Statement of
Rudolph G. Penner
Director
Congressional Budget Office

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

April 23, 1985

This statement is not available for public release until it is delivered at 10:30 a.m. (EST) on Tuesday, April 23, 1985.

Mr. Chairman, I am pleased to testify today on the issue of removing the Social Security trust funds from the unified budget.

The Congressional Budget Office (CBO) begins with the belief that the federal budget should be comprehensive--that is, we think that all federal spending and receipts should be included in the budget. The question that we must then address is: does the unique character of Social Security warrant excluding these trust funds from the budget? In my statement this morning, I will first explain why we consider a comprehensive budget to be necessary. I will then discuss the arguments for and against removing the Social Security trust funds from the budget.

NEED FOR A COMPREHENSIVE FEDERAL BUDGET

Social Security was placed on-budget in the fiscal year 1969 budget at the recommendation of the President's Commission on Budget Concepts. The Commission wrote in its report, "different and competing budgets confuse public and congressional understanding and impede governmental decision-making." This principle--that the budget should be a comprehensive report of the full range of federal activities--is still valid today.

The unified budget is constructed to show clearly the flow of cash to and from the federal government. Decisions made on spending programs or on taxation can be easily translated into increases or decreases in the deficit and in the government's need to borrow. The size of the deficit influences interest rates and the government's interest costs. The extent of government borrowing determines how much government debt will compete with private equity and debt in the portfolios of private investors, thereby crowding out private investment or increasing our debt to international lenders.

The budget should also be comprehensive to allow the Congress to make informed decisions on how to allocate public monies and how to levy taxes. Decisions on spending levels for each federal program should be based on comparisons with the spending levels of other federal programs. Similarly, tax policy should be made in the context of all revenue measures. For example, the incidence of the federal tax structure can only be considered with knowledge of all tax burdens, including payroll taxes.

Because of the need to maintain the focus on federal borrowing and the need to facilitate tradeoffs, CBO believes that the Social Security funds should be included in the budget totals. The main reason is simple--Social Security constitutes roughly one-quarter of government outlays and one-third of government revenues. Removing these outlays and revenues from the budget would result in an inaccurate, misleading report on the government's finances. The reported "size of the government" would, in fact, be only three-quarters of its actual size, and the reported payments of benefits to individuals would be less than half of actual payments. The calculation of the government's borrowing needs would be unnecessarily complicated. Treasury documents would have to add a "regular budget deficit" to a "Social Security deficit or surplus" to arrive at the "total deficit" to be financed through borrowing. To some extent, this problem already exists because of current off-budget funds, but excluding Social Security would worsen the situation appreciably. It seems clear that the end result would be greater public confusion about the federal budget and about the Social Security program.

THE 1983 SOCIAL SECURITY AMENDMENTS

The Social Security Amendments of 1983 require that three of the funds--Old Age and Survivors Insurance, Disability Insurance, and Hospital Insurance--be excluded from the budget totals beginning in fiscal year 1993. The fourth fund--Supplementary Medical Insurance--would remain on-budget. The National Commission on Social Security Reform recommended this change in budget treatment to ensure that changes in Social Security would be made only for programmatic reasons and not for the purpose of balancing the budget. Other reasons for removing Social Security from the unified budget were cited in the debate on the bill: some proponents argued that Social Security should be removed from the budget to protect its viability as an intergenerational retirement program. Probably the most pervasive argument for removing Social Security from the budget was that it was unique, unlike other federal programs—a social insurance program financed by its own worker tax contributions. In fact, many people believe their contributions earn them a right to receive a level of benefits in the future that is fixed in value at the time of contribution. They see no need for Social Security to be included in the budget if the level of benefits cannot be changed and if Social Security receipts cannot be used for other purposes.

IS SOCIAL SECURITY UNIQUE?

Are these accurate perceptions of Social Security and do they warrant removing Social Security from the budget?

In many respects, Social Security is a program much like other income security programs that redistribute income. The Congress regularly adjusts benefit levels and financing sources. The program does not provide an equal potential return on contributions to all people; it provides far greater returns to below-average wage earners than to above-average wage earners. The program, however, has historically provided most beneficiaries with values far in excess of their contributions. Earmarked payroll taxes are not the only source of financing for the program. It also receives, for example, transfers from the Treasury for interest payments on reserves and earmarked transfers for the taxation of income from certain Social Security benefits. If spending from Social Security is reduced or if the rate of its earmarked tax is raised, the federal deficit will be lower, and government will borrow less from the public.

Social Security is similar in very important ways to private annuities and insurance. Many people expect Social Security benefits to provide a substantial portion of their retirement income, and the Congress has repeatedly stated that the program embodies a long-term commitment to provide social insurance. The Congress will not be abolishing or radically altering the program. Nevertheless, the Congress should consider on occasion how much the nation's economy can afford at the margin for social insurance, given competing claims on the economy and the willingness of taxpayers to pay. Changes in Social Security eligibility requirements, basic benefits, COLAs, and payroll taxes can have important effects not only on the current beneficiaries, but also on other income security and health programs, on tax policy, and on the deficit. These effects can be identified easily within the framework of a comprehensive budget. Similar benefit and eligibility changes in other income security programs--for Supplemental Security Income, for example--are made with a recognition of these effects.

If Social Security were exactly like a private pension fund in that participants actually owned accounts containing their own and employers' past contributions and earnings on those amounts, and if they could claim nothing more from the system, there might be some justification for separating the system from other government activities. As we have seen, however, Social Security bears little resemblance to such a private pension plan.

Another issue that the Congress should consider is the effect on the reported deficit of removing Social Security from the budget. The total actual deficit--the net of all government outlays and revenues--would be unchanged. At the same time, the reported deficit would be increased substantially. The aggregate balance of the Old Age, Survivors and Disability Insurance (OASDI) and the Hospital Insurance (HI) funds is now increasing following the enactment of the Amendments of 1983. Thus, removing Social Security from the budget removes a partial offset to the deficit in the rest of the budget.

Finally, the Congress should consider whether removing Social Security from the budget could dramatically reduce the ability of the Congress to make budgetary decisions. Such an act might establish a precedent for removing other accounts from the budget. In the end, there could be a proliferation of federal sub-budgets, completely eroding the usefulness of the budget as an accounting device to illustrate the economic and allocative activities of the federal government. If all trust funds were removed from the budget, for example, the budget would substantially understate government activity and would become incomprehensible. Attached to my statement is an excerpt taken from CBO's 1985 annual report that shows the projected unified deficits and trust fund surpluses for all major trust funds. 1/

CONCLUSION

Mr. Chairman, CBO does not make recommendations on issues of program policy. When asked, we have commented on budget procedure and presentation issues.

Social Security is, after national defense, the largest single activity of the federal government. All debates on fiscal policy will have to consider the total borrowing requirements of the federal government--the Social Security balance, as well as the balances of revenues and expenditures for

---

1. See the Congressional Budget Office's The Economic and Budget Outlook; Fiscal Years 1986-1990 (February 1985), page 63.

other government activities. Similarly, debates on tax policy and the allocation of spending will have to recognize the revenues and expenditures of Social Security. We believe that public understanding of these debates will be improved if they are carried on within a comprehensive federal budget. We do not believe that inclusion of Social Security in the budget will compromise the commitment of the government to provide secure and adequate social insurance. We, therefore, recommend that the requirement that Social Security be removed from the unified budget be repealed.

FEDERAL FUNDS AND TRUST FUNDS

The federal budget is divided into two types of funds: federal funds and trust funds.

Federal fund receipts comprise those taxes and other government revenues that are not restricted to a specific purpose. These receipts and, when necessary, borrowing are used to pay for the general activities of the government, such as national defense, interest on the public **debt,** income maintenance programs, and most nondefense discretionary spending. Federal funds are sometimes called general funds.

Trust funds collect certain taxes and other receipts (such as interest income, insurance premiums, or sometimes, general fund payments) that are earmarked for specific purposes. The largest trust funds pay for federal social insurance **programs--Social** Security, Medicare, and federal civilian and military **retirement--and** for highways and airports.

The current government deficit contains a substantial trust fund surplus offset by an even larger federal funds deficit, as shown in the following table.

(In billions of dollars)

	1985	1986	1987	1988	1989	1990
Federal Funds Deficit	-264	-269	-294	-327	-359	-399
Trust Fund Surpluses						
Social Security	8	8	5	27	40	54
Medicare	5	9	15	9	4	2
Federal civilian retirement	16	18	19	20	21	22
Military retirement	12	12	12	13	14	14
Other	8	8	10	10	9	11
Subtotal	50	54	61	78	88	103
Total **Deficit**	-214	-215	-233	-249	-272	-296

An increase in trust fund revenues (other than by a transfer of federal funds) or a decrease in trust fund outlays will increase the aggregate trust fund surplus and reduce the total deficit. Although trust fund surpluses cannot be used to pay for federal fund expenditures, they do reduce the Treasury's need to borrow from the public. The Treasury, **however,** must issue interest-bearing debt securities to the trust funds in the amount of their surplus. These debt holdings represent the trust funds' future claim on the **government's** cash when the funds' earmarked receipts may-for short or long periods-fall below their spending.