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STATEMENT OF

GREGORY J. AHART, DIRECTOR

HUMAN RESOURCES DIVISION

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

COMMITTEE ON FINANCE

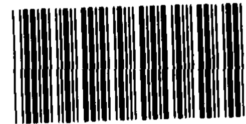
UNITED STATES SENATE

ON

[HEW REGULATIONS INCREASING THE FREQUENCY

OF STATE DEPOSITS OF

SOCIAL SECURITY CONTRIBUTIONS]



Testimony

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Mr. Chairman and Members of the Subcommittee, we are pleased to be here today to discuss the impact on the Social Security trust funds of a change in HEW's regulations regarding the frequency of State deposits of social security contributions.

As you are aware, we reviewed this matter and issued a report to the Congress on December 18, 1978, entitled, "Liberal Deposit Requirements of the States' Social Security Contributions Adversely Affected Trust Funds."

I would like at this time to submit a copy of the report for the record, and then summarize the report.

Effective January 1, 1951, the Social Security Act extended social security coverage to State and local government employees. Coverage is through voluntary agreements between the Secretary of HEW and the individual States. The act provides that the regulations of the Secretary of HEW shall be designed to make the deposit requirements imposed on States the same, so far as practicable, as those imposed on private employers.

Each State deposits the combined State and local government social security contributions directly with the Federal Reserve Bank for transfer to the trust funds. As required by HEW, each State files wage reports of covered employees with HEW within 1 month and 15 days after the end of each calendar quarter. This timeframe was requested by the States and has been in effect since

1959. Before 1959, the States were required to file wage reports and make deposits within 30 days after the end of each calendar quarter.

Contributions paid by workers and their State and local government employers increased from about $865,000 in 1951 to over $10 billion in 1977. These contributions are estimated to increase to about $14.5 billion by 1980.

On March 30, 1978, HEW published in the Federal Register its proposed rulemaking increasing from quarterly to monthly the frequency with which States must deposit social security contributions on wages and salaries paid to covered employees--the so-called 15-15-15 method.

By allowing the States to make quarterly deposits of State and local contributions, HEW lost about $1.1 billion in interest income to the trust funds from 1961 through 1979.

Monthly deposits, 15 days after the end of each month under the proposed rulemaking, and prompt investment could result in additional interest earnings to the trust funds of over $1 billion during the 5-year period 1980-84. Semi-monthly or biweekly deposits could result in additional interest income of over $70 million for the trust funds during the same 5-year period.

HEW received about 3,300 comments on its March proposal, primarily from State officials, local political subdivisions, and governmental organizations. The commenters were overwhelmingly opposed to any changes in the States' deposit procedures.

HEW considered both the oral and written comments and, as a result, made what we consider to be a significant change which required that the States deposit the social security contributions for each of the first 2 months of a calendar quarter by the 15th day after each month. However, the contributions for the third month of the quarter will not be due until 1 month and 15 days after the end of that month--the so-called 15-15-45 method. These changes were published in the Federal Register on November 20, 1978, and are to become effective July 1, 1980.

The States' primary objection to more frequent deposits is loss of interest earned from investing contributions remitted to States by State agencies and local governments and the loss of cash flow.

However, there will not be a total loss of interest. In a July 5, 1978, letter to you, Mr. Chairman, the Secretary of HEW pointed out that States and local governments could still earn, under the March 30, 1978, proposed monthly depository procedure, a minimum of $50 million annually from prudent short-term investment of withheld contributions before depositing them with the Federal Reserve Bank. We believe that HEW deposit regulations which allow States to earn interest on investment by using funds which should be deposited in and earning interest for the trust funds are not only detrimental to the financial stability of these trust funds but cannot be rationally justified and should be changed.

These funds are contributions in support of the Social Security System and should not be diverted for other purposes.

States and local governments also indicated that administrative problems such as collecting and depositing funds, reporting, and documenting States' liabilities would result if more frequent deposits are required. These matters are discussed in detail in our report and we see no insurmountable problems that could not be reasonably worked out. Further, the 18-month implementation delay provided by Public Law 94-202, should be sufficient to deal with such problems.

On November 1, 1978, before the revised proposal was approved by HEW, we met with officials and informed them that we could find no logical or valid justification for delaying the last monthly deposit. We pointed out, among other things, that

--if the third monthly deposit were required, any monetary adjustments could be made when the quarterly report is filed. Also, by delaying the last deposit, States would be sending in two deposits on the same day.

--delaying the third monthly deposit in a quarter could allow States to retain the funds as long as 2-1/2 months.

--the HEW Secretary previously stated that the States and local governments could still earn under the originally proposed monthly depository procedures a minimum of

$50 million annually from prudent short-term investments, which should fully compensate the States for administrative costs.

--HEW is considering an annual reporting system, and if adopted, there would be less administrative reporting by the States, which would seem to negate the argument that the States need more time to receive, account for, and transmit payment.

--by delaying the last deposit, HEW is placing itself in the same position it did in 1959 when it was estimated that the extra 15 days was costing the trust funds $0.5 million annually in interest income. We estimate that for 1977, the additional 15 days at the end of each quarter resulted in a loss of investment income of about $31 million to the trust funds. HEW apparently is saying that if it knew 20 years ago what it knows today, it might have acted differently and more quickly. What we are trying to prevent is a recurrence of the same situation.

Additionally, we estimate that for the 5 years from July 1, 1980 to June 30, 1985, the trust funds would earn $204.2 million less in interest income under the 15-15-45 requirements than under the March 1978 (15-15-15) proposal and $280.8 million less under the 15-15-45 requirements than under a semi-monthly deposit schedule. Social Security actuaries believe that these estimated 5-year losses

should be considered as conservative, due to our using simple interest instead of compound interest.

HEW's original proposal to increase the frequency of deposits to a monthly basis was a step in the right direction. However, if these contributions were required to be deposited biweekly or semi-monthly, additional interest could be earned.

We believe that the November 20, 1978, regulations calling for the 15-15-45 deposit requirements are not in the best interest of the trust funds since they do not maximize interest earnings to the trust funds. Since these regulations will not become effective until July 1, 1980, we recommended in our December 18, 1978, report that the Secretary of HEW reconsider his decision to implement the 15-15-45 requirements and urged that semi-monthly or biweekly deposits be required. However, at a minimum the HEW original proposal (15-15-15) would be a better alternative than the 15-15-45 requirements.

Mr. Chairman, that concludes our statement. We will be happy to answer your questions.