STATEMENT OF

Alice M. Rivlin, Director
Congressional Budget Office

before the
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
February 21, 1980

In the next few years, the Old Age and Survivors (OASI) trust fund--the largest of the three funds that finance Social Security--is likely to experience some financial problems. The main causes of OASI's anticipated difficulties are continuing high inflation, rising unemployment, and slow economic growth. The problems foreseen now are similar to those that the CBO projected in July 1979. At that time, CBO's estimates indicated a potential problem in the OASI trust fund in 1983 or 1984. Unfortunately, that assessment was based on a somewhat brighter economic outlook than CBO now forecasts.

Present estimates indicate that the OASI fund may experience financing problems as soon as the beginning of fiscal year 1982 (that is, in fact, at the end of calendar year 1981). In order to assist the Committee in dealing with these problems, my testimony today will concentrate on the short-run situation. Specifically I will discuss:

- CBO's current estimates of the financial positions of the three Social Security trust funds--OASI, Hospital Insurance (HI), and Disability Insurance (DI);
- The impact of recent developments in the economy and the economic outlook for the trust funds; and
- The Administration's proposal for fund-to-fund borrowing.

CURRENT ESTIMATES OF THE FINANCIAL POSITIONS OF THE SOCIAL SECURITY TRUST FUNDS

Both CBO and the Administration estimate that the overall solvency of the Social Security system will improve over the next five years, but that the OASI fund will encounter some difficulties. Over the five-year period from fiscal year 1981 through 1985, the overall Social Security program (including Medicare) is expected to receive about $23 billion more in tax revenues and interest than will be spent. Although the combined trust fund balance will grow, the balance as a percent of outlays is expected to fall. The financial situations of the three separate Social Security trust funds differ substantially, however. Outlays from the OASI fund will exceed revenues. At the beginning of fiscal year 1980, the OASI trust fund balance reached a level that equaled almost 27 percent of anticipated outlays; this balance could fall to about 9 percent by the start of fiscal year 1982 and to less than 2 percent by the start of fiscal year 1983. (Table 1 displays these projections.) Shortly thereafter, OASI balances are likely to become negative.

At a minimum, the trust funds need a balance of 9 to 12 percent of yearly outlays at the start of the year to guarantee that the system will be able to meet all that year's monthly payments in a timely fashion. The OASI trust fund balance probably will not become negative before fiscal year 1983, but it is likely to fall below the level needed to meet monthly payments early in fiscal year 1982.

TABLE 1. ACTUAL AND PROJECTED SOCIAL SECURITY TRUST FUND BALANCES AT BEGINNING OF FISCAL YEAR AS A PERCENT OF OUTLAYS FOR THE YEAR FOR THE OASI, DI, HI TRUST FUNDS, AND FOR THE COMBINED OASDI AND OASDHI TRUST FUNDS: IN PERCENTS, TO FISCAL YEAR 1985 AND 1990

Individual and Combined Trust Funds	1980	1981	1982	1983	1984	1985	1990
OASI	26.7	18.9	9.2	1.4	a	a	a
DI	36.1	41.4	49.3	59.1	70.8	85.9	203.7
HI	57.6	58.4	68.5	80.5	89.5	94.5	101.6
OASDI	27.9	21.8	14.3	8.8	5.1	3.0	23.6
OASDHI	32.7	27.6	23.2	20.9	19.8	19.6	40.2

SOURCE: Based on CBO's January 1980 economic assumptions.

a. Negative balance.

In contrast to OASI, balances in the DI and HI funds are likely to grow steadily during the next five years. The balance in the DI trust fund at the beginning of fiscal year 1980 was 36 percent of estimated outlays. Primarily as a result of the large increase in taxes earmarked for this fund by the Social Security Amendments of 1977 (Public Law 95-216) and also because of recent declines in the growth rate of disability benefit payments, the DI trust fund balance is projected to increase to almost 86 percent of outlays by the beginning of fiscal year 1985. Disability benefit payments, however, have been difficult to predict in recent years, and any unexpected increase in disability payments over the next five years (for example, related to a more severe economic downturn than is now expected) could reduce the DI fund's balances.

Similarly, the balance in the HI trust fund at the beginning of fiscal year 1980 was almost 58 percent of anticipated outlays and is expected to rise to almost 95 percent of outlays by the start of fiscal year 1985. The growing balances in this fund result largely from increases in the covered earnings base legislated in the 1977 Amendments, continuing increases in the HI tax rate, and somewhat slower growth in hospital expenditures than was previously anticipated.

In short, while the DI and HI trust funds are not expected to experience difficulties under CBO's current economic projections, the OASI fund could fall far below acceptable levels in the near future.

THE ECONOMIC OUTLOOK AND TRUST FUND SOLVENCY

Social Security revenues and benefit payments, and thus trust fund balances, depend in the short run on both the rate of inflation and the extent of unemployment. Consequently, forecasts of trust fund balances are significantly affected by projections of general economic conditions.

The connection between trust fund and general economic forecasts was particularly evident in January 1979, when CBO and the Administration issued forecasts that were quite different. (Table 2 displays this contrast.) At that time, the Administration projections, in anticipation of the mandated goals of the Humphrey-Hawkins Act, showed that inflation would decline quickly and reach 3 percent by 1983. The unemployment rate was shown to decline to 4 percent by 1984. Had those expectations been realized, the OASI trust fund would not have experienced financial difficulties.

In contrast, CBO forecast that the rate of inflation would be significantly higher and would remain over 6 percent in 1983. Unemployment was projected by CBO to rise in 1980 and then to decline slowly, remaining above 5 percent through 1984. Even though these economic assumptions were less optimistic than the Administration's, CBO also expected that the OASI trust fund would not encounter financial difficulties.

TABLE 2. ACTUAL AND PROJECTED CBO AND ADMINISTRATION ECONOMIC ASSUMPTIONS AS OF JANUARY 1979 AND JANUARY 1980: IN PERCENTS, TO CALENDAR YEAR 1985

	1979	1980	1981	1982	1983	1984	1985
January 1979 Assumptions							
Inflation[a]							
CBO	8.2	7.6	6.9	6.6	6.3	5.8	e
Administration	7.5	6.4	5.2	4.1	3.0	2.7	e
Unemployment[b]							
CBO	6.2	6.8	6.6	6.2	5.9	5.5	e
Administration	6.0	6.2	5.7	4.9	4.2	4.0	e
January 1980 Assumptions							
Inflation							
CBO[a]	12.6[d]	9.6	9.3	8.8	8.2	7.9	7.6
Administration[c]	13.2[d]	10.4	8.6	7.8	7.2	6.4	5.7
Unemployment[b]							
CBO	5.9[d]	7.0	8.0	7.8	7.1	6.4	6.0
Administration	5.9[d]	7.0	7.4	6.8	5.9	5.1	4.3

a. Percent change in the Consumer Price Index from preceding fourth quarter to fourth quarter.

b. Average for the calendar year.

c. Percent change in the Consumer Price Index from preceding December to December.

d. Actual.

e. Not forecast.

In January 1980, CBO and the Administration forecast a more similar financial position for the trust funds--largely because of greater agreement in short-term economic projections. Both CBO and the Administration project that the OASI trust fund will experience an inadequate balance in 1982 and a negative balance in 1983.

Even though there is widespread agreement among economic forecasts that inflation will be high and that the unemployment rate will rise in 1980, the outlook is by no means certain. Forecasts of these variables are uncertain and, as we have seen during the last few years, even when there is considerable agreement among the forecasts, they may not be realized. One reason is that many events with important implications for prices and output lie outside the range of economic forecasting. Assumptions about energy and food prices, for example, depend upon unpredictable elements such as world politics and weather conditions. Even decisions that are subject to government control--such as monetary and energy policy or defense expenditures (for example, the response in U.S. defense outlays to the current events in Iran and Afghanistan)--cannot be predicted with much confidence.

Another major cause of uncertainty in any current forecast is that the behavior o£ consumers and businesses has proved unpredictable in times of high inflation. For example, the CBO forecast assumes that saving rates will rise gradually but remain at low levels over the next two years. A change in consumer attitudes leading to sharply increased saving would be beneficial in terms of long-run economic growth. In the short-run, however, sharply increased saving is likely to produce slower economic growth. Conversely, if consumers expect inflation to accelerate, they may increase their current spending by drawing down savings, thus postponing the expected recession.

These economic uncertainties affect the projections of both trust fund outlays and revenues. The rate of inflation is the most important economic factor affecting trust fund outlays because Social Security benefits are indexed. In June of each year, benefits are increased automatically (that is, indexed) by the growth in the Consumer Price Index (CPI) over the past year. For example, both CBO and the Administration expect the June 1980 benefit increase to be about 13 percent. Each additional percentage point rise in the CPI increases outlays by more than $1 billion in the following fiscal year. Since money wages tend to increase along with inflation, payroll taxes and trust fund revenues also tend to increase only slightly less than outlays. Although the dollar amount of the trust fund balances will remain approximately the same as a result of higher inflation, the balances as a percent of outlays actually decline.

Trust fund revenues depend on the level of total taxable wages and salaries paid in the economy, so they are also sensitive to economic assumptions. For example, growth in money wages is likely to slow when economic growth is low, even if unemployment does not rise, as has been the situation in recent years. And, when unemployment does go up, not only are fewer people employed, but also the growth rate of money wages tends to slow further. Both these factors reduce payroll tax receipts. Moreover, after a period of time, some unemployed workers become eligible for benefits and find collecting OASI or DI benefits a desirable alternative in the light of poor labor market conditions. Thus, outlays also increase slightly in times of high unemployment.

THE ADMINISTRATION'S PROPOSAL

The Administration is proposing that the three trust funds--OASI, DI, and HI--be allowed to borrow from each other when the balance of any one falls below a critical level. The "critical level" proposed is 25 percent of outlays in the preceding 12 months. The amount of allowable borrowing may vary, but it must not exceed the amount that would raise the borrowing fund's balance to 25 percent of outlays in the preceding 12 months. Repayment, with interest, would be required; it would occur when the balance of the borrowing fund exceeded 30 percent of outlays in the preceding 12 months.

Interest would be set at the rate the lending trust fund would have earned by investing in obligations of the federal government.

If the OASI trust fund borrowed enough to maintain a balance at the beginning of the fiscal year equal to 25 percent of the previous year's outlays, CBO estimates that approximately $60 billion would be borrowed during fiscal years 1981 to 1985, an amount equal to almost 8 percent of outlays during the same period. (CBO's projections are presented in Table 3.) An additional $30 billion could be borrowed by the end of fiscal year 1990, approximately 2 percent of outlays during fiscal years 1986 to 1990. This borrowing would have no budgetary impact in the aggregate, but it would affect the individual trust funds.

The DI trust fund alone is not expected to have sufficient balances to meet these borrowing needs. The OASI trust fund would probably also have to borrow from the HI trust fund in fiscal years 1982 to 1985. It appears, however, that the HI loans could be repaid, with interest, from the DI trust fund by fiscal year 1990.

TABLE 3. PROJECTED ESTIMATES OF OASI BORROWING ON OCTOBER 1 FROM DI, AND SUBSEQUENTLY HI, TRUST FUNDS TO MAINTAIN BALANCE AT BEGINNING OF YEAR OF 25 PERCENT OF PREVIOUS YEAR'S OUTLAYS: TO FISCAL YEAR 1990, IN BILLIONS OF DOLLARS

Year	Borrowing by OASI Fund for the Year	Amount Borrowed from DI Fund[b]	Amount Borrowed from HI Fund	Amount Repaid to HI Fund from DI Fund
1981	3.1	3.1		—
1982	14.6	2.3	12.3	--
1983	14.6	3.0	11.6	--
1984	14.0	3.6	10.4	--
1985	13.5	5.1	8.4	
1986	7.8	7.8	--	3.0[b]
1987	4.1	4.1	--	10.8
1988	5.4	5.4	--	10.7
1989	4.7	4.7	—	13.1
1990	7.9	7.9	--	5.1[c]

SOURCE: Based on CBO's January 1980 economic assumptions.

NOTE: Details may not add to totals because of rounding.

a. Assumes that the DI and HI funds maintain balances at least as large as 25 percent of their outlays of the previous year.

b. This assumes that the amount by which the DI trust fund balance exceeds 25 percent of the preceding year's outlays is used to repay the HI fund.

c. Interest could also be paid to the HI trust fund. In fiscal year 1990, after lending the necessary amount to the OASI trust fund, repaying the remaining amount owed to the HI trust fund, and setting aside 25 percent of the previous year's outlays, the DI trust fund would have available additional funds from which interest to the HI trust fund could be paid.

On the other hand, the OASI fund could borrow less, for example--only enough to ensure that all benefits could be paid in a timely fashion. If the OASI trust fund borrowed enough to raise its balance at the beginning of the fiscal year to 12 percent of its expected outlays during the year, borrowing appears necessary at the beginning of 1982. Total borrowing during fiscal years 1981 to 1985 is expected to be about $40 billion or 5 percent of outlays during that period. Additional borrowing during fiscal years 1986 to 1990 is estimated to be about $17 billion, or slightly more than 1 percent of outlays during that period.

As before, the DI fund is not expected to be able to lend all of these amounts to the OASI fund without the former's balance falling below 12 percent of its expected outlays during the year. Borrowing from the HI trust fund is anticipated in 1983, 1984, and 1985. Loans from the HI fund could probably be repaid from the DI trust fund, with interest by 1988 (see Table 4).

CONCLUDING OBSERVATIONS

There are several other possible approaches to the OASI trust fund's short-run difficulties. Among them, the least controversial possibility is to realign the payroll tax rates so that a higher percentage would be allocated to the DI and HI

TABLE 4. PROJECTED ESTIMATES OF OASI BORROWING ON OCTOBER 1 FROM DI, AND SUBSEQUENTLY HI, TRUST FUNDS TO MAINTAIN BALANCE AT BEGINNING OF YEAR OF 12 PERCENT OF EXPECTED OUTLAYS: TO FISCAL YEAR 1990, IN BILLIONS OF DOLLARS

Year	Borrowing by OASI Fund for the Year	Amount Borrowed from DI Fund[a]	Amount Borrowed from HI Fund	Amount Repaid to HI Fund from DI Fund
1981				
1982	3.8	3.8		
1983	12.6	7.0	5.6	
1984	11.9	4.0	7.9	
1985	11.5	5.4	6.1	
1986	5.5	5.5		5.5
1987	1.8	1.8		13.3
1988	2.8	2.8		0.8[b]
1989	2.0	2.0		
1990	4.7	4.7		

SOURCE: Based on CBO's January 1980 economic assumptions.

NOTE: May not add due to rounding.

a. Assumes that the DI fund maintains a balance at the beginning of each year at least as large as 12 percent of the expected outlays.

b. Interest could also be paid to the HI trust fund. At the beginning of fiscal year 1988, after lending the necessary amount to the OASI fund, repaying the HI loan, and setting aside 12 percent of expected outlays, the DI fund is expected to have available additional funds from which interest to the HI fund could be paid.

trust funds. This approach was followed in the 1977 Amendments. Its disadvantage, however, is that it may need to be repeated should the trust fund balances behave differently from the manner anticipated.

Other approaches entail more fundamental reassessments of the Social Security system. For example, the trust funds could be merged, an alternative that would retain payroll tax financing at the same total level as under current law, as would fund-to-fund borrowing and realigning the tax rates. Alternatively, some form of general revenue funding--such as borrowing from the general fund or countercyclical general revenue financing--could be adopted. Or, an additional, earmarked source of revenues--such as a tax on gasoline or a value added tax--could be found. These possibilities could be combined with a reduced payroll tax rate. Finally, Social Security benefits themselves could be taxed, or benefit reductions could be incorporated into the system.

These last alternatives are likely to require extensive consideration by the Congress. In fact, one advantage to the Administration's proposal for interfund borrowing is that it would provide time to develop and review other proposals for dealing with longer-run issues concerning the Social Security system, as well as solve the short-run financial problem. In addition, the Administration's proposal would increase flexibility to respond to different economic circumstances, should current forecasts prove inaccurate, since different trust funds have different sensitivities to economic conditions. Thus, interfund borrowing would avoid the need to enact new legislation each time adjustments to the funds were required.

APPENDIX TABLE 1. CBO PROJECTIONS OF SOCIAL SECURITY TRUST FUND BALANCES AT THE START OF THE YEAR AS A PERCENT OF OUTLAYS: TO FISCAL YEAR 1990

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
OASI	26.7	18.9	9.2	1.4	a	a	a	a	a	a	a
DI	36.1	41.4	49.3	59.1	70.8	85.9	116.8	149.5	176.6	194.3	203.7
HI	57.6	58.4	68.5	80.5	89.5	94.5	99.1	105.8	109.3	108.1	101.6
OASDI	27.9	21.8	14.3	8.8	5.1	3.0	6.1	11.7	16.3	20.8	23.6
OASDHI	32.7	27.6	23.2	20.9	19.8	19.6	23.6	30.0	35.0	38.9	40.2

SOURCE: Based on CBO's January 1980 economic assumptions.

a. Negative balance.

APPENDIX TABLE 2. CBO PROJECTIONS OF SOCIAL SECURITY TRUST FUND BALANCES AT THE END OF THE YEAR: TO FISCAL YEAR 1990, IN BILLIONS OF DOLLARS

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
OASI	22.9	12.7	2.1	-7.8	-17.0	-20.2	-19.4	-19.3	-17.9	-18.8	-5.0
DI	7.4	9.9	13.5	17.8	23.8	34.8	50.3	67.3	86.2	105.3	131.6
HI	15.6	21.2	28.8	37.1	45.3	54.8	67.6	80.6	92.4	100.9	104.8
OASDI	30.3	22.6	15.6	10.0	6.5	14.6	30.9	48.0	68.3	86.8	126.7
OASDHI	45.9	43.8	44.4	47.1	51.8	69.4	98.5	128.6	160.7	187.4	231.5

SOURCE: Based on CBO's January 1980 economic assumptions.

NOTE: Details may not add to totals because of rounding.

APPENDIX TABLE 3. COMPARISON OF CBO AND ADMINISTRATION PROJECTED ESTIMATES OF SOCIAL SECURITY TRUST FUND BALANCES AT BEGINNING OF FISCAL YEAR AS A PERCENT OF OUTLAYS: TO FISCAL YEARS 1985

	1980	1981	1982	1983	1984	1985
Individual Trust Funds						
Old Age and Survivors Insurance (OASI)						
CBO[a]	26.7	18.9	9.2	1.4	b	b
Administration's[c]	26.6	19.1	9.6	1.9	b	b
Disability Insurance (DI)						
CBO[a]	36.1	41.4	49.3	59.1	70.8	85.9
Administration's[c]	36.4	44.3	56.0	73.1	92.3	113.1
Medicare (HI)						
CBO[a]	57.6	58.4	68.5	80.5	89.5	94.5
Administration's[c]	57.8	59.2	71.0	87.0	101.0	112.3
Combined Trust Funds						
OASDI						
CBO[a]	27.9	21.8	14.3	8.8	5.1	3.0
Administration's[c]	27.9	22.3	15.3	10.6	7.6	5.9
OASDHI						
CBO[a]	32.7	27.6	23.2	20.9	19.8	19.6
Administration's[c]	32.8	28.2	25.8	23.2	23.4	24.4

a. Under the economic projection prepared by the CBO in January 1980.

b. Negative balance.

c. Approximate.

APPENDIX TABLE 4. OLD AGE AND SURVIVORS INSURANCE, DISABILITY INSURANCE, HOSPITAL INSURANCE, AND COMBINED OASDI AND OASDHI OUTLAYS, BUDGET AUTHORITY AND TRUST FUND BALANCES: BY FISCAL YEAR, IN BILLIONS OF DOLLARS[a]

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Old Age and Survivors Insurance (OASI)											
Outlays	104.1	121.4	137.6	154.1	171.2	189.6	209.1	231.2	255.4	283.5	314.8
Budget authority	99.3	111.2	127.1	144.1	162.1	186.4	209.9	231.2	256.8	282.6	328.6
Trust fund balance at end of year	22.9	12.7	2.1	-7.8	-17.0	-20.2	-19.4	-19.3	-17.9	-18.8	-5.0
Trust fund balance at beginning of year, as a percent of outlays	26.7	18.9	9.2	1.4	b	b	b	b	b	b	b
Disability Insurance (DI)											
Outlays	15.6	17.9	20.2	22.9	25.2	27.4	29.8	33.6	38.1	44.4	51.7
Budget authority	17.4	20.4	23.8	27.2	30.9	38.6	45.3	50.7	57.0	63.5	78.0
Trust fund balance at end of year	7.4	9.9	13.5	17.8	23.5	34.8	50.3	67.3	86.2	105.3	131.6
Trust fund balance at beginning of year, as a percent of outlays	36.1	41.4	49.3	59.1	70.8	85.9	116.8	149.5	176.6	194.3	203.7
Combined OASDI											
Outlays	119.7	139.3	157.8	177.0	196.4	216.9	238.9	264.8	293.5	327.8	366.5
Budget authority	116.6	131.6	150.8	171.3	192.9	225.0	255.2	281.9	313.8	346.0	406.7
Trust fund balance at end of year	30.3	22.6	15.6	10.0	6.5	14.6	30.9	48.0	68.3	86.5	126.7
Trust fund balance at beginning of year, as a percent of outlays	27.9	21.8	14.3	8.8	5.1	3.0	6.1	11.7	16.3	20.8	23.6
Hospital Insurance (HI)											
Outlays	23.2	26.7	30.9	35.7	41.4	47.9	55.4	63.9	73.8	85.5	99.4
Budget authority	25.4	32.3	38.5	44.0	49.6	57.5	68.1	76.9	85.5	94.0	103.2
Trust fund balance at end of year	15.6	21.2	28.8	37.1	45.3	54.8	67.6	80.6	92.4	100.9	104.8
Trust fund balance at beginning of year, as a percent of outlays	57.6	58.4	68.5	80.5	89.5	94.5	99.1	105.8	109.3	108.1	101.6
Combined OASDHI											
Outlays	142.9	165.9	188.7	212.7	237.9	264.8	294.3	328.7	367.3	413.3	465.8
Budget authority	142.0	163.8	189.3	215.4	242.6	282.5	323.3	358.8	399.3	440.1	509.9
Trust fund balance at end of year	45.9	43.8	44.4	47.1	51.8	69.4	98.5	128.6	160.7	187.4	231.5
Trust fund balance at beginning of year, as a percent of outlays	32.7	27.6	23.2	20.9	19.8	19.6	23.6	30.0	35.0	38.9	40.2

NOTE: May not add due to rounding.

a. Based on CBO's January 1980 economic assumptions.