STATEMENT OF

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In the next few years, the Old Age and Survivors Insurance (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 Congressional Budget Office (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 by the beginning of fiscal year 1982 (that is, at the end of calendar year 1981). In order to assist the Committee in dealing with these problems, my testimony today will concentrate on four areas:

- 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 on the trust funds;
- An analysis of the Administration's proposal to permit fund-to-fund borrowing; and
- Alternative responses to the OASI fund's financing problems.

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

At present, both CBO and the Administration estimate that the overall solvency of the Social Security system will improve over the next five years. Over the five-year period from fiscal year 1981 through 1985, the 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 wil 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. Shortly thereafter, OASI balances are likely to become negative. (Table 1 displays these projections.) 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 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 THE START OF THE FISCAL YEAR AS A PERCENT OF EXPECTED OUTLAYS: TO FISCAL YEARS 1985 AND 1990, IN PERCENTS

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, the balance in the DI fund is 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 increases 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 could reduce the DI fund's balances.

Similarly, the balance in the HI trust fund is also likely to grow, largely because of 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. At the beginning of fiscal year 1980 the balance in this fund was almost 58 percent of anticipated outlays and it is expected to rise to almost 95 percent of outlays by the start of fiscal year 1985.

In short, while the DI and HI trust funds are not currently expected to experience difficulties, 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 hence trust fund balances, depend in the short run both on inflation and employment. The connection between trust fund forecasts and the general economic outlook is particularly evident by comparing January 1979 and January 1980 projections issued by both the Administration and CBO. In January 1979, the Administration projections, in response Co the mandated goals of the Humphrey-Hawkins Act, showed that inflation would decline quickly, reaching 3 percent by 1983 and the unemployment rate would decline to 4 percent by 1984 (see Table 2). Had those expectations been realized, the OASI trust fund would not have experienced financial difficulties.

In January 1979, CBO projected that the rate of inflation would be significantly higher and would remain over 6 percent in 1983. Unemployment was projected 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.

In January 1980, both CBO and the Administration projected that the OASI trust fund would experience an inadequate balance in 1982 and a negative balance in 1983. These projections differ from those of a year earlier because the underlying economic forecasts are more pessimistic.

Even though there is widespread agreement that in 1980 inflation will be high and that the unemployment rate will rise, the outlook is by no means certain. As we have seen during the last few years, even when there is considerable agreement, forecasters' predictions may not be realized. One reason is that

TABLE 2. COMPARISON OF C30 AND ADMINISTRATION ECONOMIC ASSUMPTIONS AS OF JANUARY 1979 AND JANUARY 1980: TO CALENDAR YEAR 1985, IN PERCENTS

	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[h]							
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. Note that the 12.6 percent inflation rate is the increase between the fourth quarters of 1978 and 1979 whereas the 13,2 percent inflation rate is the increase between December 1978 and December 1979.

e. Not forecast.

many events lie outside the range of economic forecasting. Assumptions about energy and food prices, for example, depend on world politics and weather conditions.

In addition, the behavior of consumers and businesses has proved unpredictable in times of high inflation. The current CBO forecast assumes that saving rates will rise gradually but will remain at low levels over the next two years. Should savings increase sharply, long-run economic growth prospects would improve but growth in the short-run would probably be lower.

These economic uncertainties affect projections of trust fund outlays and revenues. The rate of inflation affects trust fund outlays because Social Security benefits are indexed according to the Consumer Price Index (CPI). For example, both the Administration and CBO expect the annual benefit increase that will occur in June 1980 to be about 13 percent, increasing outlays by about $14 billion in the following fiscal year. At the same time, trust fund revenues are expected to increase only slightly less than outlays.

Trust fund revenues also depend on the level of economic growth. 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, payroll tax receipts are reduced further.

RESPONSES TO THE SHORT-RUN FINANCING PROBLEM

Policies to deal with OASI's short-run financing problem by affecting trust fund revenues fall into two general categories:

- o Reallocation of payroll tax receipts among the three funds and
- o Addition of funds from general revenues.

Alternatively, benefits could be reduced.

Reallocation of Payroll Tax Receipts

One way to reallocate tax receipts among funds is to allow fund-to-fund borrowing. The Administration has proposed that the trust funds be permitted to borrow from one another when the balance of any one fund falls below a critical level. The "critical level" proposed is 25 percent of outlays in the preceding 12 months. The Administration's proposal restricts the amount of allowable borrowing to whatever amount will raise the borrowing fund's balance to 25 percent of outlays in the preceding 12 months. Repayment, with interest, would be required when the balance of the borrowing fund exceeded 30 percent of its outlays in the preceding 12 months. Interest would be set at the rate the lending trust fund would have earned by investing in federal obligations.

One example of how the Administration's proposal could be implemented is for the OASI trust fund to borrow enough to maintain a balance at the beginning of the fiscal year equal to 25 percent of the previous year's outlays. In this case, CBO estimates roughly $60 billion would have to be borrowed over the period fiscal years 1981 through 1985. An additional $30 billion would probably have to be borrowed by the end of fiscal year 1990. (CBO's projections are presented in Table 3.)

The DI trust fund alone is not expected to have sufficient balances to meet these borrowing needs, however. The OASI trust fund would probably also have to borrow from the HI fund in fiscal years 1982 through 1985 and during fiscal years 1983 and 1984 the HI fund's balance at the beginning of the year would probably fall slightly below 25 percent of its previous year's outlays. Although it appears that the HI loans could be repaid--with interest--from the DI trust fund by fiscal year 1990, it is less clear that the OASI fund would be able to repay the DI fund.

The Administration's plan would permit the OASI fund to borrow less than the maximum amount. If the OASI trust fund borrowed only enough to raise its balance at the beginning of the fiscal year to 12 percent of its expected outlays during the year, total borrowing over fiscal years 1982 through 1985 would be about $40 billion, and additional borrowing during fiscal years 1986 through 1990 would be about $17 billion.

TABLE 3. PROJECTIONS 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[a]	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 fund maintains a balance at least as large as 25 percent of its outlays in 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 Che 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.

As in the first example, the DI fund probably could not lend all these amounts to the OASI fund. Borrowing from the HI trust fund would be needed in fiscal years 1983, 1984, and 1985. Loans from the HI fund could probably be repaid from the DI trust fund, with interest, by 1988, although repayment from OASI to DI appears more problematic (see Table 4).

The Administration's proposal would solve the short-run financing problems. An additional advantage is its flexibility; the plan would resolve additional difficulties that might arise should economic conditions be somewhat worse than anticipated, Furthermore, the proposal does not limit the Congress' future options to restructure the Social Security system in more fundamental ways to respond to long-term issues. Finally, allowing fund-to-fund borrowing would not affect the outlook for employment and inflation because the total payroll tax paid by emloyees and employers would not change. On the other hand, public concern about whether the OASI fund could repay the DI fund might develop.

A second means of reallocating revenues is to realign the payroll tax rates earmarked for the individual trust funds. A simple realignment could overcome the currently predicted short-run financing problem and would not raise the question of whether one fund could repay another, but it would be less

TABLE 4. PROJECTIONS 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: Details may not add to totals because of 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.

flexible for adapting to changing economic conditions. Tax-rate realignment would increase the likelihood that additional legislative changes would be needed in the near future.

A third alternative would be to merge the funds but retain separate analyses of expenditures for different types of benefits. This option shares the advantages of the Administration's proposal, but it is likely to be more controversial. Some people believe that it would make Congressional control of the three separate programs more difficult. It would certainly require joint consideration of funding for programs that are now assigned to different functional areas in the budget.

Partial Funding from General Revenues

A greater departure than altering the three trust funds would involve Social Security's use of general federal revenues, for example, through:

- o Trust fund borrowing from the general fund;
- o Countercyclical financing from general revenues, with or without repayment; or
- o Use of other earmarked taxes to supplement OASDHI payroll tax receipts.

These approaches would solve the short-run financing problem without losing the distinctions among the three trust funds and the system would be able to deal more easily with future fluctuations in economic conditions. Furthermore, any of these approaches could be expanded, if needed, to resolve longer-term financing problems. Public concern that there will not be adequate funding to pay for future benefits would probably be allayed, although this is less likely if borrowing were not repaid. Finally, should a decrease in payroll taxes be desired as an anti-inflationary and stimulative policy, it could be combined easily with general revenue funding.

There are several disadvantages to these approaches, however. Some people are concerned that partial reliance on general revenues would eventually lead to complete reliance (that is, elimination of the payroll tax as a source of funding) which in turn would lead to means-tested rather than entitlement benefits. In addition, these proposals would require people not covered by Social Security, or those already receiving benefits, to help pay for the system. Finally, if general revenue financing were used, either another source of revenues would have to be found, or the deficit would have to increase, or other programs would have to be reduced.

General revenue financing could also be incorporated indirectly. For example, the Congress could increase the payroll tax sufficiently to cover benefit payments for the near future and provide an income tax credit to reduce the impact of the increase on employers and employees. Alternatively, components of the Social Security system--such as Medicare--could be removed from the Social Security system and funded from general revenues. The portion of the payroll tax now allocated to these program components could be used to increase funding for the OASI fund and to lower the total payroll tax rate.

Reducing Benefits

There are many ways either to lower benefits in the short run or to limit their future growth. Some have been suggested in the past, for example, in the Administration's 1980 budget proposals. Such changes could avoid the need for increased funding from payroll taxes or other sources, as would taxing benefits and returning the revenue to the trust funds. But proposals to constrain benefits tend to be controversial and they have not been given serious attention by the Congress in the recent past.

CONCLUDING OBSERVATIONS

At the moment, responding to the short-term financial problem of the OASI trust fund is of primary concern. In the future, however, both changing demographics and a worsened economic outlook are expected to lead to more severe financing problems. These problems will require extensive consideration by the Congress. The revenue options are basically the same as those that could be adopted in the short run. With more time in which to phase in changes in benefits, however, the Congress may want to consider major restructuring of the system.

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

Individual and Combined Trust Funds	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. COO PROJECTIONS OF SOCIAL SECURITY TRUST FUND BALANCES AT THE END OF THIS YEAR: TO FISCAL YEAR 1990, IN BILLIONS OF DOLLARS

Individual and Combined Trust Funds	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 ESTIMATES OF SOCIAL SECURITY TRUST FUND BALANCES AT BEGINNING OF FISCAL YEAR AS A PERCENT OF EXPECTED OUTLAYS: TO FISCAL YEAR 1985, IN PERCENTS

Individual and Combined Trust Fund	1980	1981	1982	1983	1984	1985
OASI						
CBO[a]	26.7	18.9	9.2	1.4	b	b
Administration[c]	26.6	19.1	• 9.6	1.9	b	b
DI						
CBO[a]	36.1	41.4	49.3	59.1	70.8	85.9
Administration[c]	36.4	44.3	56.0	73.1	92.3	113.1
HI						
CBO[a]	57.6	58.4	68.5	80.5	89.5	94.5
Administration[c]	57.8	59.2	71.0	87.0	101.0	112.3
OASDI						
CBO[a]	27.9	21.8	14.3	8.8	5.1	3.0
Administration[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[c]	32.8	28.2	25.8	23.2	23.4	24.4

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

b. Negative balance.

c. Approximate.

APPENDIX TABLE 4. PROJECTED SOCIAL SECURITY TRUST FUND OUTLAYS, BUDGET AUTHORITY, AND BALANCES: TO FISCAL YEAR 1990, IN BILLIONS OF DOLLARS

Breakdown by Individual and Combined Trust Fund	1900	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
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	a	a	a	a	a	a	a
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
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
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
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

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

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

a Negative balances.