Statement of
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before the
Subcommittee on Social Security
Committee on Ways and Means
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NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EST), Thursday, November 2, 1989.

Mr. Chairman, thank you for providing me with this opportunity to discuss the Congressional Budget Office's (CBO's) position on the treatment of Social Security in the deficit reduction process. The Congressional Budget Office believes that Social Security should remain subject to the same fiscal discipline as the rest of the budget, as the Balanced Budget Act now provides. Should the Congress decide to exclude Social Security from the Balanced Budget Act targets, however, we feel that it would be prudent to adopt some additional measures to restrain Social Security benefit increases or tax reductions. Such constraints, it should be recognized, would limit the Congress's flexibility in adapting Social Security and the rest of the budget to changing circumstances. My statement elaborates on these points.

SOCIAL SECURITY SHOULD STAY IN THE DEFICIT TARGETS

From an economic perspective, it makes sense to include Social Security in the Balanced Budget Act calculations. The purpose of reducing the deficit is to promote national saving. The federal budget deficit absorbs private saving, thereby impairing future living standards and the nation's ability to support the retirement of the baby-boom generation in the next century. Because Social Security surpluses contribute to government saving or dissaving in exactly the same way as the balance in non-trust fund accounts, they should continue to be included in any deficit target.

Similarly, the most appropriate measure of the impact of the federal budget on the economy is the total deficit, not any part of it. The total government deficit, including Social Security and other trust funds, determines the government's fiscal stance, its drain on credit markets, and the amount of saving that it diverts from uses that promote growth in living standards.

If Social Security were excluded from the Balanced Budget Act targets, a large part of the budget would be excused from making any further contribution to resolving the deficit problem. This could make the solution all the harder. For example, many budget experts have suggested that increased taxes on Social Security benefits should be a component of any major deficit reduction effort. But the idea would lose all appeal if the proceeds from taxing benefits continue to be credited to the Social Security trust funds, and if the trust funds do not count toward deficit reduction.

Exempting part of the budget is also likely to spawn demands to exclude other programs from the discipline of deficit reduction. If Social Security were removed from the deficit targets, federal retirees would press for equal treatment for the civil service and military retirement trust funds. And what about Hospital Insurance, which is scheduled to be taken off-budget in 1993? Once one program is given special consideration, it becomes harder to require sacrifice elsewhere in the budget.

Despite these reasons for keeping Social Security in the Balanced Budget Act calculations, many are calling for excluding Social Security from Gramm-Rudman-Hollings. What are their arguments, and how do we respond?

One contention is that, if attention were focused on the non-Social Security deficit, public perception of the deficit problem would be heightened, and the Administration and the Congress would be galvanized into making the needed spending cuts or tax increases. While this is possible, increasing the gap between the deficit and the target could equally well lead to greater frustration and even less deficit reduction.

Another common argument for excluding Social Security from the Balanced Budget Act targets is that it would strengthen the financial position of the trust funds and thereby protect the retirement benefits of the baby-boom generation. True, if the non-Social Security budget were balanced, and if Social Security continued to accumulate reserves, the federal government would contribute more to national saving. In the long run, this would increase wages and payroll tax collections. But future Social Security benefits would rise almost equally, because they, too, are tied to earnings. On balance, the position of the trust funds would be little improved.

The retirement income of the baby-boom generation will have to come from economic resources produced in the next century, and there is no way to get around that fact. Moreover, the only ways for the government to lay claim to those resources will be through tax increases, spending cuts, or borrowing. Even if Social Security builds up gargantuan reserves and the remainder of the budget is in balance, the Treasury will be able to redeem Social Security's holdings of federal securities only by borrowing from the public, or by cutting spending or raising taxes elsewhere in the budget. But higher living standards for the general population would result from increased national saving, and that might ease the inevitable stress resulting from reallocating resources to the aged.

While excluding Social Security from Gramm-Rudman-Hollings and accumulating large reserves would do little to improve the economic stability of Social Security, they might reduce the likelihood that the benefit formula will be scaled back in the future. As long as Social Security is included in the Balanced Budget Act calculations, benefit reductions or payroll tax increases remain options for meeting the deficit targets. While changes in Social Security cannot be included in reconciliation bills without being subject to a point of order, removing Social Security from the Balanced Budget Act process would provide further assurance that benefits would not be cut.

The accumulation of trust fund balances would strengthen the claims of future retirees to currently promised benefits, but it would also make it more difficult to enact long-term adjustments in the Social

Security system. Social Security has generally been viewed as a commitment that should not be altered simply to meet short-run budget goals. The current structure of Social Security, however, should not be considered sacrosanct. Changing demographic and economic circumstances, as well as the evolution of society's values, could render the present benefit structure less suitable for the next century. For example, some have suggested that the age of eligibility for benefits be increased even more than now scheduled in law to reflect the lengthening lifespan of the population. If huge trust fund reserves accumulate, there will be little incentive to reexamine Social Security periodically in light of the nation's retirement policy objectives.

EXCLUDING SOCIAL SECURITY FROM DEFICIT TARGETS MAY BACKFIRE

Taking Social Security out of the deficit targets might even backfire. That is, without additional protections of the sort this Subcommittee is considering, excluding Social Security from the Balanced Budget Act might fail to limit total federal borrowing and might undermine the trust fund surpluses that it would be intended to preserve. It certainly would be harder to fend off proposals to raise benefits or cut payroll taxes without the discipline of deficit reduction. For example, the calls for eliminating the so-called notch by increasing benefits might have proved irresistible if Social Security had been excluded from the deficit calculations.

Furthermore, without the discipline of deficit targets, others might be tempted to expand the number of programs supported by the trust funds as a means of freeing up resources in the budget for additional spending. For example, if funding for Supplemental Security Income (SSI) were shifted to Social Security, the general fund resources that are currently devoted to SSI would be available for additional spending, since deficit targets would apply only to the non-Social Security budget. Alternatively, additional assistance to the low-income elderly and disabled might be sought directly through Social Security, even though SSI is the more efficient way of providing aid to the poor.

SOCIAL SECURITY SOLVENCY PROTECTION ACT

For these reasons, if Social Security were to be excluded from the deficit reduction process, it would be important to adopt some constraints to ensure that the financial integrity of the program could not easily be jeopardized. The bill before this Subcommittee would create a point of order against considering any legislation that would worsen Social Security's financial condition over either the next 75 years or the next six years.

The 75-Year Test

Social Security has used a 75-year valuation period since 1966. Thus, the 75-year test in the bill formalizes, for the most part, a standard that has long applied in practice. Even so, a caveat is in order. Any estimates that span so many years are inherently uncertain. As we at CBO know all too well, it is difficult enough to project federal spending or revenues for the next five years. Social Security is only now entering its fiftieth year of paying benefits. Projecting the state of Social Security 75 years from now is like estimating the 1990 budget from the vantage point of 1915, two years before America entered World War I and 21 years before Keynes's *General Theory* was published.

From time to time, Social Security actuaries have proposed that the uncertainty or relative reliability of the estimates be taken into account in assessing the financial status of the program. The public trustees are currently considering these suggestions as part of their review of measures of the trust funds' financial condition. Their study of this issue underscores the important truth that the longer the estimating period, the greater the uncertainty of the estimates.

Two smaller points merit elaboration or clarification in the bill. First, with the Social Security trust funds projected to be exhausted in about 2045, a prohibition on making the long-run financial situation of the program any worse makes sense. But if future economic or demographic developments or changes in law were to put Social Security in the position of being adequately financed, this prohibition would be unnecessary and could hamper sensible actions. Second, the bill does not specify a precise trigger for the point of order. One reasonable standard is that the net change in financing would have to exceed 0.005 percent of payroll, the amount that is currently regarded as negligible by the Social Security actuaries.

The Six-Year Test

Unlike the 75-year criterion, the six-year financial constraint in the bill is a new test. If it were not routinely overridden, it would significantly limit Congressional flexibility in dealing with Social Security. But it would not discriminate among proposals according to any measure of merit. The proposal's beauty, or lack thereof, will therefore be in the eyes of the beholder.

For example, had it been in law, the six-year test might have deterred the Congress from considering the relaxation in the retirement test that both Houses have passed this year. It would also have stood in the way of the modifications in the disability review procedures that were enacted in 1984. The six-year test could also hamper a reallocation of the payroll tax between Social Security cash benefits and Hospital Insurance, an action that the Congress has taken in the past and may need to consider again in the 1990s. Similarly, it would impede any future effort to make the federal tax system more progressive by substituting income for payroll taxes.

THE ROLE OF THE CONGRESSIONAL BUDGET OFFICE

The draft bill provides that all estimates of revenues and outlays for purposes of enforcing the point of order shall be made by the Congressional Budget Office, in consultation with the staff director of the Joint Committee on Taxation. While CBO foresees no trouble in carrying out this task, the additional work involved could be substantial. It will take some time and additional resources for CBO to gear up to evaluate Social Security estimates over a 75-year horizon. CBO analysts will also need access to selected Social Security earnings data, from which we are now barred by the Internal Revenue Code.

REFORMS HAVE UNINTENDED CONSEQUENCES

Let me conclude by repeating the aphorism that you have heard many times--the problem is not the process; the problem is the problem. To be sure, the current budget process has its flaws, and some changes in budgetary accounting or Congressional procedures could make a small contribution toward reducing the deficit and maintaining the long-run strength of Social Security. But no change in the legislative process can assure wise legislation. Moreover, the experience of the last few years makes it clear that every attempt at reforming the budget process has unintended consequences.

The legislation before you appears to handle many of the problems that would be created by removing Social Security from the Balanced Budget Act targets and calculations. But it would also significantly limit Congressional flexibility and could involve risks that we cannot now perceive. In any event, the crucial questions before the Congress do not involve procedural deficiencies. Rather, the Congress should focus its attention on meeting the current deficit targets for 1990 and beyond.