis of treatments and outcomes. Researchers are excited about this comprehensive, new, and rich data base which we hope will facilitate and improve effectiveness studies in the future.

This is an exciting new area for the Medicare program and one I am pleased to initiate. It will not be implemented overnight because it requires a thoughtful approach, the strength of which lies in building consensus with the medical community along the way. We have begun the dialogue and the initial reactions have encouraged us to move ahead.

Another promising area for reform has lead us to develop a demonstration model to test a preferred provider organization -- PPO -- for Medicare beneficiaries who elect to enroll in the demonstration. Beneficiaries will have a financial incentive to enroll -- namely reduced cost-sharing. Physicians who participate in the PPO will have a greater likelihood of a stable and full patient load, but must agree to more intensive utilization review as a means of insuring that only appropriate services are provided.

We must not forget that intensified utilization review may reduce the amount of unnecessary services but it does not eliminate the incentives inherent in a fee for service system -- additional services mean additional payments. In addition, strengthened administrative controls, such as intensive utilization review, come with a cost -- more federal regulation and oversight.

MORE FUNDAMENTAL REFORM

We believe that it is necessary to make more fundamental reforms in the Medicare program in order to control program costs while providing quality health care. A long run solution is to make a single payment per beneficiary to a private health plan of the beneficiary's choice. Such managed care systems will control costs and ensure that beneficiaries get the quality of care they need--without the added risk of care that is not needed.

Currently about one million Medicare beneficiaries are enrolled in pre-paid private health plans. Nearly half of physicians currently receive some portion of their income from organized delivery systems, such as HMOs. We expect the growth in future enrollment to be steady as more people recognize that private health plans offer them a better health care deal -- financial protection and quality care.

LONG TERM CARE DEBATE

Mr. Chairman, we are here today talking about the stability and viability of the Medicare trust funds. As you know, the Congress is now in conference on major legislation put forth by this Administration to provide catastrophic health insurance as part the Medicare program. This new benefit will be largely financed by the beneficiaries through flat and supplemental premiums--thus avoiding the problem of inter-generational inequity.

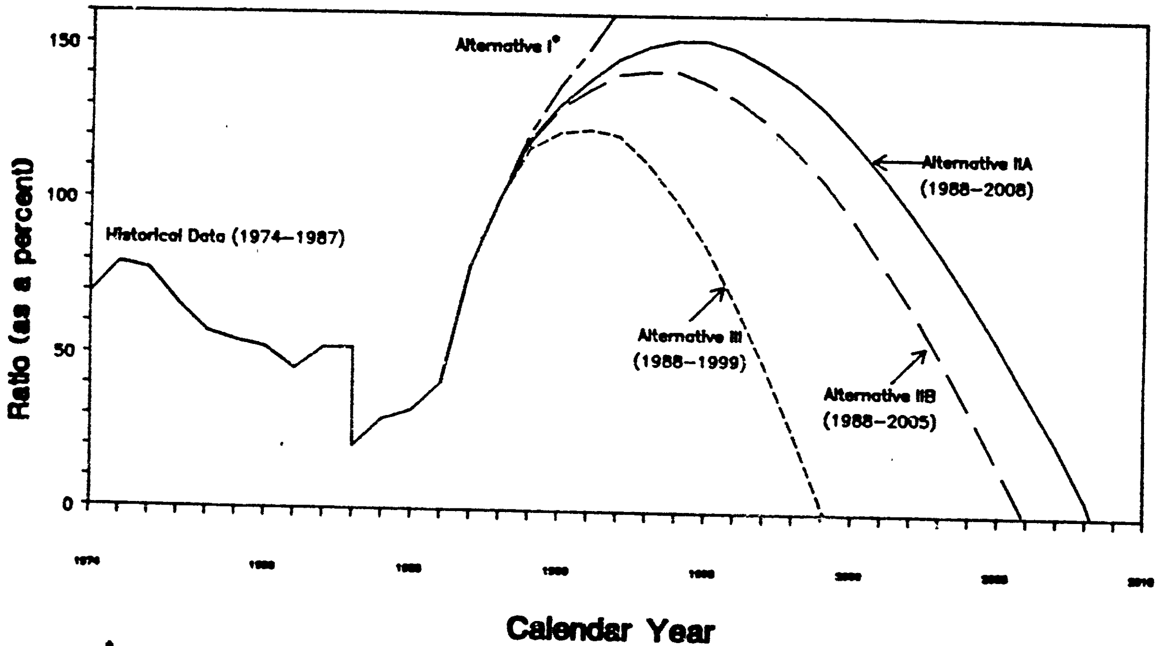
But, as we begin the debate on the difficult issue of financing long-term care in this country --even as bills are pending before this committee -- we must recognize the link between these discussions and the continued solvency of the trust fund. We must be particularly alert to equity effects in how such programs are to be financed. To the extent that a solution for long-term care is found in the Medicare program, that solution will radically affect the stability of the trust fund and will change the nature of the trust fund debate.

CONCLUSION

I want to conclude my testimony today with a positive message. The public, the Congress, and every President since Franklin Roosevelt have demonstrated a strong commitment to maintaining a sound Social Security system. This same support holds true for the Medicare program.

We cannot be complacent -- the Medicare program is dynamic and we, as a society, will make the changes to keep it sound. The debate is healthy -- public consensus is not reached overnight. But, the public can be sure that the Medicare program will confront and resolve the financing problems facing the system in the future.

Figure 1
Short Term HI Trust Fund Ratios



*The trust fund is depleted in 2044 under alternative I.

Note: The trust fund ratio is defined as the ratio of assets at the beginning of the year to disbursements during the year.

Statement of
Paul N. Van de Water
Chief, Projections Unit
Congressional Budget Office

Mr. Chairman, I am pleased to be here to discuss government budget trends and their relation to projected demographic and labor force changes. After a brief overview of federal budget developments during the past 25 years, my testimony provides three illustrative budget paths through the year 2000. It also examines the fiscal outlook for the entire government sector, including state and local governments, and considers some of the issues raised for long-run federal fiscal policy.

FEDERAL BUDGETARY TRENDS, 1962-1988

The role of the federal government in the economy has grown over the past 25 years, as depicted in Figure 1. After a period of 13 years from 1962 to 1974, during which federal spending rarely reached 20 percent of gross national product (GNP), outlays averaged 21.3 percent of GNP during the 1975-1979 period and 23.3 percent of GNP during the 1980s. Total federal revenues showed less distinct trends, fluctuating between 17.4 percent and 20.1 percent of GNP over the entire period. In the 20 years from 1962 to 1981, the federal budget deficit averaged 1.7 percent of GNP. Since then, however, the deficit has averaged almost 5 percent of GNP.

Figure 2 illustrates the substantial shifts that have occurred in the components of federal spending. Spending for discretionary appropriated accounts--defense and nondefense combined--declined by about one-fourth over the 1962-1988 period when measured as a share of GNP. The ratio of defense spending to GNP has been on a downward trend since

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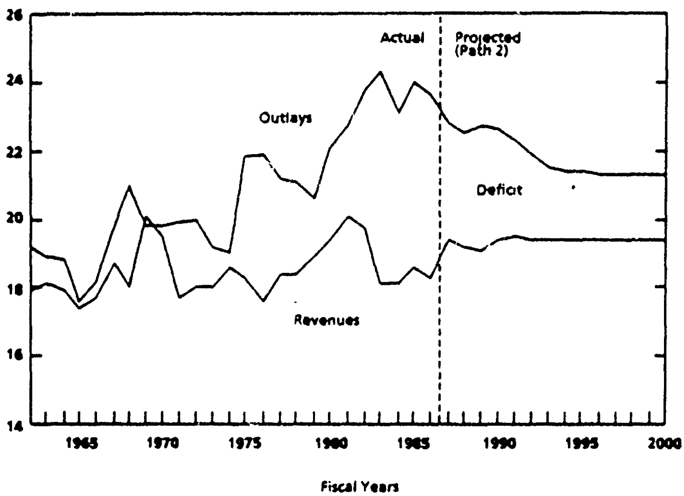
the early 1950s, interrupted only by the Vietnam War and the defense buildup of the early 1980s. National defense outlays fell to 4.8 percent of GNP in the late 1970s and recently peaked at 6.5 percent of GNP in 1986.

Nondefense discretionary programs have borne the brunt of budgetary restraint in the 1980s, declining from almost 6 percent of GNP at the start of the decade to 3.8 percent at present. This category encompasses a wide variety of federal activities, including international affairs, transportation, health research, subsidized housing, veterans' medical care, and the administrative costs of Social Security and Medicare. Slightly over a fifth of nondefense discretionary outlays provide pay and benefits for employees of the civilian

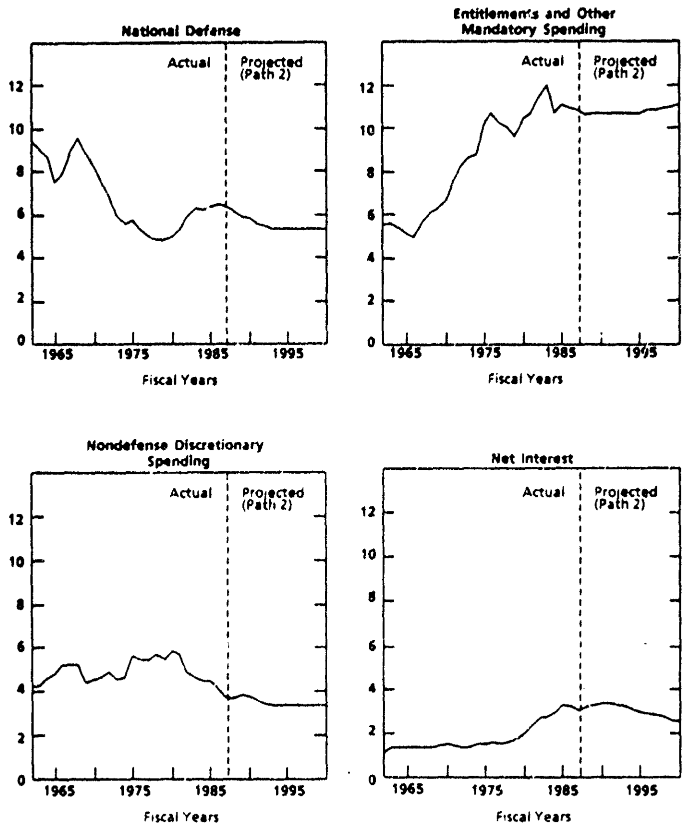
Figure 1.
Revenues and Outlays as Percents of GNP, 1962-2000



SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget. The projected outlays show the second of the three paths described later in the text.

Figure 2.
Outlays by Category as Percents of GNP, 1962-2000



SOURCE: Congressional Budget Office

NOTE: The totals include Social Security, which is off-budget. The projected outlays show the second of the three paths described later in the text

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agencies of government, and about a third of them represent grants-in-aid to state and local governments.

Entitlements and other mandatory spending have nearly doubled their share of GNP over the past 25 years. The increase in entitlement spending (which includes Social

Security and Medicare benefits, federal employee retirement, unemployment compensation, farm price supports, and most means-tested benefits) has more than offset the fall in discretionary programs. In addition, the rapid rise in federal borrowing and relatively high interest rates during the 1980s have caused net interest on the public debt to be the fastest growing spending category in the federal budget.

Table 1 provides further details on federal fiscal activities in recent years. It shows separately the activities of the Old-Age and Survivors and Disability Insurance trust funds, which were removed from the budget totals by the Balanced Budget Act of 1985. Almost 95 percent of federal spending for the aged is accounted for by just a few entitlements--Social Security, Medicare and Medicaid, and programs providing benefits for retired and disabled federal employees, coal miners, railroad workers, and veterans. Between 1965 and 1985, these entitlement programs more than doubled, growing from 3.7 percent to 8.8 percent of GNP. Over this period, the number of Americans age 65 and over grew from 18.5 million to 28.5 million, an increase of a little more than half. But, more important than this demographic shift, decisions were made to pay for an increasing share of the needs of the aged through public programs. Medicare began operation in 1966, and Medicaid was greatly expanded. Social Security replacement ratios were increased substantially during the early 1970s. In more recent years, however, modest steps have been taken to stem the growth of both Social Security and Medicare.

PROJECTIONS THROUGH THE YEAR 2000

Projections inevitably lack the richness of history. Federal spending and revenues during the past 25 years have been

TABLE 1. FEDERAL OUTLAYS, REVENUES, AND DEFICITS, SELECTED YEARS 1965-1988 (By fiscal year, as percents of GNP)

Category	1965	1970	1975	1980	1985	1988 a/
			On-Budget			
National Defense	7.5	8.2	5.7	5.0	6.4	6.1
Nondefense Discretionary	4.8	4.5	5.5	5.8	4.4	3.7
Entitlements						
Social Security b/	*	*	*	*	0.1	0.1
Medicare and Medicaid	*	1.0	1.4	1.8	2.3	2.5
Other retirement and disability c/	1.1	1.2	1.9	1.8	1.7	1.7
Other	1.4	1.6	2.8	2.4	2.3	1.9
Subtotal	2.6	3.8	6.1	6.1	6.5	6.2
Net Interest	1.4	1.6	1.7	2.1	3.4	3.4
Offsetting Receipts	-1.1	-1.1	-1.2	-1.1	-1.2	-1.1
Outlays	15.1	17.0	17.9	17.8	19.5	18.3
Revenues	14.9	16.1	14.2	15.1	13.9	14.0
Deficit	-0.2	-0.9	-3.6	-2.7	-5.6	-4.3
			Off-Budget (OASI and DI Trust Funds)			
Nondefense Discretionary	0.1	0.1	0.1	0.1	0.1	*
Entitlements	2.5	2.9	4.1	4.4	4.6	4.5
Net Interest	-0.1	-0.2	-0.2	-0.1	-0.1	-0.2
Offsetting Receipts	*	-0.1	-0.1	*	-0.1	-0.1
Outlays	2.5	2.8	4.0	4.3	4.5	4.3
Revenues	2.5	3.4	4.1	4.2	4.7	5.1
Surplus	*	0.6	0.1	*	0.2	0.8
			Total			
Outlays	17.6	19.8	21.8	22.1	24.0	22.6
Revenues	17.4	19.5	18.3	19.4	18.6	19.2
Deficit	-0.2	-0.3	-3.5	-2.8	-5.4	-3.5

SOURCE: Congressional Budget Office.

* Less than 0.05 percent.

a. Estimate.
b. Includes general fund payments to Social Security for military service wage credits, special age-72 benefits, self-employment tax credits, and income taxes on benefits.
c. Includes federal civilian and military retirement and disability, Black Lung benefits, Railroad Retirement, Supplemental Security Income, and veterans' compensation and pensions.

pushed up or down by events such as the Great Society, the Vietnam War, OPEC oil shocks, periodic recessions, and biennial revisions of the tax law. But it is hard to look ahead and see other than smooth trends, even though we can be quite sure that the future will be as variable as the past.

<u>Baseline Budget Projections, 1988-1993</u>

Budget projections depend both on the assumed tax and spending policies and on assumptions about economic performance. CBO's five-year baseline budget projections assume that revenues, offsetting receipts, and entitlement spending are projected according to the laws now on the statute books. Defense and nondefense discretionary appropriations are assumed to be held constant in real terms. The baseline projections are not forecasts of future budgets, which will doubtless include numerous policy changes, but are a benchmark against which to judge the budgetary consequences of proposed legislation. The baseline projections discussed here are based on a CBO economic forecast in which real growth averages 2.2 percent per year in 1988 and 1989. Interest rates are expected to rise later this year. Beyond 1989, CBO's economic assumptions are not a forecast of future conditions but are projections based on historical trends. These longer-term economic assumptions are characterized by annual real growth of about 2.7 percent, inflation stabilizing in the 4 percent to 5 percent range, and slowly declining unemployment and interest rates.

The baseline projection shows federal spending rising at a rate somewhat slower than nominal GNP over the next five years, resulting in federal outlays shrinking gradually as a share of GNP. This occurs principally because spending in defense and nondefense discretionary programs slows--a reflection of the assumption that appropriations grow only at the rate of inflation. While there are small fluctuations in the other spending categories, the 1988 and 1993 spending estimates for those categories as a percentage of GNP are virtually unchanged. On the other hand, revenues under current law are anticipated to increase modestly as a share of GNP and stabilize around 19.4 percent by 1993. As a result of the spending and tax assumptions, the baseline deficit rises slightly from 1987 to 1989, and declines slowly thereafter, reaching 2.1 percent of GNP by 1993.

Looking separately at the on-budget and off-budget components of federal fiscal activities, two clear patterns emerge. First, Social Security is projected to have large surpluses. In the CBO baseline, this surplus grows from $46 billion (0.9 percent of GNP) in 1989 to $97 billion (1.5 percent of GNP) in 1993. Second, during the same period the non-Social Security portion of the budget shows deficits of about $230 billion per year, or roughly 4 percent of GNP.

Extensions of the CBO Projections, 1994-2000

By the mid-1990s, the elderly population will grow less rapidly, and its share of the total population will stabilize at 13 percent. Concurrently, the working-age population will become a larger portion of the total. Under these relatively favorable demographic conditions, a straightforward extension of the five-year projections might suggest a lessening of the fiscal pressures on the federal government. In fact, some analysts have argued that the deficit will disappear by the turn of the century as a result of the Social Security financing structure now in place. In this section, we discuss three illustrative budgetary paths for the 1990s and their implications for the federal deficit. Under only one of these paths, as shown in Table 2, does the deficit disappear.

TABLE 2. ALTERNATIVE BUDGET PROJECTIONS TO THE YEAR 2000 (By fiscal year, as percents of GNP)

Category	Path 1			Path 2			Path 3		
	1989	1993	2000	1989	1993	2000	1989	1993	2000
				On-Budget					
National Defense	5.9	5.3	4.4	5.9	5.3	5.3	5.9	5.5	5.5
Nondefense Discretionary	3.8	3.4	2.7	3.8	3.4	3.4	3.8	3.9	3.9
Entitlements									
Social Security a/	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Medicare and Medicaid	2.6	3.1	4.1	2.6	3.1	4.1	2.6	3.1	4.1
Other retirement and disability b/	1.7	1.6	1.5	1.7	1.6	1.5	1.7	1.6	1.5
Other	1.8	1.3	1.0	1.8	1.3	1.0	1.8	1.3	1.0
Subtotal	6.2	6.1	6.7	6.2	6.1	6.7	6.2	6.1	6.7
Net Interest	3.5	3.7	3.2	3.5	3.7	3.6	3.5	3.8	4.0
Offsetting Receipts	-1.1	-1.0	-1.0	-1.1	-1.0	-1.0	-1.1	-1.0	-1.0
Outlays	18.4	17.6	16.0	18.4	17.6	18.1	18.4	18.3	19.1
Revenues	13.9	14.0	14.0	13.9	14.0	14.0	13.9	14.0	14.0
Deficit	-4.5	-3.6	-2.1	-4.5	-3.6	-4.1	-4.5	-4.3	-5.1
				Off-Budget (OASI and DI Trust Funds)					
Nondefense Discretionary	*	*	*	*	*	*	*	*	*
Entitlements	4.5	4.5	4.3	4.5	4.5	4.3	4.5	4.5	4.3
Net Interest	-0.2	-0.5	-1.0	-0.2	-0.5	-1.0	-0.2	-0.5	-1.0
Offsetting Receipts	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Outlays	4.3	3.9	3.2	4.3	3.9	3.2	4.3	3.9	3.2
Revenues	5.2	5.4	5.4	5.2	5.4	5.4	5.2	5.4	5.4
Surplus	0.9	1.5	2.3	0.9	1.5	2.2	0.9	1.5	2.2
				Total					
Outlays	22.7	21.5	19.2	22.7	21.5	21.3	22.7	22.3	22.3
Revenues	19.1	19.4	19.4	19.1	19.4	19.4	19.1	19.4	19.4
Deficit	-3.6	-2.1	0.2	-3.6	-2.1	-1.9	-3.5	-2.8	-2.9

SOURCE: Congressional Budget Office. See text for details.

* Less than 0.05 percent.

a. Includes general fund payments to Social Security for military service wage credits, special age-72 benefits, self-employment tax credits, and income taxes on benefits.

b. Includes federal civilian and military retirement and disability, Black Lung benefits, Railroad Retirement, Supplemental Security Income, and veterans' compensation and pensions.

As in the baseline projections through 1993, entitlement outlays and tax revenues in 1994 through 2000 are assumed to follow current law. While we have prepared the extrapolations beyond 1993 in much less detail than the projections for earlier years, we believe that they are quite reasonable. The projections for Social Security and Hospital Insurance correspond closely to those in the recently released trustees' reports.

The extrapolations assume that federal revenues in 1994 through 2000 maintain the same share of GNP as in 1993. Personal income tax receipts tend to rise faster than GNP as increases in real income move taxpayers into higher tax brackets, but many excise taxes and fees are specified in nominal dollars and shrink relative to GNP over time. With no increases in total Social Security tax rates scheduled after 1990, social insurance contributions should grow at roughly the same rate as GNP. While these changes will not be perfectly offsetting, the ratio of total tax revenues to GNP should remain relatively constant.

The three budget paths differ only with respect to the assumptions about defense and nondefense discretionary appropriations. As a result, debt service costs are also different. For Path 1, funding for discretionary programs reflects adjustments for inflation but provides for no real growth; that is, it continues CBO's baseline projections methodology. Discretionary spending in Path 2 is increased so as to maintain defense and nondefense programs at their 1993 shares of GNP over the 1994-2000 period. Finally, Path 3 holds discretionary programs, not at their 1993 shares of GNP, but rather at their higher 1989 shares, using the budget authority figures specified in last year's budget summit agreement. After 1989, budget authority for both defense and nondefense discretionary programs is assumed to grow by about 2-1/2 percent per year in real terms. Defense outlays continue to decline as a share of GNP for several years, however, because appropriations for fiscal years 1986 through 1988 (and, by assumption, 1989) grew less than inflation.

Deficits under the three scenarios for the year 2000 range from a small surplus under Path 1 to 2.9 percent of GNP under Path 3. Path 2--extending the CBO baseline using the

1993 shares of GNP for discretionary programs--falls near the middle of the range at 1.9 percent of GNP. With discretionary spending held constant in relation to GNP after 1993, entitlement growth is more than offset by the declining share of GNP devoted to debt service. The Path 2 scenario shows that, even with rather stringent budget policy with regard to discretionary programs, federal deficits would remain at relatively high levels through the 1990s, absent legislated tax increases or further spending cuts.

STATE AND LOCAL GOVERNMENT BUDGETS

The fiscal burdens of the aging population also affect state and local governments. Not only must they pay a share of the Medicaid costs of the elderly, but their work force is also maturing. For those state and local pension funds that are not well funded, past funding shortfalls will impose additional burdens on taxpayers in the future.

Moreover, children constitute the largest dependent group, and their costs are borne primarily by families and local governments. For example, education spending in 1985 totaled $247 billion, with state and local governments bearing almost two-thirds of these costs, and private spending accounting for another one-quarter. With the new education reform movement and associated increases in teachers' salaries, many localities are facing demands for more spending. The distribution of these costs varies considerably, however; certain jurisdictions face substantial increases in the student population, while others will experience little or no growth, or even declines.

The activities of the federal government also cause reverberations in the budgets of states and localities. For example, the creation of the Supplemental Security Income program, while relieving states of some income maintenance costs, increased the number of people eligible for Medicaid. Similarly, cutbacks in federal discretionary spending during the 1980s have fallen heavily on grant-in-aid programs, such as urban mass transit, employment and training, subsidized housing, and general revenue sharing. The federal government can also impose additional costs on state and local governments--for example, to meet water quality standards--without providing commensurate financial resources. For all these reasons, it is important to look at total government fiscal activities, not just those of the federal government.

Table 3 displays the trends in governmental finance since 1950 for all levels of government. In order to make the federal and the state and local data comparable, the figures are shown on a National Income and Product Accounts (NIPA) basis by calendar year. As a result, the federal budget figures differ somewhat from those shown earlier in Tables 1 and 2. Because federal grants-in-aid to state and local governments are reflected in federal expenditures and state and local receipts, total government receipts and expenditures have been adjusted to eliminate this duplication.

Spending by state and local governments grew rapidly as a share of GNP during the 1950s, 1960s, and early 1970s. But in the late 1970s and early 1980s, declining school-age populations and taxpayer revolts caused state and local spending to grow less rapidly than GNP. Revenue growth also fell off, but not by as much, so that the state and local sector has shown substantial surpluses during the 1980s. Most of these surpluses, however, are associated with public employee pension funds. State and local operating budgets--

TABLE 3. GOVERNMENT SPENDING, REVENUES, AND DEFICITS IN THE NATIONAL INCOME AND PRODUCT ACCOUNTS, SELECTED YEARS 1950-2000 (By calendar year, as percents of GNP)

	Actual								Projected (Path 2)	
	1950	1955	1960	1965	1970	1975	1980	1985	1990	2000
					Federal					
Outlays	14.3	16.9	18.2	17.8	20.5	22.8	22.5	24.6	23.5	22.1
Revenues	17.5	18.0	18.8	17.8	19.2	18.4	20.3	19.7	20.7	20.5
Surplus or Deficit (-)	3.2	1.1	0.6	0.1	-1.2	-4.3	-2.2	-4.9	-2.8	-1.6
					State and Local					
Outlays	7.8	8.1	9.7	10.7	13.2	14.7	13.3	12.9	13.7	14.2
Revenues	7.4	7.8	9.7	10.7	13.4	15.0	14.3	14.5	14.9	15.5
Surplus or Deficit (-)	-0.4	-0.3	*	*	0.2	0.3	1.0	1.6	1.2	1.3
					Total					
Outlays	21.3	24.3	26.6	26.9	31.3	34.1	32.6	34.9	34.9	34.1
Revenues	24.1	25.0	27.2	27.0	30.2	30.0	31.3	31.6	33.3	33.8
Surplus or Deficit (-)	2.8	0.8	0.6	0.1	-1.0	-4.1	-1.3	-3.3	-1.6	-0.3

SOURCE: Calculations for historical years are based on Tables B-1 and B-79 in The Economic Report of the President (February 1988). Projections of federal spending, revenues, and deficits are based on CBO's baseline economic and budget projections for 1990 and on Path 2 for 2000. (See Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1989-1993, February 1988). State and local government finances are derived from Data Resources, Inc., U.S. Long-Term Review (Winter 1987-1988).

NOTE: Federal grants-in-aid to state and local governments are reflected in federal expenditures and in state and local revenues. Total government revenues and expenditures have been adjusted to eliminate this duplication.

* Less than 0.05 percent.

that is, excluding social insurance programs--have been in approximate balance for the last several years.

Government activities as a share of GNP increased by almost two-thirds over the 1950-1985 period. Before 1975 spending grew at all levels of government. In recent years, however, federal spending has grown somewhat as a share of GNP, while state and local spending has diminished. Federal government revenues have risen less rapidly than federal spending, while the opposite is true for state and local governments.

The projections of federal government spending for 1990 and 2000 shown in Table 3 are consistent with Path 2, described earlier. The state and local government projections derive from the January 1988 long-term trend projection prepared by Data Resources, Inc. (DRI), which is representative of other private forecasts. In the DRI projections, state and local expenditures and revenues both rise slightly in relation to GNP, and the state and local surplus remains a bit over 1 percent of GNP. By the year 2000, in these projections, the federal deficit declines to the point where it is only slightly greater than the state and local surplus, so that the total government sector is roughly in balance. Excluding state and local pension funds, however, the deficit of the government sector as a whole would roughly equal that of the federal government.

Whether state and local governments will expand their social programs or institute new ones cannot be foreseen, and action is likely to differ substantially among the states. For example, Massachusetts has recently enacted a universal health insurance program for state residents. But this move is not necessarily a precursor of similar initiatives in other states. Although Hawaii has had an extensive health insurance program since 1974, it has taken 14 years for the second state to enter the arena. Moreover, state finances vary considerably. New England is currently experiencing an economic boom, while the oil-producing states of the South and Southwest face significant fiscal stress.

IMPLICATIONS FOR FEDERAL FISCAL POLICY

Projecting the course of the federal budget beyond the year 2000 is mostly a matter of speculation. Demographics play a major role, of course. The Social Security actuaries project that, with the retirement of the baby boom, expenditures for cash benefit programs will rise from 4.4 percent of GNP in the year 2000 to 5.0 percent of GNP in 2015 and 6.5 percent in 2030. Including Hospital Insurance, costs would rise from 6.0 percent to 9.2 percent of GNP over the 30 years. As we have seen, however, an increase of two or three percentage points in government spending is neither unprecedented nor unmanageable. When the baby boom started attending school, for example, state and local government expenditures for education rose from 2.5 percent of GNP in 1950 to 5.6 percent of GNP in 1970.

But government budgets depend on far more than demography. They also reflect political judgments about the shape of the American economy, economic and military developments abroad, and domestic social needs. These other factors have had a much greater effect on budget developments over the past 25 years than have changes in the age structure of the population, and it is likely that they will continue to dominate the course of the budget into the next century.

Uncertainties in the Projections

As indicated earlier, these budget projections are deceptively smooth on account of the inability to foresee the myriad of special factors--for example, natural and man-made disasters--that will impinge upon the budget. But these are not the only uncertainties in the projections.

First, the budget projections depend critically upon the underlying economic assumptions. In our February 1988 annual report, CBO attempted to quantify the economic uncertainty. We find that there are about two chances in three that the level of real GNP in 1993 will turn out to be within 7 percent of its projected value, or that the average real growth rate will be between 1.6 percent and 3.6 percent. As a result, there is a two-in-three chance that the baseline deficit in 1993 will fall between 4.4 percent of GNP and zero. While this is already a substantial range, the economic uncertainty grows even larger as we look beyond 1993 into the twenty-first century.

Second, as the presence of three alternatives shows, the assumptions made about discretionary appropriations are crucial to any budget projections. While Path 2 is marked by higher discretionary spending than Path 1, it still represents a rather stringent policy. As Figure 2 shows, defense spending is assumed to stabilize at 5.3 percent of GNP--a level that was widely considered to be inadequate in the late 1970s and early 1980s. As mentioned earlier, nondefense discretionary spending as a share of GNP has fallen sharply during the 1980s. With numerous pent-up spending demands, for example, in education and basic research, it may be difficult to hold this category to 3.4 percent of GNP, as Path 2 assumes.

While demographic changes affect the level of spending for discretionary programs, the connection is indirect and not automatic. For example, increases in the number of single-parent families and in the population 65 and over have put competing demands on funds available for social services, such as Head Start and meals for the elderly. Similarly, because of the growing labor force participation of women, the Congress is now debating a major new federal commitment to providing childcare services.

Third, the extent of budgetary easing that might result from the relatively favorable demographic trends of the 1990s depends on the growth in the costs and use of medical care services. In CBO's five-year baseline projections, increases in Medicare and Medicaid spending per enrollee more than offset the slowing of the growth in the elderly population. Medicare and Medicaid benefits are projected to rise from 2.5 percent of GNP in 1988 to 3.1 percent of GNP in 1993. In our extrapolations, these health programs account for nearly 18 percent of the budget and about 4.1 percent of GNP by the year 2000.

In addition to the overall aging of the population, the very old--those age 85 and older--are becoming more numerous. Over the 1985-2000 period, the very old population is projected to grow by more than two-thirds, while the elderly population as a whole will rise by less than a quarter. Under these projections, the 85-and-over group would grow from 9 percent of all persons age 65 and over to about 12 percent by the turn of the century. The very old are 80 percent more likely to use Medicare-covered hospital services than are their younger counterparts, and they are 18 times as likely to reside in a nursing or personal care home. Currently, the federal government pays for long-term care on a means-tested basis through the Medicaid program. Whether the federal role in long-term care should be expanded will be a major issue for the 1990s.

Long-Term Targets for the Deficit

Because they are an extrapolation of recent tendencies and not a forecast of budget outcomes, the budget projections we have presented do not assume any overall budgetary targets. In particular, they do not incorporate the deficit targets contained in the Balanced Budget Reaffirmation Act of 1987 (Public Law 100-119), which requires that the total federal budget, including both on- and off-budget items, be balanced by fiscal year 1993. In the short run, fiscal policy will continue to be dominated by questions of economic stabilization. Thus, the Balanced Budget Act targets would have to be modified again, as they were in 1987, if economic developments put them out of reach.

In the longer run, the choice of a fiscal target turns on questions of national saving and investment, both domestic and foreign. Among possible targets are the following:

- A continuation of the budget policies of the post-World War II period, with federal deficits of about 1-1/2 percent of GNP. This is roughly the outcome of the Path 2 projections presented above.
- A balanced total budget, as incorporated in the current Balanced Budget Act targets. This implies that the non-Social Security portion of the budget could remain in deficit, but just enough to offset the Social Security surpluses.
- A balance in the part of the federal budget that does not include Social Security. The implication of this target--the most stringent of the three--is that the federal government would save an amount equal to the Social Security surpluses.

The committee will be exploring the issues in choosing a long-term deficit target at next week's hearing.

SAVING AND DEBT IN THE UNITED STATES, JAPAN, AND WEST GERMANY

	1970	1975	1980	1985	1986	OECD Forecast 1987	1988
			Gross Saving a/ (As a percentage of GNP)				
United States	18.3	18.1	19.2	16.5	NA	NA	NA
Japan	40.2	32.3	31.1	31.4	NA	NA	NA
West Germany	28.1	20.9	21.8	22.2	NA	NA	NA
			General Government Surplus or Deficit (-) b/ c/ (As a percentage of nominal GNP or GDP)				
United States	-1.0	-4.1	-1.3	-3.3	-3.5	-2.4	-2.4
Japan	1.8	-2.7	-4.4	-0.8	-0.9	-1.2	-1.1
West Germany	0.2	-5.7	-2.9	-1.1	-1.2	-1.7	-2.3
			General Government Debt c/ (As a percentage of GNP)				
United States	NA	42.6	37.7	48.5	50.5	51.6	52.2
Japan	NA	22.4	52.0	69.4	69.1	69.5	68.8
West Germany	NA	25.0	32.5	42.3	42.4	43.2	44.4

SOURCE: Organization for Economic Cooperation and Development.

NA=Not available.

a. Gross saving equals gross national disposable income minus private and government consumption.
b. For purposes of making international comparisons, the tables show figures for total general government, which includes central government, state or provincial governments, local governments, and social security funds.
c. Debt of general government (called gross debt by OECD) equals total financial liabilities of governments minus government holdings of government securities.

STATEMENT OF
DAVID M. WALKER, CPA
ASSISTANT SECRETARY OF LABOR
PENSION AND WELFARE BENEFITS ADMINISTRATION

I. INTRODUCTION:

Thank you, Mr. Chairman and Members of the Subcommittee, for inviting me to testify today. My name is David M. Walker; as Assistant Secretary of Labor for Pension and Welfare Benefits, I am pleased to have this opportunity to discuss with you the relationship between Social Security and our voluntary private pension system, and the role this relationship plays with respect to Federal policy.

As an introduction to my discussion of this subject, I would like to present a brief overview of the detailed topics I will be covering.

II. OVERVIEW:

Although the Social Security program provides benefits to Americans of all ages, most people think of Social Security primarily as a source of retirement income. This aspect of the program has in fact been traditionally viewed as the first leg of the so-called "three-legged stool" of retirement income policy.

Social Security, though the foundation of retirement income security for most Americans, cannot stand alone. Employment based pensions and private individual savings -- the other two "legs of the stool" -- represent a pool of assets set aside to provide millions of Americans with additional economic security in retirement.

The purpose of my testimony is to describe for you the nature and extent of our voluntary private pension system, and how it complements our Social Security system as an element of retirement income policy. I intend to discuss three principal topics: first, trends in the growth of private pension plans; second, trends in pension benefit receipt; and third, how the voluntary private pension system and Social Security are interrelated.

Before I proceed to a discussion of these three topics, however, it is necessary for me to make a point about the comparability of pension data before and after 1974.

Although voluntary employment based private pension plans have been in existence for nearly 100 years, and have been regulated under the Tax Code since the 1920's, the voluntary private pension system was revolutionized 14 years ago with the enactment of the Employee Retirement Income Security Act of 1974 (ERISA). This legislation imposed broad uniform Federal standards on pension plans, regulating such areas as reporting and disclosure, coverage, vesting, funding, and fiduciary conduct.

As a result of this sweeping overhaul of the voluntary private pension system, it is difficult to compare pre-ERISA pension plan statistics with post-ERISA statistics without encumbering the discussion with numerous qualifications. Thus, while I will occasionally refer to pension plan data that spans several decades for the purpose of providing some historical perspective, I intend for the most part to focus attention on the growth and development of our voluntary private pension system in its post-ERISA context.

Having noted this important point, I will summarize for you recent trends in private pension plan growth.

III. <u>TRENDS IN PENSION PLAN GROWTH</u>:

There are several ways we can measure the growth and extent of the voluntary private pension system. Some of these indicia relate to plans themselves, such as the total number of plans and their characteristics, and the total assets held by pension plan trusts. We can also examine the number of workers with pension coverage, and the proportion of the total work force they represent. Appended to my written testimony is a table which illustrates the changes in certain pension plan characteristics which reflect the growth and maturation of the voluntary private pension system between 1975 and 1987. I will summarize the contents of this table very briefly.

Our statistics are generally based on reports required to be filed annually with the Department of Labor and the Internal Revenue Service by sponsors of private pension plans. According to these data, between 1975 and 1987 the total number of private pension plans increased by an estimated 156 percent: from 340,000 in 1975 to 870,000 in 1987. The vast majority of this growth occurred among single employer, as opposed to collectively bargained multi-employer, pension plans. In addition, the number of defined contribution plans increased significantly, far outpacing growth among defined benefit plans. In 1975 there were 233,000 defined contribution and 107,000 defined benefit plans; by 1987 there were an estimated 638,000 defined contribution and 232,000 defined benefit plans. However, we must be careful not to read too much into this trend, because many employers have adopted defined contribution plans as second tier supplements to pre-existing pension plans.

Assets held by plans grew even more rapidly than the number of plans. Federal Reserve Board data reveal that the total amount of assets held by pension trusts increased from $290 billion to $1,500 billion between 1975 and 1987, a 417 percent increase. Annual contributions to pension plans increased from $37.1 billion a year to $95 billion a year during the same 13 year period. Among the related consequences of this increase in assets held by plans is a marked improvement in the funded status of pension plans as compared to the situation prior to the enactment of ERISA. Prior to 1974, many plans were essentially unfunded pay-as-you-go arrangements; today, despite growing claims against the PBGC insurance program, benefit security has been enhanced to the extent that less than one-fourth of ERISA regulated defined benefit plans would have insufficient assets to pay all promised benefits if they were terminated.

During this time span the number of workers covered by employment based pension plans has expanded as well, although the proportion of the work force covered by plans (either defined benefit or defined contribution) has remained relatively stable. Annual reporting data show that an estimated 41.9 million workers were covered by private pension plans in 1987, up from 30.7 million in 1975. However, the percent of full-time private wage and salary workers covered was an estimated 53 perent in 1987, up only one percentage point from 1975.

The steady coverage rate over the past 13 years probably reflects several factors. The relative stability in coverage rates may be a natural consequence of our now mature voluntary private pension system. In addition, uncertainty regarding the regulatory and economic climate -- resulting from frequent pension-related legislative enactments during the last decade, coupled with the recession of the early 1980's -- may have discouraged additional plan sponsors from adopting new plans to cover more workers.

To complement this discussion of trends in pension plan growth, I would now like to turn your attention to contemporary trends in pension benefit receipt.

IV. TRENDS IN PENSION BENEFIT RECEIPT:

Trends among retirees enjoying private sector benefits indicate that the impact of ERISA is just beginning to be felt. For the retired population as a whole, approximately one-fourth of retirees receive income from a private pension. Between 1975 and 1987 the number of retirees receiving pension benefits is estimated to have increased from 4.8 million to 9.0 million persons, an 87.5% increase; in the last seven years alone, the number of retirees receiving benefits has risen approximately 41 percent. The average annual benefit received is estimated to have also increased from $2,400 to $5,200 a year between 1975 and 1987.

Those persons recently entering retirement represent the first full generation whose principal worklife occurred largely during the rapid economic expansion of the 1950's and 1960's. As a result, recent new retirees have enjoyed consistently higher levels of total retirement income from various sources as compared to preceding generations of retirees.

According to SSA's Survey of New Beneficiaries, 32 percent of recent retirees (those first receiving Social Security benefits in 1981) received or expected to receive private pensions. Thus, in the future we can expect that at least this proportion of older Americans will receive private pensions. Currently, over 75 percent of full-time workers over age 55 are covered by a pension plan, and over 45 percent of all workers aged 55-59, are vested in at least one pension benefit. There is every reason to believe that, as the full impact of ERISA is felt over the next decade and a half, the proportion of retirees receiving a private pension will grow to at least 45 percent.

Moreover, some census survey data regarding pension benefit receipt probably understate the total benefits generated by the significant tax preferences accorded these plans. Pension plans have traditionally paid out benefits in several different forms, including annuities, lump sums, and installment payments. Unfortunately, many income surveys are designed principally to measure retirement income in the form of an annuity stream, and may tend to report benefits payments in any form other than an annuity (i.e., a lump sum payment) as asset income rather than pension income. With respect to our Department's aggregate benefit receipt data, however, we can say that between 1975 and 1987 total annual benefit payments rose from $19 billion per year to an estimated $95 billion per year (including both annuities and lump-sum payments).

Now that we have discussed basic trends in the development of our volutary private pension system, I would like to turn your attention to the relationship of this maturing pension system to Social Security.

V. THE RELATIONSHIP OF PRIVATE PENSIONS TO SOCIAL SECURITY:

The near universal coverage of the work force, the full portability of benefit accruals and their mandatory preservation for retirement, and the emphasis on benefits for middle and low-wage workers which characterize Social Security are essential to the program's relationship to our voluntary employment based private pension system. Typically, employers providing rank and file workers with pension benefits view Social Security as the foundation of their retirees' income, with the pension benefit supplementing that base.

Because Social Security offers a floor of protection, this foundation of Social Security retirement income allows employers to exercise more flexibility in designing private pension plans to maximize their competitiveness, to meet their own economic needs, and to meet the needs of their workers. It is uncertain that plan sponsors, in the absence of our current Social Security system, would voluntarily assume the costs of expanding pension benefits and coverage to provide a level of retirement income comparable to the current combination of Social Security and private pension income.

Keeping in mind this important relationship between private pension plans and Social Security, what can we say about prospects for the future?

VI. PROSPECTS FOR THE FUTURE:

The private pension system has matured substantially since its first period of rapid growth following the Second World War. After adjusting for inflation, private pension assets grew from $56.2 billion in 1950 to $1486.7 billion in 1987. Over the same period, coverage increased from 22 to 46 percent of the private sector wage and salary work force.

Those sectors of private employment with traditionally lower coverage rates are largely a function of employer type, size and plan cost; most large and medium employers now sponsor some type of pension plan. Issues continue to arise as we assess the ever changing retirement income picture. Such issues include: optimizing flexibility for plan sponsors, encouraging the adoption of suitable plans by new or smaller employers that cannot afford more sophisticated voluntary pension plans, encouraging the preservation for retirement of money set aside through private pensions plans and meeting the need for portability of a more mobile work force. The promotion and protection of our voluntary private pension system is a central element in any strategy seeking to promote continued provision of retirement income. Private pensions and personal savings represent important supplements to Social Security and a vital source of capital to fuel our economic growth.

Recent bipartisan legislation -- including the Retirement Equity Act; Tax Reform Act changes to pension vesting standards, nondiscrimination rules, 401(k) plans and IRAs; and last year's reform of pension funding standards -- has served to expand participation, increase equity, and improve security of plan funding in the private pension system. It has also meant that the voluntary private pension system is still in a state of flux. The final effects of these legislative changes are difficult to quantify and may not be reliably measurable for some time to come; therefore, it is important that we foster stability and an environment conducive to plan maintenance and growth.

VII. <u>CONCLUSION</u>:

This concludes my prepared remarks. I would be pleased to respond to any questions you may have regarding my statement.

SELECTED PRIVATE PENSION PLAN STATISTICS
1975 and 1987 (estimated)

	1975	1987
PLANS:		
Total Plans 1/	340,000	870,000
Defined Benefit	107,000	232,000
Defined Contribution	233,000	638,000
Single Employer Plans	337,500	867,000
Multiemployer Plans	2,500	3,000
COVERED WORKERS:		
Net Number of Covered Workers	30.7M	41.9M
Percent of Private Wage & Salary Labor Force With Pension Coverage	45%	46%
Percent of Full-time Private Wage & Salary Labor Force With Pension Coverage	52%	53%
Percent of Covered Workers With Supplemental Plan Coverage	21%	40%
Total Active Participants 2/	38.4M	64.6M
RETIREES:		
Number of Retirees Receiving Benefits 3/	4.8M	9.0M
Average Annual Benefit	$2,400	$5,200
Total Annual Benefit Payments	$19.0B	$95.0B
FINANCIAL DATA:		
Total Assets	$290.0B	$1500.0B
Total Annual Contributions	$37.1B	$95.0B
Percent Of Plans With Insufficient Current Assets to Pay Liabilities If Terminated:		
Single Employer	59%	20%
Multiemployer	76%	33%

1/ Excludes Keogh plans and IRAs.
2/ Includes double counting of workers covered by two or more pension plans.
3/ Excludes retirees receiving lump-sum distributions.

Source: Unpublished data, U.S. Department of Labor, Pension and Welfare Benefits Administration, May 1988.

COMMUNICATIONS

STATEMENT OF THE COMMITTEE ON SOCIAL INSURANCE OF THE AMERICAN ACADEMY OF ACTUARIES REGARDING THE 1988 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS

MAY 24, 1988

The American Academy of Actuaries is a professional association of somewhat over 8,800 actuaries involved in all areas of specialization within the actuarial profession. As a national organization of actuaries, the Academy is unique in that its members have expertise in all areas of actuarial specialization. Issues relating to the financing of Social Security are part of the responsibility of the Academy's Committee on Social Insurance.

The committee has reviewed the 1988 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (OASDI). The committee has not considered the validity and nature of the many demographic assumptions in order to derive the actuarial estimates. The committee does, however, wish to comment on a specific recommendation contained in the report. Because the program is entering a period of large fund accumulation, the Board of Trustees recommends that the proper level of fund accumulation should be made a part of the agenda for the next Advisory Council on Social Security. The Board also suggests that a panel of financing experts (consisting of actuaries, economists, and demographers) be appointed by the Advisory Council, and "that the panel be instructed to provide advice regarding the measures that should be used to judge the program's short-range and long-range financial soundness." The Committee on Social Insurance strongly supports this recommendation and hopes that such a panel would also be consulted with regard to the Medicare program. We would be happy to lend our expertise to such a panel.

In connection with this, we would also reiterate our previous recommendation that, in the interest both of developing more public confidence in the system and of assuring the continued integrity of the actuarial estimates, an independent board of actuaries should be appointed to conduct a continuing review of the methodology underlying the actuarial estimates for the Social Security and Medicare systems, as well as the measures of actuarial status used. This procedure would be similar to that currently being followed by the Civil Service Retirement System, the Military Retirement System, and the Railroad Retirement System.

Committee on Social Insurance
Robert J. Myers, Chairperson
John I. Mange
Roland E. King
James L. Cowen
Dwight K. Bartlett, III
Joseph L. Petrelli
Sam Gutterman
Francisco R. Bayo
Bruce D. Schobel
Warren R. Luckner
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May 13, 1988

Dear Senator Moynihan,

I am delighted to see that the Finance Subcommittee which you chair is investigating the Social Security Trust Funds. Having been continually frustrated by the misleading and ambiguous manner in which the Trust Funds' cash flows in the federal budget statistics are presented in the "Treasury Bulletin," I enthusiastically endorse your efforts to take a fresh look at the full picture. The many articles appearing in the press about the so-called social security surplus and its implications for the federal budget deficit are evidence of the general confusion surrounding the relation between the Trust Funds and the operating budget.

My own feeling (consistent with the way we did things in my Treasury days in the early 'sixties) is that the revenues, disbursements and net surplus or deficit of the Social Security Trust Funds should be kept out of the federal operating budget. It is important separately to clarify the revenues and costs of the social security program, and to protect that splendid system from the ongoing debate on how to cut the federal government's deficit. The proponents of combining social security trust accounts with the federal operating budget argue, correctly of course, that such a consolidated deficit or surplus most accurately reflects the overall impact of federal government inflows and outflows on the economy.

There are, however, better ways to identify needed action than just lumping everything together. A start would be made in the right direction if both the net operating budget and the net position of the Trust Funds were reported side by side. If there were a clear separation in accounting treatment, the implications of a deficit in the operating budget, for example, would then be to cut expenses somewhere and possibly to raise taxes, but there would certainly be no compelling necessity to affect the social policy embedded in the schedule for social security disbursements and the actuarially determined employment tax rates required to support the social security system. With proper segregation, a straightforward measure of the impact of a deficit in the operating budget on the economy should not carry any implication for curtailing social security or medicare benefits, nor for impairing the traditional "self-financing" principle. Let me explain.

In any current year, the surplus or deficit in the Trust Funds could be held fiscally neutral (as we did in the early '60s) insofar as the macroeconomic aspects of the net overall cash flow impact of the operating budget on the national economy are concerned. The relevant procedure is simply to have any surplus generated by the Social Security Trust Funds invested in ordinary Treasury securities of the same maturities and interest rates that are available to the public. When a deficit in the operating budget requires the Treasury to add to the public debt, the Trust Funds can put current surpluses (if they have them) into a preferred allotment at the terms determined by the public auction of the Treasury securities being publicly issued. Alternatively, the Funds can use surpluses to buy marketable Treasury debt in the market if for any reason at some time acquisition on original issue is not feasible. Looked at the other way around, if instead of running surpluses the Trust Funds have disbursements exceeding current inflows, such deficits or shortfalls of the Funds can be met either by selling in the market some of the Treasury securities held in the Funds or by redeeming maturing securities when the Treasury is replacing them through refunding in the public market.

The steps in this neutralization become even clearer by tracing through the net cash flows. When more cash is coming into the Trust Funds from employment taxes than is currently being paid out in benefits, the resulting net inflow "from the public" would be fiscally neutralized in one of two ways: either the net inflow would replace an equal amount that would otherwise be directly withdrawn from the public by Treasury borrowing in the market, or the Funds would put that amount back into the market by buying already outstanding government securities, and that amount would eventually be available to be reabsorbed by Treasury borrowing when the operating deficit required added borrowing. Shortfalls in the Trust Funds would be met either by drawing funds from the market through selling Governments, or an equal amount would be drawn directly from the Treasury whose borrowing needs from the market would be correspondingly increased. Either way, the public would end up holding as many more government securities as would be needed to cover a shortfall in the Trust Funds. And the outstanding total of government securities would still be whatever emerged from the surplus or deficit in the operating budget.

What this means, then, is that the magnitudes of the Treasury marketable debt outstanding will always represent the net effect of past deficits in the operating budget. There would be no obscuring of the government's actual operational borrowing needs by merging them inconspicuously into the net inflows or outflows of the Trust Funds. Moreover, future beneficiaries of the Trust Funds could have the assurance that interest-bearing Treasury securities constitute a clearly identifiable asset base on which they can rely for their future benefits. In fiscal policy terms, neither surpluses nor deficits in the Trust Funds would then have any effect on the net flow of funds from the public into the Treasury to finance the operating budget (i.e., what the British call the "public sector borrowing requirement").

I hope that your committee will find this approach both meaningful and consistent with the principles expressed by the Greenspan Commission a few years ago.

Sincerely,

Senator Daniel P. Moynihan
United States Senate
Washington, D. C. 20510