

STATEMENT OF ALICE M. RIVLIN
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BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY
HOUSE WAYS AND MEANS COMMITTEE
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Mr. Chairman:

Two years ago, the Congress passed the Social Security Amendments of 1977, following a period of concern about the effects of inflation and recession on the Social Security trust funds. At that time, the annual flow of revenues into the trust funds was not sufficient to cover expected expenditures, and the trust fund balances were eroded. The possibility arose that these balances could fall to an unacceptably low level. In order to avert this possibility, the amendments increased the payroll tax rate and the covered earnings base in a number of steps beginning in 1979.

At the time of the 1977 Amendments, the Congressional Budget Office (CBO) examined the impact of these increased taxes on the trust fund balances, and found that the short-run outlook for the trust funds was good. The funds were projected to have a balance of 35 percent of outlays by 1983. Unfortunately, this assessment was based on an economic outlook that has proved to be overly optimistic. In July of this year, CBO reexamined the status of the Social Security trust funds. These more recent estimates indicate a potential problem in the Old Age and Survivors trust fund in 1983 or 1984.

My statement today will cover three points:

- o CBO's most recent five-year estimates;
- o The changing economic outlook that is responsible for the revised estimates; and
- o Several options the Congress might consider to ensure adequate reserves in the trust funds even under the projected slowdown in economic activity.

CURRENT ESTIMATES

As part of its updated budget projections prepared for the House Budget Committee in July, CBO reestimated the revenues and outlays of the Social Security trust funds for fiscal years 1979 to 1984. Over the five-year period from 1980 to 1984, the combined OASDHI program is expected to receive in tax revenues and interest \$27 billion more than will be spent; in other words, the overall trust fund balances should grow. Under current law, however, there are three separate Social Security trust funds: the Old Age and Survivors Insurance Fund (OASI), the Disability Insurance Fund (DI), and the Health Insurance Fund (HI).^{*} CBO projects the outlays in the Old Age and Survivors Insurance fund to exceed income over the next five years. At the beginning of fiscal year 1979, the OASI trust fund balance reached a level of 34.3 percent of anticipated outlays; this balance could fall to 8.0 percent by the start of fiscal year 1983 and to 5.4 percent by the start of fiscal year 1984 (See Table 1).

^{*}The Supplementary Medical Insurance trust fund is not included in this discussion.

TABLE 1. 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 1/

	<u>Funds at Beginning Of Year As A Percent of Outlays</u>					
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Old Age and Survivors Insurance (OASI)	34.3	26.2	18.9	11.8	8.0	5.4
Disability Insurance (DI)	31.4	35.4	37.8	41.6	47.9	55.8
Combined OASDI	33.9	27.4	21.5	15.9	13.5	12.4
Medicare (HI)	57.3	55.9	55.4	66.1	80.3	91.5
Combined OASDHI	37.7	32.1	27.0	24.2	24.9	26.8

1/ Under the July 1979 House Budget Committee set of economic assumptions.

Current balances in the Disability Insurance trust fund are 31.4 percent of estimated outlays. As a result of the large boost in taxes earmarked for this fund and recent declines in the rate of growth in DI benefit payments, the DI trust fund balances are projected to increase to 55.8 percent of outlays by 1984. DI benefit payments, however, have been very difficult to predict in recent years, and any unexpected increase in disability payments over the next five years could cut into these balances.

Balances in the Hospital Insurance trust fund are currently 57.3 percent of anticipated outlays and are expected to increase to 91.5 percent of outlays in 1984. The growing balances in the Hospital Insurance fund result from the increases in the covered earnings base legislated in the 1977 Amendments and from a somewhat slower growth in hospital expenditures than was previously anticipated.

While there is some disagreement concerning the "ideal" balances for the trust funds, studies conducted within the Office of the Secretary of Health, Education, and Welfare and by the Social Security Advisory Council's Panel of Actuaries and Economists have stated that the balances in each trust fund should be maintained at a 60 to 75 percent level of outlays to meet contingencies and to ensure public confidence. 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 in a timely fashion all monthly payments during the year. Thus, while the DI and HI trust funds appear to be in acceptable shape over the short run, the OASI fund could fall well below desirable levels and even into a problematic range.

THE CHANGING OUTLOOK

CBO's estimates of the financial position of the trust funds has changed primarily because of the unforeseen deterioration in the economic outlook, as characterized by the rapid growth in inflation and a rising unemployment rate.

In 1977, CBO forecast that over the 1979 to 1983 period the average annual rate of inflation would be 5.7 percent and the average unemployment rate would be 5.3 percent (see Table 2). In July 1979, the House Budget Committee with the assistance of CBO developed a forecast for the same 1979 to 1983 period showing an average annual rate of inflation of 8.9 percent and an unemployment rate of 6.8. The House Budget Committee's economic assumptions are neither overly optimistic nor overly pessimistic; they fall within the range of those projected by DRI, Wharton, Chase Econometrics, and the other major forecasting services.

TABLE 2. CHANGE IN ECONOMIC ASSUMPTIONS BETWEEN 1977 AND JULY 1979: BY CALENDAR YEAR

Economic Variable	1979	1980	1981	1982	1983	5-Year Average
Consumer Price Index (percent change from first quarter to first quarter)						
1977 forecast by CBO	5.9	5.9	5.5	5.6	5.8	5.7
July 1979 forecast by HBC	9.9	10.3	8.9	8.1	7.3	8.9
Unemployment Rate (average for calendar year)						
1977 forecast by CBO	6.2	5.7	5.2	4.7	4.5	5.3
July 1979 forecast by HBC	6.2	7.3	7.1	6.9	6.6	6.8

The deterioration in the economic outlook over the past two years has resulted from a series of unforeseen shocks, such as the rapid increase in the OPEC price of oil. Inflation, as measured by the Consumer Price Index (CPI), accelerated from an annual rate of 6.8 percent in 1977 to 9 percent in 1978 to 13 percent in the first half of 1979. This rapid rise in inflation was largely due to the sharp rise in the price of food, especially beef, and to the unanticipated jump in energy prices. Rising mortgage interest costs, the depreciation of the dollar against major world currencies, and a deterioration in productivity growth in the United States have also contributed to higher inflation rates.

The rate of inflation is the most important economic factor affecting outlays from the Social Security trust funds. In June of each year, benefits are increased automatically by the growth in the CPI over the past year. Each additional percentage point rise in the CPI adds more than \$1 billion to outlays in the following year. Since money wages tend to increase along with the rate of inflation, payroll taxes and trust fund revenues also tend to increase by about as much as 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 will decline. For example, if the rate of inflation and the growth in money wages were both 1 percent higher in each year from 1980 through 1984 than the levels in the House Budget Committee path, the combined OASDI trust fund would fall from an anticipated level of 12.4 percent of outlays to 11.3 percent by 1984.

The economic uncertainty and hardship associated with the rapid acceleration in inflation has also worsened the outlook for real growth and employment. While in 1977 most forecasters were assuming slow growth but no downturn in the 1979-1980 period, these same forecasters now agree that a recession is likely.

The level of unemployment affects the flow of revenues into the trust fund. As fewer people are employed, wages and salaries fall, and payroll tax receipts are reduced. Moreover, after a period of time, some of these unemployed workers become eligible and begin to collect OASI or DI benefits. Thus, outlays also increase slightly in times of high unemployment. If the rate of unemployment for 1981 rose 1 percent above the rate assumed by the House Budget Committee, for example, while all other economic variables remained constant, and if the rate then gradually returned to the HBC level by 1984, the OASDI trust funds would fall to 3.4 percent of outlays by 1984, as compared with the projected 12.4 percent.

OPTIONS

If the economy develops as the House Budget Committee forecasts, the OASI trust fund will have cash flow problems by 1983, and steps may have to be taken to restore an adequate level of trust fund reserves. In addition, the combined balances of all the trust funds will be well below those previously anticipated and below the levels generally thought to be

desirable. A more severe recession than is currently anticipated would exacerbate these problems. In this context, there are a number of policy options that the Congress might consider.

Combine the Trust Funds

In the short run, legislation combining either the OASI and DI trust funds or the OASI, DI, and HI trust funds would probably prevent a cash flow problem from occurring between now and 1984. Under the House Budget Committee's economic assumptions, CBO projects trust fund balances in the combined OASDI trust funds to fall to 12.4 percent of outlays by 1984, while combined OASDHI balances are projected to fall only to 26.8 percent. While a slightly more severe recession could create cash flow problems even in the combined OASDI trust funds, the total OASDHI balances would likely be sufficient.

Institute Countercyclical Borrowing from General Revenues

Another possibility would be to allow the trust funds to borrow from general revenues when an economic slowdown cuts into expected receipts. The legislation could stipulate the economic conditions and the time period during which the general fund had to be repaid. A similar approach was included in the original House version of the 1977 Amendments. The repayment could come from surpluses in future years generated by tax increases, benefit reductions, or an improved economic situation. These

loans and repayments could possibly be countercyclical in nature, with transfers from general revenues to the trust funds in times of recession and repayments — with or without tax increases — in periods of economic growth. Although their final report is not yet complete, the Advisory Council on Social Security has tentatively endorsed a form of countercyclical financing, as has the Carter Administration in the past.

Reduce the Rate of Growth of Benefits

Certain benefits not directly related to payroll tax contributions -- that is, the so called "welfare" portions of OASI and DI benefits -- could be either reduced or financed from general revenues. Such changes, however, might not be possible in the short run since they involve complicated issues that are difficult to implement quickly.

One way of reducing the rate of increase in Social Security expenditures would be to substitute the rate of increase in wages for the June cost-of-living increase whenever the cost-of-living increase exceeds the wage rise. (The June 1979 increase was 9.9 percent, while actual money wages increased by 8.2 percent.) This would distribute the real income loss caused by the recession more evenly between workers and retirees, although it could cause hardship for many OASDI beneficiaries.

Increase the Tax

In the absence of other measures, the Congress might consider a tax increase, particularly for OASI, in order to maintain adequate balances in the trust funds. This would, however, tend to increase unemployment and add inflationary pressure during a period when we will be trying to reduce both.

Finance Medicare from General Revenues

Finally, the Congress could consider using all or part of the HI tax rate to finance the OASI program, while funding HI from general revenues. This approach has been suggested by former Social Security Commissioner Robert Ball, as well as by the Advisory Council and others. They argue that general revenues could be used to fund HI because Medicare benefits are not related to contributions. Because the HI receipts would be more than sufficient to maintain a reasonable OASI fund balance relative to outlays, the total payroll tax rate could be cut if it was determined that a noninflationary form of fiscal stimulus was desirable.

CONCLUSION

Although CBO's current projections of the Old Age and Survivors Insurance trust fund do indicate a potential funding problem, this problem is not as serious as that faced by the Congress before the 1977 Amendments. In addition, there is ample time to develop solutions that are consistent not only with a financially sound Social Security system but also with other national goals such as controlling inflation and unemployment.

TECHNICAL APPENDIX

APPENDIX TABLE 1. OASDHI TAX RATES AND TAXABLE EARNINGS
BASE BEFORE AND AFTER 1977 AMENDMENTS,
CALENDAR YEARS 1979-1984

Calendar Year	Employer and Employee Rates, Each					Taxable Earnings Base
	OASI	DI	OASDI Combined	HI	OASDHI	
Current Law						
1979	4.330	.750	5.080	1.050	6.130	22,900
1980	4.330	.750	5.080	1.050	6.130	25,900
1981	4.525	.825	5.350	1.300	6.650	29,700
1982	4.575	.825	5.400	1.300	6.700	32,700*
1983	4.575	.825	5.400	1.300	6.700	36,300*
1984	4.575	.825	5.400	1.300	6.700	40,200*
Prior to 1977 Act						
1979	4.350	.600	4.950	1.100	6.050	18,900*
1980	4.350	.600	4.950	1.100	6.050	20,400*
1981	4.300	.650	4.950	1.350	6.300	22,200*
1982	4.300	.650	4.950	1.350	6.300	24,300*
1983	4.300	.650	4.950	1.350	6.300	27,000*
1984	4.300	.650	4.950	1.350	6.300	30,000*

*Automatic increases based on HBC economic assumptions.

APPENDIX TABLE 2. CBO'S PAST AND CURRENT PROJECTIONS OF COMBINED OASDI TRUST FUND BALANCES: BY FISCAL YEAR

	1979	1980	1981	1982	1983	1984
<u>Trust Fund Balance at End of Year</u> (In Billions of Dollars)						
<u>CBO Estimates</u>						
September 1977 Pre-Amendments	25.9	17.4	7.3	-4.9	-19.7	--
June 1978 Post-Amendments ^{1/}	33.9	33.9	40.2	53.6	70.2	--
July 1979: HBC economic assumptions	32.9	29.7	25.1	23.5	23.8	26.2
<u>Trust Fund Balance at Beginning of Year as Percent of Outlays</u>						
<u>CBO Estimates</u>						
September 1977 Pre-Amendments	31.8	22.4	14.1	5.2	<u>2/</u>	--
June 1978 Post-Amendments	34.2	29.1	26.5	28.8	34.8	--
July 1979: HBC economic assumptions	33.9	27.4	21.5	15.9	13.5	12.4

^{1/} Law change.

^{2/} Negative balance.

APPENDIX TABLE 3. OLD AGE AND SURVIVORS INSURANCE, DISABILITY INSURANCE, AND COMBINED OASDI OUTLAYS, BUDGET AUTHORITY, TRUST FUND REVENUES, AND TRUST FUND BALANCES: BY FISCAL YEAR, IN BILLIONS OF DOLLARS a/

	1979	1980	1981	1982	1983	1984
<u>Old Age and Survivors Insurance (OASI)</u>						
Outlays	90.5	104.0	119.8	135.7	150.4	165.3
Budget authority	86.7	99.4	113.1	131.7	147.3	163.8
Revenues	84.1	97.1	111.2	129.7	146.0	162.7
Trust fund balance at end of year	27.2	22.7	16.0	12.0	8.9	7.4
Trust fund balance at end of previous year, as a percent of outlays	34.3	26.2	18.9	11.8	8.0	5.4
<u>Disability Insurance (DI)</u>						
Outlays	14.0	16.1	18.5	21.9	24.0	26.7
Budget authority	15.3	17.4	20.7	24.3	27.4	30.7
Revenues	14.8	16.8	20.0	23.5	26.3	29.3
Trust fund balance at end of year	5.7	7.0	9.1	11.5	14.9	18.8
Trust fund balance at end of previous year, as a percent of outlays	31.4	35.4	37.8	41.6	47.9	55.8
<u>Combined OASDI</u>						
Outlays	104.5	120.1	138.3	157.6	174.4	192.0
Budget authority	102.0	116.8	133.8	156.0	174.7	194.5
Revenues	98.9	113.9	131.2	153.2	172.3	192.0
Trust fund balance at end of year	32.9	29.7	25.1	23.5	23.8	26.2
Trust fund balance at end of previous year, as a percent of outlays	33.9	27.4	21.5	15.9	13.5	12.4

a/ Based on the House Budget Committee July 1979 economic assumptions.

APPENDIX TABLE 4. CBO'S PROJECTIONS BASED ON HOUSE BUDGET COMMITTEE STAFF ECONOMIC ASSUMPTIONS OF COMBINED OLD AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE, HOSPITAL INSURANCE AND COMBINED OASDHI OUTLAYS, BUDGET AUTHORITY, AND TRUST FUND BALANCES: BY FISCAL YEAR, IN BILLIONS OF DOLLARS a/

	1979	1980	1981	1982	1983	1984
<u>Combined OASDI</u>						
Outlays	104.5	120.1	138.3	157.6	174.4	192.0
Budget authority	102.0	116.8	133.8	156.0	174.7	194.5
Trust fund balance at end of year	32.9	29.7	25.1	23.5	23.8	26.2
Trust fund balance at beginning of year as a percent of outlays	33.9	27.4	21.5	15.9	13.5	12.4
<u>Hospital Insurance (HI)</u>						
Outlays	20.6	23.6	27.1	31.3	36.0	41.2
Budget Authority	22.0	25.4	32.8	39.6	44.7	50.0
Trust Fund Balance at end of year	13.2	15.0	20.7	28.9	37.7	46.5
Trust fund balance beginning of year as a percent of outlays	57.3	55.9	55.4	66.1	80.3	91.5
<u>Combined OASDHI</u>						
Outlays	125.1	143.7	165.4	188.9	210.4	233.2
Budget authority	124.0	142.2	166.6	195.6	219.4	244.5
Trust fund balance at end of year	46.1	44.7	45.8	52.4	61.5	72.7
Trust fund balance at beginning of year as a percent of outlays	37.7	32.1	27.0	24.2	24.9	26.8

a/ Based on the House Budget Committee July 1979 economic assumptions.

APPENDIX TABLE 5. COMPARISON OF CBO'S ECONOMIC ASSUMPTIONS WITH THOSE OF THE HOUSE BUDGET COMMITTEE, DRI, WHARTON, AND CHASE ECONOMETRICS: AVERAGES OVER THE PERIOD 1980 TO 1984

	Unemployment Rate	Percentage Change In:			
		Real GNP	GNP Deflator	CPI (Urban)	CPI (all items)
CBO	6.44	3.32	8.38	8.48	*
HBC	6.84	3.30	7.86	7.92	*
DRI	6.77	3.08	8.16	8.26	8.60
Wharton	7.92	2.42	7.64	*	8.28
Chase	6.52	2.86	7.38	*	7.78

* Not projected.

APPENDIX TABLE 6. HISTORICAL AND PROJECTED ASSETS OF THE OLD AGE AND SURVIVORS INSURANCE (OASI) AND THE DISABILITY INSURANCE (DI) TRUST FUNDS AT THE BEGINNING OF YEAR AS A PERCENT OF OUTLAYS IN THE FISCAL YEAR

<u>Fiscal Year</u>	<u>OASI</u>	<u>DI</u>	<u>Combined OASI and DI</u>
1960	195	313	200
1965	123	151	126
1970	103	125	105
1971	101	142	105
1972	96	149	101
1973	83	135	89
1974	74	123	79
1975	67	103	71
1976	62	85	65
1977	50	56	51
1978	44	34	42
1979 <u>1/</u>	34	31	34
1980 <u>1/</u>	26	35	27
1981 <u>1/</u>	19	38	21
1982 <u>1/</u>	12	42	16
1983 <u>1/</u>	8	48	13
1984 <u>1/</u>	5	56	12

1/ CBO projections based on House Budget Committee's staff preliminary economic assumptions.

APPENDIX TABLE 7. COMPARISON OF THE ECONOMIC ASSUMPTIONS OF THE SENATE BUDGET COMMITTEE, HOUSE BUDGET COMMITTEE, ADMINISTRATION'S MID-SESSION ALTERNATIVE PATH 1/, THE 1979 TRUSTEES' PESSIMISTIC PATH III AND OMB'S REVISED, FINAL MID-SESSION PATH, FOR CALENDAR YEARS

	1979	1980	1981	1982	1983	1984
<u>UNEMPLOYMENT RATE (AVERAGE FOR YEAR)</u>						
SBC	6.2	7.3	7.0	6.3	5.7	5.3
HBC	6.2	7.3	7.1	6.9	6.6	6.3
Administration's Mid-Session 1/ Trustees' Pessimistic Path III	6.1	6.8	6.5	6.2	5.9	5.6
OMB Revised Post-OPEC Mid-Session	6.3	8.2	7.4	6.9	6.4	6.0
OMB Revised Post-OPEC Mid-Session	6.1	6.8	6.5	6.1	5.8	5.6
<u>PERCENTAGE GROWTH IN REAL GNP</u>						
SBC	1.8	1.0	3.8	5.3	4.3	3.9
HBC	1.8	1.0	3.5	4.0	4.0	4.0
Administration's Mid-Session 1/ Trustees' Pessimistic Path III	1.9	1.4	3.5	3.6	3.5	3.5
OMB Revised Post-OPEC Mid-Session	2.3	-1.1	5.4	4.1	4.0	3.7
OMB Revised Post-OPEC Mid-Session	1.7	1.0	3.4	3.7	3.5	3.5
<u>PERCENTAGE GROWTH IN CPI</u>						
SBC	10.6	9.3	8.4	7.6	7.5	7.5
HBC	10.6	9.3	8.6	7.8	7.1	6.8
Administration's Mid-Session 1/ Trustees' Pessimistic Path III	10.0	8.2	7.4	6.6	6.2	5.4
OMB Revised Post-OPEC Mid-Session	10.3	8.9	7.3	6.3	6.0	6.0
OMB Revised Post-OPEC Mid-Session	10.7	8.6	7.5	6.6	6.2	5.6
<u>JUNE SOCIAL SECURITY BENEFIT INCREASE</u>						
SBC	9.9	10.3	8.8	7.7	7.5	7.4
HBC	9.9	10.3	8.9	8.1	7.3	6.5
Administration's Mid-Session 1/ Trustees' Pessimistic Path III	9.9	8.9	7.9	6.7	6.4	5.9
OMB Revised Post-OPEC Mid-Session	9.8	9.8	7.9	6.5	6.0	6.0
OMB Revised Post-OPEC Mid-Session	9.9	9.7	8.2	6.7	6.4	5.8

1/ Assumptions used to determine the OASI and DI outlays and budget authority by the Social Security Administration carried in the mid-session review by OMB. Subsequent revisions by OMB of the assumptions (also shown) have increased OMB's estimates of outlays and budget authority, and these differences are carried in an allowance account by OMB.

