

THE PRESIDENT'S SOCIAL SECURITY FRAMEWORK

HEARING BEFORE THE COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

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THE PRESIDENT'S SOCIAL SECURITY FRAMEWORK

TUESDAY, FEBRUARY 23, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to call, at 3:04 p.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE

Contact (202) 225-1721

February 16, 1999

No. FC-6

Archer Announces Hearing on the President's Social Security Framework

Congressman Bill Archer (R-TX), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on an evaluation of the features and effects of the President's framework to reform Social Security. The hearing will take place on Tuesday, February 23, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 3:00 p.m.

Oral testimony at this hearing will be from invited witnesses only. Witnesses will include representatives of the Congressional Budget Office, the General Accounting Office and other experts in Social Security and budget policy. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

In his 1999 State of the Union address, President Clinton proposed using 62% of the projected Federal budget surpluses over the next 15 years to shore up simultaneously the Social Security system and pay down the publicly-held debt. In addition, the President would allow the government to invest almost \$600 billion of the trust funds in the private market for the first time ever. The President has estimated that his proposal would extend the life of the Social Security Trust Funds until 2055. The President's framework for reform fundamentally changes the self-financing nature of Social Security by using general revenues and private market investments to support the program. Historically, Social Security has been financed almost exclusively with dedicated payroll taxes.

On February 4, 1999, Secretary of the Treasury Robert E. Rubin presented the President's budget proposals to the Committee, including the Social Security framework.

In announcing the hearing, Chairman Archer stated: "The President has presented the Nation with his Social Security framework. This hearing will help us better understand what the President's framework does and does not do. Only by clearly laying out the benefits and defects of the President's approach can we constructively move forward together, as we must, to save and strengthen Social Security for current and future generations."

FOCUS OF THE HEARING:

The hearing will focus on an evaluation of the features and effects of the President's framework to reform Social Security.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the *close of business*,

Tuesday, March 9, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman ARCHER. The Committee will come to order. Good afternoon.

Today's hearing continues our series of meetings on how to save Social Security. We have with us today a group of experts who will review the President's proposal.

I am pleased that the administration is here to answer any questions that Members might have about their approach.

From what we have learned, many leading nonpartisan authorities have not been kind to the President's framework. We have been informed the White House plan represents a double count. It increases the debt, throws more IOUs into the trust fund, and doesn't do anything to save Social Security for the long-term. Those

are allegations that have been made from various quarters that I have seen over the last month.

All of this may be true. Perhaps the witnesses can explain that it is not true, but that is our opportunity today. Members from both sides of the aisle will benefit from a straightforward review of the White House framework.

Today, however, I want to make clear that regardless of any flaws that may exist in the administration's proposal, I am personally determined to make every reasonable effort to save Social Security and to see that it is signed into law by the President during my remaining 2 years in the Congress. I will focus my efforts on the areas where we can make progress.

I want to make clear that the President's framework contains one major element that can bring us together. For the first time, the President of the United States, a Democrat mind you, advocates investing in the stock market as a solution to Social Security's problems. This is a breakthrough, and it is without precedent.

The White House and I may differ on who should own and control these investments. The White House calls for government control over people's investment choices. I believe if there is to be investment in the markets, it must be under the control of individuals, free to make up their own minds.

But I do not intend to let this important difference stop us from making progress. I believe that the White House won't forever cling to this unpopular proposal. Indeed, the President has proposed individual ownership in the markets as a part of his add-on plan called the USA Plan.

While the USA Plan doesn't in itself do anything to save Social Security, it represents another potential building block upon which we can possibly make progress.

Finally, I believe it is appropriate to set aside 62 percent of the projected surplus until Social Security is saved. We have the resources. The economy is strong, and the time is right. I intend to listen and learn from today's witnesses. Where there are flaws in the White House approach, let's fix them. Where there are good ideas, let's seize them.

Now I am happy to yield to the gentleman from New York, the Ranking—oh, I'm sorry. Oh, the gentleman from New York is not here. In his stead, I yield to the gentleman from California, Mr. Matsui, for any comments he might like to make.

Mr. MATSUI. Thank you very much, Mr. Chairman. Mr. Rangel, the gentleman from New York, is not feeling well today. He has the flu. So he is up in New York. He should be here tomorrow.

But thank you very much. I am going to be brief. Let me just say this. I appreciate the Chairman's remarks and the constructive approach that he has taken to this hearing today and his comments. Over the last month since the President has introduced his bill, the other side of the aisle has been spending most of its time criticizing the President's plan. I think this hopefully will be a first step in a new direction.

I might just point out what the President's plan does. Very simply, it sets aside 62 percent of the budget surplus for Social Security.

ity, with a portion to be invested in equities, and the rest to buy down the debt. It also sets aside another 15 percent for Medicare.

The criticisms that have been raised on the President's plan as set forth by the Chairman, is that some of the proceeds of the surplus would be invested in private equities. I might just point out that the thrift savings plan, which every Member of this Committee and every Member of the House participates in, invests in the equity markets itself. If it is good enough for us, I should imagine it would be good enough for the American public as well.

In terms of the double accounting, that has been used in scoring Federal budgets for decades. My understanding is that even plans that come from the other body, and perhaps plans that might come from this body will suffer the same kind of criticisms.

So, I hope that if we criticize the President's plan for double accounting, we will also do the same for any subsequent plan, if in fact it should do that.

There is also a confusing argument about the debt limit, and, if I might just say, the President's plan does not increase the public debt. What it does is decrease the public debt substantially from the current approximately 44 percent of gross domestic product, down to, by the year 2014, 15 years from now, 7 percent. I think that, in and of itself, will have a great deal of impact in terms of what the second panel will be talking about in terms of increasing economic growth in the United States. Alan Greenspan referred to that as well.

I was very happy to hear and read in the New York Times last Thursday that Mr. Shaw is working on a Social Security plan himself. I think what we really need now, after 30 days of the President's plan being out there, is a comparison. I think once we see the comparisons between the various plans on both sides of the aisle, including Mr. Feldstein's plan, which doesn't have any co-sponsors, or a sponsor yet, even though people keep talking about it, we will be in a better position to evaluate exactly what plan should be the retirement program for Americans in the future.

But let me conclude by making another observation. It would piggyback onto what the Chairman has said. That is, we appreciate his cooperative attitude. We think the only way we are going to solve this problem is by working together. We think the President has come up with a strong framework for solving Social Security for the next 55 years, until 2055. We need obviously an additional 20 years to make it up to 2075. We want to work in a bipartisan fashion in order to try to achieve that.

It is my hope that within the next 4, 5, 6 months, before the end of this year, before the next Presidential and congressional election, we are going to be able to come up with a solution to this very, very difficult problem.

Thank you, Mr. Chairman.

Chairman ARCHER. Without objection, each Member may insert written statements in the record at this point.

[The opening statement of Mr. Ramstad follows:]

Statement of Hon. Jim Ramstad, a Representative in Congress from the State of Minnesota

Mr. Chairman, thank you for calling this important hearing to review the President's Social Security framework.

I am hopeful that we can discuss, in a bipartisan, pragmatic way, how to truly restructure the system to make it financially solvent for the future. That's why I applaud the President's attention to this issue, as it is important that the President help us engage the American public on how best to preserve, protect and strengthen their retirement safety net.

Having said this, however, I must once again express my concern about the President's proposal and the fact that it does nothing to ensure the long-term solvency of the system. As my predecessor and friend, the Honorable Bill Frenzel will testify today, the President's framework consists of a curious budgetary scheme to make the Trust Fund accounts look safe.

These budgetary transfers, however, do not create new resources. They do not affect debt held by the public. They would, however, increase gross debt and cause the debt to exceed the statutory debt limit ceiling.

Mr. Chairman, my constituents expect more from us than budgetary magic. They want real improvements to be made so Social Security is operating as promised for current and future beneficiaries. They also do not want taxes raised or benefits cut. Most importantly, they believe financial soundness is paramount in the design of any new system.

These are my guiding principles too, and I look forward to learning more today from our witnesses about those elements within the President's framework that support these important goals.

Chairman ARCHER. The Chair is pleased to have with us today Hon. Jacob Lew, who is the Director of OMB, and Hon. Kenneth Apfel, Commissioner of the Social Security Administration.

Welcome, gentlemen.

The Chair would like to recognize Mr. Lew to lead off. We would be pleased to receive your testimony.

**STATEMENT OF HON. JACOB J. LEW, DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET**

Mr. LEW. Thank you very much, Mr. Chairman, and Members of the Committee. It is a pleasure to appear here this afternoon to present the President's economic program.

We really have to begin by looking at where we are in the economy. The results of the fiscal policy over the last 6 years are truly remarkable. When the President took office 6 years ago, we were looking at deficits that were projected to grow to \$600 or \$700 billion a year. Now we are looking at surpluses of hundreds of billions of dollars a year in the foreseeable future. It is a remarkable turnaround. It gives us a very special opportunity today to be discussing what to do with the surplus.

It is important to remember that the threat was not turned back by accident. It took very difficult policy decisions in 1993 and 1997 in order to get to where we are now in 1999. For the first time in 29 years, we have balanced the budget. We did it by making hard decisions. Now we have to be very careful in how we pave a way to the future, a world of surpluses.

The economic benefits that go along with the deficit reduction have been profound. They are profound in terms of economic growth, and they are profound in terms of the well-being of America's families, with unemployment at 30-year lows, and interest rates at 30-year lows. It is important to note that the economic well-being is reflected in what are for most families the lowest tax rates in decades.

The 2000 budget is a defining moment. After two decades of talking about fiscal discipline, we now have fiscal discipline. Just as the surpluses are appearing, it is very important for us not to turn back to the old ways of spending and cutting taxes first, and asking later about the consequences. Our challenge is to use the surplus prudently.

We are looking today at surpluses of \$4.8 trillion over the next 15 years. The President's policy would devote more than three-fourths of the surpluses to reducing the Nation's publicly held debt, and transferring assets to Social Security and Medicare in order to extend the life of the Social Security Trust Funds. He would also put 12 percent of the surplus into USA Accounts, a tax cut that is designed to encourage savings for personal retirement.

It is important for four reasons to have a policy that promotes national savings the way this policy does. First, when we increase the national savings rate, we are going to produce higher productivity and more economic growth. Second, as we reduce the publicly held debt, we reduce the interest on the publicly held debt. That means less interest payments going out of the government, more dollars within the government for purposes including financing Social Security benefits.

Third, it puts the country in a better fiscal position, which means that if things don't go as well as expected, we are in a better position to respond. We have the ability to make decisions whether it is to reduce spending or in some cases to borrow without the burden of inherited debt weighing on our shoulders. Finally, it improves the retirement security of all Americans.

The structure of the President's framework is very clear. It is consistent with the State of the Union last year and his budget and State of the Union this year. We need to save Social Security first. A statement of good intentions is not enough. I very much appreciate the Chairman's constructive comments opening this hearing. We look forward to working together to solve this problem. But it is important that we actually fix Social Security, and after we fix Social Security, move on to allocate the surplus in other ways.

The President's policy calls for bipartisan Social Security reform this year. The President has committed 62 percent of our projected budget surpluses to Social Security. This, together with investing a portion of the surplus in equities, will extend the trust funds to 2055. We are gratified that many in Congress have accepted this principle. We need to work together on the other reforms that will be necessary to get to the traditional 75-year solvency, and also address other problems that the President identified in the State of the Union, including very high poverty rates amongst elderly widows, and the need to address the earnings limit. But that is not coming from an allocation of the surplus. Those would be as part of a bipartisan discussion of additional measures needed for Social Security reform.

Only after we address Social Security reform do we move on to putting 15 percent of the surplus into Medicare, 12 percent into USA Accounts, and the remaining 11 percent for discretionary priorities, in particular, national defense and education.

The President's framework will extend trust fund solvency. After the trust fund is credited for its own receipts, exactly as it is under

current law, a substantial unified budget surplus will remain. As has been noted many times, that surplus can only be used once. It can be used for a tax cut. It can be used for spending. Or it can be used to make deposits into the trust fund. That is what the President has proposed, that we credit the trust fund in the form of Treasury securities for an additional amount that will extend the life of the trust fund under our projections to 2055.

At the same time, the President's proposal will dramatically reduce publicly held debt. At the end of 1999, the current estimate of balances in the Old Age and Survivors, and Disability Insurance Trust Funds is about \$850 billion. Through 2014, we estimate that additional contributions to the trust funds under current law, including interest, will total \$2.7 trillion. The President's program would contribute an additional \$2.8 trillion to the trust funds over the next 15 years.

Taking into account additional interest earnings, that would leave a balance in the trust funds of more than \$7 trillion, instead of approximately \$3.5 trillion under current law. It is that additional deposit into the trust funds that will enable us to extend the life of the trust funds. We reduce the debt borrowed from the public, and deposit an equal amount in the trust funds. Interest payments will go to the trust funds as opposed to the holders of private debt. That means that the payments of interest will go to paying Social Security benefits, not just interest payments to banks, individuals, and others who own Treasury securities.

The economic benefits of the President's plan we think are very clear. Rather than put it in our words, I would like to quote, if I could, from a report that Merrill Lynch recently put out to its investors. They said, "Allocating a portion of budget surpluses to debt reduction, as the President proposes, is a conservative strategy that makes sense. Reduced debt will result in increased national savings, lower interest rates, and stronger long-term economic growth than would otherwise be the case." That really is the heart of the economic argument behind the President's plan.

The President believes that we must put money aside to meet our current obligations before we incur any new obligations. The President's program does that by retiring debt and accumulating assets toward the Social Security commitments that we already have.

Many have asked technical questions about the current Social Security financing system, and the effect of the President's framework on budget accounting. The President's proposals are new policies that are designed to address new circumstances and new public needs. But sound accounting principles explain these policies. The unified budget surplus provides the best standard for assessing the fiscal impact of general fund transfers to Social Security.

As OMB, CBO, and others have long noted, the unified budget is really the most comprehensive and accurate measure of the government's burden or role in the economy. To quote from CBO's most recent economic outlook, "Most economists, policymakers and participants in credit markets look at total budget figures, including Social Security when they seek to gage the government's role in the economy and its drain on credit resources."

The shortcomings of focusing on the on-budget results can be illustrated by contrasting the administration's proposed transfers to Social Security with proposals for tax cuts of the same magnitude. These policies may appear similar, but in fact, the tax cut would increase publicly held debt and reduce national savings, thereby hindering the Nation's ability to meet future fiscal challenges of Social Security and Medicare. In contrast, the President's proposal would reduce publicly held debt and extend trust fund solvency.

There is a similar comparison in the discussions between debt held by the public and the Nation's gross debt, or the closely related subject of the debt subject to limit. Gross debt in the broadest terms includes debt held by the public, plus the debt held by government agencies. Such debt is owed by one part of the government to another, and financial market analysts have long believed that the economy is not affected by the amounts of agency-held debt. Such debt does not influence interest rates, future business investment, or future rates of economic growth.

If gross debt increases because of policies that drive up the Nation's unified budget deficit and our publicly held debt, this would in fact signal an adverse impact on the economy. However, if as under the President's plan, gross debt increases while the debt held by the public decreases, the effect on the economy will be favorable and nonadverse.

I would note that just this morning, Chairman Greenspan testifying at the Banking Committee reiterated that the measure that really indicates the impact of the trust funds on the economy is debt held by the public.

Many of the comments that have been made about the accounting issues relating to the President's framework really relate to the basic question of whether or not one can advance fund Social Security. As we go through the discussion this afternoon, I hope we can note that the 1983 Social Security amendments that were written in this room really rely on the same principles of trust fund financing that the President's plan relies on. The President's plan says we should keep the commitments made in 1983, and make similar commitments with these transfers.

I would like to, if I could conclude, perhaps put the President's plan in a framework that most families tend to think about when considering these kinds of financial matters. If we think about a family that has an 8-year-old child, and you are beginning to plan for college, you know it is going to be expensive. The first thing you do is try to put your family's financial house in order. You struggle and you put your house in order. But you still know that it is going to be tough to pay for college because it is going to exceed your income on a current basis, and you are going to need to save.

You begin to prepare by reducing your debt, if you can. You pay down your credit card bills. You don't incur new debts. What does that do for you? It means that you won't have to make large payments on the debt that you owe, and you will have more cash available to pay those tuition bills.

Second, you put some money aside. You put it into equities if you can. You put it into bonds, if you can. You try to have a prudent balanced package of investments so that you will have some savings to draw on.

But the real goal, is to try to improve your ability to put as much of your income as possible into paying the bills when they come due for college. If instead of planning for college you were to take out a long-term loan to buy a boat that you have always wanted to have, you know that you are going to have bills to pay back that loan. You know you are going to have expenses to support that purchase. You know that it doesn't all add up.

By analogy we are saying now is the time to buy down our debt. Now is the time to look ahead and make sure that our income, when we get out to the point when we have to pay back these bonds, can be sufficient to pay back the bonds that we owe to the Social Security Trust Funds now and the bonds that we are proposing to put into the trust funds.

We know that based on our current forecast, there are surpluses for the foreseeable future. If we make the right fiscal policy decisions today, we know that we will put our house in order, just like the American family tries to put its house in order.

Mr. Chairman, thank you very much. I appreciate the chance to go through this summary of the President's plan, and I would be delighted to answer any questions that you have.

[The prepared statement follows:]

Statement of Hon. Jacob J. Lew, Director, Office of Management and Budget

One year ago, President Clinton set the course of the Nation's budget policy with his charge to "Save Social Security First." The President recognized that we were entering a new era as we left behind the decades of large budget deficits. He was building the foundation for budgeting in this new era of surpluses.

FISCAL PROGRESS HAS PRODUCED A STRONG ECONOMY

The year 1998 was one of the most extraordinary in modern U.S. economic history. We enjoyed the first budget surplus in 29 years—the largest ever in dollar terms, the largest as a percentage of the economy in more than 40 years. And this budget surplus was not the result of a temporary wartime policy, as was the last surplus in 1969. We will have a budget surplus again in the ongoing fiscal year—at an estimated \$79 billion, larger than last year's—which will mark the first back-to-back surpluses in more than 40 years. The President's budget for fiscal year 2000 proposes a third consecutive surplus—the first time that will have happened in half a century. And our 1998 budget surplus was the sixth consecutive year of improvement in the U.S. fiscal position—the first time that has happened in American history.

The private sector is the key to economic progress, but we have clearly seen in the decade immediately past that the Federal Government can either hinder or promote economic progress. If the Federal budget deficit is high, so that the cost of capital is driven up and the financial future is uncertain, the private sector cannot yield the progress of which it is otherwise capable. But if, instead, the Federal Government declares its intentions of responsible fiscal behavior, and lives by those intentions—and if the Federal Government supplies the public investments that America needs—then the economy is free to prosper. This is the path that this Administration has taken.

In 1998, we reaped the fruits of five years of fiscal responsibility. After the best sustained growth of business investment since the 1960s, the U.S. economy fueled that decades-absent budget surplus. And the economy itself defied the pundits, staying on a pace of solid, above-trend expansion, in the face of an international financial disruption that broke the stride of most other economies around the world. Unemployment and inflation both hit three-decade lows, with the lowest unemployment rates for African Americans and Hispanics in the history of those statistics; real wages continued to grow after more than a decade of stagnation, and a record percentage of adult Americans worked in those higher-paying jobs; the percentage of Americans on welfare fell to a 30-year low; the 10-year Treasury bond rate reached its lowest level in 30 years; and a higher percentage of Americans attained home ownership than at any time in our history.

The President deserves a great deal of credit for the virtuous economic cycle that we now enjoy. The announcement of a firm intention of fiscal responsibility in 1993 was greeted by a continued reduction of interest rates, which helped to trigger the investment boom that has proved central to sustained strong, non-inflationary economic growth. The two other pillars of the President's policy—investing in our people and our technology, and opening foreign markets to U.S. exports—complete this winning economic strategy.

THE 2000 BUDGET IS A DEFINING MOMENT

This extraordinary budget-and-economic performance—with the budget setting historical standards and the resilience of the economy setting global standards—tells us something. It tells us that we have developed a winning economic policy and that we must not turn back. We must not discard the economic philosophy that got us here, to this confluence of economic indicators that all sides now agree is the best in modern memory.

So in one sense, our budget policy now clearly should be built on continuity. We have achieved a sustained fiscal improvement, and we should continue to sustain that improvement. We have an economy that achieved a record sustained peacetime expansion, and we should continue to sustain that expansion.

But in another sense, we have stepped into a new world. Where our budget used to be written in red—for so many years that people came to take it for granted—now we are in the black. And this change has tempted some to throw away all of the policy principles that got us here.

For two decades now, there has been much discussion about fiscal discipline, restraint, and deficit reduction. Since 1993, we have taken action; and far beyond the expectations of even the most optimistic, we now have budget surpluses as far as the eye can see. But now, as the first surpluses appear, it is important that we not revert to the practice of cutting taxes and raising spending first, and thinking about the fiscal consequences later.

As the President suggested in his State of the Union address in January, this is a moment that will do much to determine the character of our country at the end of the next century. We can build and strengthen the fiscal foundation that first arose in these last few years. Or we can sweep it away, before it is firm and strong, and set our economy to foundering again. The choice is clear and the President is determined to pursue a balanced program of fiscal discipline and prudent investment for the future. This budget charts that course into an era of surplus.

FISCAL POLICY SINCE 1993 WAS PIVOTAL TO OUR CURRENT GOOD FORTUNE

To see why fiscal responsibility matters, consider where this Administration started six years ago. In 1992, the budget deficit was \$290 billion, the largest in the Nation's history. Between 1980 and 1992, the debt held by the public, the sum of all past unified budget deficits, quadrupled; it doubled as a share of our Nation's production, or GDP—from about 25 percent to about 50 percent.

These adverse trends showed every sign of accelerating. Both CBO and OMB projected that, without changes of budget policy, growing deficits would add to the Nation's debt, and growing debt service costs would add, in turn, to the Nation's deficits. OMB forecast the 1998 deficit, in the absence of policy change, at \$390 billion, or 5.0 percent of GDP; by 2003, we expected the deficit to be \$639 billion, or 6.6 percent of GDP. And there was nothing in the forecast to indicate that this exponential trend would stop.

This threat was not turned back by accident. It required tough policy choices, which the Administration and the Congress took in 1993 and 1997. The President's initial economic program cut spending and increased revenues in equal amounts. Since that time, deficit reduction (and ultimately surplus increase) has more than doubled the estimates for the President's plan—instead of the projected cumulative \$505 billion, deficits have fallen by \$1.2 trillion. That is \$1.2 trillion less in debt that the American taxpayer must service—forever.

And this deficit reduction has come as much from lower spending as from higher revenues. Spending has declined to its smallest share of the GDP in a quarter of a century. And thanks to the strong economy, receipts have grown beyond expectations, even though the tax burden on individual families is **lower** than it has been for about a quarter century:

- The typical family of four—with the median family income of \$54,900—will pay a lower share of its income in income and payroll taxes this year than at any time in 23 years. Its income tax payment considered alone will be the lowest share of income since 1966.

- A family with an income at one-half of the median level, \$27,450, will pay the lowest share of its income in income and payroll taxes since 1965. Its income tax bill will be negative; it will receive money back because of the earned income tax credit. That was never the case before 1998.

- Even a family at twice the median income level, \$109,800, will pay less in income tax as a percentage of income than at any time since 1973.

Receipts have risen as a percentage of GDP not because of a heavier tax burden on typical individual families, but rather because of the extraordinary growth of incomes of comparatively affluent Americans (including capital gains and stock options that are not included in measured GDP); and because of the rapid growth of corporate profits.

The historic bipartisan balanced budget agreement of 1997 has reinforced expectations of Federal fiscal responsibility. This has had a favorable effect on interest rates, and the economy at large.

In the last six years, we have enjoyed an extraordinary economic performance because our fiscal policy was responsible and sound. If we want to continue to enjoy such strong economic performance, we must continue our sound fiscal policy. As the experience of the last 20 years clearly shows, budget problems are very easy to begin, and very hard to end.

Reducing debt burden is as important to the Nation as it would be to a family. The Nation must service its debt. If we gratify ourselves today by collecting taxes insufficient to cover our spending, and accumulate debt, our children and our grandchildren will have to service that debt. If, instead, we reduce our debt, our children and our grandchildren will be freed of the obligation to tax themselves more heavily in the future just to pay the interest on the debt they inherited from us as our legacy.

The President's proposal will fully reverse the buildup of debt of the 1980s—and then go further. By 2014, the end of the 15-year horizon of the President's program, the combined effects of the President's commitments to Social Security and Medicare will reduce the Nation's debt burden to an estimated seven percent of GDP. This will be the lowest ratio of debt to income that the Nation has enjoyed since before it entered World War I. And as most experts would tell us, this will be one of the greatest gifts that we could ever give our children, as we exercise our fiscal stewardship of these United States.

The President's policy would devote more than three-fourths of future budget surpluses to reducing the Nation's debt and accumulating assets through contributions to Social Security and Medicare; and would dedicate another 12 percent to household savings through Universal Savings Accounts. This is important to our economic performance for four basic reasons: First, it increases the Nation's savings rate, which is critical to productivity gains and economic growth. Second, it reduces the debt. Third, it improves the fiscal position of the country, and puts it on a stronger footing for whatever uncertainties might arise. And finally, it improves the retirement security of all Americans.

THE CURRENT CHALLENGE IS TO USE THE SURPLUS PRUDENTLY

In 1993, we faced the challenge of eliminating projected budget deficits of \$4.3 trillion over ten years. Today we face the enormous opportunity of projected surpluses of more than \$4.8 trillion over the next 15 years. The challenge is to use this surplus prudently—to maintain our strong economic and budgetary performance.

We must save Social Security first. A statement of good intentions is not good enough for the millions of Americans, retired and working today, who rely on Social Security for their retirement security—and for protection for their families against disability and premature death. From the beginning, this Administration has kept its eyes on the future, and taken policies that would benefit the Nation for generations to come. It has paid off. Saving Social Security first is precisely such a future-oriented policy.

The President's FY 2000 budget—symbolically, as well as financially, “in the black”—continues firmly on that successful path. The budget maps a course for the Federal Government after Social Security is reformed—and makes its own policy recommendations for the beginning of the bipartisan Social Security reform process that the President inaugurated last year. But the budget also draws a line that this Administration will not pass without Social Security reform.

Thus, the FY 2000 budget is fully paid for within the existing budget law. Just as in every previous year, the President has specified his own priority initiatives, but has paid for all of them—line by line, dime by dime—with savings from elsewhere in the budget. The budget proposes a framework for allocating the surplus to meet national objectives if Social Security is reformed.

The President's policy calls for a bipartisan Social Security reform, this year. The President has already committed 62 percent of our projected budget surpluses—enough to extend Social Security's solvency almost an extra quarter century, to 2055. We hope that this will launch a bipartisan process to address long-term Social Security solvency. We are gratified that several leaders from the Congress have already accepted this principle and hope that both parties, the President and the Congress, can follow through on this commitment and achieve sufficient additional reforms to extend the solvency of the trust fund at least through the traditional 75-year actuarial horizon.

If we achieve that objective, the budget makes further commitments of the surplus to priority National objectives in the future. The President proposes to dedicate 15 percent of the surplus to extending the solvency of the Medicare trust fund. This is a key element of the President's program, because the financial security of Medicare will be threatened even sooner than that of Social Security. In 1997, the President and the Congress, acting together, made Medicare financially sound through 2010. The President's 2000 budget would extend that lifetime ten years further, to 2020. We see the commitment of the surplus as a vital step to facilitate an environment in which a bipartisan effort—including the current Medicare Commission—can go even farther; with the time horizon so short, even after the contribution of 15 percent of the surplus, we cannot delay Medicare reform. As the President stated, he wants to consider, as a part of this reform process, expanding Medicare coverage to include prescription drugs.

The President also proposes using 12 percent of the surplus to finance his new Universal Savings Accounts—"USAs"—a tax cut which would provide seed money plus matching contributions for individual accounts. The matching contributions will provide a substantial inducement for low- and moderate-wage workers. The goal is for all Americans to see the rewards of saving building up in these USAs—and with this introduction to the power of compound interest, to begin to save further on their own. The President believes that this program, with its Government seed contribution, has the potential to reach even those who have failed to respond to the generous subsidies in the current-law Individual Retirement Accounts (IRAs).

The President wants a fiscally responsible tax cut. He believes that the USA is the right kind of tax cut—targeted toward the future, and helping the many American families who have the most difficulty saving for their retirement. It strengthens perhaps the most neglected of the figurative three legs of the retirement stool—personal saving, to stand alongside Social Security and employer pension plans—and for the many who have no employer plan, this initiative may be crucial. Most importantly, it is part of a plan that fixes Social Security first.

Finally, the budget proposes that the remaining 11 percent of the surplus be dedicated to other important priorities—including education, National security, and health care.

THE PRESIDENT'S FRAMEWORK WILL EXTEND TRUST FUND SOLVENCY

The President's contribution of the surplus to Social Security will use many of the existing financial management tools of the Federal Government. It will be in addition to the accumulation in the Social Security trust fund that would occur with no change in the current law.

After the trust fund is credited for all of its own receipts, exactly as in current law, the Treasury will be left with the unified budget surplus. Each dollar of that unified surplus can be used only once—for cutting taxes, increasing spending, or buying down the debt. The President has brought the debate right to the point: What should we do with that surplus? Or to put it another way: If we were to look back fifteen years from now, or at the end of the next century—what would we want to be able to say that we had accomplished with this opportunity? The President wants to leave a legacy of building for the future: saving Social Security and Medicare; encouraging Americans to save for their own futures, build wealth, and prepare for retirement; investing in education; ensuring our National security; and making other key investments.

So the President started by committing 62 percent of the surplus to save Social Security first. Most of the share committed by the President to Social Security will be used to buy down the publicly held Federal debt through the periodic debt refundings of the Treasury Department, in exactly the same way as debt was retired last year. That same amount will be credited to the Social Security Trust Fund, in the form of Treasury securities. This same procedure will be followed for the President's contribution to the Medicare trust fund.

This commitment will significantly extend Social Security solvency. At the end of 1999, the currently estimated combined balances of the OASDI trust funds is about

\$850 billion. Through 2014, we estimate that additional contributions to the trust funds under the current law, including interest, will total about \$2.7 trillion, leaving a total balance of about \$3.5 trillion. The President's program would contribute an additional \$2.8 trillion to the trust funds over the next 15 years. Taking into account additional interest earnings, that would leave a balance in the trust funds of more than \$7 trillion—instead of the approximately \$3.5 trillion under the current law. The President's program will more than double the balances in the trust funds over the next 15 years. (This does not account for the anticipated higher earnings on the portion of the surplus invested in corporate equities.)

Because the President's plan will reduce the public debt, the total obligations of the Federal Government will not increase. We are already committed to paying benefits beyond 2032, when the trust fund is now expected to be exhausted. The President's proposal would reduce the debt borrowed from the public, and deposit assets of an equal amount in the Social Security trust fund. Interest payments will go to the trust fund, to cover future Social Security benefits, rather than to banks, individuals and other investors in Government bonds.

A small portion of the President's commitment to Social Security (21 percent of the commitment) will take the form of holdings of corporate stock. Because the Federal Government will need that amount of the cash surplus to purchase the shares, this contribution will not reduce the public debt. However, it will improve the Federal Government's implicit balance sheet—to the same degree, but in a different way. While the reduction of debt will reduce the Federal Government's *liabilities*, the corporate shares will increase the Federal Government's *assets*. The salutary effect on the Government's balance sheet will be the same, but it will appear on the other side of the balance sheet. Furthermore, this amount will add to national savings, just as it would if it were used to buy down debt.

Thus, the President's policy in no way increases the *total* obligations of the Federal Government. In fact, by retiring part of the public debt, it strengthens our economy in exactly the same way that reducing the budget deficit, and *avoiding the accumulation* of debt, has helped the economy over the last six years. The President's program does *shift* the Federal Government's commitments to Social Security, however, and in that way improves Social Security's solvency for the next century. This will give Social Security a first call on the economic benefits associated with long-term reductions in publicly held debt. In a recent report, Merrill Lynch noted:

Allocating a portion of budget surpluses to debt reduction, as the President proposes, is a conservative strategy that makes sense. Reduced debt will result in increased national savings, lower interest rates, and stronger long-term economic growth than would otherwise be the case. (Merrill Lynch, *Assessing the Investment Climate: Focus on Washington*, 10 February 1999.)

The President believes that budgeting in an era of surpluses requires a focus firmly on the future. We must put money aside against our current obligations before we incur any new obligations. The President's program does that, by retiring debt and accumulating assets against the Social Security commitments that we already have.

ACCOUNTING FOR SOUND POLICY

There are some further, highly technical questions that one might ask about the effect of the President's framework on budget accounting, and on the presentation in the budget documents in the coming years. These questions are issues of detail, and have no bearing on the substance of the President's proposals, and on their effect on the economy and the nation broadly. The President's proposals are new policies that are designed to address new circumstances and new public needs, but sound accounting principles can explain these policies.

The unified budget surplus provides the best and most meaningful standard for assessing the fiscal impact of general fund transfers to Social Security. The unified budget is a comprehensive measure of the fiscal activities of the Federal Government, and the surplus or deficit in the unified budget is the best indication of the Government's demands in the private credit market. As OMB, CBO, and others have long noted, the unified budget is a comprehensive measure of the fiscal activities of the Federal Government, and the surplus or deficit in the unified budget is the best indication of the Government's demands in the private credit market.

. . . most economists, policymakers, and participants in credit markets look at the total budget figures, including Social Security, when they seek to gauge the government's role in the economy and its drain on credit re-

sources. (CBO, *The Economic and Budget Outlook: Fiscal Years 2000–2009*, January 1999, p. 34.)

The shortcomings of focusing on the on-budget results can be illustrated by contrasting the Administration's proposed transfers to Social Security with alternative proposals for tax cuts that would reduce receipts by the amount of the on-budget surplus. While a dollar of tax cuts and a dollar transferred to Social Security would seem numerically equivalent and equally fiscally responsible, the dollar of tax cuts would increase publicly held debt and reduce national saving, thereby hindering the nation's ability to meet the future fiscal challenges of Social Security and Medicare. In contrast, the dollar of transfers would allow the debt reduction to take place.

There is a similar, and analogous, comparison between discussions of the debt held by the public, on the one hand, and the nation's gross debt (or the closely related debt subject to limit), on the other. Gross debt, in the broadest terms, includes debt held by the public plus debt owned by Government agencies (such as the Treasury securities held by the Social Security trust fund). Such debt is owed by one part of the Government to another. It does not therefore in any way reduce the Federal Government's ability to meet its obligations to actors in the economy at large. Financial market analysts have long believed that the economy is not affected by the amounts of agency-held debt; such debt does not influence interest rates, and thus does not influence the cost of capital to American businesses. Therefore, future business investment, and hence future rates of economic growth, will be driven by changes in debt held by the public, rather than in gross debt. Policies that reduce debt held by the public are thus far more important than changes in gross debt.

Of course, a policy that increases debt held by the public will also, all else equal, increase gross debt dollar for dollar. Accordingly, changes in gross debt are not irrelevant, but it is essential to consider why gross debt changes. If gross debt increases because of policies that increase the nation's budget deficit and publicly held debt, then that change does signal an adverse impact on the economy. However, if, as under the President's Social Security framework, gross debt increases while debt held by the public declines, the effect on the economy will be favorable, not adverse. It may be worth noting that the President's framework, in buying down the publicly held debt and increasing the assets in the Social Security trust fund, would have exactly the same qualitative economic effects as the bipartisan and now universally hailed Social Security Act Amendments of 1983.

WE HAVE AN HISTORIC OPPORTUNITY FOR LONG-TERM PROSPERITY IF WE RISE TO THE
MOMENT

There is much to be proud of in America today. By balancing the budget, we have not just put our fiscal house in order; we have left behind an era in which the budget deficit, as the President said recently, "came to symbolize what was amiss with the way we were dealing with changes in the world." Today we have risen to the challenge of change—by preparing our people through education and training to compete in the global economy, by funding the research that will lead to the technological tools of the next generation, by helping working parents balance the twin demands of work and family, and by providing investment to our distressed communities to bridge the opportunity gap.

If the deficit once loomed over us as a symbol of what was wrong, our balanced budget is proof that we can set things right. Not only do we have well-deserved confidence, we have hard-earned resources with which to enter the next century.

As the President said, what we do now—after having balanced the budget—will shape the character of the next century. We can build upon our newfound firm economic foundation; or we can squander it.

The President has brought the debate right to the point: What should we do with the surplus? Or to put it another way: If we were to look back fifteen years from now, or at the end of the *next* century—what would we want to be able to say that we had accomplished with this opportunity?

The President wants to leave a legacy of building for the future: saving Social Security and Medicare; encouraging Americans to save for their own futures, build wealth, and prepare for retirement; investing in education; ensuring our National security; and making other key investments.

There is no more pressing issue facing us as a nation than the need to guarantee that Social Security will be there for generations to come. And there is no better time to act than now while the system is still strong. This is truly an exceptional moment in America—the economy is prosperous, the budget is in balance, and the President's commitment to national dialogue has created conditions for constructive action. We must seize this moment.

Chairman ARCHER. Thank you, Mr. Lew.

We have just received notice that there are votes on the floor. There I understand will be more than one vote. The Chair would like the Committee to stand in recess until we have voted and returned as quickly as possible after the vote.

I apologize to our witnesses, but we have no control.

The Committee will stand in recess.

[Recess.]

Chairman ARCHER. The Committee will come to order, what there is of it.

Commissioner Apfel, welcome to the Committee. The Chair would encourage you to limit your verbal comments to 5 minutes, if you will. Your entire written statement, without objection, will be printed in the record. We are glad to have you here. You may proceed.

**STATEMENT OF HON. KENNETH S. APFEL, COMMISSIONER,
SOCIAL SECURITY ADMINISTRATION**

Mr. APFEL. Thank you, Mr. Chairman, and Member staffs, if there are no other Members present right now. [Laughter.]

The challenging situation that we face right now is very major. It is going to dominate the debate over the course of the next year. I believe there is no greater need than addressing the long-range Social Security and Medicare issues that are now before this Committee.

Over the course of the past year, Mr. Chairman, thousands of Americans in forums, in townhall meetings across the country, have made clear to me that they believe that this vital program is really irreplaceable. They understand just how important Social Security is for older Americans, for people with disabilities, for families who have lost a spouse and a parent. Since the creation of a Social Security program in 1935, it has become part of the fabric of the American life. In my opinion, it is the most successful domestic program in our Nation's history, and our most important anti-poverty program.

Today, only 11 percent of older Americans have income below the poverty line. But without Social Security, about half of those beneficiaries would be living in poverty. Social Security is more than a retirement program, however. It is America's family protection program. About a third of our beneficiaries are not retirees. They are severely disabled workers and their families, or the surviving family members of workers. All of these people are able to live fuller and more independent lives than they could if Social Security were not there for them.

But today, this critically important program faces serious long-range financing issues based on major demographic challenges that we face in the future. Since my written statement goes into this I am not going to spend the time to go through it here.

If we take remedial action now when there is no crisis, we can prevent a crisis from ever occurring. I sincerely believe that we owe it to our children and our grandchildren to resolve these issues on our watch. If we were to delay action for a generation, the size of

the financing problem would double. As you know, this is the first time in a generation when our fiscal position enables us to take action. Federal budget surpluses, which could not have been imagined at the beginning of this decade, are now projected for many years into the next century. We need to use this opportunity wisely.

The President believes, and I wholeheartedly agree, that we should use the budget surpluses to advance fund more of the Nation's Social Security system. The government should set aside current resources to meet future obligations, and do this as our first priority. I believe that President Clinton's plan, consisting of the three actions outlined by Director Lew will do just that—the transfer of surpluses, the equity transfers, and, third, achieving bipartisan action on the hard choices that must be made to ensure long-range solvency.

I strongly believe, Mr. Chairman, that we need all three parts of the President's framework to achieve long-term solvency and stability of the Social Security system. The President's first two proposals would resolve more than half of the long-range funding problem that Social Security now faces, and would extend program solvency through 2055. By paying down the publicly held debt, the President's plan will ensure that the country will have the resources to pay Social Security benefits until the middle of the next century. Lower interest costs and higher growth will make it possible for the Social Security Trust Funds to redeem bonds without creating pressure on other government programs. Indeed, OMB calculations indicate that the decline in government interest payments will provide sufficient resources so that the combined government expenditures on interest and Social Security benefits will be below current levels, as a share of the economy for many decades into the future.

Bipartisan action can assure solvency for at least 75 years, which I think is centrally important. The President has also said that a comprehensive reform package must include provisions to reduce poverty among elderly women. The poverty rates for elderly women who live alone are significantly higher than those of the general population. It is essential that we work together to ensure that they have the best protection that society can offer.

I would also note here that the President has proposed eliminating the annual retirement earnings test, and he has called for the creation of Universal Savings Accounts (USA's) separate from Social Security. We have always told the American people that while Social Security is a solid and dependable foundation for retirement planning, they also need employer pensions and personal savings to enjoy a comfortable retirement. The USA Accounts can help every American worker build the wealth they need to finance longer lifespans.

In conclusion, Mr. Chairman, I believe that as we discuss the critical macroeconomic issues involved in ensuring long-range Social Security financing, we should remember that the American public has a different focus. Their concerns are with kitchen table economics, and the questions of providing for a family's own big ticket budget items, education, health care, and retirement.

In each of these areas, the American people have looked to their government for help. That is why most Americans do not consider Social Security just another government program, or just another budget item. It is a financial foundation for American families.

Today we have a remarkable window of opportunity to preserve and strengthen that foundation. Paying down the publicly held debt, transferring a portion of the projected budget surpluses to the trust funds, and equity investments, increase the likelihood of real reforms I believe these actions will prepare us for the long-term demographic challenges that we face.

I look forward to working with this Committee in the future on this very important endeavor. Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Hon. Kenneth S. Apfel, Commissioner, Social Security Administration

Good morning, Mr. Chairman and Members of the Committee. I appreciate the opportunity to appear before you today to discuss the President's plan to strengthen Social Security. I believe that assuring the future financing of Social Security and Medicare is the most important domestic issue that we face as a Nation and I am delighted to be a part of these ongoing discussions.

In my testimony today I will briefly review for you the importance of Social Security as well as its long-range solvency situation, the Nation's changing demographics, and then discuss why I believe the President's framework for protecting Social Security is the right approach.

IMPORTANCE OF SOCIAL SECURITY

In the course of the past year, thousands of Americans, in forums and town hall meetings across this country, have made it clear that they believe that Social Security is important and it is worth protecting. I personally have spoken to women, minorities, people with disabilities, older Americans, baby boomers, college students, to business and labor leaders, to academicians and policy makers. And what I have learned from my year-long dialogue with the American people, is that they understand just how important Social Security is for retirees and their families, for people with disabilities, for children who have lost a parent, for young widows and widowers struggling to raise children alone. They know what Social Security means to those millions of Americans for whom those monthly benefit checks make the difference between dignity and devastation.

Today, Social Security provides benefits to 44 million men, women and children. In 1998, an estimated 150 million people worked in jobs covered by the Social Security program and paid contributions on their earnings, giving them peace of mind that comes from knowing that they and their families will be protected when they retire or if they should become disabled or die. Nearly 1 in 6 Americans receives Social Security benefits and 95 percent of Americans have the benefit protection provided by our programs.

Social Security is the most effective anti-poverty program in history. It is the major source of income for two-third of beneficiaries age 65 and older, and contributes 90 percent or more of income for about one-third percent. Today, only about 11 percent of older Americans are poor. Without Social Security, about half of all older Americans would be living in poverty. This is a program that has worked. It has worked extraordinarily well for the American people—young and old—for over a half of a century. We should be very careful to protect the guaranteed benefit that Americans—both those who are now recipients and those who have been promised benefits—will need.

The program also provides a financial floor of protection for millions of working-age Americans. About a third of our beneficiaries are not retirees, but are severely disabled workers, their children, or the surviving family members of workers who have died untimely deaths. This protection is extremely important, especially for young families struggling to afford adequate private insurance policies. For a young married average worker with two children, Social Security is the equivalent of a \$300,000 disability insurance policy and a \$300,000 life insurance policy. About one in six of today's twenty year olds will die before retirement, and nearly thirty percent will become disabled.

For all of these reasons, the program is irreplaceable, and I am delighted to have an opportunity to talk to you today about the President's framework for making Social Security strong for the 21st century.

TRUSTEES' ESTIMATES

As you know, under the 1998 Trustees Report intermediate assumptions, the annual combined tax income of the OASDI program is projected to exceed annual expenditures from the funds until 2013. After that, because of interest income, total income is projected to continue to exceed expenditures until 2021. The funds would begin to decline in 2021 and would be exhausted in 2032. In 2032, when the trust funds are projected to become exhausted, the Social Security system will have enough income to cover only about three-fourths of benefit obligations.

DEMOGRAPHICS

We are all familiar with our Nation's demographics—and it can be summed up this way: we are living longer lives, but it is not just the number of years we are living, it is also the number of people who are living longer. This is good news. More of us are living to retirement age, and life expectancy at age 65 is increasing:

- In the U.S. in 1995, the elderly population (aged 65 and over) was about 34 million, making up about 12 percent of the population. In contrast, there were about 9 million aged people in the U.S. in 1940, and then they accounted for less than 7 percent of the population.
- The elderly population growth rate is expected to be modest from now through 2010, but it will increase dramatically between 2010 and 2030 as the baby-boom generation ages into the 65-or-older age group. By 2030 our elderly population will have doubled from 34 million, about 12 percent of the population, in 1995 to 68 million, about 20 percent of the population.
- When benefits were first paid in 1940, a 65-year old on average lived about 12½ more years. Today, a 65-year old can expect to live about 17½ more years. By 2070, life expectancy at age 65 is projected to be 20½ years.

ACTING NOW IS IMPORTANT

These millions of people, retired and working, rely on Social Security for their retirement security, and protection for their families against loss of earnings due to severe disability and death. Clearly, we must preserve and protect Social Security; millions are counting on us for strong and decisive action. The time to act is now. Not because Social Security is in crisis, but because delay will greatly increase the cost of achieving solvency. At the present time, our financing is sound. We can have modest changes now, or much more drastic changes later. The size of the financing gap will double if we delay for a generation, and young Americans could lose faith in our system. We face serious but manageable challenges with early action. We can prevent a crisis from ever occurring with responsible action in the near term.

WINDOW OF OPPORTUNITY

I strongly support the Administration's decision to try to use the window of opportunity presented by the budget surpluses to advance fund more of the nation's Social Security system. This is the first time in a generation our fiscal position enables us to take such action. Through advance funding, we can prepare for the inevitable challenges of the retirement of the baby boomers and succeeding generations.

PRESIDENT'S FRAMEWORK

I'd like to talk about how the President's framework would impact the Social Security program. The President proposed the following three distinct actions to solve the Social Security program financing problem:

- The framework provides for transferring amounts equal to 62 percent of projected federal budget surpluses over the next 15 years—about \$2.8 trillion—to the Social Security system. Except for a small investment in corporate equities, the framework uses this transfer to pay down the publicly held debt, strengthening our economy for the future.
- The framework calls for investing a small portion of the transferred amounts in the private sector to achieve higher returns for Social Security. The amount of the Trust Funds invested in the private sector would be about 15 percent, representing, on average, no more than about 4 percent of the stock market. Funds would be invested in broad market indexes by private managers, not the government.

- The President's framework calls for a bipartisan effort to take further action to ensure the system's solvency until at least 2075. There are hard choices that we must face. To assure confidence in Social Security it is important to bring the program into 75-year actuarial balance.

The first two steps will keep Social Security solvent until 2055, and bipartisan agreement on the hard choices could extend that solvency at least through 2075.

BENEFITS OF THE PRESIDENT'S PLAN

By paying down publicly held debt, the President's plan will ensure that the country will have the resources necessary to pay Social Security until the middle of the next century. Merrill Lynch recently released a report that concluded:

Allocating a portion of budget surpluses to debt reduction, as the President proposes, is a conservative strategy that makes sense. Reducing the debt will result in increased national savings, lower interest rates, and stronger long-term economic growth than would otherwise be the case.

The lower interest costs and higher growth will make it possible for the Social Security Trust Fund to redeem its bonds without creating pressure on other government programs. Indeed, OMB calculations indicate that the decline in government interest payments will provide sufficient resources so that the combined government expenditures on interest and Social Security benefits will be below current levels as a share of the economy until 2050 and beyond.

INVESTMENT IN THE PRIVATE SECTOR

The President's plan would require that transfers be made from the U.S. Treasury to the Social Security trust fund each year for 15 years. The amount transferred each year would be specified in law, so that by 2015, about \$2.8 trillion would have been transferred. A portion of these funds would be invested in the private sector each year, from 2000 through 2014, until such time as 14.6 percent of the Trust Funds are in private investments. The remainder, 85.4 percent, would continue to be held in government securities. This allows the trust funds to achieve a higher rate of return without assuming undue risk.

Stocks over time have returned about 7 percent annually after inflation, while Treasury bonds have yielded about half as much. Diversifying the trust fund investment to include stocks would produce more investment income and reduce the projected shortfall that needs to be made up through potential revenue and benefit changes.

Under the proposal, total investment in the private sector would account, on average, for around 4 percent or less of the U.S. stock market over the next 30 to 40 years. This, by the way, is about the size of Fidelity's share of the stock market today. State and local pension funds now represent more than twice as much—about 10 percent—of total stock market investments. If State and local pensions had not, years ago, gone in the direction of a diversified portfolio, then States and localities would have had to increase taxes or curtail pensions significantly. State and local government pension plans now hold roughly 60 percent of their total investment portfolios in the private sector.

We must provide safeguards to avoid politicizing the investment process. Under the President's proposal, the Administration and Congress together would craft a plan that ensures independent management without political interference. I believe that this can be done, and that the Federal Reserve Board and the Federal Retirement Thrift Investment Board could serve as models. The Federal Reserve Board makes extremely important and sensitive economic decisions and no one doubts its independence. The Federal Retirement Thrift Investment Board oversees the investment of billions of dollars in the private sector and there has been no allegation of political interference in those investment decisions.

USA ACCOUNTS

Social Security is one part of a "three legged" retirement system, which includes employer sponsored retirement plans and personal savings. I strongly support the President's program to create Universal Savings Accounts (USAs) by using part of the budget surpluses to help Americans build up wealth to finance their longer lifespans. Under the proposal, we will reserve 12 percent of the projected surpluses over the next 15 years—averaging about \$36 billion per year.

These accounts would be separate from Social Security, not a substitute for the guaranteed benefit. No resources for these accounts would be drained from the Social Security system.

The President would extend this savings opportunity on a progressive basis to assure that those most in need of increased resources in retirement would benefit. The USA accounts will provide individuals with additional resources and individual choices in saving for retirement. Today the overwhelming preponderance of funds from pensions and savings go to the top half of the population by income, leaving only a tiny percentage for the bottom half by income. USA accounts, separate from Social Security, will mean hundreds of dollars in targeted tax cuts for working Americans who choose to save more for retirement, with more help for lower-income workers.

PROGRAM IMPROVEMENTS

The President said a comprehensive reform package must include provisions to reduce poverty among elderly women. While the poverty rate for the elderly population is approximately 11 percent, for elderly widows it's 18 percent. Elderly women often are more dependent on Social Security because they are less likely to have pensions, and sometimes outlive their assets. Almost three-quarters of Social Security beneficiaries over age 85 are women—our mothers, grandmothers and great grandmothers. It is essential that we work together in a bipartisan effort to ensure that they have the best protection that society can provide.

In addition, as part of the broader reform package, the President's proposal would eliminate the retirement earnings test. This provision of the law is a confusing and anachronistic hold-over from the earliest years of the program. Eliminating this work disincentive will allow people the freedom to choose to continue to work in their retirement.

CONCLUSION

Today we have a remarkable window of opportunity—a window created by the responsible fiscal policy of the last six years and the economy it helped to produce. The President's framework does much more than protect Social Security and Medicare. President Clinton's approach would pay down the publicly held debt, thereby increasing national savings and promoting economic growth which will reduce burdens on future generations.

This is a moment we could not have foreseen just a few years ago. It is a moment in which we can begin to deal with the future. It is the moment to address long-term generational challenges. The President's framework for Social Security solvency gives a solid foundation on which to preserve our social insurance program for the 21st century. The Administration and the Congress worked together successfully to achieve a robust economy. We now must focus on strengthening and protecting the Social Security system for future generations of Americans.

Chairman ARCHER. Thank you, Commissioner Apfel.

Mr. Crane will inquire.

Mr. CRANE. Thank you, Mr. Chairman.

Mr. Lew, there has been a lot of criticism about transferring general revenues to the trust fund, and therefore, changing the self-financing nature of Social Security. How do you defend the use of general revenues to support the program?

Mr. LEW. Congressman, the policy that we put forward is a change. I think it is important to discuss the merits of it.

In the past, the principal means of financing Social Security has been the payroll tax. The only exceptions to that are when we pay interest on the debt and use tax revenues coming from the taxation of benefits to reinforce the trust funds. That has been general revenues.

I think the important point to look at is where the obligation lies. Today the obligation is there to pay benefits based on current law. The obligation to pay benefits is not increased or decreased by anything in our plan. We asked the question, given that obligation, given the choices that we have: what would be the best way to

meet the obligation? Preserving the structure of the traditional financing and benefit program was very important to us. We do not view this as being a radical deviation.

But when looking at the choices, we think the President's framework for Social Security reform is the most desirable option. We have the fiscal ability because of the surpluses we are projecting into the future to meet those commitments to pay back the bonds out of general revenue. We know that the alternatives, benefit cuts or payroll tax increases would be very painful. So we think that it is the right balance. It preserves the structure of the current program, but does enable us to meet the commitments we have to pay the benefits today in the form that we think is most desirable.

Mr. CRANE. But you definitely wouldn't look favorably upon increasing the Social Security tax?

Mr. LEW. We think that the payroll tax is a very substantial burden on working people, on employers.

Mr. CRANE. Except where is the money coming from, the same people.

Mr. LEW. At the present time, the projected surpluses that we look at within the 5-year budget, as well as 15- and 20-year forecasts, assume that all of the payments to Social Security will be made. It is really a very important point, that the obligations are there as we project out the cost to the government.

If we are showing a surplus in our long-term projection, then we don't have to go out and raise new revenues. Our current cash flow will support the transfer and the repayment that we are proposing.

However, if we have tax cuts today or spending policies today that drive our revenues down or our outlays up, then we may or may not be able to pay the bills when they come due. We think the decisions really have to be made today to set aside the assets, and really to defer, as it were, the consumption to later. Not to spend the money on a tax cut or spending program today, but to be in a position so that we can pay these commitments when they come due.

Mr. CRANE. When would the debt limit have to be raised under current law?

Mr. LEW. I would have to check, but it is several years from now.

Mr. CRANE. Well, according to CBO, no sooner than 2009.

Mr. LEW. I can look it up, Congressman. I would be happy to check. It is several years from now.

Mr. CRANE. And how about under the President's proposal?

Mr. LEW. Well, we would reach the debt limit sooner because the debt limit measures not just the debt held by the public, but the debt in all trust funds as well.

I think that in my prepared remarks I tried to address this. I think there is a very important distinction to be made. We view the debt held by the public as the important indicator of the government's participation in private credit markets. The debt held by the public is what Chairman Greenspan suggested we should be looking at. It is what most economists suggest that we should look at.

The debt subject to limit is a broader measure. It includes debt held by the trust funds, but they are not the same. If the debt subject to limit goes up because the trust fund is owed a dollar, it is not the same as if we owe a dollar in private treasuries. When we

pay back the trust fund, we are paying Social Security benefits. When we pay back private bond holders, we are not.

For a number of reasons that I would love to go through in more detail if we have the time, as a matter of economics, it is very different to have the debt subject to limit going up because the debt held by the public is going up, which is not the case under the President's plan, as opposed to the debt held by the trust funds. We view the debt in the trust funds as an asset. That is how we set aside funds for the future.

In order to put bonds in the trust funds, those bonds are counted as debt. This is a case where debt is good. The debt is saying that instead of spending the money today, we will pay it later for Social Security benefits.

Mr. CRANE. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Shaw?

Mr. SHAW. I would like to follow up on that just a minute. You just said that we don't view the bonds in the trust fund as public debt. Don't you view that as being owed to future Social Security recipients?

Mr. LEW. Congressman Shaw, the debt in the trust funds is not debt held by the public. It is debt held by the trust funds. So as a technical matter and as an economic matter, it is not public debt.

Mr. SHAW. No. Would you answer my question, please? Don't you view this as money owed to people that are paying into Social Security for when they retire?

Mr. LEW. Yes, Congressman, it is money that is owed. The benefits are owed today. This is really just putting the commitment to pay the bond with the benefit that is already owed. So it is not increasing the obligation. The obligation is already there.

Mr. SHAW. Let me ask you a couple more questions regarding the 62-percent surplus. If you were to take the trust fund out of the unified budget, there wouldn't be any surplus. So the surplus that you are putting through the Social Security Trust Fund, couldn't it certainly be argued that it has already been through there once?

Mr. LEW. Well, the unified budget, as you know, is composed of all of the net receipts in excess of outlays.

Mr. SHAW. I know that. I only have 5 minutes. Please answer my question without explaining the system to me, because I think all of us up here know how it works. The simple question is, in that this money may very well be those same dollars, in fact, it is those same dollars that have already gone through the Social Security Trust Fund. Isn't that right?

Mr. LEW. We have not taken any dollars from the trust fund. The trust fund holds bonds. The trust fund does not hold dollars.

Mr. SHAW. It goes through.

Mr. LEW. That is the current system that we have today.

Mr. SHAW. The money, the surplus, the tax dollars go through. The FICA taxes go through the trust fund and come out the other end. Treasury bills go into the trust fund, which is nothing but IOUs or calls on future taxpayers. Then that goes into the unified budget to make it look like we have a big surplus. The President commits 62 percent of that surplus to run it through the Social Security Trust Fund again.

Based upon that, let me ask you another question. Why couldn't you run it through 2 or 3 more times? It is the same money. It is the same money.

Mr. LEW. Congressman, the proposal the President has made is that we should treat these deposits, these transfers into the Social Security and Medicare trust funds, as we would treat outlays, and not run it through any more times.

Mr. SHAW. It has already been through. You run it through twice.

Mr. LEW. That is the way we have been budgeting for years and years. That is nothing that is new about this program. We are ending the practice of—

Mr. SHAW. I know that. I don't want to appear to be discourteous. There are some things that the President put out that I do like. But I think that this is smoke and mirrors with regard to setting aside 62 percent of the surplus. He says we are going to put it in, and we are going to retire the public debt and put it into debt, into the Social Security Trust Fund. The moneys that are in there, the IOUs that are backed by the full faith and credit of the Federal Government, are backed by the taxpayers of tomorrow. That is what concerns me. Once that trust fund starts depleting, some taxpayers, either through FICA taxes or general income taxes, are going to have to step up to the plate and put that money in there. It means more and higher taxes.

As a matter of fact, with the plan that the President has, I believe that it is dependent upon the new taxes that he sets forth in his budget. Isn't that true?

Mr. LEW. Congressman, if you are asking about the other parts of the budget, I would be happy to discuss them. But nothing in this plan is dependent on other parts of the budget.

Mr. SHAW. But is it all interrelated?

Mr. LEW. No. The proposal for the framework is not related.

Mr. SHAW. Doesn't the President make surplus assumptions based upon his total budget? In order to come up with those exact assumptions, isn't it true that we would have to buy the whole deal?

Mr. LEW. I would be happy to respond to the question. It is going to take me more than 30 seconds though.

Mr. SHAW. Go right ahead. I will give you the rest of my time to answer it.

Mr. LEW. The President's budget is—

Chairman ARCHER. The director has 1 minute.

Mr. LEW. Thank you very much, Mr. Chairman. The President's budget has to be viewed in its entirety. In its entirety, the budget projects surpluses that go quite far into the future, 40 or 50 years. There are no substantial changes on long-term tax policy in this budget. Receipts do rise because incomes rise. That is not tax policy. That is a matter of the economy working and the tax system that we have working.

The decision that we make today, this year, will really determine whether the surpluses materialize or not. We could decide to have a tax cut. If we decide to have a tax cut, there will be smaller surpluses. We could decide to spend that surplus. If so, we will have smaller surpluses. But if we have the surplus we are projecting,

which we think is a conservative economic projection, then when we get to the point where these bonds are redeemed, we will have the adequate resources to pay the bills.

We need to have a fiscal policy today that doesn't consume the surpluses, either in the form of tax cuts or spending policy. Again, without meaning to be argumentative in response, I think one has to view the unified surplus the way it has been viewed really for all the 20 years that I have worked on the Federal budget. That is, that you have to make choices on the bottom line—what do you do with the dollars.

If we view it as a choice between tax cuts, spending, or setting it aside for the trust funds, those are very different choices. Setting it aside for the trust funds could accomplish the macroeconomic policy without putting dollars back into the trust fund. I do not disagree with that. But that would not extend the life of the trust fund.

We think it is appropriate to put the bonds in so that bills will be repaid in the future.

Mr. SHAW. Yes, sir. With all due respect, I think the answer to my question was yes.

Chairman ARCHER. The gentleman's time has expired.

Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

Jack, let me follow up on that because the President's program goes to the year 2055. The President has never said that that is the end of it. In fact, you have said, and I know that Mr. Apfel has said, and I know Mr. Rubin has said numerous times that you really have to have a 75-year projection because that is what the actuaries use. If 4 or 5 years go by with only up until 2055, we are going to be out of balance by the year 2002, 2003. Is that correct?

Mr. LEW. It is true. The traditional measure of Social Security solvency has been 75 years. The President was very careful in the State of the Union and in the budget not to deviate from the normal objective of 75-year actuarial balance.

What he has tried to do in the framework for Social Security reform is to try and solve roughly half the problem, by transferring the surplus so that it is available in the future to pay back the trust funds and cover benefits that are currently due. It does not eliminate the need for further action. We think it does change the challenge, and it makes it an easier bar to pass, which we would hope would encourage both sides in Congress and the White House to work together on a bipartisan basis to solve the problem and to combine the transfers with the kind of programmatic changes that would be envisioned.

Mr. MATSUI. It's your sense that solving the additional 20 years, from 2055 to 2075, would take probably some structural changes, although that depends upon what the Congress wants to do. I would imagine that is where it has to be on a bipartisan basis. Is that your—

Mr. LEW. Well, those are certainly the tough choices. We think that the first step should be easy. But obviously we have a little work to do in order to agree on how to handle the use of 62 percent of the surplus.

But it will be very tough, just like in 1983, when many of us worked together. They are tough choices that can only be done on a bipartisan basis.

What the President did for the last year has been to try and encourage the kind of dialog that many in this Committee have participated in that leaves us in a position to address the problem together. By solving half the problem through the financing mechanism that's proposed in the framework for Social Security reform, we hope that is a big step forward to try and tackle a long-term problem, because tackling long-term problems is tough. We think it will be best to do it when we have a lot of time so that the steps would be as modest as possible.

Mr. MATSUI. Thank you.

Mr. Apfel, would you like to comment?

Mr. APFEL. Well, I just wanted to paraphrase what the head of the General Accounting Office has said, that the President's proposal has financing reforms. What he has said is that we still need structural reforms. I think we would say yes, we do. Clearly, there are some further steps that need to be taken. Some of those steps may be further financing reforms, but that we have to be able to move to long-term stability of the system over time.

Mr. MATSUI. Let me ask you, because structural reform is what the comptroller general and the second panel, will probably speak about. Does the Feldstein plan, which I know both of you have looked at and perhaps analyzed, and it's been a revolving, changing type approach, have structural reforms in it?

Mr. APFEL. Well, there are two or three different variations. I am not sure exactly which one we would be talking about. The administration also proposes that outside of Social Security, some of the surpluses should be devoted to creating Universal Savings Accounts, which we think are very important. At the proposed size, we believe they can be fully accommodated.

There are proposals like Mr. Feldstein's outside of Social Security that use much larger portions of the surplus. The effect would be to seriously reduce the ability to pay down publicly held debt in the short-term. There are also some serious issues about what happens to the Social Security foundation benefit over time with some of the proposals that are out there.

There are certainly some potential structural changes there, but those are very, very dramatic. We would be looking at them very, very carefully before we would be comfortable moving in that direction.

Mr. MATSUI. Mr. Lew, can I ask you about the double accounting issue? What I understand is that since 1974, perhaps even before then, we have been using the Social Security surplus for general expenditures. Now, can you make the same case about double accounting there, as well as using it in the example that was just given?

Mr. APFEL. I think it is certainly a complicated question what actually happens to these dollars. It sounds argumentative when we talk about it, but it is complicated and it really does have to be unraveled.

There is no doubt that the unified surplus does comingle different surpluses and deficits to bring you to a bottom line. One

could say that you are using the contribution to the surplus from Social Security for other purposes. But the commitment to Social Security remains in the form of a bond. So you are not taking any resources from Social Security, but you do have a projected unified surplus that is larger because Social Security runs a surplus.

Interestingly, the issue of double counting never arose in the past when there were proposals for tax cuts out of a unified surplus or proposals for spending for other kinds of programs out of unified surplus. We don't think that there is any additional double counting issue by putting a dollar into the trust fund, than by using it for any of these other purposes. One has to work through the complexities, but it really is the same. We think it is a tradeoff between the choices. We think the choice of putting the dollars into the trust fund is far and away the best choice.

Chairman ARCHER. The congressman's time has expired, but would the gentleman like the indulgence of the Chair for how much additional time?

Mr. MATSUI. Actually, I just wanted to ask one more question.

Chairman ARCHER. All right. The gentleman has an additional 30 seconds.

Mr. MATSUI. Thank you, Mr. Chairman. What I wanted to ask in follow-up to that is about the analysis that you are using now or that was used perhaps by Mr. Shaw in terms of double accounting. Would you say a significant tax cut would be potentially double accounting too?

Mr. LEW. Well, I don't think it is double counting. But it would have a very much more negative effect, which would be that it would not reduce the debt held by the public; a tax cut would have the effect of leaving us in the position where the debt held by the public would be that much higher.

Mr. MATSUI. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman. Actually, I think the argument over Social Security and Chairman Greenspan indicated I think in front of this Committee that whether it is in the surplus or whether it is in the Social Security Trust Fund, it buys down the debt, and that is a positive. When you begin to use it for other programmatic uses, then there is some concern. I think I understand that part of the President's program.

What I would like to have you, Jack, explain to me for just a minute or two is the Medicare part of that. I am not clear whether we are going to do 62 percent and then utilize those other funds, or we are going to save Social Security for 75 years and only when that is done are we able to use those other funds. But I don't want to go down that trail in the short time that we have.

What I want to ask you is in the agreement in 1997, we were able to secure another 6 to 8 years solvency on the Part A fund because in essence, we transferred programs, the Home Health Care Program from Part A to Part B. The President has now proposed to extend the "solvency" of Part A to 2020, by transferring money which is surplus or general fund or on the other side of the ledger to Part A. Part A is the hospital fund. Part B is where. And in that same State of the Union speech, the President said he wanted prescription drugs available for our seniors on Medicare.

I looked in the budget and I could not find a provision for prescription drugs. Since the \$700 billion was a transfer to extend Part A. Frankly, I think the question of Part A solvency is really moot since we either do programmatic changes, as you did in 1997, or you transfer dollars, I think the real question is the exposure to the general fund of general fund money, whether surplus or general fund to pay for Medicare. But that is another discussion.

Where are you proposing to get the money to support the President's prescription drug program for Medicare if the \$700 billion is to extend the solvency of Part A by pumping general fund money over into the payroll tax?

Mr. LEW. Congressman Thomas, the President very carefully in the State of the Union tried to make exactly the point that you observed, which is the transfer of 15 percent of the surplus is for the purpose of extending trust fund solvency.

In order to——

Mr. THOMAS. But I just have to underscore that solvency of the trust fund is meaningless now if we transfer programs or we transfer surplus funds to the payroll tax fund. It really doesn't have a lot of relevance.

Mr. LEW. What the President proposes in the budget and what he proposed in the State of the Union was to transfer these bonds into the Medicare trust fund. It does create the need for general funds to repay those bonds after 2008.

Mr. THOMAS. We could transfer the hospital functions of Part A over to the general fund as we did the home health care function, and we could create an infinitely solvent Part A.

Mr. LEW. I would like to address two issues if I could, in response to your question. In 1997, as you know, there were many real policy reductions in Medicare. They were the largest savings in Medicare that we have ever done. The industry, the health economy is very much feeling the pinch of the policies that were put into effect in 1997.

The reason that it is so important to transfer 15 percent of the surplus in order to extend the trust fund solvency is that we know the alternative is very deep provider reductions or payroll tax increases.

As far as the prescription drug benefit goes, we understand there is a need for further programmatic reforms. The President invited debate on those programmatic reforms, and he said that the prescription drug benefit should be part of the discussion of those programmatic reforms. So there would need to be additional savings in order to finance the prescription drug benefit.

Mr. THOMAS. OK. Indeed, in his budget he proposes reductions to hospitals and to providers beyond the BBA 1997 reductions. Are those to go for prescription drugs?

Mr. LEW. No, Congressman. But that I think underscores——

Mr. THOMAS. Yes or no?

Mr. LEW. No. They are not.

Mr. THOMAS. So although you described the 1997 changes as a pinch, you are advocating even additional reductions to pinch it even more. Although programmatic changes are necessary to fund prescription drugs, that additional pinch, those additional dollars,

are not to be applied to prescription drugs. What are they applied to then?

If you are taking money out of Medicare, where are you spending it?

Mr. LEW. The amount of savings that are in the President's budget in Medicare would come nowhere near funding the prescription drug benefit.

Mr. THOMAS. Yes. But if you are taking it out of the program and sending it some place else, that is not the right message to send. Is it?

Mr. LEW. As a practical matter, they do increase trust fund solvency very modestly. But they are not large enough to give you very much additional trust fund solvency.

Mr. THOMAS. Where do the reductions in hospital and provider payments go in the President's budget? Into Medicare?

Mr. LEW. In terms of Medicare, reducing outlays for Medicare will have some modest effect on trust fund solvency. So the reduction itself will have a modest effect on trust fund solvency.

Mr. THOMAS. Is that the purpose of the reductions to hospitals and providers?

Mr. LEW. I wouldn't argue it's the purpose because the savings are small enough and the effect is modest enough that it doesn't really constitute a Medicare reform proposal. But I think it does illustrate how difficult Medicare reform is.

Mr. THOMAS. I would have felt much better if your answer was in all honesty, given the caps on discretionary domestic spending, you have some programs you want to cover and you have to move dollars in that category. That is how you chose to do it. That kind of an honest response would have been much more appreciated.

Chairman ARCHER. The gentleman's time has expired.

Mrs. JOHNSON.

Mrs. JOHNSON of Connecticut. I thank you. I want to just first clear up an implication of your testimony, Mr. Lew, that comes through to me, at least loud and clear.

You described this as a defining moment. I believe it is. Now within your budget you in a number of places allude to the fact that the budget has to be taken as a policy document as a whole, and that only if all of the things in it happened will it work. Would you agree?

Mr. LEW. The budget does have to be taken as a whole. The forecasts in the budget assume that the budget will be enacted. But the driving force behind the long-term projections are the actions already taken in 1993 and 1997. It is the virtuous cycle of reducing debt that reduces net interest costs that drives the deficit down, and then the surpluses up.

Mrs. JOHNSON of Connecticut. Would you agree with Mr. Rubin when he testified before this Committee that any spending increases, given your stress on fiscal discipline and a balanced budget, have to be funded? You have funded them within the budget.

Mr. LEW. For the Fiscal 2000 portion of the budget, all of the spending initiatives are funded. The only aspects of the budget that are funded out of the allocation of the surplus are the pieces that we have specifically noted, the USA Accounts and the—

Mrs. JOHNSON of Connecticut. Yes. I thank you. I just want to move on with my other question.

I just want to put on the record that while your spending increases are funded for education, for a long list of other initiatives, that at least 70 percent of the revenue raisers to fund those initiatives are things this Committee has rejected on a bipartisan basis year after year. The cuts that you recommend in Medicare are cuts that we will reject, we must reject, because particularly our rural hospitals will simply go under if we are not more honest about reimbursement rates.

So I just want to remind us all that while your budget may work on paper, you have included in it many proposals that Members on both sides of the aisle do not agree with. So we are not going to be able to proceed in exactly the way you would like. I just want to put that on the record because promises are being made out there on the assumption that because this is a balanced budget, there is the money to fund them. When all of those fees are simply people paying more money for things that taxes already now provide them with. The tax increases particularly, is a category in which most of your recommended increases have been rejected by this Committee.

But I want to get to my real question, Mr. Apfel, although both of you are free to answer it. You have said over and over again, that you recommend some changes in how Social Security is financed, and that will take care of half of the problem. I have no doubt but that we are going to find a way, for instance, to get the high returns of the private market into the Social Security system to some extent and be able to help better finance our system through that mechanism.

But the half that requires structural changes, I know you do not want to take a stand on specific structural changes, but you have taken a stand against increasing taxes, reducing benefits, or raising the age. So if you would just enumerate the other say 20 options that we have that are the kinds of things that we ought to be thinking about and where we are going to come together, that would be very helpful.

Mr. APFEL. Mrs. Johnson, I think that the Administration has correctly expressed very strong reservations about a payroll tax rate increase and broad-based privatization of the Social Security system.

Mrs. JOHNSON of Connecticut. And I would agree with them on both of those things. So I want to hear the suggestions of the things that we could choose from.

Mr. APFEL. But we have kept open, without condemnation, virtually every other option that is under consideration. We have not taken an active—

Mrs. JOHNSON of Connecticut. But what are some of those options? I need to know what are your stars?

Mr. APFEL. I can provide for the record a whole list of different options that the advisory board and others have explored. There are things such as raising the wage cap on the taxation side, extending coverage to State and local workers, raising the retirement age, bend points, and increasing the computation years from 35 to 38 years.

[The following was subsequently received:]

Cost Effects of Various Solvency Proposals

A wide range of proposals to address Social Security's long-term financing problem has been advanced by Members of Congress as well as by research organizations and academicians.

The advantages and disadvantages of each proposal for resolving the problems facing Social Security will have to be carefully examined. It is also important to recognize that the options need to be evaluated in terms of the total package agreed upon. That is, individual elements in a given package will interact. These interactions will also need to be fully understood.

Attached is an excerpt from a report issued by the Social Security Advisory Board in 1998. The proposals listed illustrate the range of options that have been suggested to address the long-range deficit. Cost effect information is shown both as a percent of taxable payroll and as a percent of the long-range deficit that would be resolved by the change. (In evaluating the cost effect of a given change, it is useful to know that the benchmark used for this purpose was the long-range OASDI actuarial deficit under the intermediate assumptions of the 1998 OASDI Trustees Report—2.19 percent of taxable payroll.)

Attachment

EFFECT OF PROPOSALS TO ADDRESS THE LONG-RANGE SOLVENCY PROBLEM

Options	Savings as % of taxable payroll	% of Social Security deficit resolved
Reduce the COLA by 0.5 percentage point below CPI, beginning in 2000.	0.73	34
Reduce the COLA by 1 percentage point below CPI, beginning in 2000.	1.42	65
Increase the number of years used to calculate benefits for retirees and survivors from 35 to 38 (phased in 2000–2002).	0.25	11
Increase the number of years used to calculate benefits for retirees and survivors from 35 to 40 (phased in 2000–2004).	0.42	19
Reduce benefits across the board by 3 percent for those newly eligible for benefits, beginning in 2000.	0.36	16
Reduce benefits across the board by 5 percent for those newly eligible for benefits, beginning in 2000.	0.59	27
Speed up the phase-in of the currently scheduled increase in the normal retirement age to 67.	0.11	5
In addition to speeding up the increase to age 67, index the normal retirement age (by 1 month every 2 years) up to age 68.	0.39	18
In addition to speeding up the increase to age 67, index the normal retirement age (by 1 month every 2 years) up to age 70.	0.48	22
Reduce benefits by 10 percent beginning at family income of \$40,000 annually and 10 additional percent for each additional \$ 10,000 (maximum reduction of 85 percent).	1.65	75
Raise payroll tax rates (for employees and employers combined) by 2.3 percentage points in 2000.	2.20	100
Raise payroll tax rates (for employees and employers combined) by 2.9 percentage points in 2020 and an additional 2.9 percentage points in 2050.	2.19	100
Eliminate the special income thresholds for taxing Social Security benefits (and put revenue in the Trust Funds).	0.35	16
Make all earnings subject to the payroll tax (but retain the cap for benefit calculations) beginning in 1999.	1.99	91
Make all earnings subject to the payroll tax and credit them for benefit purposes beginning in 1999.	1.50	68
Make 90 percent of earnings subject to the payroll tax and credit them for benefit purposes (phased in 2001–2003).	0.55	25

*EFFECT OF PROPOSALS TO ADDRESS THE LONG-RANGE SOLVENCY PROBLEM—
CONTINUED*

Options	Savings as % of taxable payroll	% of Social Security deficit resolved
Cover all newly hired State and local government employees beginning in 2000.	0.21	10
Invest 40 percent of the Trust Funds in stocks (phased in 2000–2014).	1.00	46
Transfer money from general revenues to offset the Trust Fund deficit.	Impact on Trust Fund deficit would depend on amount transferred	
Use a portion of the payroll tax (e.g., 2 or 5 percent) to provide mandatory individual investment accounts.	Trust Fund deficit would be increased unless revenue loss is offset by benefit cuts	
Allow or require workers to contribute to individual investment accounts funded by additional amounts withheld from wages.	No direct effect on the Trust Fund deficit. Benefits from these accounts would enhance retirement income	
Use the budget surplus to establish individual investment accounts.	No direct effect on the Trust Fund deficit. Benefits from these accounts would enhance retirement income	
Return to pay-as-you-go financing and allow workers to put money saved from temporary payroll tax reduction into individual investment accounts.	Trust Fund deficit would be eliminated by raising payroll taxes as needed to meet future benefit obligations	

Mrs. JOHNSON of Connecticut. What does that mean, 35 to 38 years?

Mr. APFEL. Pardon me. The number of years that would be counted in determining the benefit calculation.

Mrs. JOHNSON of Connecticut. In other words, you would increase the number of quarters?

Mr. APFEL. Not quarters. It's actually years for determining benefit calculations.

Mrs. JOHNSON of Connecticut. So that would have the effect of lowering the benefit, because the more years you include, the more low earning years you include.

Mr. APFEL. If you increase the number of years, you increase the number of low-earning years. This is again—

Mrs. JOHNSON of Connecticut. Correct. And you effectively lower the benefit.

Mr. APFEL. that is not an Administration proposal.

Mrs. JOHNSON of Connecticut. I understand that. I understand that.

Mr. APFEL. We have not ruled out a series of different options on both the revenue side and the spending side, and have tried to do everything that we could to keep discussions going forward so that we could have an open discussion about future changes on a bipartisan basis this year.

Mrs. JOHNSON of Connecticut. Well, I certainly want to have that discussion on a bipartisan basis. I just think that the side that you have chosen to talk about is the easiest side. The other side really needs more.

Mr. APFEL. Actually, Mrs. Johnson, I am not so sure it is so easy, or else the proposals wouldn't have generated so much heat.

Chairman ARCHER. The gentlelady's time has expired.

Mr. Apfel, I feel constrained to try to set a foundation for your testimony today, which I am now a little bit confused about.

Do you speak for the administration, for the Clinton White House? Because you commented that you did a few minutes ago, and I just wondered if that was accurate.

Mr. APFEL. At that point in time I was, yes, sir.

Chairman ARCHER. You appear here today as a representative of the Clinton White House and their policies?

Mr. APFEL. No not as a "representative" of the Clinton White House, but, as the Commissioner of Social Security, and therefore as a senior government official, yes sir.

Chairman ARCHER. No, I do understand you are Commissioner. But I also understand that for many, many years I joined with Congressman Jake Pickle on this panel on a bipartisan basis to make Social Security an independent agency. We finally accomplished that and had it signed into law. Under the law, I believe that your purpose and your representation before this Committee should be as an independent agent that has no connection with the administration's policies. I am a little bit troubled by that.

Is it not true that your agency is now independent under the law and not an instrument of the White House?

Mr. APFEL. I believe that the Independent Agency legislation created the appropriate balance between independence and still an executive branch agency. I report directly to the President of the United States. I am appointed by the President and a member of his broader cabinet.

At the same time, I believe the Independent Agency legislation created the appropriate balance of a term position through January 2001 to enable the appropriate balance as an executive branch agency, but also with a term appointment. I believe that is the appropriate balance.

So when Mrs. Johnson asked about the administration, I can very, very comfortably articulate the administration's positions. On the President's proposal, Mr. Chairman, I strongly endorse all three components of the administration's bill. Personally as Commissioner and as a senior administration official.

Chairman ARCHER. I picked that up from your testimony and I understand that. But, Mr. Apfel, you do give me some concern because I think that if Congressman Pickle were here, he would agree with me that the way you described your role is not at all what we intended when we made Social Security an independent agency.

We wanted it to be completely removed from any political hand-out of the White House, completely. Perhaps we need to redesign the legislation if we missed in that regard in some way. We wanted it to be more like the Federal Reserve, whose Chairman also happens to be appointed by the President. The mere appointment by the President, in our view, was not to make it an arm of the White House.

I hope that Commissioner Rossotti, now that we have also changed the IRS, will not come in here one day and say what you said as a description of his role.

Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. I don't want to enter into the discussion at length, but I do think that the Social Security Administration has been given added stature and standing and that

it is not only an arm of the administration, and I think Mr. Apfel's administration of that agency has shown the wisdom of our action.

Let me ask you, if I might, you are not going to be here for Mr. Crippen's testimony I guess, either of you. We kind of set these panels up seriatim. So there isn't a lot of back and forth among you, but mainly between each panel and us. Sometimes maybe that is not the most constructive way to proceed. It becomes adversarial among us instead of among you, with different points of view.

So I would like to ask you to react to a few parts of Mr. Crippen's testimony. I will read it verbatim so I don't in any way misquote it.

On page 6, he talks about several important questions about the structure of the program, and first asks, would breaking the link between payroll taxes and benefits eliminate an important mechanism of program discipline? Then he concludes the President essentially substitutes general funds solutions for programmatic solutions.

Would either of you like to comment on that? Mr. Lew.

Mr. LEW. Congressman Levin, we agree that there is a need for both financing and programmatic approaches. We would argue very strongly that the financing proposals that we put forward are very real, that the proposal to transfer bonds into the trust fund and to have that commitment be there so that in the future when we are running a surplus, the first call on the surplus is to pay back those bonds. That creates a very real source of funding for the current benefits which we already owe. The benefits we owe. The question is how we pay for them.

The choice really is between how you use the unified surplus—whether you use it for spending, for a tax cut, or set it aside for the trust funds. So we would agree that there is a need for programmatic reform. The discussion we have had earlier in terms of getting from 50- to 75-year solvency very much underscores that. But the step that we are proposing in terms of financing is very real.

A point that I think is very important for us to keep in mind is that many of us have thought through these questions analytically from the perspective of large and growing deficits. In the eighties and, the early nineties, when you looked at 2012, 2015, and you saw deficits growing from \$600 billion a year to \$1 trillion a year, it was almost impossible to say how would we repay the bonds already in the trust funds.

Now that we are looking at surpluses in those years, surpluses that are based on the assumption that we pay back the bonds that are already in the trust funds, we are in a very different world. Our point is that the fiscal policy choices that we make this year will very much affect how much flexibility we have to keep these commitments in the future. That is why it is so important to view it as a choice between tax cuts and spending today versus setting funds aside for tomorrow, and yes, to move on and make the programmatic changes to get to 75-year solvency.

Mr. LEVIN. Thank you.

Mr. Apfel, if you don't mind, maybe you would like to talk about this or Mr. Lew. And by the way, he says later on that point about the use of general funds. The recent past in the U.S. and the expe-

rience in other countries is not promising in this regard, that they will actually be used for those purposes. I will have to ask him that.

Let me just ask you quickly. On page 12, he concludes, so the President's proposals lower the debt relative to where it is now, but increase it relative to no new action at all. Would either of you like to comment on that?

Mr. LEW. Mr. Levin, I think the comparison is to a baseline that assumes no policy change, no tax cut, no spending.

One of the very difficult problems that we face is that baselines are not law. Baselines are projections of current law. The laws are made in this Committee, in this Congress, and between the Congress and the President. It is very difficult to lock a baseline in. We think that what we put forward is the most effective way of locking in debt reduction by transferring bonds into the Social Security and Medicare trust funds. We think that creates a kind of lockbox, where we can get the benefits of the baseline. Certainly if you compare it to a tax cut or other uses of the baseline, it is highly preferable.

Baseline is a kind of a theoretical construct, but we proposed a policy that would lock in what we think are many of the virtues in the baseline.

Mr. LEVIN. Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Houghton. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Mr. Lew, I think you said that by depositing bonds into the Social Security Trust Fund you would be issuing debt to the trust fund instead of debt to the public. Did I hear you wrong or is that what you said? If so, would you explain that?

Mr. LEW. Well, I think one has to sort of separate the different parts of the transaction. If we did nothing, we would reduce debt held by the public and we would not be issuing any debt to the trust fund.

Mr. MCCRERY. You would be reducing debt to the public. Is that what you said?

Mr. LEW. If we did nothing. But I believe in an earlier hearing in this Committee, the point was made in a rather pointed way that it is very difficult in this political system to do nothing; that the demand for tax cuts, the demand for spending increases is very great.

We think that the best way to lock in the benefits of debt reduction is to have a transaction that puts the resources into the trust funds instead of putting it toward a tax cut or toward spending. That does create a new bond, which does increase total debt, but that is how we are extending the life of the trust fund. Those are the additional payments that will be made to the trust fund, that extend the life of the trust fund from 2032 to 2055.

Mr. MCCRERY. But it's not true that if we didn't issue debt to the Social Security Trust Fund, we would be issuing debt to the public. In fact, there is nothing keeping us, even if we don't issue new debt with the unified budget surplus, to the Social Security Trust Fund, we could buy down the publicly held debt just as much as you plan to under your budget.

Mr. LEW. You definitely could. One of the policy choices would be to buy down debt without the transfer. But that would not extend the trust funds. I think it also is a difficult policy that we have not in the past had much success sticking to.

Mr. MCCRERY. Well, your policy, while you get some satisfaction from putting more bonds in the Social Security Trust Fund, you believe that that would make it more likely that policymakers would buy down the publicly held debt because somehow it is going to put us in a better position to pay off the internal debt 20 or 30 years down the road, I would submit is a giant leap of faith.

I don't think there is any stronger inclination on the part of policymakers today to buy down the publicly held debt if there is more bonds in the Social Security Trust Fund that might come due 30 years from now as there is just to buy down the publicly held debt for the good, very sound economic reasons that you have stated.

I agree that we should buy down the publicly held debt, and that will hit a large part of the surplus, but let's not try to create this link between putting more bonds into the Social Security Trust Fund and the will of policymakers to buy down the publicly held debt with the cash that is available to us today. I think that is a very tenuous relationship.

Mr. LEW. The history of the last 20 years is exactly consistent, I think, with what I have predicted would happen in the future. If we would just go back to business as usual—

Mr. MCCRERY. But, Mr. Lew, for the last 20 years, we have had bonds in the Social Security Trust Fund. It hasn't deterred us from deficit spending. So what makes you think just putting more bonds in the trust fund is going to give us any more conscience here?

Mr. LEW. What we are proposing is that the budgetary treatment of these transfers should be treated as if we were outlaying the money and remove it from the unified surplus, so that the money would not be there to spend again. We think that would be the most responsible way to treat these transactions and it would then remove the ability to spend it again.

Mr. MCCRERY. We can choose some other legislative mechanism if we so desire to mandate that we buy down the publicly held debt. So don't tell me that there is some magic connection here. There's not. Either we have the will to buy down the debt or we don't. That is all I am saying. Just be honest about it.

Look, I think the proposal is a sound proposal. I am glad the President brought it forward. It doesn't solve the whole problem. It gets us to 2055. However, if I am not mistaken, these are all long-range numbers and they are going to be wrong. We all know that. But we have got to use them as best we can to solve this problem.

If I am not mistaken, under your long-range projections, you only have a budget surplus, a unified budget surplus until about the year 2039. Is that correct?

Mr. LEW. It is a little farther than that. It is in the mid-twenties or forties, I believe.

Mr. MCCRERY. OK, 2042.

Mr. LEW. It's after 2040.

Mr. MCCRERY. But it doesn't get to 2055. So at some point, 2039, 2042, 2043, you are going to have to come up with some more revenues, aren't you, just to get us to 2055 and not add to the deficit.

Mr. LEW. At that point, we will have no debt held by the public and be in a very different fiscal posture.

Mr. MCCRERY. No doubt about it. I agree with you. We will be in a much stronger financial position to go to the markets and borrow if we have to, but we don't want to do that, if we can help it.

I think you have got some sound reasoning here. I wish you would be a little more up front though and not try to link these things as something magic that's not. Either we have the will to do it or we don't. Then I think we can get along and create something here.

Mr. APFEL. Mr. Chairman, could I get 30 seconds?

Chairman ARCHER. Sure.

Mr. APFEL. Again, I think that is one of the reasons why the third part of this proposal is so important. We have got to get to long-term reform.

If you look at the long-term surpluses and those projections and the depletion 30, 40, and 50 years from now, part of the long-term solution is going to be what we are going to do about Social Security reform in the very long term. So that is part of our long-term solution.

Mr. MCCRERY. But, Commissioner, by virtue of dumping more money into the trust fund, which is what you are proposing to do by issuing these magic bonds in there, by doing that, you are forestalling the need to come up with structural reforms. You know that the earlier we do structural reforms, the better chance we have to make Social Security solvent for us, as far as the eye can see. So I think you are doing damage to the inclination of this body, this political body, to do something structural, to do something important to save Social Security for the long term by putting in this magic money.

Chairman ARCHER. OK. The gentleman's time has expired, but I am going to give the Commissioner a chance to answer one question that relates to this. That is, what would be your number one priority for structural reform, forgetting about whether you have delayed it or hindered it or helped it or anything else? What would be your number one priority for structural reform as commissioner?

Mr. APFEL. I believe that we need to engage in those on a bipartisan basis as the President has—

Chairman ARCHER. But, Mr. Apfel, you are not a representative of the White House, even though you may think you are. I am asking you as Commissioner, a nonpolitical Commissioner of Social Security, with your knowledge and your understanding of the Social Security program, what would be your number one priority for structural reform? Certainly you can answer that.

Mr. APFEL. Well, Mr. Chairman, I have spent the last year in public forums all throughout this country talking about the pros and the cons of every one of those options that are out there. I must say, Mr. Chairman—

Chairman ARCHER. Mr. Commissioner, Mr. Commissioner, we have very limited time. Can you answer my question? At some other time I would like to talk to you privately at length at some time convenient to both of us and you can tell me about what you have done around the country and everything, but for right now, what would be your number one priority for structural reform? I

am asking you as Commissioner to make a recommendation to us as to your number one priority for structural reform.

Mr. APFEL. I believe it is premature until we work together on a bipartisan basis to discuss these. We must talk about them within the context of a bipartisan process.

Chairman ARCHER. If we can't get, Mr. Commissioner, if we can't get a recommendation from you as the number one authority in the country on Social Security, responsible for running the program, for a top priority for structural reform, from whom can we get it?

Mr. APFEL. I believe that what we will be doing is just that process in the next—

Chairman ARCHER. No. I am just asking you, can you suggest someone else to me in the Social Security Administration that would give us a number one priority for structural reform?

Mr. APFEL. I believe, Mr. Chairman, that I am your person.

Chairman ARCHER. Then why won't you give it to me?

Mr. APFEL. Because I believe we need to work on a bipartisan basis.

Chairman ARCHER. You are, you are by the very nature of your job, nonpartisan. Your job is to run the Social Security system and to make recommendations to the Congress and to the administration as to what is an important priority. I am asking you simply. I don't know why you want to duck out on this. Why will you not simply give me a recommendation in the position that you hold for the number one priority for structural reform? You have examined all of them, I know.

Mr. APFEL. I have examined them.

Chairman ARCHER. OK. Give me a recommendation for the number one priority for structural reform.

Mr. APFEL. I believe that it is inappropriate at this point in time until we engage in that bipartisan process to make that recommendation.

Chairman ARCHER. Thank you very much.

Ms. Dunn. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. Apfel, based on that last exchange, I must say I am deeply disappointed because the point of this hearing is to get objective information to inform the bipartisan discussions. I feel like I have just heard a set of talking points out of Dick Morris rather than a serious move to inform our policy discussion.

You know, looking at the President's framework, and I use the term framework here to describe what he has proposed in Social Security because there is clearly not enough detail to call it a plan or to call it a blueprint. I have some questions that I would like to pursue that I think address some of the more promising aspects of it.

First of all, I see that the President in his budget has set aside 62 percent of the surplus rather than 100 percent of the surplus, which is what he had proposed last year and had kind of drawn a line in the sand on.

According to Mr. Frenzel's testimony, it is actually closer to 57 percent of the surplus. I wonder, under your budget proposal and the President's Social Security framework, would payroll tax reve-

nues still be used for non-Social Security retirement purposes? Mr. Lew.

Mr. LEW. Congressman, I believe I responded to that question. I am delighted to respond again. The way the Social Security Trust Funds work, the trust fund——

Mr. ENGLISH. I know how it works. It is a simple question, yes or no.

Mr. LEW. Unfortunately it is not a simple question.

Mr. ENGLISH. Would payroll tax revenues be used for non-Social Security retirement purposes?

Mr. LEW. If I have to answer yes or no, the answer is no, but it is not a simple question that has a yes or no answer.

Mr. ENGLISH. It does not?

Mr. LEW. No. It is not a simple question at all. Social Security financing is quite complicated. I think it is quite misunderstood, which is why I am trying to explain it. I would be happy to do so.

Mr. ENGLISH. Well, if it is any consolation, I used to be a city finance officer. I can don the green eyeshade. I believe I understand these things reasonably well. But I am puzzled how only 57 percent of the surplus being used under the President's framework for Social Security doesn't mean that we are using payroll tax revenues for purposes other than setting those aside as assets for Social Security retirement purposes. I do not understand.

Mr. LEW. I would be delighted to respond.

Mr. ENGLISH. Then please do.

Mr. LEW. The current financing of Social Security is really what we are mirroring in our proposal. The dollars that go into the trust fund in the form of bonds stay there. We don't take the bonds out. The bonds are——

Mr. ENGLISH. OK. I understand where you are headed with this, and I really think that is a dead end. I think most people realize that under the current system, surpluses in Social Security are used to prop up deficits that otherwise exist in the general fund.

Let me ask this a different way. Does the President's proposal contain anything to retire the \$700 billion in IOUs currently in this quote unquote, "Social Security Trust Fund"? Are you going to be buying those down and converting them into real assets or are you going to leave them as IOUs?

Mr. LEW. Well those bonds are very real assets. They are obligations of the Federal——

Mr. ENGLISH. They are non-negotiable Treasury bonds. They don't exist anywhere else on Earth.

Mr. LEW. They are backed by the full faith and credit of the United States government. When they come due, they will be paid.

Mr. ENGLISH. How do you know that?

Mr. LEW. I think the crux of why you think our answer perhaps is not a good one is that we perhaps have a different understanding of the current system. I apologize for going back to that, but if you view those——

Mr. ENGLISH. Let me reclaim my time.

Mr. LEW. You can reclaim it.

Mr. ENGLISH. I appreciate it very much, but what you are saying is the President's proposal does nothing to put real assets into the Social Security Trust Fund to replace the IOUs that are there.

Mr. LEW. No, sir.

Mr. ENGLISH. Let me ask you when is the President's proposal going to be offered in legislative language?

Mr. LEW. I would really like to respond to the question because you attributed a position to me that is not my position.

Mr. ENGLISH. OK. Well that is my understanding of your position. Can you tell me when the President is going to offer his Social Security proposal in legislative language so we can see the details?

Mr. LEW. The President has put forward the first full plan for using the surplus and for dealing with Social Security. It has engendered a very serious debate. We have said that we are working on the details. We will provide further details. I would be delighted to discuss further details—

Mr. ENGLISH. Mr. Lew, reclaiming my time. The devil is in the details. I would like to see the President's proposal in legislative language so we can see the actual details and assess them for ourselves. Some of the most important details are not in a broad budget outline. They are the specifics of how certain issues are handled, how certain investments might or might not be made.

I am sorry I don't have more time to pursue this, Mr. Chairman. I don't feel that the answers we have received here are particularly informative today. Thank you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. As I listened to these last couple exchanges, it reminds me of whether we are really interested in getting a bipartisan result or whether we are interested in making partisan gains here.

Mr. Apfel, I want to thank you for your response to the chairman's question. The Chairman asked a very serious question and well-intended. But if you would have given specifics on long-term reform, it would have been used by partisans, not by the Chairman, to make it more difficult for us to get a bipartisan agreement on Social Security.

The President has come forward with a proposal that gives us the opportunity to work together as Members of Congress to fill in the details so that we can deal with the long-term solvency of Social Security.

Mr. Chairman, I just want to put in the record that in every conversation and every opportunity I have had with Mr. Apfel, I think he is doing exactly what Congress intended in passing the Independent Social Security Act. The information that he has made available to me and his conversations have been exactly what I would like to see from an independent Commissioner.

I just really want to compliment you on the manner in which you are performing your responsibilities. It is interesting that you keep on emphasizing a point that many Members of this Committee, indeed, many Members of Congress refuse to acknowledge. That is, you have put forward three parts to a Social Security solution. People will harp on one or the other, but not all three together, which are important in order to provide for the objectives of Social Security and long-term solvency.

I would like to add a fourth though. That is, your universal savings accounts. I know they are not tied into the Social Security sys-

tem directly, but it does deal with retirement security, building up the other two legs of the retirement security stool, not only Social Security, but private retirement and private savings. Your universal savings accounts give us an opportunity to improve private retirement for individuals. I want to compliment you on that.

It is interesting that on your first part of your proposal, transferring 62 percent of the surplus into the trust fund, one point I would like to at least underscore, if I understand correctly, is that it does not increase any of the current obligations. You are transferring more assets into the Social Security Trust Fund, not changing the current responsibilities. So I am somewhat at a loss at those who criticize and say this does anything but a more conservative approach, transfer more assets into the Social Security Trust Fund without increasing any of the obligations within the Social Security Trust Fund, giving us a much better long-term financial outlook for meeting our obligations.

Mr. APFEL. Obligations under the President's proposal remain the same as they are under current law.

I want to thank you for what you said. I am doing everything in my power as Commissioner to try and move the ball forward. I commit to this Chair and to everyone here to do everything that I can, to do what I think are the best steps necessary, to move to Social Security reform, which I believe is centrally important for this country.

Mr. CARDIN. And there are many Members of this Committee that are working in a bipartisan way and we are going to work with you. I appreciated the comments of Mr. McCrery a little bit earlier. We are working, under very difficult circumstances to try to bring about a bipartisan result because it is so important to the future. That is why we are here—to legislate.

Your second part, to get a better return. Private retirement plans, public retirement plans, all have diversified investment portfolios. Every one except for the Social Security trustees. It seems to make sense that we should be able to figure out some way for the sake of the beneficiaries, to get a better return on the assets that you have. There has got to be some way that we can do that and protect the Trust Funds. Legitimate concerns have been raised about the Social Security trustees investing in equities.

Mr. APFEL. I believe there are legitimate concerns that need to be addressed in terms of protecting those equity investments from any interference at all. Clearly, if we look at the experience of State and local governments and the experience of Canada and other countries, we ought to be able to find ways to diversify our portfolio to increase rates of return in a very modest share of trust fund balances, which we think is prudent, cautious, and appropriate.

Mr. CARDIN. And third, working in a bipartisan way for the long-term structural changes. You have said, and I'll just repeat again for the record, there is a long list of eligible candidates that we could look at in a very collective way and come up with structural changes that would fit into the proposal that the President has brought forward.

We don't need you to identify, or anyone to identify a specific, what is number one priority in that list. Let us sit together as

Democrats and Republicans, as Members of Congress, and we can come up with a framework to deal with the 75-year solvency and protect Social Security in the future. That is exactly what the President brought forward. I really do thank you very much for your testimony.

Chairman ARCHER. Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman.

Mr. Apfel, it bothers me that you cannot give a straight answer. And I understand why.

There are several variables that we have to deal with along the way, and some combination of those variables. Maybe another way to ask it is, could you advise the Committee what some of those adjustments would have to be or if you think that we should use some combination of variables to make sure Social Security is sound?

Mr. APFEL. We could certainly provide some cost implications, as well as benefit implications, of various alternatives, to help in this decisionmaking process. I think we've been doing that and we will continue to provide that information to the Committee.

Mr. WATKINS. I think that would be helpful information. I think that some variables or a combination of variables needs to be presented to this Committee. This would be helpful in our decision-making process.

My friend Jack, I was quite interested in your comment, about Merrill Lynch. You know, Saddam Hussein talked about Desert Storm being the mother of all wars. What alarms me about the President's proposal is this being the mother of all political slush funds. That political strings could be pulled for different social concerns or problems.

It bothers me if the strategists, the person at Merrill Lynch says this is one of the most conservative strategies going. I don't know if I want him to handle my account.

Mr. LEW. Congressman, I believe he was referring to the debt reduction strategy. I don't know what their views on equity investments are.

Mr. WATKINS. Well, I admit that there's going to be some debt restructuring here, but I think there is a lot of other things involved. I'm concerned about this. I—

Mr. LEW. I believe it is a fair characterization.

Mr. WATKINS. Is Merrill Lynch a candidate in being an investor for the President's plan? Or are they—

Mr. LEW. The way we would propose that these funds be invested is that a number of private fund managers would competitively bid so that there wouldn't be just one fund manager. They would be very much constrained so that they would be investing in the broadest market indexes available; not picking and choosing; not timing purchases; not subject to the influence of political decisions. So that it could not become the kind of slush fund that you're worried about.

Mr. WATKINS. Well, I just returned from my district work period in which I had a number of townhall meetings. Besides discussing the crisis in the oil patch, which your administration has not even dealt with, hasn't been willing to even discuss, I have been discussing Social Security with my constituents. I know in the steel

industry there is a dumping issue, but there are more jobs being lost in oil patch right now. We're losing the domestic economy of that oil patch. I mean, we're losing infrastructure. We're not going to have one.

On Independence Day, because of a lack of leadership, we're going to be more dependent on foreign oil than at any other time in the history of our country. Our small independent producers are gone. I just want to say we're not addressing that either, so I'm worried about some of these things.

When we discuss Social Security, the one factor that's alarming the people across my district is the political strings that would be utilized with this proposal by the President. They would prefer to see individuals have control of their Social Security and to utilize and invest it. I think that's one thing that will have to be addressed. I think the Chairman is alluding to that also.

Mr. LEW. Mr. Watkins, I have a couple of responses. First, if the transfer itself were just put in Treasury bonds, it would extend the trust fund until 2049. So a very significant part of the benefit would come with or without equity investment.

We think that equity investment is a very prudent step to take if it's done carefully. I don't disagree at all that it has to be done very carefully. The criteria that we've put forward in terms of what it would entail to have a prudent investment plan I think are very responsive to the criticisms that you've heard.

Our difference is we think those problems can be solved. We think that you could construct an independent investment mechanism, that would not be subject to the kind of political influence that you're concerned about.

Frankly, if we can't insulate it, we would share many of the concerns. We don't think it would be an acceptable option to have a politically invested trust fund.

Mr. WATKINS. Jac, when do we start solving those?

Mr. LEW. Pardon me?

Mr. WATKINS. When do we start solving those?

Mr. LEW. Well, we think this hearing today is a good place to discuss some of these issues, and we're ready to work.

Mr. WATKINS. Well, that's why—

Mr. LEW. We're ready to work.

Mr. WATKINS [continuing]. I'm disappointed Mr. Apfel didn't give us any suggestions on the variables to deal with in Social Security reform. We know the overall proposal that has been made by the President, but we haven't seen anything on the table. I'm interested in getting some of those issues on the table.

Mr. LEW. We're interested in making some progress, too. We are very interested in making progress, too.

Chairman ARCHER. Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman. And, of course, in the spirit of bipartisanship, and as a Member of the Social Security Subcommittee, I'd just like to refer to our new speaker's statement on his day he was sworn in as Speaker of the House. He said when it comes to bipartisanship, that means both parties need to make an effort to come part of the way to the other side. And, of course, he made the point that Democrats need to figure they need to come

halfway, and Republicans need to figure we need to come halfway on the tough issues that are before us.

And I just hope that the definition of bipartisanship doesn't become, before this is over with, that one side is supposed to adopt the other's ideas, and that's the way bipartisanship is defined.

So in the spirit of bipartisanship, I do want to express some similar concern that other Members have expressed to the Commissioner. You know, I've sat in on numerous Social Security hearings, Mr. Commissioner, in which you've participated in, and, of course, we've been asking for ideas and solutions.

And I'm disappointed, once again, that really no specifics are being offered. And if we're going to move in a bipartisan way, we need to hear some specifics in a bipartisan forum when everyone is in the room and open and out and in the public, so we can really have, I think, an open and honest discussion regarding our efforts to save Social Security.

And right now just before us, of course, in the President's budget, it really appears there are really only two provisions in his budget that really deal with the issue of Social Security. One, is earmarking 62 percent of surplus tax revenues for the effort to save Social Security, and I think there's a lot of support for that concept on both sides of the aisle.

The President also proposes government ownership of private business, kind of like France and Italy. And I sense that there is not a lot of support for that idea, but I know it will be discussed during this year.

I do want to note that, while the President says 62 percent of surplus should go for Social Security, that this Committee and the House passed last fall a plan which was nicknamed "The 90/10 Plan" that was crafted by Chairman Archer, which set aside 90 percent of the surplus for the effort to save Social Security and use the rest to bring some fairness to the Tax Code by eliminating the marriage tax penalty for the majority of those who suffer it.

Now, Mr. Lew, one thing I find when I was back home over the district work period, during the President's Day recess, some folks said to me they always wonder when we talk about budgets whether or not we really read the fine print. And I find a lot of times the folks back home do in Illinois.

And yesterday I was in Ottawa, Illinois, and I spent time with some of those who read the fine print—hospitals and doctors who shared with me the impact on La Salle County hospitals, the four hospitals, the local physicians that serve that area with the President's proposed cut by \$9 billion in Medicare reimbursements and the new taxes on Medicare providers that the President proposes.

A little later in the day I went to the Kiwanis Club in Ottawa, where I had a chance to meet with about 50 Kiwanians, and one of them asked a pretty tough question. Now there's someone else who actually read the fine print. And the taxpayer read the fine print of the President's budget, and he noticed that the President's budget double counts. He noted that the President's budget puts more IOUs in the Social Security Trust Fund.

He particularly noted that the President's budget increases taxes by over \$80 billion. It creates \$150 billion in new debt, confiscates the States' share of the tobacco settlement, and cuts Medicare re-

imbursements for local hospitals, getting back to what I heard earlier in that day from some local doctors and administrators.

And here is his question. He really wanted to better understand, considering that saving Social Security is the centerpiece of the President's budget concept that he has presented. He wonders why, in this time of a massive surplus of extra tax revenue, that the President proposes over \$80 billion in new taxes in addition to his other provisions in the budget.

Mr. LEW. Congressman, there were a number of questions. On the Medicare point, I think that illustrates how important it is to use 15 percent of the surplus for Medicare solvency. The \$9 billion you referred to are relatively modest changes. And if they have the kind of consequences that you're hearing, we want to know that. They're not intended to have those kinds of—

Mr. WELLER. Well, Mr. Lew, if I could reclaim my time here, you say that, you know, using the 15 percent for Medicare—well, if your budget does that, you're still cutting Medicare reimbursements for hospitals that serve Illinois—

Mr. LEW. Mr. Congressman—

Mr. WELLER. And the impact on those four hospitals was \$1½ million in Medicare cuttings impacting just four rural hospitals in one county.

Mr. LEW. But I think that really puts into perspective how important it is to dedicate 15 percent of the surplus to Medicare. Our plan over 15 years would dedicate almost \$700 billion to Medicare.

Mr. WELLER. Right, Mr. Lew, but—

Mr. LEW. Now, that has the effect of—

Mr. WELLER. Mr. Lew, reclaiming my time—

Mr. LEW. I haven't—

Mr. WELLER. Still, while you're dedicating a portion of the surplus, you're increasing taxes by \$80 billion, and your net cuts in Medicare reimbursements for hospitals in this one county total \$1½ million as part of that \$9 billion cut in Medicare reimbursement.

Mr. LEW. Since I don't really have a chance to answer the question, maybe I'll just ask one. As an alternative to putting 15 percent of the surplus in, we've not seen any other plan yet that would have the effect of extending the Medicare Trust Fund for another 12 years.

I think that \$686 billion of savings would be very difficult to achieve, and we think this is a very constructive step, and we would look forward to seeing anything you could suggest that would—

Mr. WELLER. Mr. Lew, in reclaiming my time, you still haven't answered my question why, in this time of surplus, we need \$80 billion in new tax increases.

Chairman ARCHER. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman.

Let me thank the two witnesses for being here and for engaging in a bipartisan discussion here. And what I might want to do is begin by perhaps giving you each a little bit of time, hopefully not too much, to respond to some of the questions that were posed that you didn't have a chance to answer.

Mr. Lew or Mr. Apfel, I'll give you a chance to respond to anything you'd like. You don't have much time, but there have been a lot of questions posed without time to give answers.

Mr. LEW. Well, I hate to use your time, but if I may respond just to two points. First, Congressman McCrery asked a question which I think was a very constructive question. I'd just like to answer that the transfers to the Social Security Trust Funds would get us to 2049. So it would leave the last several years of the period between 2049 and 2055 where we would need to either borrow or find other savings. But it does get us a full 50 years.

In terms of the rest of the budget, we think it's a very good budget. We think it's a budget that puts our priorities forward. And, frankly, we think they're the priorities that reflect the needs of the American people. You need to look at what's inside the proposals. It's really the policy that has to be analyzed, not just the total numbers.

The dispute over tobacco policy is a very serious policy question. We are not ashamed to be for increased tobacco revenues. We think those tobacco revenues reflect a policy of stopping youth smoking, which improves public health more than anything else we could do.

So we would love to go through issue by issue and discuss the policies and not just let a quick review of the numbers confuse the issue.

Mr. BECERRA. Haven't the States also just reached an agreement with the tobacco companies where they themselves are going to be reaping the benefits of hundreds of billions of dollars in revenues?

Mr. LEW. The States' settlement would, in fact, bring substantial revenues into the States. And what we propose is not to take the money from the States. What we've proposed is that we develop Federal legislation where we would waive the Federal right to recoupment, in exchange for having the States dedicate the funds to an agreed upon list of programs that are shared State-Federal priorities.

We think that's the right way to resolve this, rather than have long litigation. It's not an attempt to take the money but to work together to address the common problems.

Mr. BECERRA. Mr. Apfel.

Mr. APFEL. Nothing to add, sir.

Mr. BECERRA. OK. Let me ask a question, then. I guess most of the actuaries agree that by sometime around the mid teens of the next century, 2013 or so, we're going to run out of enough payroll tax coming in—the contributions by the employee and the employer combined the 12.4 percent coming in, to pay off the benefits to all of those who will be retired in the year 2013 or so.

At that point, we'll have to kick in the moneys from the trust fund, and then soon thereafter, about 10 years after that, in 2032, the trust fund dollars and interest on that will have expired, and then we'll have the crisis where we can only pay about three-quarters of all benefits.

But focusing on 2013, if that's the date when we really find that our Social Security contributions coming in from employers and employees combined are not, by themselves, enough to meet the needs for those who are retired, right now we don't find ourselves in that case.

But in 2013 when we find ourselves there, what happens if we should today or tomorrow or before 2013 come up with a proposal to resolve the Social Security issue? And that proposal would include removing part of that 12.4 percent that's currently collected and put into the Social Security system, and, instead, take some of that out and use it for an individual account, a private account. What would that do to the financing or to the payout that we would have to take—would have to see occur, say, by 2013?

Mr. APFEL. Well, a carve out would dig a deeper hole. It would also mean that the lines would not cross in 2013. The lines would probably cross as early as next year. In other words, the payroll tax income coming into the system would become less than the outgo, with a 2-percent carve out, for example, by next year.

Mr. BECERRA. So if we had a proposal for a 2-percent carve out, meaning taking 2-percent of the 12.4 percent so that we could create an individual private savings account for each person in the country who is putting money into Social Security, what does that do in terms of when our incoming money is insufficient to pay the outgoing benefits?

Mr. APFEL. If the proposal were effective next year, the crossing point for those lines would move from 2013 to almost immediately.

Mr. BECERRA. And so what would we need to do to make up for that shortfall?

Mr. APFEL. Well, the 2-percent carve out would mean that rather than a 25-percent hole 30 years from now, we'd be looking at somewhere in the vicinity of a 40-plus-percent hole. So it would mean almost definitely a lower benefit structure, compensated in part or in whole for individuals by this individual account. But the basic benefit structure potentially would be lower.

Mr. BECERRA. Thank you.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Foley.

Mr. FOLEY. Thank you very much, Mr. Chairman.

I'm encouraged by the President's proposals in several areas. Clearly, I think we're in agreement on the surplus and attempting to put some more money into the Social Security Trust Fund. I'm intrigued by the personal savings account, and I think we've, on our side, talked about that as well.

But can you tell me, if you will, based on your analysis, what is plan B if everything goes south financially? You have right now a fairly optimistic projection. Not just you, but I think the Nation is under the notion that we'll continue to have prosperity, budget surpluses, economic times, stock market gains, capital gains tax income. What happens if we are heavily impacted by the global economy?

And what is our option, once we start these types of accounts, how do we then manage the midstream if there would become such a financial problem that we can't either fund the personal savings accounts, we can't contribute as much as we would have thought to Social Security, or, in fact, the downpayment of debt becomes impossible because you're now at the borrower's window again?

Mr. APFEL. Well, I'd like to handle it from the trustees' perspective. The trustees' assumptions over the 75 years are, we believe, prudent and cautious in terms of long-term economic projections.

There are some that argue that the assumptions may be too pessimistic, that basically growth could be potentially higher and, therefore, the problem would not be as large. There are others that argue the other way around, that, say, life expectancy would go up so that we'd have a larger long-term hole.

From the trustees' perspective, the assumptions are, I believe, appropriately balanced in the intermediate assumptions, so that we take the action along the lines of the intermediate assumptions. If we find out over time that growth is significantly higher, I'm sure that the Congress, in the future, will be able to determine what to do with those added resources.

If, instead, we find out that the situation is not as positive, not as optimistic, I believe we would have taken a significant action to resolve the long-term issue. So I think that the intermediate assumptions are the right balance between prudence and action.

Now, the other side of it is your—

Mr. LEW. I was going to say, from a macroeconomic and broader budget perspective, I think the President's framework is designed to be able to address that kind of question better than any alternative could be, because it's devoting most of the money—three-quarters—to debt reduction, and another 12 percent to U.S.A. accounts to increasing national savings.

So fully 89 percent of the allocation of the surplus is to increase savings and increase growth potential in our economy. It's only the remaining 11 percent for defense and other important discretionary priorities that is consumption in the conventional sense.

The choices in terms of how we use the balance of the surplus has a lot of bearing on the question you asked. The more we spend or consume in either a tax cut or spending, the more risk there is that the long-term economic future will not be as bright as our forecast. So we control it to some extent through the macroeconomic and fiscal policies that we follow.

Clearly, there are risks to any economic forecast. The world economy has many risks in it. But we don't think it's an accident that the United States economy has been very strong while other economies have been facing a lot of tumultuous times. Our good solid fiscal policy is part of it, and we're proposing to extend that, really, for another generation.

It's not an absolute guarantee, but it's the best protection we have.

Mr. FOLEY. You mentioned the economy, and you mentioned if we give a lot of tax cuts. Do you disagree that tax cuts can, in fact, spur the economy at a time when we may be suffering external problems?

Mr. LEW. Well, certainly, if we were looking at a period of economic weakness, a stimulative fiscal policy would have an effect. We're looking at a forecast right now that isn't showing a weak economy. We're looking at an economy that's consuming quite a lot. Our national savings rate being as low as it is, is an indication that consumption is not a short-term problem. There's a lot of consumption going on.

We do have a problem in terms of national savings, and the President's program really is aimed at increasing national savings. And there are a lot of ways to do it, and we're not opposed to a

tax cut. We have a tax cut proposal, our U.S.A. accounts, but what we've said is it should be designed to encourage savings, not consumption, which we think is an important difference. It's an issue that one could have a serious policy debate about, and we'd look forward to it.

Mr. FOLEY. Let me ask one question on the U.S.A. accounts, the savings accounts. What happens to them at the age of 65? Do these convert into annuities, or do they remain as an IRA-type account that's transferrable to an heir?

Mr. LEW. The U.S.A. account is actually a fairly complicated proposal that we're working through all the details on. This is one of the questions that we're going to have to address that obviously is an important question. The idea is that during a working life one would contribute to the U.S.A. accounts. In retirement, it would be available.

There are questions that we will have to address, and I think it's a little premature for us to answer that. But we are very close to being able to answer that.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Lew, we had a very interesting conversation the other day in the Budget Committee. Listening to you as you described the family with the child 8 years old, as you plan for college, and you talked about beginning to pay down the credit card debts and pay down other debts, and you don't increase debt as you make those preparations.

But I find with interest that you don't consider the debt to the trust funds as debt. We talked about that the other day. But overall, you also stated that the national debt increases year after year, and we have to raise the debt ceiling earlier than 2009, as under the current projections.

Now, which way is it? You don't increase debt as you prepare yourself to pay for future costs, which in this case future costs will be the benefits.

Mr. LEW. Congressman—

Mr. COLLINS [continuing]. But yet the national debt goes up, and the debt ceiling has to be increased, but we don't count the debt to the trust fund as debt.

Mr. LEW. Just to carry the example that I used in my testimony, if one were to look at the Federal budget, the debt held by the public would be the equivalent of a private individual's mortgage or credit card debt. And paying that down would free up your cashflow.

When you pay back a dollar of debt to the trust fund, you have to look at where the dollar goes. And I believe we had this conversation at the Budget Committee. If you were a family and you were at the receiving end of that dollar to the trust fund, you'd have a dollar for tuition, and we will have a dollar for Social Security. And there is the key point.

Mr. COLLINS. I follow what you're saying. But then folks at home look at me and say, "But, Mac, the national debt is going up. You are creating more debt. You didn't have enough money at the end of the year to pay your bills. You borrowed more money." So you've

not only increased the national debt, but you didn't have a real surplus.

Mr. LEW. Well——

Mr. COLLINS [continuing]. If you had had a real surplus, that debt wouldn't have gone up.

Mr. LEW. This gets back to the distinction between the on-budget and off-budget surplus versus the unified surplus. The fact of the matter is that the debt held by the public measures the private sector borrowing. The total debt, or debt subject to limit, is not a concept that is comparable to a business or an individual's financing.

The internal transactions within the government are, by their basic nature, a bit complicated. But I believe the answer I gave you showing where the stream of payments back to the trust fund go, really help explain why there's such a material difference. Net interest paid on debt held by the public is not available for Social Security.

What we're proposing is to have payments be made into the trust funds so that benefits can be paid.

Mr. COLLINS. I appreciate that. That's Potomac fever. You know, we don't have that fever in the Third District of Georgia. We have the Flint River and the Chattahoochee, but we don't have the Potomac to give us that fever.

Mr. Apfel, you mentioned that the proposal that we do have, in general terms, by the President is financial reform. Is that not true? Is that what you said? It is financial reform?

Mr. APFEL. There is financing reform in the proposal. That's correct.

Mr. COLLINS. It's very creative financing reform, I must say, and I've done a lot of creative financing in my lifetime as a small business person. But it doesn't affect the current pay-as-you-go system structurally. Is that right? The pay-as-you-go, where the current workers of payroll tax are paying the current beneficiary checks, the President's proposal, the financial proposal, doesn't affect that at all.

Mr. APFEL. Right. The President called for the third step, which is coming together on a bipartisan basis.

Mr. COLLINS. Well, I know——

Mr. APFEL [continuing]. We must resolve the issue over the longer term, but that——

Mr. COLLINS. That does not. To answer, it does not.

Mr. APFEL. That is correct.

Mr. COLLINS. And you said that we do need structural change. You do have some ideas, right?

Mr. APFEL. There are a number of ideas that we've discussed over the course of the year.

Mr. COLLINS. But you, as the Commissioner of Social Security, you do have some ideas. I'm not asking for your ideas. But you do have some ideas. You are going to be forthcoming with recommendations, is that true?

Mr. APFEL. I have not come forward with recommendations.

Mr. COLLINS. No, I know you haven't. You do have ideas. You will be forthcoming. And if you're a Democrat and I'm a Republican, we sit down and we've got us a bipartisan Committee, will

you share those recommendations and ideas with me and who they focus on? That's about as bipartisan as you can get.

Mr. APFEL. The desire is to talk about the tradeoffs to every one of those options and to come together to determine how best we can assure the long-term solvency of the system.

Mr. COLLINS. I don't know what—

Mr. APFEL. And I hope to work together to do that, sir.

Mr. COLLINS. Good. I don't know if aspirin will cure your fever or not, but try it tonight and see. Thank you.

Chairman ARCHER. You know, Mr. Lew, I've been trying to think through the budgetary aspects of this Social Security proposal, and I'm still trying to learn. It's a type of budgetary transfer that, in my experience in 28 plus years here, has never ever been done before. Is that your feeling, too?

Mr. LEW. These are the first surpluses we've had in those 28 years. This is a fairly new phenomenon.

Chairman ARCHER. Well, I—no, I do understand that. And that's a fair answer. But surpluses are, at this point, simply projections on paper, are they not?

Mr. LEW. Well, no, Last year there was a real surplus. The year we're in—

Chairman ARCHER. I understand.

Mr. LEW [continuing]. Will have a real surplus.

Chairman ARCHER. I understand that, and we paid down the debt with all of that and I'm proud of it, because it was—whatever was left at the end of the year, over and above our bills, we used to pay down the debt. And that was—

Mr. LEW. That's correct.

Chairman ARCHER [continuing]. A very solid achievement. It would have been more had the President not spent \$20 billion out of the surplus. Of course, that was not called surplus because surplus is only what's left over after the spending occurs. But we would have had a greater surplus, would we not, if the President had not spent money in Bosnia?

Mr. LEW. There would have been a larger surplus if any spending—

Chairman ARCHER. OK. There would have been a larger surplus had he not spent money in Bosnia on the people of Bosnia.

Mr. LEW. Mr. Chairman, I—

Chairman ARCHER. No. OK. I've got a couple of other things that I want to get at as quickly as possible because I'm using up time and I apologize to the other Members. But I want to try to understand this.

Traditionally, debt has been created by the Treasury when there has been a shortfall of money necessary to pay government bills, is that not correct?

Mr. LEW. That's correct.

Chairman ARCHER. OK. So this is a new twist. We are now creating money when we have excess money coming in, under your plan. Instead of creating debt when we need it to pay bills, we're now taking money in excess of what comes in and creating debt with it. And that's a total turnaround from previous circumstances. And I understand that that's what you're doing, and it's a new technique.

Now, it is, as my friend from Georgia said, very creative. And I have to compliment you on that. It is exceedingly creative, so creative that nobody fully understands it, although you've done as good a job of explaining it as anybody that I've listened to. But I think that it opens the opportunity for us to achieve even more.

We have a shortfall in the future in Medicare that is massive. And the elderly in this country want to be able to know that there will be Medicare funds there to pay their health bills through the next century, just as much as they want to know that their Social Security retirement benefits are going to be there through the year 2075.

What we probably ought to do is to take more of this money that's coming in, create debt with it, put it into the Medicare trust fund, save Medicare, and take the money and pay down the public debt, and we will reduce the public debt even more. It is an incredibly creative answer, and there are many other programs where we have obligations that are unfunded.

The Federal Retirement Program is unfunded in the amount of about a trillion dollars going into the next century. We should take this extra money coming in, create debt, put it into the Federal retirement fund, and then use that money to pay down the public debt, and we will have reduced the public debt even more, which economists will say will be a wonderful result.

This is incredibly creative. It probably should be used over and over and over again, because what's owed into the trust funds is not debt. It's not considered. It's OK.

You know, I want to applaud you. I think it is an incredible creative approach to solving all of the long-term problems that this country faces in the next century.

And now I'm going to recognize Mrs. Thurman.

Mr. MATSUI. Mr. Chairman, could he respond? That sounds like—

Chairman ARCHER. No. That doesn't require a response. I'm just making a suggestion. It doesn't not require a response. It's not a question. I'm just making a comment, so it does not require a response.

Mrs. Thurman.

Mrs. THURMAN. Mr. Lew, however, I will give you an opportunity, if you would like to respond to that, and if you see what he said differently than maybe you can explain.

Mr. LEW. Thank you, Mrs. Thurman.

Mr. Chairman, I think that one can take a good idea and change it and it's no longer a good idea. And I think what you've described is not the same as the President's proposal.

The President's proposal is a very careful and I think fiscally very conservative approach that says we have a unified surplus of a set amount. The way we have traditionally treated the unified surplus, the way past proposals coming out of many Members of this Committee have treated the unified surplus as money available to spend.

And what the President has said is that rather than spend it, rather than give it away in a tax cut, no matter how virtuous either the spending or the tax cut might be, we should put it aside. Now, the way our accounting rules work, putting it aside does

count as debt subject to limit, because it's an obligation to pay back the trust fund.

But the obligation to pay the benefits already exists. We're not going and borrowing money from private individuals or banks. What we're saying is that the first call on the surpluses we've created should be to pay the bills for Social Security and Medicare that we already owe. We think that's fiscally conservative.

One could carry it to an extreme. One could say that instead of treating it as an outlay, it should still be available to spend again, but that's not the President's proposal. The President has proposed that every dollar we transfer to the trust fund should be used to reduce the unified surplus so that it won't be available to spend again. It's a very important budgetary proposal.

If one were to treat it as not being spent, then you could have a fairly ridiculous result, which is not the proposal. So we think it's a very conservative proposal, and we hope that all of the aspects of the proposal, including the budgetary treatment of the transfers, would be adopted.

Mrs. THURMAN. And being from Florida, the other issue, of course, is Medicare, which we're taking, what, 15 percent over. And if we don't do something with Medicare, with this 15 percent, we're in a similar situation?

Mr. LEW. Absolutely. And, you know, I've heard a number of questions today and in past hearings raising very serious concerns about the effects of the Medicare savings proposals in the President's budget. And I think that reflects how difficult it is to deal with Medicare solvency.

If proposals to save \$9 billion over 5 years have created an uproar in terms of the response from providers, what would be the response to a proposal to save \$650 billion over 15 years?

In order to continue to pay Medicare benefits, we need to extend trust fund solvency. We need to increase the assets in the trust fund or reduce the payments. The only options we have are to cut benefits, reduce provider payments, or raise the payroll taxes, unless the President's proposal is adopted and we transfer some of the surplus to the Medicare trust fund and give Medicare the second call, after Social Security, on the fruits of our fiscal good fortune.

Now, I think that that is a very conservative approach. It's saying, "Don't make other commitments. Don't have commitments for a popular tax cut. Don't have commitments for popular spending programs until we make the financial resources available to meet the commitments we already have to the Medicare Program."

And we look forward to a debate on how to use the surplus. We think Medicare should come right after Social Security.

Mrs. THURMAN. I just want to tell both of you that we appreciate the time you've spent here today. I think all of us are looking forward to more of these kinds of conversations, and so I won't even let the green light change. Thank you for being here.

Mr. LEW. Thank you.

Chairman ARCHER. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. Out of respect for the next two panels, and also these witnesses, I'm going to yield back my time.

But first, before I do that, I've just got to say this. As one who genuinely tries to work together on these policy issues in a bipartisan, pragmatic, common sense way, I hope that this doesn't set the tone for the rest of our work on Social Security. There's nothing more important to the people I represent back in Minnesota than saving Social Security.

I just came from a meeting with Governor Ventura, where openness and plain speak prevailed, and it's like going from day to night when you can't even answer the Chairman's question, "Give me one recommendation for restructuring Social Security." I hope we don't have to do this behind closed doors, making deals. Let's just be open and honest and candid and come forward with—on both sides—with proposals to shore up and to save Social Security. It's too important for politics as usual. It really is.

And with that, Mr. Chairman, I yield back the balance of my time.

Chairman ARCHER. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman. And

I just have to say amen to what the gentleman from Minnesota said. It's absolutely, I believe, a necessity that we work together. This is not a Democrat-Republican issue. It isn't liberal-conservative. It is something that I'm convinced that only by the administration, the Senate, the House, all of us working together, are we going to solve this.

So I share the same concern that my colleague from Minnesota has. It would be nice if somehow we could have a little more give and take on what suggestions we might have.

I do want to commend the President for at least putting out the fact of setting up a—I don't agree with how he's doing it, but at least he put it out—of doing, as Federal employees are able to do, at least have—invest into the market perhaps, where people have a chance, at least with part of their funds, to make something. So I want to commend you on that.

However, there are some other areas that I do have some concerns, and I think it's important that we talk through these concerns if we're going to solve the problem. We've mentioned surpluses.

Director Lew, we've talked about putting money aside, first call, making commitments. I believe this is your document, isn't it, a document that you put out, Mr. Lew? It's the President's budget, the one we went over in the Budget Committee here a couple of weeks ago, which you appeared before us. And we pointed out at that time—well, we've talked—you've mentioned surpluses.

I have some concerns. I have some concerns that even in your budget—again, page 389—most of us—and I just came from a series of townhall meetings. When I talk to my constituents, and we talk about surpluses, we envision somehow that means we have more money at the end of the year than we had before. And yet, on page 389, again, the debt not only doesn't go down, it goes up, and it goes up by \$1.3 trillion over 5 years.

Now, I have a follow up to that question, and we talked about that in the Budget Committee here a couple of weeks ago. And this is specific to our hearing today on Social Security.

And in the President's plan, he has indicated that he is going to be able to extend Social Security's solvency by increasing the trust funds or the IOUs which is all the trust is—balances. The President's own budget document—and I have another document. I believe this is your document as well, as Director of OMB, that you've put out. So this is what you have put out on behalf of the President.

Again, turning to page 337 of this, "Analytical Perspectives, Budget of the United States"—again, put out by the President. Quoting from there, so this is your quote, your book, "These balances are available"—and we're referring to all of this money you're talking about putting in the Social Security Trust Fund. "These balances are available to finance future benefit payments and other trust fund expenditures, but only in a bookkeeping sense." "But only in a bookkeeping sense", it says here.

Continuing, "These funds do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury." And you've mentioned that a number of times, by the first call. That they're not assets, they're only claims.

Continuing, "Claims on the Treasury that, when redeemed, will have to be financed by: 1) raising taxes, 2) borrowing from the public, or 3) reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, have any impact on the government's ability to pay benefits." Now, this is your own document, not anything we've put out but your own document.

My question is: Mr. Lew, if increasing these trust fund balances only helps Social Security in a bookkeeping sense, and large balances have no impact on the government's ability to pay benefits, then exactly how does the President plan to pay full benefits after 2012? And is this repayment explicitly defined in the President's plan?

Mr. LEW. Mr. Chairman, may I respond to the question now that the time has expired?

Chairman ARCHER. The gentleman certainly will have 30 to 60 seconds, if he can do it, to respond.

Mr. LEW. Congressman Herger, we've talked about this at the Budget Committee. I responded to this question at the Senate Budget Committee. The paragraph you read, frankly, should have been changed, because it was written at a time of deficits and, frankly, does not reflect the current situation fairly.

For example, in a year when you're running a surplus, there is no need to borrow money to pay back the Social Security Trust Fund. There is no need to cut other benefits. The fiscal policy decisions we make this year will determine whether or not there are resources on a current basis to pay back the Social Security bonds.

Now, regarding the question of whether they are assets or not—they are full faith and credit obligations of the United States government. They are no different than privately held bonds in that sense. They are not marketable. They are a different form of a bond. But I would submit that there is no full faith and credit obligation of the United States in our history that has ever not been paid, and these will not be an exception.

The problem, I think, is that from 1983 to 1993, while we were running deficits projected to be in the hundreds of billions of dollars a year, it was very difficult to answer, how would we pay the bills from 2012 to 2032? That would really mean, how would we implement the 1983 Social Security reforms while we were running huge deficits?

Well, we have a different fiscal policy now. We're running surpluses, and by running surpluses we can pay the bills that we promised to pay in 1983.

Now, what we're suggesting is that we should use this moment when our fiscal policy projects surpluses far in excess of what's necessary to meet the obligations committed to in 1983, that we add to the resources in the Social Security Trust Fund, and, yes, create a first call; say we are not going to make other new commitments either to spend the money or to reduce taxes. And that will enable us to pay the benefits that are due through 2049, as I answered to Mr. McCrery, without needing to borrow any money under our current projections.

I wish that we had edited this paragraph 2 years ago. Frankly, it wasn't true last year or this year. But there are thousands of pages in the budget documents, and little by little they're all conforming to a world of surplus instead of a world of deficits.

Mr. HERGER. But, Mr. Lew, it still is in here written in that manner, and, yes, we have, at least at this time, surpluses. None of us know for sure whether these surpluses will go forever as this budget projects. Debt is debt is debt. The American public understands that. I really believe that we need to begin understanding that here within the Washington beltway. Thank you.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. And I'm delighted that we're having these hearings, and I want to commend the Chairman for spending time as we begin the process of trying to put together, as Mr. Apfel has talked about a lot, a bipartisan solution to this Social Security problem we find ourselves in because of the demographic shift that the President articulates constantly.

I'm going to get away from the debt issue, although I think it has not been fully resolved. And I do think that that is an important part of the overall bipartisan agreement we're going to have, is we have to be honest with the American people and deal with that and be sure that we are, indeed, not double counting and are not just adding, in the end, more debt internally, although we're paying off—the debt that is privately held, which is so-called public debt.

But let me talk about the U.S.A. accounts for a second, if I might. And, Mr. Lew, I know that this was put together with Treasury, White House, OMB involvement, and so on, and we're all very eager to see some of the details. But I would have, really, three questions about the U.S.A. accounts.

First is: what will their impact be on private savings? And by that I mean all of the savings that's out there in terms of 401(k)s, IRAs, other retirement savings programs which are really private in nature where we are leveraging private dollars through a tax preference.

The second question I would have is: how does it affect the solvency of Social Security, if at all? I think the answer is it doesn't.

And the third question I would have is: are these funds that would accumulate in the U.S.A. accounts locked in for retirement only, or can they indeed be used, which is unclear to me in the documents we've seen, for other purposes—first-time home, health care, education, and so on?

Mr. LEW. Congressman Portman, the first question regarding the integration of the U.S.A.s and 401(k)s is a very complicated matter, technically, which we're working through because our goal is that it should encourage new savings. And we don't want to discourage employers who provide matched 401(k) contributions or other forms of private pensions.

And one of the reasons it's taking a little bit longer to design the policy is that we want to get that right. We want to make this an additional incentive to save.

Regarding Social Security solvency, this is independent of Social Security. It would have nothing to do with Social Security, either in terms of taking any payroll tax dollars away or changing benefits. So it's really a separate element of retirement planning. You'd have Social Security, you would have private savings now, and you'd have private pensions.

The third question regarding locking in the use of the U.S.A. accounts, the President, in the State of the Union, proposed it as a form of retirement savings. We've heard many questions raised since then, why only retirement? That's something we're going to need to talk through and work through.

Clearly, if one uses the U.S.A. accounts for more than retirement, then it's less likely to be there as a retirement asset when people turn to it. On the other hand, there is a lot of interest in other forms of incentives for saving.

I think that the core principle is that a savings incentive is a very different kind of a tax proposal than a consumption incentive, and that's something that we think is critically important. We are designing this as a retirement incentive, but I think that there will be a lot of discussions on the question of exactly how one might look at other possible uses. We are looking at it as a retirement plan, but we understand there's a lot of interest in other uses.

Mr. PORTMAN. If I could just briefly respond now to your three responses to the three questions. First, with regard to displacing private savings—in other words, 401(k), profit sharing, defined benefit plans—I don't know how you're going to avoid it.

And although I commend you for focusing on personal savings, and I agree with you entirely in terms of your intent, I think it would be a grave mistake for the government to get into the business of providing a generous match, particularly for the lower income workers who you are targeting, because in the end I think you will find, particularly among smaller businesses, most of whom are not offering any kind of retirement plan right now, a further disincentive to do so.

The government is going to take care of it. And, frankly, if you're an individual working in those companies, making \$20,000, \$30,000 a year, you're going to see this probably as more generous than most of the 401(k)s or "simple" plans out there.

So I would respectfully suggest that instead we focus on making the retirement system work better. And you know there are some

proposals to do that, to increase contributions, simplify to get more bang for the buck on the private side, to leverage, again, more of those private dollars. This, I think, as well intended as it is, goes exactly in the wrong way, and I know that the administration is very interested in expanding private retirement savings.

Mr. LEW. As we have looked at the question of integration, there is such a low participation rate in 401(k)s and IRAs at the lower income levels that it actually appears to be of an issue in the middle income levels. The disincentives are great enough now that the participation rate is low, and our goal is to get more people into savings. And I think we agree on that.

Mr. PORTMAN. I would just say, don't look at the world as it is, but as it should be, and that would be allowing small businesses to offer more of these plans, making the plans more generous so workers will want to do so.

And I would just make one further point, and it goes back to what Mr. Apfel said earlier, which is that long-term stability over time is the goal of Social Security. If, indeed, you could tie the U.S.A. accounts to Social Security, if, indeed, there could be some kind of individual accounts that buildup real assets for individuals, which would in the end get the advantage that you're trying to get to, having the government invest—that is, higher rates of return—you really begin to solve the Social Security solvency problem and the retirement problem in a much more direct way; at the same time doing other things on the private retirement side to leverage, again, those private dollars.

So as I am totally in agreement with you in terms of your intent, I would just suggest that maybe there's a better way to do this by taking the U.S.A. account idea, folding it back into Social Security, with all kinds of government controls and regulations, and in the end, solving Mr. Apfel's problem, which is long-term solvency, but at the same time encouraging more private savings.

Thank you, Mr. Chairman. Whatever time I have, I think I'm past—

Mr. APFEL. Thirty seconds, Mr. Chairman?

Chairman ARCHER. OK, Commissioner.

Mr. APFEL. It's a pretty steep hill in terms of integrating within the Social Security system because it's shifting away from the defined benefit model to the defined contribution model. So we would be looking at it. That's why the administration proposed a separate U.S.A. account, separately entirely from the Social Security system, to strengthen retirement savings, which we believe is the absolute right way to go.

Mr. PORTMAN. Well, I just think it's not much of a shift. I mean, it depends how much you're talking—you'd still have a defined benefit plan. The only question is whether you would voluntarily permit people to go into some—

Chairman ARCHER. Mr. Lewis.

Mr. LEWIS of Kentucky. Thank you, Mr. Chairman.

I just want to follow up on Mr. Portman's question with the U.S.A. accounts.

You talk about the U.S.A. accounts as being targeted tax cuts. But in the President's budget, it doesn't list U.S.A. accounts as tax cuts. Can you explain what you mean by—

Mr. LEW. The President's budget distinguished between the tax proposals that were financed and the tax proposals that were proposed to come out of the surplus. Our view is that any tax cuts, until we've addressed Social Security, should be paid for. And it's only in the context of using the surplus to address the Social Security financing problem that we should reach the question of, should a portion of the surplus be used for a tax cut?

In our framework for Social Security reform and long-term fiscal discipline, we do have a tax cut component, that is the U.S.A. account. It's in the budget in several places. I'd be happy to point you to it. It's not there integrated into the proposals for fiscal year 2000 in the same form as, say, the child care, the environmental bonds or the other tax provisions that we have, because it's not paid for.

And the sequence is important. The sequence to us matters very much because we think that we should deal with Social Security and only then deal with allocating the rest of the surplus.

The President never said 100 percent of the surplus should go to Social Security. He said we should save 100 percent of the surplus until we fix Social Security, and that's really why it is displayed separately. I think there's been a little confusion about that.

There are several proposals that are not in the body of the budget, the U.S.A. accounts and the discretionary spending, because it's part of the framework which has to be part of allocating the surplus.

Mr. LEWIS of Kentucky. Do you have an idea of who would manage the U.S.A. account?

Mr. LEW. Well, we think—

Mr. LEWIS of Kentucky. It's very important that it not be government-directed investment, that it be—that the U.S.A. accounts have to be set up so that individuals are making choices for themselves.

Mr. LEW. Now, the question of how they make the choices is one that we're working through. If one were to have unlimited choice, and the way anyone with an IRA account would, there's a real risk to the administrative cost. It would grow to the point that they really would eat up accounts until they grew large.

On the other hand, we know from our experience with the TSP, the Federal Thrift Savings Plan, the Federal Reserve Retirement Plan, a number of other retirement plans that we have a lot of familiarity with, that it's very possible to set up choices for individuals where they can pick either a bond fund or a stock fund.

What we're trying to do is find the right balance between choice on the part of the individual and controlling the administrative costs. And it would not, in any case, be government-directed investments. It would be the individual choosing the form of investment.

Mr. LEWIS of Kentucky. When do you expect to have more specifics on the U.S.A. accounts, hard specifics?

Mr. LEW. We are working on that now. To tell you the truth, we're ahead of schedule in terms of a normal budget cycle. Normally, those kinds of details don't come up until late spring, and we've made very good progress.

Frankly, the U.S.A. accounts are very substantial tax policy, and they are very complicated, and we're trying to get it right. We will

get a proposal put forward sooner rather than later. But I can't sit here today and say that it's finished.

We have been going through, in a very systematic way, reviewing the interaction with other tax provisions like 401(k)s, and how to design it so that it works. And we look forward to sending those details forward very shortly.

Mr. LEWIS of Kentucky. OK. Thank you.

Mr. SHAW [presiding]. I have just a couple of quick questions that I wanted to ask this panel before you're released. You've certainly put in enough time today, and we certainly appreciate it.

In doing your projections, you, as part of the surplus, invested directly from the trust fund into the private sector what figure?

Mr. APFEL. It was 20 percent—

Mr. SHAW. One-fifth, 20 percent.

Mr. APFEL. Of the surplus, which would mean that equities would amount to about 15 percent of the Social Security Trust Fund.

Mr. SHAW. All right. In doing that, I know you did some projections as to the growth of the trust fund because of adding private sector investments in it. Did you do some projections beyond the 15 or 20 percent? In other words, what would be the effect if you put a greater amount into private equities such as stocks and bonds in the private sector?

Mr. APFEL. I have not seen projections on—if the 15 percent, say, was 30 percent, is that what you're asking, if—

Mr. SHAW. Obviously, the reason that you went into equities was because it certainly gives you a tremendously increased return on your investment from a historical standpoint. And in doing so, I would guess that you tapped into several scenarios before you arrived at one. I'm sure you just didn't start with a 20 percent. I'm sure you went at various steps.

What was the result of those experiments? Did you find that the trust fund profited better by actually increasing the percentage of the investment of the surplus into equities?

Mr. APFEL. Well, if the percentage was, say, 30 percent, as opposed to 15 percent, that would resolve probably another 0.4 or 0.5 percent of payroll; in other words, another quarter or so of the long-term issue.

If you would like, Mr. Chairman, I could ask the actuaries to run, say, 30 percent, if that's a—

Mr. SHAW. I think it would be helpful to us because, obviously, I know that there is a great deal of controversy, particularly on the Democratic side, about getting involved at all in equities. And I think the President was very courageous in coming forward and putting a percentage of the trust fund into that, even though there's a great concern on my side of the aisle as to whether that should be done directly via the trust fund or be done in private savings accounts. Obviously, that's a line that we're going to have to discuss.

But, obviously, the President didn't do that unless he thought that it was going to get a lot better return on the FICA taxes that were being paid in. And I think it would be helpful to this Committee if you would submit for the record what the results of those

studies were, and it would be helpful to us in trying to craft legislation. And I would very much appreciate having that information.

Mr. APFEL. To put some perspective on it, the surplus transfer would resolve about 1 percent of taxable payroll of the total 2 percent of taxable payroll deficit. The 15 percent in equities resolved about 0.4 percent of taxable payroll, about, again—

Mr. SHAW. What did you use as the return on investment on equities as opposed to the 2 percent which you get on Treasury—

Mr. APFEL. It's about a 4-percent increase, $6\frac{3}{4}$ as opposed to 2.8. Both real.

Mr. SHAW. So it better than doubles the return.

Mr. APFEL. It doubles the real rate of return.

Mr. SHAW. That's interesting. I think that gives us some help. So I guess it would only be logical to say that if you invested one-fifth of it in equities, and you doubled your return, that you could certainly do a lot better by investing half of the surplus or even more, that your return would actually increase.

Mr. APFEL. Well, the—

Mr. SHAW. I don't see any way you could think otherwise.

Mr. APFEL. That's right. But I think that we appropriately set the balance at a very low level, at 15 percent, even though compared to State and local pensions, which now have gone from 40 percent to really 60 percent over the last decade, the concern has to do with overall size of the stock market that potentially could be affected.

The proposal assumes about four percent of the market would be held by the Social Security Trust Funds. If the percentage of trust fund investment in equities is up to 30 percent, or 40 percent, or 50 percent, that share goes up. We thought it made sense to keep it modest for the sake of an appropriate balance. But we will get the actuarial projections for you, I would hope within a very short period of time, say, at 30 percent, what that revenue stream would be over the 75 years.

Mr. SHAW. OK.

Mrs. JOHNSON of Connecticut. Would the Chairman yield?

Mr. SHAW. It would be very helpful.

Yes, I would yield.

[The following was subsequently received:]

LONG-RANGE OASDI FINANCIAL EFFECTS OF MODIFYING THE PRESIDENT'S PROPOSAL TO INVEST 30 PERCENT OF TRUST FUND ASSETS IN STOCKS ¹

Under the President's proposal, 21 percent of the amount transferred in each year 2000 through 2014 would be used to purchase stocks. All dividends would be reinvested in stocks until the market value of all stocks held by the OASDI Trust Funds reaches 14.6 percent of total OASDI Trust Fund assets. Thereafter, the percentage of total OASDI Trust Fund assets that is held in stocks would be maintained at 14.6 percent. The average percentage of the total stock market value held by the OASDI Trust Fund over the period 2001–2040 is estimated as 3.7 percent.

A higher percentage of the total stock market value would be held by the OASDI Trust Funds if the President's proposal were modified to allow:

- 40 percent of the amount transferred in each year to be used to purchase stocks, and
- 30 percent of total OASDI Trust Fund assets to be held in stocks.

¹All estimates are provided by the SSA Office of the Actuary, and are based on the intermediate assumptions of the 1998 OASDI Trustees Report.

Under these modifications, the average percentage of the total stock market value held by the OASDI Trust Funds over the period 2001–2040 is estimated as 8.4 percent.

In addition, under these modifications of the President's proposal, the year in which the combined OASDI Trust Funds would become exhausted would be extended an additional 10 years from the year projected under the President's proposal, from 2055 to 2065. The long-range actuarial deficit would be reduced an additional 0.45 percent of taxable payroll. Thus, the long-range actuarial deficit estimated as 2.19 under present-law is reduced to 0.75 under the President's proposal and is further reduced to 0.30 under these modifications of the President's proposal.

Mrs. JOHNSON of Connecticut. It would be helpful when you—if you do those runs and give us some information about that. You know, of the 62 percent of the surplus that you want to set aside for Social Security, 82 percent of that 62 percent is FICA taxes. So they are literally already set aside.

So what we're looking sort of is at that 18 percent of the 62 percent that we have to fill in. So we need to know how much of that we can fill in, that what it would take—what would it take to fill in the hole, that hole wedge left through higher yields? It would be interesting to know that.

What percentage would you need to get up to? Because that's—we're really talking about a rather precise and narrower number than we are talking about publicly. And I'd appreciate it if we'd do a run and find out what that—

Mr. APFEL. What's that outer bound for—

Mrs. JOHNSON of Connecticut. So what is the outer bound? If you're going to get to the 62 percent, recognizing that 82 percent of that is already FICA taxes, so that's already Social Security money.

Mr. APFEL. Actually about 70 percent is FICA taxes. In other words, if we look out 30 years from now—

Mrs. JOHNSON of Connecticut. In the 5—right, in the first 5-year window it's 82 percent, I think. But, so that if you look at, what do you have to do to get up to 62 percent? if you can get up to 62 percent through FICA tax earnings, then you're not putting any general revenue fund into it.

And so we at least need to know what would it take to do that, because then you don't have to get into this issue of diverting general revenue funds, which effectively, for future generations, is a tax increase because it's diverting more of the tax dollars from the support programs for them to support programs for the other generation.

Mr. APFEL. Mrs. Johnson, we can do a run that shows no surplus transfers and some equity investments. Those numbers shrink in terms of their implications, because with surplus transfer the trust fund is larger, and, therefore, the amount of the long-term—

Mrs. JOHNSON of Connecticut. Well, I don't mind including the benefits of using surplus to buy down the debt. That's still a little different. But FICA taxes are a different status of revenue, and earnings on FICA taxes are also a little different status, and they have a little different command on our Federal budget. And it does avoid this issue of Social Security becoming dependent on FICA taxes and general revenues.

So I'd just like to know, what would it take—what percentage of the surplus would—of all of the money that's going to come into Social Security, which you have to invest in the private market, not just the current Social Security, the money—the percentage of that surplus, which is already FICA taxes coming in—I think you get my meaning, even if I'm not very—

Mr. APFEL. If I don't have it exactly right, we will reach out to you tomorrow to get the exact framework.

[The following was subsequently received:]

MODIFICATING THE PRESIDENT'S PROPOSAL TO ELIMINATE THE OASDI LONG-RANGE ACTUARIAL DEFICIT²

Under the President's proposal, 21 percent of the amount transferred in each year 2000 through 2014 would be used to purchase stocks. All dividends would be reinvested in stocks until the market value of all stocks held by the OASDI Trust Funds reaches 14.6 percent of total OASDI Trust Fund assets. Thereafter, the percentage of total OASDI Trust Fund assets that is held in stocks would be maintained at 14.6 percent. The average percentage of the total stock market value held by the OASDI Trust Funds over the period 2001–2040 is estimated as 3.7 percent.

To eliminate the OASDI long-range actuarial deficit, the following modifications to the President's proposal are proposed:

- 60 percent of the amount transferred in each year be used to purchase stocks, and
- 40 percent of total OASDI Trust Fund assets be held in stocks.

Under these modifications of the President's proposal, the long-range actuarial deficit would be eliminated. The combined OASDI Trust Funds would rise to a peak of 782 percent of annual cost for 2016, declining thereafter, and reaching a level of 111 percent of annual cost at the end of the long-range period (end of 2072). The average percentage of the total stock market value held by the OASDI Trust Funds over the period 2001–2040 is estimated as 12.6 percent.

Mr. SHAW. Perhaps it would be helpful—if as you raise the amount of investment in equities, to get that information as to what percentage of the surplus is necessary to accomplish the same result? Obviously, that's going to go down because the return on your investment is going to go up. So I think it would be very helpful to this Committee in drafting this legislation.

I want to thank you both for staying with us. This panel has gone on far longer than any of us had expected, but I think it's been a very good use of our time.

I thank both you gentlemen for being with us.

We've lost a couple of witnesses because of the lateness of the hour, and we've lost a great deal of our Members because of the lateness of the hour. But I'd like to call the next two panels together.

We've got the Honorable David Walker, who is Comptroller General of the United States General Accounting Office. We have Daniel Crippen, Director of the Congressional Budget Office; Barry Anderson, Deputy Director of the Congressional Budget Office. And a former Member and former Member of this Committee, Bill Frenzel, who cochairs the Committee for a Responsible Federal Budget.

I believe both Mr. Gramlich and Mr. Blinder have both had to leave. If I'm incorrect about that, please come forward.

²All estimates are provided by the SSA Office of the Actuary, and are based on the intermediate assumptions of the 1998 OASDI Trustees Report.

And the people that cannot stay to testify are certainly—we look forward to and will place their testimony in the record. And I'd like to tell all of the witnesses that we have your full testimony that will be made a part of the record, and you may summarize as you see fit.

Mr. SHAW. Mr. Walker.

**STATEMENT OF HON. DAVID M. WALKER, COMPTROLLER
GENERAL, U.S. GENERAL ACCOUNTING OFFICE**

Mr. WALKER. Mr. Chairman.

Mr. SHAW. Welcome to our Committee.

Mr. WALKER. Thank you, Mr. Chairman. It's a pleasure to be here, and to be able to speak to you about two important topics.

First, what to do with the temporary budget surpluses that are projected; and, second, what to do about Social Security reform.

Specifically, I've been asked to present the GAO's views of the President's proposals in connection therewith.

And let me say at the outset, Mr. Chairman, just for the benefit of the Members that are here, in addition to being Comptroller General of the United States at the present point in time, I'm a former trustee of Social Security and Medicare for 5 years under both President Bush and President Clinton's administrations, as well as an Assistant Secretary of Labor for ERISA. So, therefore, retirement security is an issue that I've been involved with for many years and probably—

Mr. SHAW. And also a former member of a very fine accounting firm, Arthur Andersen.

Mr. WALKER. Thank you very much, Mr. Chairman.

If I can, let me start with the proverbial bottom line, because I realize Members have to come and go. With regard to the President's proposal, from our perspective, on the positive side the President takes a long-term view on what should be done with this temporary surplus, which is important given the tremendous demographic tidal wave that faces us and that will come.

Second, the President proposes to reduce debt held by the public, and this will increase our future economic capacity to deal with future demands. That's on the plus side.

However, the President proposes two fundamental changes in Social Security financing. First, an infusion of a significant amount of general fund commitments to back Social Security in the form of a grant of additional securities; and, second, a modest investment in equities in order to try to enhance long-term returns associated with the defined benefit portion of the program.

In addition, and probably most importantly, while the President is proposing Social Security financing reform, the President has not proposed any fundamental programmatic restructuring. Such programmatic restructuring is essential in order to "save Social Security."

If I can proceed, Mr. Chairman, we have some flipcharts, and what I'll try to do is try to graphically display some of these important points for the Members of the Committee.

Let me, if I can, start off with how Social Security and the unified budget works right now, because it is somewhat complex and

sometimes a graph can say a thousand words. If you look at the circle around figure 1, you'll see that represents the unified budget.

On the left-hand side you'll see the Social Security budget account. What happens in Social Security is you have primarily payroll taxes coming in, you have benefit payments and administrative expenses going out, and, to the extent that there is a surplus, a FICA surplus primarily, it is lent—a loan to the Treasury. Specifically, the excess cash is sent to the general fund, and the general fund gives notes back to the budget account, to the trust fund, special issue, nonmarketable U.S. Government securities, which represent a claim on future taxpayers for future revenues.

Then you look at the general fund, of which, keep in mind, Social Security, from a budget standpoint, is a part of the overall unified budget. You look at the results of operations for the general fund, which includes both mandatory and discretionary spending. And, as we know, mandatory spending now represents about 70 percent of the budget. That's up from about 30 percent when John F. Kennedy was President. And it's increasing every year.

To the extent that there are excess cashflows on a consolidated basis, you have a unified surplus. And what happens if you have a unified surplus is debt held by the public is paid down. In fact, that's what happened in fiscal 1998. We ran a unified surplus, and, as a result, debt held by the public was paid down by \$50 billion.

Figure 2 demonstrates what the President is proposing to do. What the President is proposing to do is the same thing that I just described with a couple of adjustments. He is proposing to transfer—a supplemental transfer to the trust fund. That supplemental transfer would be equal to 62 percent of the unified budget surplus projected over a 15-year period.

That transfer would come in two forms, in effect. Number one, a purchase of equities that would accumulate over time, hopefully with enhanced returns. And, second, a grant, or, as the President has said, a gift of additional securities which represent future claims that have to be satisfied through either increased taxes, reduced spending, or increased borrowing from the public. That is what is being proposed.

The President is proposing to reduce debt held by the public from 44 percent of GDP to 7 percent, over a 15-year period. That would be a significant accomplishment. We've testified before about how paying down publicly held debt lowers interest rates, leads to larger surpluses, leads to lower debt, and that's a virtuous economic circle which serves to enhance economic capacity.

Lower debt levels will increase national saving, free up resources for private investment, increase productivity and economic growth, which will result in an enhanced standard of living for American workers.

And figure 3 shows an example. If you look at an on-budget balance scenario—and, by the way, on page 10, I believe it is, of my written statement for the record, Mr. Chairman, footnote 5 provides the details of what these three scenarios are. If you look at an on-budget balance scenario, a save-the-surplus scenario, or a spend-the-surplus scenario, you'll see that for the first two we have increasing per capita GDP. And, as a result, our standard of living continues to improve for American workers.

If, on the other hand, the surplus is spent, then there will be a dramatic reduction in per capita GDP, based on constant dollars, such that there will ultimately be a declining standard of living.

A lot has been talked about debt, and I think it's important that one recognizes that there are two types of debt that we've been talking about. There is debt held by—debt owed to—the public, which represents a current burden and which competes in current markets that affect interest rates. And then there's debt owed by one governmental account to another governmental account—or debt held by the trust funds—which represents a future claim on the general fund which must be satisfied at some point in time.

Now, I'm going to show on the left-hand side the composition of debt. I'm going to first talk about debt held by the public on the left, and then, on the right, debt held by the trust funds. There are the two types of debt. The combination of these two equal total debt subject to the debt limit.

If you can see, there is a reduction in debt held by the public under all three scenarios. But the biggest reduction comes under the status quo. If the Congress had the discipline not to spend the surplus, or otherwise cause it to evaporate, then the debt held by the public would actually go down further than is being proposed by the President. That is of what happened in fiscal 1998.

On the other hand, the debt held by the trust fund will go up no matter whether the President's proposal is adopted or not, because under current law all surpluses in Social Security must be invested in government securities. And, therefore, to the extent that you have a positive cashflow for Social Security, which is part of that unified budget surplus, by definition trust fund debt will go up.

Now, it is true that trust fund debt will go up more dramatically under the President's proposal because the President is proposing a grant—equal to a significant part of the unified budget surplus—in the form of additional Treasury securities that would be given to Social Security above and beyond what would be due under current law.

The President, in effect, has seemed to merge two key policy questions. First, how much of the surplus should be devoted to reducing debt held by the public? And, second, how should the nation finance the Social Security system? They are not inherently linked.

In particular, the issue of deciding to grant additional securities to the Social Security Trust Fund is separate and distinct from paying down publicly held debt, and they really have little to do with each other.

Importantly, Mr. Chairman, and Members of the Committee, I've noted in our written statement that we're not the only democracy to face this challenge, meaning the challenge of temporary surpluses followed by demographic tsunami that—we will have to deal with at some point in time.

There are other nations that have faced this, and they dealt with it in various ways. And I would commend to you in my statement some examples of what other countries have done in order to try to deal with a similar challenge. We believe it's instructive to look at them.

If we can look at Social Security now, importantly, yes, the President proposes financing changes for Social Security through the modest stock market investment as well as the additional grants of additional Treasury securities. But he has not proposed underlying Social Security program reform. As a result, the structural imbalance and cashflows in Social Security has not been affected.

Figure 7 represents the projected cashflows in the Social Security part of the budget and in the trust funds. The solid line represents the expenditures; the dotted line, the revenue. Today we have surpluses. In the year 2013, we will begin to have cashflow deficits. That is the key date—2013, not 2032, not 2049, not 2055, it's 2013.

Now, I could put up another chart here that shows what the cashflows will be like after the President's proposal. However, I don't need to do that because they are the same with one modest footnote. The President is proposing to invest a portion of this unified surplus in equities, which should result in additional dividend income and some enhanced cashflows, which he proposes to use primarily in the outyears to extend solvency from 2049 to 2055.

I think it's important to note that the cashflow picture does not change, that we face significant deficits in the future. Now I would like to demonstrate the need for structural change.

There is no free lunch. Saving Social Security will require fundamental reform to the Social Security program in order to assure that the program is fiscally sound and sustainable. We must do that. Financing reform might be part of a solution, but it won't get the job done by itself.

We need fundamental program reform, and we need it sooner rather than later, because the longer we wait, the tougher and more dramatic it will have to be. And, quite frankly, Social Security reform is easy lifting, believe it or not, when you compare it to some of our other challenges like Medicare reform.

Figure 8 demonstrates the need. If we look on the right, you'll see under a scenario where we save all the projected surplus, that by year 2030, under our projections, which are generally similar to CBO's economic model as well, there is a significant hair cutting of discretionary spending in the year 2030, and all discretionary spending is eliminated by the year 2050. Now, that's if we save the surplus.

Importantly, discretionary spending includes such things as national defense, the judicial system, infrastructure, youth programs. On the other hand, if you look at figure 9, if we spend the surplus, then we reach a total crowding out of discretionary spending by the year 2030.

Ladies and gentlemen, what we face here is temporary surpluses and a demographic tsunami—a tidal wave. This demonstrates that. We must be prudent today in order to take the actions necessary to provide ourselves more flexibility in future years.

I have provided in my statement, Mr. Chairman, some principles of reform that the Congress may want to consider in moving forward in Social Security. I have also provided in my statement some questions that the Congress may wish to ask and seek to get answers to in connection therewith.

In closing, let me end where I started. The President proposes to reduce debt held by the public, which is good. The President pro-

poses to fundamentally change Social Security financing in a very dramatic manner, which deserves serious attention and considered debate. The President has not proposed Social Security program reform. He has proposed financing reform. Fundamental program reform will be essential in order to save Social Security, to make it financially secure and sustainable for future generations.

Mr. Chairman, the GAO stands ready to help this Committee and the Congress address this and other challenges in a way that will make a positive and lasting difference for American citizens. Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Hon. David M. Walker, Comptroller General, U.S. General Accounting Office

Mr. Chairman and Members of the Committee:

It is a pleasure to be here today to discuss the President's recent proposal for addressing Social Security and use of the budget surplus. These proposals address some of the most important issues facing the nation, both now and over the longer term. As you know, both GAO as an institution and I as an individual have a long-standing interest in these issues.

The President's proposal is complex, which makes it all the more important for us to focus our attention on what it does—and what it does not do—for our long-term future. In summary, the President's proposal:

- Reduces debt held by the public from current levels, thereby also reducing net interest costs, raising national saving, and contributing to future economic growth.
- Fundamentally changes Social Security financing in two ways:
 - It promises general funds in the future by, in effect, trading publicly held debt for debt held by the Social Security Trust Fund (SSTF).
 - It invests some of the trust fund in equities with the goal of capturing higher returns over the long term.
- Does not have any effect on the projected cash flow imbalance in the Social Security program's taxes and benefits which begins in 2013
- Does not represent a Social Security reform plan and does not come close to "saving Social Security."

CONTEXT: LONG-TERM OUTLOOK IS IMPORTANT

It is important to look at the President's proposal in the context of the fiscal situation in which we find ourselves. After nearly 30 years of unified budget deficits, we look ahead to projections for "surpluses as far as the eye can see." At the same time, we know that we face a demographic tsunami in the future that poses significant challenges for the Social Security system, Medicare, and our economy as a whole. In this context, we should recognize that the President uses a longer-term framework for resource allocation than has been customary in federal budgeting.

Although all projections are uncertain—and they get more uncertain the farther out they go—we have long held that a long-term perspective is important in formulating fiscal policy for the nation. Each generation is in part the custodian for the economy it hands the next and the nation's long-term economic future depends in large part on today's budget decisions. This perspective is particularly important because our model and that of the Congressional Budget Office (CBO) continue to show that absent a change in policy, the changing demographics to which I referred above will lead to renewed deficits. This longer-term problem provides the critical backdrop for making decisions about today's surpluses.

Surpluses are the result of a good economy and difficult policy decisions. They also provide a unique opportunity to put our nation on a more sustainable path for the long term, both for fiscal policy and the Social Security program itself. Current decisions can help in several important respects: (1) current fiscal policy decisions can help expand the future capacity of our economy by increasing national savings and investment, (2) engaging in substantive reforms of retirement and health programs can reduce future claims, (3) by acting now, we have the opportunity of phasing in changes to Social Security and health programs over a sufficient period of time to enable our citizens to adjust, and (4) failure to achieve needed reforms in the Social Security and Medicare programs will drive future spending to unsustainable levels and eventually "squeeze out" most or all discretionary spending. If we let the achievement of a budget surplus lull us into complacency about

the budget, then in the middle of the 21st century, we could face daunting demographic challenges without having built the economic capacity or program/policy reforms to handle them.

THE PROPOSAL

Before turning to the context for and analysis of the President's proposal, let me briefly describe it. The President proposes to use approximately two-thirds of the total projected unified budget surpluses over the next 15 years to reduce debt held by the public and to address Social Security's financing problem. His approach to this, however, is extremely complex and confusing. The President proposes to "transfer" an amount equal to a portion of the projected surplus to the Social Security and Medicare trust funds.¹ This transfer is projected to extend the solvency of Social Security from 2032 to 2049. His proposal to permit the trust fund to invest in equities is expected to further extend trust fund solvency to 2055. He calls on Congress to work with him on program changes to get to 2075.

To understand and evaluate this proposal it is important to understand the nature of the federal budget, how trust funds fit into that budget, and the challenges of "saving" within the federal budget.

CAN WE SAVE FOR THE FUTURE IN THE FEDERAL BUDGET?

The federal budget is a vehicle for making choices about the allocation of scarce resources. It is different from state budgets in ways important to this discussion. Most states use "fund budgeting" in which pension funds that are separate and distinct legal entities, build up surpluses that are routinely invested in assets outside the government (e.g. readily marketable securities held in separate funds). In contrast, the federal government's unified budget shows all governmental transactions and all funds are available for current activities, including current-year activities of all trust funds. We cannot park our surplus in a cookie jar. The only way to save in the federal budget is to run a surplus or purchase a financial asset. When there is a cash surplus it is used to reduce debt held by the public. Therefore, to the extent that there is an actual cash surplus, debt held by the public falls.

This presents a problem for any attempt to "advance fund" all or part of future Social Security benefits. Advance funding within the current program would mean increasing the flows to the SSTF. Although it is officially "off budget," the fact remains that the SSTF is a governmental fund. In the federal budget, trust funds are not like private trust funds. They are simply budget accounts used to record receipts and expenditures earmarked for specific purposes. A private trust fund can set aside money for the future by increasing its assets. However, under current law, when the SSTF's receipts exceed costs, they are invested in Treasury securities and used to meet current cash needs of the government. These securities are an asset to the trust fund, but they are a claim on the Treasury. Any increase in assets to the SSTF is an equal increase in claims on the Treasury. One government fund is lending to another. The transactions net out on the government's books. Given this investment policy, any increase in the trust fund balances would only become an increase in saving if this increment were to add to the unified budget surplus (or decrease the unified budget deficit) and thereby reduce the debt held by the public. This is also the only way in which an increase in the SSTF balance could be a form of advance funding.

How do these transactions affect the government's debt? Gross federal debt is the sum of debt held by the public and debt held by governmental accounts—largely trust funds. This means that increases in the trust fund surplus will increase gross debt unless debt held by the public declines by at least the same amount. Any reform of Social Security that increases the annual SSTF surplus would increase debt held by government accounts since, under current law, any excess of revenues over benefit payments is loaned to Treasury for current needs. As a result, total government debt would go up unless these surpluses were used to reduce debt held by the public by an equivalent amount.

For most people, the different types of "debt" in the federal budget may be confusing—especially since what is "good news" for a trust fund may be "bad news" for total debt and vice versa. This is so because total debt (or gross debt) is the sum of two very different types of debt—debt owed to the public and debt owed by one part of the government (general fund) to another part of the government (trust funds). Therefore, if a trust fund surplus grows faster than debt held by the public

¹In this testimony, I will address only the Social Security portion of this transfer. The issues are similar but not identical for the Medicare trust fund transfer.

falls, total debt grows—even if the trust fund surplus is created as an attempt to “save” or to “pre-fund” some of the future benefit payments. These contradictory movements emphasize the need to differentiate between different types of debt and what they mean. Both debt held by the public and debt held by trust funds are important—but for different reasons. Analytically, therefore, what is most important is not whether total debt increases but rather the reasons behind the increase—does it represent an attempt to “advance fund” through substantive reform or merely the promise of future resources?

Debt held by the public and debt held by trust funds represent very different concepts. Debt held by the public approximates the federal government’s competition with other sectors in the credit markets. This affects interest rates and private capital accumulation. Further, interest on debt held by the public is a current burden on taxpayers. Reducing this burden frees up capacity to meet future needs.

In contrast, debt held by trust funds performs an accounting function and currently represents the cumulative annual surpluses of these funds (i.e., excess of receipts over disbursements plus accrued interest). Importantly, debt held by the SSTF does not represent the actuarial present value of expected future benefits for either current or future participants. Nor does this debt have any of the economic effects of borrowing from the public. It is not a current transaction of the government with the public; it does not compete with the private sector for available funds in the credit market. It reduces the need to borrow from the public and so may hold down interest rates. Unlike debt held by the public, debt held by trust funds does not represent an immediate burden on current taxpayers. Rather, it is a claim on future resources. The surplus is held in Treasury securities which give the SSTF a claim on the Treasury equal to the value of those securities. When the securities have to be redeemed, the Treasury must come up with the cash. At that time taxpayers will see some combination of a lower surplus, lower spending, higher taxes and/or greater borrowing from the public.

If borrowing from the public is increased to cover this cash need, there could be upward pressure on interest rates. In addition, because debt held by the trust fund is not equal to future benefit payments—it is not a measure of the unfunded liability of the current system—it cannot be seen as a measure of this future burden. Nevertheless, it provides an important signal of the existence of this burden. Whether the debt constitutes a new economic burden for the future or merely recognizes an existing one depends on whether these currently-promised benefits would be paid even in the absence of the securities.

HOW DOES THE PRESIDENT’S PROPOSAL WORK?

This information is important to understand the President’s proposal because in large part he proposes a set of transactions that, in effect, trade debt held by the public for debt held by the SSTF.² By running a cash surplus over the next 15 years, debt held by the public falls. To “save” this surplus, the President proposes to “transfer” it to the trust fund in the form of increased Treasury securities. Under his proposal, debt held by the public falls, but debt held by the trust funds increases. Because he shows the transfer as a subtraction from the surplus—a new budgetary concept—he shows no surplus. As a result, he attempts to save some of the projected surplus by hiding it.

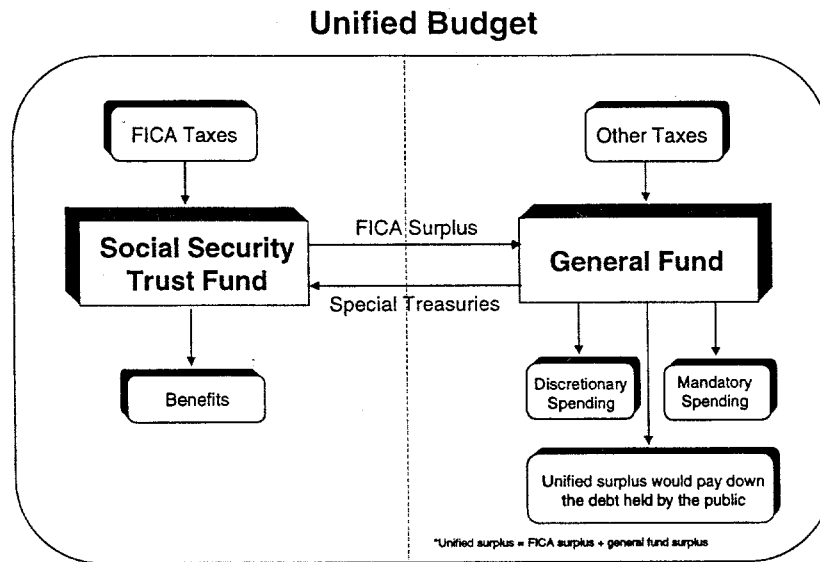
The mechanics of the proposed transfer of surpluses to the SSTF are complex and difficult to follow. Few details have been made available, and there is conflicting information on exactly how it would work. Figures 1 and 2 are flow charts representing our best understanding of the Social Security portion of this transfer. Since it is impossible to understand the changes proposed by the President without understanding the present system, figure 1 shows the flows under the current system. Under current law, annual cash flow surpluses (largely attributable to excess payroll taxes over benefits payments and program expenses) are invested in Treasury securities.³ This excess “cash” is commingled with other revenues and used to finance other governmental activities. In this way, SSTF surpluses have helped and continue to help finance the rest of the government. This year, the SSTF surplus is expected to exceed the general fund deficit so there is also a surplus in the unified

² Paying down publicly held debt and issuing new special securities to the SSTF are two different transactions. Nevertheless, the effect is as if the securities are exchanged.

³ This presentation is somewhat simplified. In reality, FICA taxes are collected with income and corporate taxes by the Treasury and then allocated by the Treasury to Social Security, Medicare, or the general fund. In addition, a portion of income taxes paid on Social Security benefits flow into the SSTF. The expenditure side of the SSTF transactions is also simplified since administrative expenses also flow from the trust fund. These elements are unchanged by the President’s proposal and do not change the flows critical to understanding it.

budget. Over the entire 15-year period, more than half of the projected unified surplus is composed of Social Security surpluses. Absent any change in policy, these unified surpluses will be used to reduce the debt held by the public.

Figure 1: Current Social Security Flows

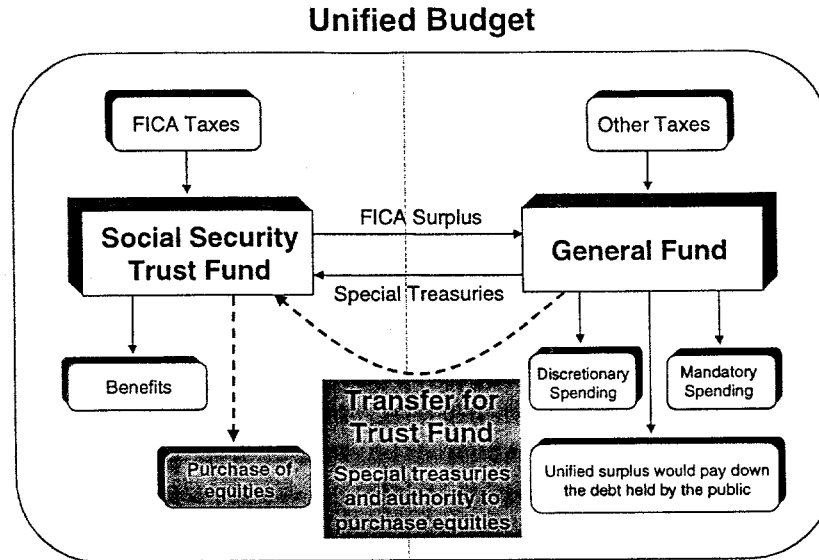


Source: GAO Analysis

Source: GAO Analysis

Under the President's proposal, this would continue. However, as shown in figure 2, at the point where total tax receipts are allocated to pay for government activities, a new financing step would be added to "transfer" a portion of the unified budget surpluses to the Social Security and Medicare trust funds. The unified budget would do this by providing a new set of securities for these trust funds. However, the excess cash would still be used to reduce the debt held by the public.

Figure 2: Social Security Flows Under President's Proposal



Source: GAO Analysis

In essence, this exchanges debt held by the public for debt held by the trust funds. While there are many benefits to reducing publicly held debt, it is important to recognize that under the current law baseline—i.e., with no changes in tax or spending policy—this would happen without crediting additional securities to the trust funds.

The administration has defended this approach as a way of assuring both a reduction in debt held by the public and giving Social Security first claim on what they call the “debt-reduction dividend” to pay future benefits.

However, issuing these additional securities to the SSTF is a discretionary act with major legal and economic consequences for the future. Some could view this as double counting—or double-crediting. Importantly, to the extent it appears that way to the public, it could undermine confidence in a system that is already difficult to explain. However, the debate over double counting focuses on the form of the proposal rather than its substance. Although form is important when it interferes with our ability to understand the substance—and I think this proposal falls into that trap—the important debate must be on the substance of the proposal.

This proposal represents a fundamental shift in the way the Social Security program is financed. It moves it away from payroll financing toward a formal commitment of future general fund resources for the program. This is unprecedented. Later in my statement, I will discuss the implications of this proposal for overall fiscal policy and for the Social Security program.

GOVERNMENT FINANCING AND DEBT

The President's proposals would have the effect of reducing debt held by the public from the current level of 44 percent of Gross Domestic Product to 7 percent over the 15-year period. The President notes that this would be the lowest level since 1917. Nearly two-thirds of the projected unified budget surplus would be used to reduce debt held by the public. Because the surplus is also to be used for other governmental activities, the amount of debt reduction achieved would be less than the baseline (i.e. a situation in which none of the surplus was used), but nonetheless the outcome would confer significant benefits to the budget and the economy.

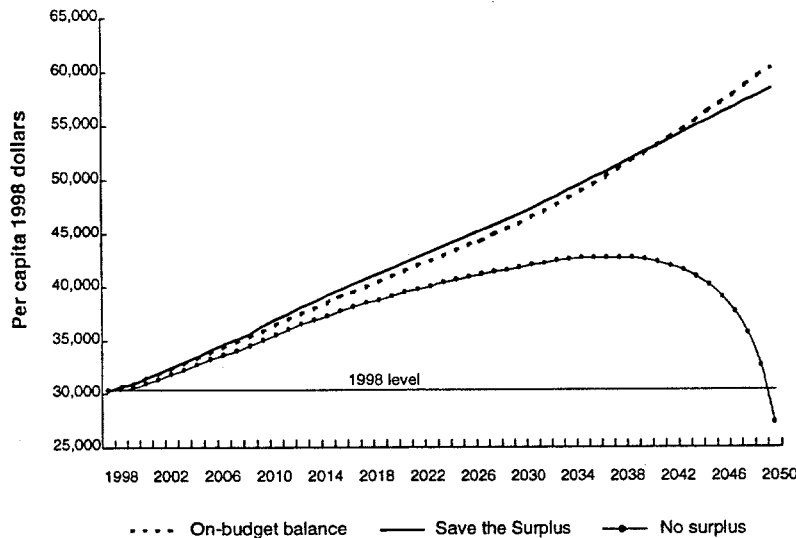
Our previous work on the long-term effects of federal fiscal policy has shown the substantial benefits of debt reduction.⁴ One is lowering the burden of interest pay-

⁴ *Budget Issues: Analysis of Long-Term Fiscal Outlook* (GAO/AIMD/OCE-98-19, October 22, 1997).

ments in the budget. Today net interest represents the third-largest “program” in the budget, after Social Security and Defense. Interest payments, of course, are a function of both the amount of debt on which interest is charged and the interest rate. At any given interest rate, reducing publicly held debt reduces net interest payments within the budget. For example, CBO estimates that the difference between spending the surplus and saving the surplus is \$123 billion in annual interest payments by 2009—or almost \$500 billion cumulatively between now and then. Compared to spending the entire surplus, the President’s proposal would also substantially reduce projected interest payments. Lower interest payments lead to larger surpluses; these in turn lead to lower debt which leads to lower interest payments and so on: the miracle of compound interest produces a “virtuous circle.” The result would be to provide increased budgetary flexibility for future decisionmakers who will be faced with enormous and growing spending pressures from the aging population.

For the economy, lowering debt levels increases national saving and frees up resources for private investment. This in turn leads to increased productivity and stronger economic growth over the long term. Over the last several years, we and CBO have both simulated the long-term economic results from various fiscal policy paths. These projections consistently show that reducing debt held by the public increases national income over the next 50 years, thereby making it easier for the nation to meet future needs and commitments. Our latest simulations done for the Senate Budget Committee, as shown in figure 3, illustrate that any path that saving all or a significant share of the surplus in the near term would produce demonstrable gains in per capita GDP over the long run.⁵ This higher GDP in turn would increase the nation’s economic capacity to handle all its commitments in the future.

Figure 3: GDP Per Capita Under Alternate Fiscal Policy Simulations

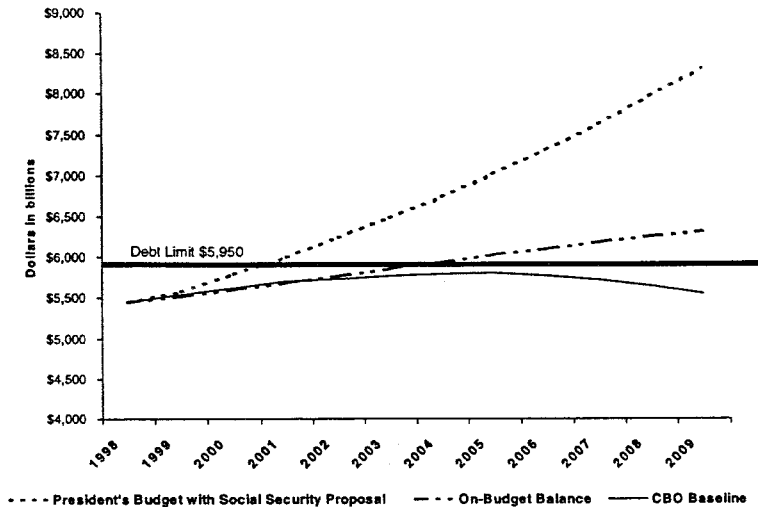


Under the President’s proposal, debt held by trust funds goes up more rapidly than debt held by the public falls, largely due to these additional securities trans-

⁵The “On budget balance” path assumes that any surplus in the non Social Security part of the budget is “spent” on either a tax cut or spending increases or some combination but assumes the current law path for the Social Security trust fund. Thus the surplus in the Social Security trust fund remains untouched until it disappears in 2013 after which the unified budget runs a deficit equal to the SSTF deficit. The “Save the Surplus” path assumes no changes in current policies and that budget surpluses through 2024 are used to reduce debt held by the public. The “No Surplus” path assumes that permanent increases in discretionary spending and tax cuts deplete the surpluses but keep the budget in balance through 2009. Thereafter, deficits re-emerge as spending pressures grow.

ferred to the trust funds. Gross debt, therefore, increases. It is gross debt—with minor exceptions—that is the measure that is subject to the debt limit. The current limit is \$5.95 trillion. Under the President's plan, the limit would need to be raised sometime during 2001. Under either the CBO or the Office of Management and Budget baseline (i.e., save the entire surplus), the limit would not need to be raised during at least the next 10 years. Since other proposals to use the surplus would also bring forward the time when the debt limit would have to be raised, the impact of the President's proposal on debt is in part a "compared to what?" question. In figure 4 we show the debt subject to limit under the baseline, the President's proposal, and a hypothetical path we have labeled "on-budget balance."⁶

Figure 4: Debt Subject to Limit Under Baseline and President's Proposal

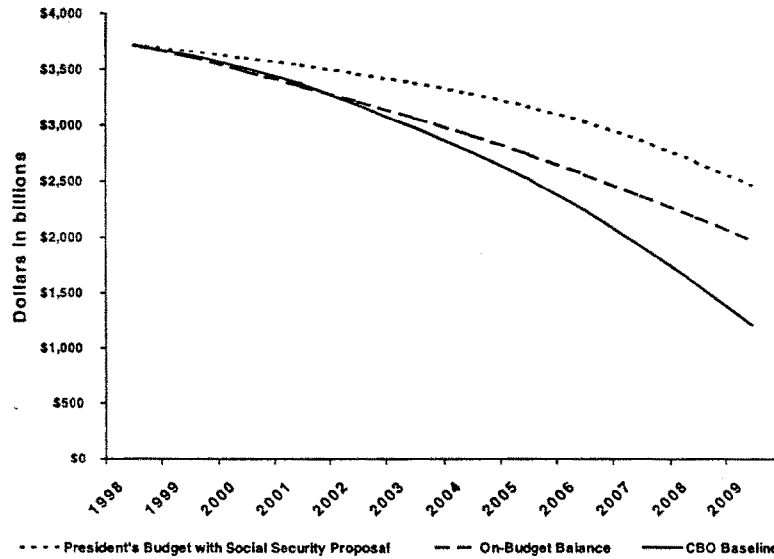


Source: OMB, CBO, Senate Budget Committee, and GAO Analysis.

Figures 5 and 6 below compare the composition of debt under the same three paths: the baseline (save the entire surplus), the President's proposal (including both the Social Security proposal and the other spending), and "on-budget balance." Figure 5 shows debt held by the public under all three scenarios and Figure 6 shows debt held by governmental accounts.

As figure 5 shows, debt held by the public falls under all three scenarios. Since the baseline assumes the entire surplus is devoted to reducing debt held by the public, it shows the greatest drop. Under the "on-budget balance" path there are no tax cuts or spending increases until there is an on-budget balance in 2001 while under the President's proposal spending increases and tax cuts are front-loaded. As a result, the President's proposal is projected to reduce debt held by the public less than the "on budget balance" path during these 10 years.

⁶The baseline is the CBO baseline. It assumes that none of the surplus is used for tax cuts or spending increases. "On budget balance" assumes that any surplus in the non Social Security part of the budget is "spent" on either a tax cut or spending increases or some combination but that the surplus in the Social Security trust fund remains untouched. There is no "on-budget" surplus until 2001.

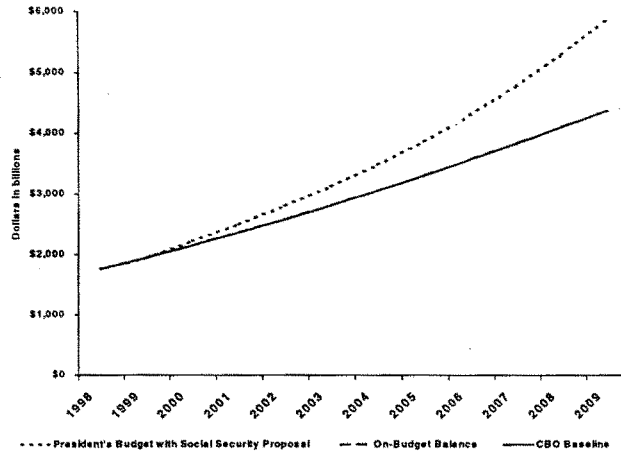
Figure 5: Composition of Federal Debt: Debt Held by the Public

Source: OMB, CBO, Senate Budget Committee, and GAO Analysis.

Figure 6 shows the impact of the President's proposal to transfer securities to the SSTF. The projections for debt held by government accounts are the same for the baseline and the "on-budget balance" paths since neither changes current law. Under the President's proposal, however, debt held by the SSTF increases as securities are transferred to it. This leads to the increase shown in figure 6.

While reducing debt held by the public appears to be a centerpiece of the proposal—and has significant benefits—as I noted above, the transfer of unified surpluses to Social Security is a separate issue. The transfer is not technically necessary: whenever revenue exceeds outlays and the cash needs of the Treasury—whenever there is an actual surplus—debt held by the public falls. The President's proposal appears to be premised on the belief that the only the way to sustain surpluses is to tie them to Social Security. He has merged two separate questions: (1) how much of the surplus should be devoted to reducing debt held by the public; and, (2) how should the nation finance the Social Security program in the future.

Let me turn now to the question of Social Security financing.

Figure 6: Composition of Debt: Debt Held by Government Accounts

Source: OMB, CBO, Senate Budget, and GAO analysis.

Note: Debt held by government accounts is the same under CBO baseline and the on-budget balance path.

SOCIAL SECURITY FINANCING

The President proposes two changes in the financing of Social Security: a pledge of general funds in the future and a modest amount of investment in equities. Both of these represent major shifts in approach to financing the program.

GENERAL FUND FINANCING

By, in effect, trading debt held by the public for debt held by the trust funds, the President is committing future general revenues to the Social Security program. This is true because the newly transferred securities would be in addition to any buildup of payroll tax surpluses. Securities held by the SSTF have always represented annual cash flows in excess of benefits and expenses, plus interest.⁷ Under the President's proposal, this would no longer continue to be true. The value of the securities held by the SSTF would be greater than the amount by which annual revenues plus interest exceed annual benefits and expenditures.

This means that for the first time there is an explicit general fund subsidy. This is a major change in the underlying theoretical design of this program. Whether you believe it is a major change in reality depends on what you assume about the likely future use of general revenues under the current circumstances. For example, current projections are that in 2032 the fund will lack sufficient resources to pay the full promised benefits. If you believe that this shortfall would—when the time came—be made up with general fund moneys, then the shift embedded in the President's proposal merely makes that explicit. If, however, you believe that there would be changes in the benefit or tax structure of the fund instead, then the President's proposal represents a very big change. In either case, the question of bringing significant general revenues into the financing of Social Security is a question that deserves full and open debate. The debate should not be overshadowed by the accounting complexity and budgetary confusion of the proposal.

One disconcerting aspect of the President's proposal is that it appears that the transfers to the trust fund would be made regardless of whether the expected budget surpluses are actually realized. The amounts to be transferred to Social Security apparently would be written into law as either a fixed dollar amount or as a percent

⁷ Cash flow into the SSTF is composed of payroll taxes and a portion of the income taxes paid on Social Security benefits. Income taxes make up a relatively small component of the surplus. Interest paid to Social Security is analogous to interest paid on publicly held debt. Both come from the general fund. Interest on publicly held debt is paid in cash while interest to the trust fund is credited in the form of additional Treasury securities.

of taxable payroll rather than as a percent of the actual unified surplus in any given year. These transfers would have a claim on the general fund even if the actual surplus fell below the amount specified for transfer to Social Security—and that does present a risk.⁸ However, it is important to emphasize that any proposal to allocate surpluses is vulnerable to the risk that those projected surpluses may not materialize. Proposals making permanent changes to use the surplus over a long period of time are especially vulnerable to this risk.

The history of budget forecasts should remind us not to be complacent about the certainty of these large projected surpluses. In its most recent outlook book, CBO compared the actual deficits or surpluses for 1988–1998 with the first projection it produced five years before the start of each fiscal year. Excluding the estimated impact of legislation, CBO says its errors averaged about 13% of actual outlays. Such a shift in 2004 would mean a surplus \$250 billion higher or lower; in 2009 the swing would be about \$300 billion. Accordingly, we should consider carefully any permanent commitments that are dependent on the realization of a long-term forecast.

INVESTMENT IN EQUITIES

Under current law, the SSTF is required to invest only in securities that are issued or backed by the Treasury. The President proposes changing current law to allow the SSTF to invest a portion of its assets in equities. His proposal calls for the fund to gradually invest 15 percent of its total assets in the equity market. According to the administration's estimates, the SSTF's equity holdings would represent only a small portion—about 4 percent—of the total equity market. To insulate investment decisions from political considerations, the administration proposes investing passively in a broad-based stock index and creating an independent board to oversee the portfolio.

Last year, we reported on the implications of allowing the SSTF to invest in equities.⁹ In that report, we concluded that stock investing offers the prospect of higher returns in exchange for greater risk. We found that, by itself, stock investing was unlikely to solve Social Security's long-term financing imbalance but that it could reduce the size of other reforms needed to restore the program's solvency. We also concluded that investing in a broad-based index would help reduce, but not eliminate, the possibility of political influence over stock selections. However, the issue of how to handle stock voting rights could prove more difficult to resolve. If the government voted its shares, it would raise concerns about potential federal involvement in corporate affairs. If the government chose not to vote, it would affect corporate decision-making by enhancing the voting power of other shareholders or investment managers. The model applicable to passive private sector investment managers under the Employee Retirement Income Security Act may be relevant to the resolution of this issue.

Stock investing would have approximately the same impact on national saving as using the same amount of money to reduce debt held by the public. Both approaches would add about the same amount of funds to private capital markets, meaning that national saving would essentially be unchanged. From a budget accounting standpoint, they are not the same. Under current scoring rules the purchase of equities would be counted as an outlay, even though it is a financial transaction, because it is a transfer of funds from a governmental entity to a nongovernmental entity. The proposal apparently would change that. The administration proposes to show the entire transfer to the SSTF as a reduction in the surplus and the equity purchases would be part of that. The purchase of equities has another financial impact: since part of the surplus would be used to purchase equities, debt held by the public would be reduced less in the near term than if that amount went to reduce publicly held debt. However, in the future, claims on the Treasury would be lower because the program would rely in part on stock sales to pay benefits.

HAVE OTHER COUNTRIES TACKLED THESE PROBLEMS?

Although the dilemma we are facing of whether and how to save for the future is a very difficult one, it is not unique. A look at other democracies shows that surpluses are difficult to sustain. However, several nations have succeeded in sus-

⁸It is worth noting that something like this happens now. Treasury does not track how much of the revenues it collects are for Social Security and how much for income taxes. It credits the SSTF with funds equal to the appropriate tax rate applied to the taxable wage base—whether or not those FICA taxes were actually paid.

⁹*Social Security Financing: Implications of Government Stock Investing for the Trust Fund, the Federal Budget, and the Economy* (GAO/AIMD/HEHS-98-74, April 22, 1998).

taining surpluses. In those nations, political leaders were able to articulate a compelling rationale to justify the need to set aside current resources for future needs.

For example, those countries that have come to the conclusion that the debt burden matters make it an explicit part of their fiscal decision making process. Australia, New Zealand, and the United Kingdom all attempt to define prudent debt levels as a national goal to strive for. These debt goals can prove important in times of surplus. New Zealand, for example, used its debt goals as justification for maintaining spending restraint and attempting to run sustained surpluses. They promised that once they met their initial debt target they would give a tax cut. Importantly, when they hit that specified debt target, they delivered on their promise of tax cuts.

Other countries have saved for the future by separating their pension or Social Security-related assets from the rest of the government's budget. For example, the Canadian Pension Plan is completely separate from both federal and provincial budgets. When the fund earns surplus cash, it is invested in provincial debt securities and, starting this year, in the stock market. Sweden also maintains a pension fund outside the government's budget and invests assets in stocks and bonds.

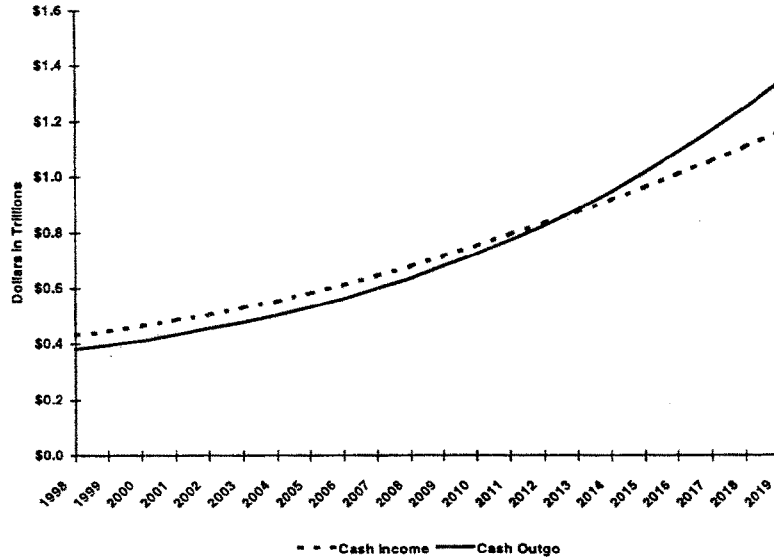
Norway may be the most dramatic example of setting aside current surpluses to address long-term fiscal and economic concerns. Norway faces the two-edged problem of a rapidly aging population and declining oil revenues—a significant source of current government revenue. To address these long-term concerns, Norway started setting aside year-end budget surpluses in 1996 to be invested in foreign stocks and bonds. Their express intention is to draw down these assets to pay for the retirement costs for their baby boomers.

It should be noted that other nations that have attempted to directly address their debt and pension problems have usually done so during or shortly after a fiscal or economic crisis. Fortunately, we do not have that problem. Instead, we have a unique opportunity to use our current good fortune to meet the challenges of the future.

SOCIAL SECURITY REFORM IS STILL NEEDED

Finally, it is important to note that the President's proposal does not alter the projected payroll tax and benefit imbalances in the Social Security program. In addition, it does not come close to "saving Social Security." Benefit costs and revenues currently associated with the program will not be affected by even 1 cent. Figure 7, which shows Social Security's payroll tax receipts and benefit payments, illustrates this point. Without the President's proposal, payroll tax receipts will fall short of benefit payments in 2013;¹⁰ with the President's proposal, payroll tax receipts also fall short of benefit payments in 2013—the graph doesn't change at all. Under the President's proposal, expected stock market returns would be used to fill part of this gap, but from 2013 on the trust funds will need cash from redeemed Treasury securities, whether or not the President's proposal is adopted.

¹⁰Cash inflows actually consist of payroll taxes plus the income taxes paid on Social Security benefits. Cash outflows are almost entirely made up of benefit payments, but they also include the fund's administrative expenses.

Figure 7: SSTF Projected Cash Income and Outflow through 2019

Source: Social Security Trustees 1998 Report, Intermediate Assumptions.

What does this mean? In 2013, inflows to the SSTF from payroll taxes and income taxes on Social Security benefits will no longer exceed outflows for benefits and administrative expenses. As a result, the year 2013 is the key date from a government financing perspective. At this point, the SSTF will have to begin drawing on its other income sources—the transfers from the general fund proposed by the President and the returns on its existing assets. Beginning in 2015, the SSTF will obtain some of the additional cash it needs from its equity holdings. However, most of the cash needed in the years that follow would come from tapping the SSTF's Treasury securities. When the SSTF begins drawing on the Treasury, it means that the rest of the government will have to come up with the cash. If there is a unified budget surplus, it will shrink. If, however, there is no surplus, there are only three choices: cut spending, raise taxes, and/or increase borrowing from the public. The amount needed from the rest of the government to help cover the SSTF's cash deficit will escalate rapidly, exceeding \$100 billion annually by 2019. This has already happened to Medicare's Hospital Insurance Trust Fund—it has been drawing on its special treasuries for several years.

Under the President's proposal, the changes to the Social Security program will be more perceived than real: although the trust funds will appear to have more resources as a result of the proposal, in reality, nothing about the program has changed. The proposal does not represent Social Security program reform, but rather a different means to finance the current program. Although the President has called for bipartisan cooperation to make programmatic changes, one of the risks of his proposal is that the additional years of financing it provides could very well diminish the urgency to achieve meaningful changes in the program. This would not be in the overall best interests of the nation.

To achieve long-term solvency and sustainability, the Social Security program itself must be reformed. The demographic trends that are driving the program's financial problems affect the program well into the future. The impending retirement of the baby boom generation is the best known of these trends, but is not the only challenge the system faces. If this were so, perhaps a one-time financing strategy could be sufficient. But people are retiring earlier, birth rates have fallen, and life expectancies are increasing—all these factors suggest that Social Security's financial problems will outlive the baby boom generation and continue far into the future.

These problems cannot be addressed without changes to the Social Security program itself.

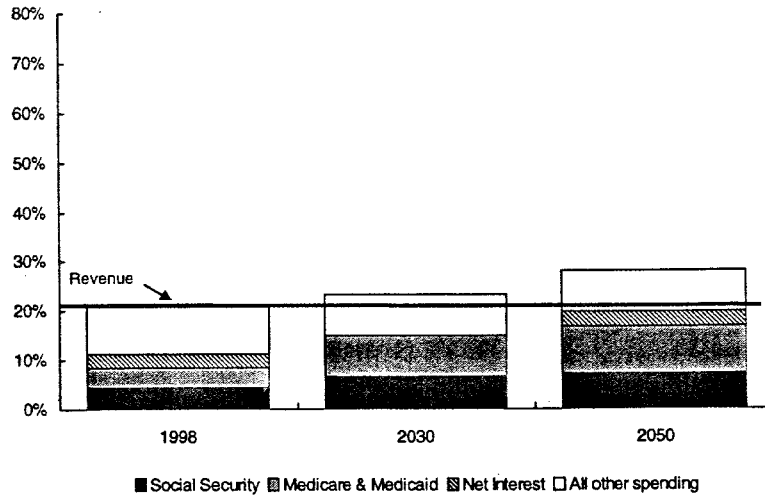
Changes to the Social Security system should be made sooner rather than later. The longer meaningful action is delayed, the more severe such actions will have to be in the future. Changes made today would be relatively minor compared to what could be necessary years from now, with less time for the fiscal effects of those changes to build. Moreover, acting now would allow any benefit changes to be phased in gradually so that participants would have time to adjust their saving or retirement goals accordingly. It would be tragic indeed if this proposal, through its budgetary accounting complexity, masked the urgency of the Social Security solvency problem and served to delay much-needed action.

There is another reason to take action on Social Security now. Social Security is not the only entitlement program needing urgent attention. In fact, the issues surrounding the Medicare program are much more urgent and complex. Furthermore, the many variables associated with health care consumption and Medicare costs and the personal emotions associated with health decisions make reform in this program particularly difficult.

To move into the future without changes in Social Security or health programs is to envision a very different role for the federal government. Assuming no financing or benefit changes, our long-term model (and that of CBO) shows a world in 2050 in which Social Security and health care absorb an increasing share of the federal budget. (See figure 8) Budgetary flexibility declines drastically and there is increasingly less room for programs for national defense, the young, infrastructure, and law enforcement—i.e., essentially no discretionary programs at all. Eventually, again assuming no program or financing changes, Social Security, health and interest take nearly all the revenue the federal government takes in by 2050. This is true even if we assume that the entire surplus is saved and these continued surpluses reduce interest from current levels. As shown in figure 9, the picture below is even more dramatic if we assume the entire surplus is used.¹¹ In that scenario lower GDP and higher interest payments lead to a world in which revenues cover only Social Security, health and interest in 2030. And in 2050 revenues don't even cover Social Security and health!

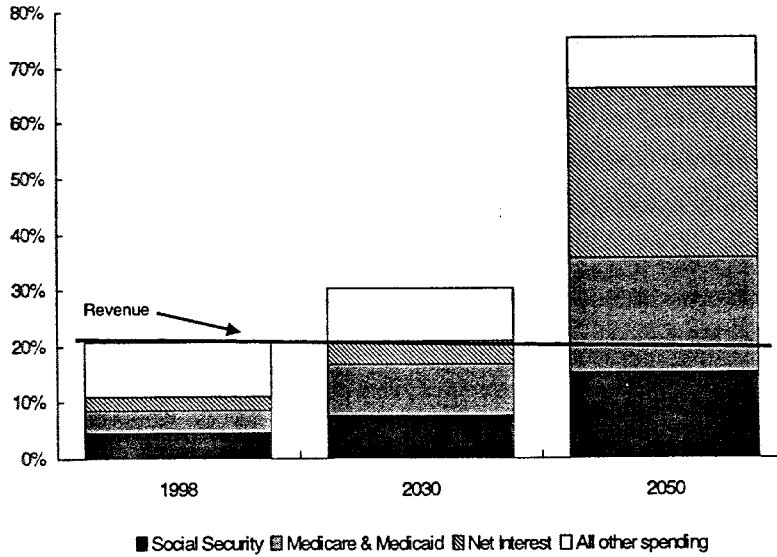
¹¹Our “No Surplus” simulation is not a forecast but rather an illustration of the implications of enacting permanent tax cuts and/or spending increases that eliminate projected surpluses and the fiscal pressures posed by the aging of the baby boom generation. This simulation shows ever-increasing deficits that result in declining investment, a diminishing capital stock, and a collapsing economy. In reality these economic consequences would inevitably force policy changes to avert such a catastrophic outcome.

Figure 8: Composition of Spending as a Share of GDP Under "Save the Surplus" Simulation



Source: GAO Analysis

Figure 9: Composition of Spending as a Share of GDP Under "No Surplus" Simulation



Source: GAO Analysis

Although views about the role of government differ, it seems unlikely that many would advocate a government devoted solely to sending checks and health care reimbursements to the elderly.

Let us address Social Security for the long term today so that the nation can turn its attention to these other more pressing and difficult issues early in the new millennium. Look again at figures 8 and 9: Social Security is not the fastest growing portion of those bars—health grows faster.

Much remains to be done in reforming entitlement programs, and engaging in meaningful Social Security reform would represent an important and significant first step. The Congress and the administration, working together, can find a comprehensive and sustainable solution to this important challenge.

I recognize, though, that restoring Social Security solvency is not easy. However, it is easy lifting compared to what faces us in connection with the Medicare program. Ultimately, any reforms to Social Security will address not only the relatively narrow question of how to restore solvency and assure sustainability but will also go to the larger question of what role Social Security and the federal government should play in providing retirement income. There are many proposals being made to address these questions; choosing among them will involve difficult and complex choices, choices that will be critically important to nearly every American's retirement income.

In my view, progress is likely to be greatest if we see these choices not as "either/or" decisions but rather as an array of possibilities along a continuum. Combining elements of different approaches may offer the best chance to produce a package that addresses the problem comprehensively for the long term in a way that is meaningful and acceptable to the American people. For example, such a continuum may identify individual accounts that could serve as a voluntary or mandatory supplement to a financially sound and sustainable base defined benefit structure. In addition, master trust principles can be used to provide for collective investment of base defined benefit and individual account funds in ways that would serve to prevent political manipulation of investments.

In order to help structure these choices, I would suggest five criteria for evaluating possible Social Security proposals.

Sustainable solvency: a proposal should eliminate the gap between trust fund resources and expenditures over 75 years, and have the ability to sustain a stable system beyond that time period.

Equity: a proposal should create no "big winners" or "big losers." Those who are most reliant on Social Security for retirement and disability income should continue to receive adequate support; those who contribute the most would also benefit from participation in the system, and intergenerational equity would improve.

Adequacy: Consistent with Social Security's social insurance feature, a proposal should provide for a certain and secure defined benefit promise that is geared to providing higher replacement rates for lower-income workers and reasonable minimum benefits to minimize poverty among the elderly.

Feasibility: a proposal should be structured so that it could be implemented within a reasonable time period, it could be readily administered, and the administrative costs associated with it would be reasonable.

Transparency: a proposal should be readily understandable to the general public and, as a result, generate broad support.

Applying such criteria will require a detailed understanding of the possible outcomes and issues associated with the various elements of proposals. We are working to provide the data, information, and analysis needed to help policymakers evaluate the relative merits of various proposals and move toward a agreement on a comprehensive Social Security reform proposal.

CONCLUSIONS

Budget surpluses provide a valuable opportunity to capture significant long-term gains to both improve the nation's capacity to address the looming fiscal challenges arising from demographic change and aid in the transition to a more sustainable Social Security program. The President's proposal offers may prompt a discussion and decision on both how much of our current resources we want to save for the future and how we can best do so. The President's proposal is both wide ranging and complex, and it behooves us to clarify the consequences for both our national economy and the Social Security program.

A substantial share of the surpluses would be used to reduce publicly held debt, providing demonstrable gains for our economic capacity to afford our future commitments. In this way, the proposal would help us, in effect, prefund these commit-

ments by using today's wealth earned by current workers to enhance the resources for the next generations.

Saving a good portion of today's surpluses can help future generations of workers better afford the billowing costs of these commitments, but this is only one side of the equation. We must also reform the programs themselves to make these commitments more affordable. Even if we save the entire surplus over the next 50 years Social Security and health programs will double as a share of the economy and consume nearly all federal revenues—essentially crowding out all other spending programs. Thus, it is vital that any proposal to expand economic growth be accompanied by real entitlement reform.

The transfer of surplus resources to the trust fund, which the administration argues is necessary to lock in surpluses for the future, would nonetheless constitute a major shift in financing for the Social Security program, but it would not constitute real Social Security reform because it does not modify the program's underlying commitments for the future. Moreover, the proposed transfer may very well make it more difficult for the public to understand and support the savings goals articulated. Several other nations have shown how debt reduction itself can be made to be publicly compelling, but only you can decide whether such an approach will work here.

I am very concerned that enhancing the financial condition of the trust fund alone without any comprehensive and substantive program reforms may in fact undermine the case for fundamental program changes. In addition, explicitly pledging federal general revenues to Social Security will limit the options for dealing with other national issues.

The time has come for meaningful Social Security reform. Delay will only serve to make the necessary changes more painful down the road. We must be straight with the American people, achieving the goal of "saving Social Security" will require real options to increase program revenues and/or decrease program expenses. There is no "free lunch." After all, we have much larger and more complex challenges to tackle like the Medicare program.

As you consider various proposals, you should consider the following questions.

- How much of the unified budget surplus should go to debt reduction versus other priorities?

- If we are to use some portion of the surplus to reduce publicly held debt, is the President's proposed approach the way to do this?

- Should Social Security be financed in part by general revenues?

- Should the SSTF invest in the stock market?

- How can we best assure the solvency, sustainability, equity, and integrity of the Social Security program for current and future generations of Americans?

- How can we best increase real savings for our future?

- How can we best assure the public's understanding of and support for any comprehensive Social Security reform proposal?

We at GAO stand ready to help you address both Social Security reform and other critical national challenges. Working together, we can make a positive and lasting difference for our country and the American people.

Mr. SHAW. Thank you, Mr. Walker.
Mr. Crippen.

**STATEMENT OF DAN L. CRIPPEN, DIRECTOR,
CONGRESSIONAL BUDGET OFFICE**

Mr. CRIPPEN. Thank you, Mr. Chairman. I'm going to, obviously, in the interest of the hour, forgo making very many remarks. But I did want to say a couple of things.

One, the Congressional Budget Office, I think it's important to remember, was spawned from the 1974 Congressional Budget and Impoundment Control Act. Most of you are too young to remember that. Unfortunately, I'm not.

The impoundment control piece of it was because of President Nixon's impoundments of appropriations of 1972, and the Congress responded. The Congressional Budget Office (CBO) is designed to

try and give the Congress an alternative analysis of, in many cases, executive action; in this case, as you've asked us today, the President's budget. So it's in that spirit that my colleague and I appear today.

I hope—I'm new to this, and may be rough around the edges in some regards that we will be able to provide you with an analysis of what the budget does in a way that is both fair and evenhanded.

I take some comfort, however, Mr. Chairman in my newness in that most of my colleagues like those sitting at the table today, and many outside of this room whom you have read or heard from, share the concerns that the Congressional Budget Office has of how the President's budget accounts for some of these things.

I wanted to tell you, too, as I did last week when Chairman Archer was chairing, that because I am new I am certainly willing to say I don't know all of the answers. But there is probably somebody at CBO who does. And one of the reasons I have invited Barry here today to share this testimony is that Barry knows more about budgetary accounting than anyone I know. And he served at the Office of Management and Budget (OMB) for 18 years and has been at this a very long time, so I asked him to join me in this testimony.

But in the spirit of analyzing the President's budget, Mr. Chairman, let me say there are a number of things that are very critical that we agree on, particularly with Director Lew's testimony this afternoon. First, there are three things you can do with the surplus. You can save it, you can spend it, you can cut taxes. And that is essentially one of the things the Director said.

We agree, as the Comptroller just testified and Mr. Lew said, that saving the surplus is a good idea—that, in effect, as an economist, I will tell you, as the Comptroller's charts suggest, saving the surplus should allow the economy to grow faster than it would otherwise, making everything a lot easier. I'll have a couple more things to say about that in a minute.

It is critically important—and, again, we agree with the Director of OMB—that debt held by the public is what you want to keep your eye on. That tells us how much the saving of the U.S. Government is changing, and whether we're dissaving, whether we're saving, and how much. So we have to keep our eye on that number—debt held by the public.

And one further thing, and certainly the Director—these are my words, and wouldn't be Jack's—but if you look at OMB's budget, lest you have the impression that the President chooses to save it all, his own numbers suggest that's not the case. If you look at 2014, for example, his baseline and ours would say that by then debt held by the public would be zero. But in the President's budget, debt held by the public is still \$1.168 trillion. So somewhere along the line that amount of money didn't get saved.

We have under way—and will have a preliminary analysis for you next week—a look at the President's budget. There are a lot of details we don't have. We don't have 15-year numbers. As the Director told you, they don't have detail on USA accounts, so there are lots of very important details that we don't have.

But from the gross numbers the President supplied to you in his budget, it's clear he doesn't save it all either—he does not save the totality of the Social Security Trust Fund surplus.

If he did, by his own budget, the debt held by the public would be \$961 billion in 2014. Rather, again, it's \$1.168 trillion. So, some money disappeared in here. We don't know where yet, and we're searching for it diligently. But the point simply is that you should not have the impression—no one should—that the President saves it all or proposes to save it all. And I'm not arguing that he ought to, but I do want to make it clear that he doesn't save it all.

The thing that the Director and Barry and I probably disagree about the most is what you can do with trust fund accounting. It is not designed to do, in many ways, what the administration in the President's proposal would like it to do. As the Comptroller said, the important date here is 2013, not 2032, 2049, 2055.

So it doesn't matter when we think the trust fund on paper runs out of money, in a macroeconomic sense. And by infusing general fund revenues, or apparently doing that, and extending the life of the trust fund—again it has very little real effect, certainly not on the macroeconomy, and not much, as the Comptroller said, on the program itself.

Let me say just a couple of quick things before I turn it over to Barry in a little more formal way. The President proposes to change the budgetary accounting rules and extend our time horizons in order to facilitate his policy objectives. In the modern history of the budget, that's not new. Previous Presidents and Congresses have proposed or enacted changes similar to this. What is new is the magnitude of the changes, the implications for policy, and the diminishing of trust funds as accounting mechanisms.

It is not that the trust fund accounting is useless; rather it's that it is often misused. Traditional trust fund accounting makes clear that if obligations exceed earmarked revenues over a long period of time, the program is not sustainable under current policies.

Massive infusions of general funds, as proposed in the President's budget, will defeat the original purpose of establishing the trust. However, the Committee may well decide to change accounting for this and other trust funds. It's been done before.

There is a unique nexus between taxes and the benefits of these programs. Perhaps more important, the accounting up to now has allowed the impression that there are assets in those trust funds—assets that could be sold to meet the obligations of paying benefits—but that accounting ignores what is happening in the rest of the budget.

On net we have debt, not assets. The trust fund accounting is imperfect in protecting the surpluses of the system. It is even less appropriate for assessing the impact of reforms. Judging the desirability of reform depends on several principles, several related questions.

There's only one, Mr. Chairman, that I want to propose to spend any time on today, and it's very similar to what Mr. Walker just said. That is that we need to keep our eye on net national savings and its effect on economic growth. What is critical here is economic growth and the size of the economy.

It's the size of the economy that ultimately determines the Nation's ability to support a growing elderly population with fewer workers. In the macro sense, which mechanism is used to transfer resources from the working population to retirees matters little. What matters most is how much the working population creates, how big the pie is relative to the piece devoted to retirees. What that means in the context of Social Security reform is what the Comptroller already said.

If we increase national savings, we will increase economic growth and therefore increase the size of the economy. That's the most important thing. Few generalities apply to the answers here.

We know that paying down the debt will help increase economic growth. That should be the standard by which we judge other alternatives. Having said that, the details of each alternative matter, as does the current state of the U.S. and international economies. There may be governmental programs or tax reductions that increase growth more than debt reduction. Elements of our economy such as interest rates are affected greatly by other countries.

Mr. Chairman, we cannot reach these important issues if we bog down in a debate over accounting and scoring. Obscuring the issue should not win the day. In the end, there are only three things you can do with the surplus: save it, spend it, or cut taxes.

The President's proposal is not necessary to save the surplus. Current law will actually do a better job of that. The President's proposal does not change the realities of Social Security. Starting in 2013, possibly sooner with the President's expansions, the Federal Government will need to infuse general funds. The President's proposal does change the locus of the adjustments required, not the size or the timing, moving the locus to the rest of the budget outside of Social Security.

Now I'd like to turn it over to Barry, who will go through a few of the numbers in the budget and do a better job than I have of making those points probably.

Mr. SHAW. Thank you, Mr. Crippen.

Mr. Anderson.

**STATEMENT OF BARRY B. ANDERSON, DEPUTY DIRECTOR,
CONGRESSIONAL BUDGET OFFICE**

Mr. ANDERSON. I'd like to just spend a few moments going through the proposals for Social Security in the 2000 budget. Both the administration and CBO project that under current laws and policies, the Federal budget will record a total surplus of more than \$100 billion in fiscal year 2000 and more than \$200 billion in 2004.

Excluding the framework for Social Security, the proposals in the President's budget are intended to leave the surplus unaffected. That is, the cost of the proposals to increase spending or lower taxes is said to be fully offset by spending cuts or tax increases elsewhere in the budget.

As Dan has just said, we will have more to say about this next week after we finish reestimating the President's budget. But right now, by using only the data available in the budget and including the Social Security framework, the surplus is smaller in all years than it would have been in the absence of the President's proposal.

I'd like to demonstrate the impact of the President's budget proposals through the use of four tables included in the prepared statement.

Table 1 shows that the President's proposals clearly lower the debt held by the public by \$380 billion in fiscal year 2004 and by more than \$2.5 trillion in 2014 relative to where the debt is expected to be at the end of 1999, as Table 1 shows.

But under the administration's own current-services baseline projections, debt held by the public would drop \$3,670 billion at the end of 1999 to \$2,927 billion at the end of 2004 and would be totally paid off by about 2014.

That is, as Table 2 shows, debt held by the public under the administration's policies would be \$3,290 billion in 2004, or \$362 billion higher than if the budget policies for fiscal year 2000, including the proposed Social Security framework, were not implemented. So the President's budget lowers the debt relative to where it is now—but increases it relative to no new action at all. This statement—this sentence in my statement was raised earlier today, and I'd just like to elaborate a little bit on it.

The President's proposal does not lock in the baseline, as was said before. Quite the contrary, it does not produce the reduction in the debt that the baseline would do. It increases the debt, as this table indicates.

However, as Table 3 shows, relative to saving Social Security surpluses over the period, the President's proposal increases the debt held by the public. That is, some of the Social Security surpluses are used for non-Social Security spending. In this case, specifically, \$43 billion in 2000 and increasing amounts thereafter. Again, if the goal is to save the Social Security surplus, the President's budget does not do it when using the measure of debt held by the public.

Another element of the administration's framework consists of general resume payments from the Treasury to the Social Security and Medicare Hospital Insurance Trust Funds. From 2000 through 2004, the administration would credit an additional \$445 billion to Social Security and \$124 billion to Hospital Insurance above and beyond the payroll taxes, interest, and other income that would be credited under current law.

Although the administration describes the proposed general resume payments as a use of the budget surplus, those payments would not alter the total surplus as traditionally measured. In fact, they would not affect the surplus no matter how large or small the payments were.

The Administration further proposes treating general revenue payments as a reduction in the total budget surplus, although not as a net outlay to the public. That approach can be viewed as attempting to protect the surplus by making it seem to disappear, but it is not consistent with the principles of Federal budgeting that were set forth by the President's Commission on Budget Concepts, and those principles have been followed for more than 30 years.

A similar approach was proposed, however, in the context of the fiscal year 1991 budget. President Bush asked for a similar change for similar reasons: to "save" the "surplus" of a trust fund.

Although the fiscal year 1991 budget did not artificially inflate the trust fund through transfers to the general fund, the Congress did not approve it anyway, and the change to budget accounting was criticized by Members of Congress from both parties.

Some observers have worried that the proposed general revenue payments plus interest would substantially increase gross Federal debt and debt subject to statutory limit. As Table 4 points out, however, that concern is somewhat misplaced. The increase in the amount of debt held by the Social Security Trust Funds would be merely a bookkeeping transaction and would not represent an increase in the net liabilities of the Federal Government. The government's liability for Social Security and Medicare is the obligation to pay future benefits, and, as we've stated previously, those benefits, and therefore the government's liability, would be unaffected by the proposed payments of general revenues and unaffected by any "balance" in the trust fund.

That concludes our statement. We will be happy to provide additional details and analysis of the administration's proposal as more details become available.

[The prepared statement follows:]

Statement of Dan L. Crippen, Director, Congressional Budget Office, and Barry B. Anderson, Deputy Director, Congressional Budget Office

Mr. Chairman and Members of the Committee, we are pleased to be here today to discuss the framework for Social Security in the President's budget.

The President's budget is, and has always been, a policy document. Budget folklore holds that President Lyndon Johnson created the President's Commission on Budget Concepts in part to mask the costs of the Vietnam War. Creating the unified budget moved the Social Security trust funds and their surpluses on-budget. The most recent President's budget continues this long-standing, bipartisan tradition—observed by the executive branch and the Congress alike—of using trust fund accounting to facilitate policy and political objectives that are often unrelated to the trust funds or the programs with which they are associated. In the process, clarity and ease of understanding are often sacrificed.

Our presentation today is based solely on the President's budget. The Congressional Budget Office (CBO) is now working on a reestimate of the President's budget, the results of which should be available in a few weeks. Our reestimate will change the numbers somewhat, but it will not change much of what we say today.

The President's budget does not contain details on a number of relevant and potentially significant policy proposals that the President or members of his Cabinet have announced or endorsed. For example, the changes in Social Security benefits that the President mentioned in his State of the Union address are included in the text of the budget but are not incorporated into any of the numerical presentations.

Those changes, if made without offsetting reductions in benefits, would result in expenditures from the Social Security trust funds that are greater than current law—that is, greater than the baseline CBO presented to you last month. The same is true of the proposal to add a pharmaceutical benefit to Medicare. A recently announced regulatory change in the Disability Insurance program will also add costs. The Administration has not indicated how the additional obligations would be financed.

The President's budget also lacks details on the full 15-year estimates included in many of the tables. We expect that some of those details will be forthcoming. Today we will take you through the accounting as presented in the budget, discuss some of the history behind those conventions, and offer selected comparisons with current scoring practices and the baseline.

After you have thought about it for a while, you may well conclude, as the President has, that you should change the accounting for this and other trust funds. The connection between taxes and benefits is unique to those programs. Perhaps more important, "accounting" up to now has allowed the impression that there are assets in those trust funds—assets that can be subsequently sold to help defray the cost of benefits. But that accounting ignores what has happened in the rest of budget. On net, we have debt, not assets.

PRINCIPLES FOR REFORM

Trust fund accounting is an imperfect means of assessing the viability of a program. It is even less appropriate for assessing the impact of reforms. For a more complete view of the President's proposal and its effects on the real economy, it is necessary to step back and look at a broader range of issues. I will suggest several questions that might guide our analysis of the President's proposal as well as others. Other experts, such as the Comptroller General, have made similar suggestions.

Judging the desirability of reform depends critically on several related questions:

- Can the reform help economic growth?
- Does the reform improve the long-term fiscal balance of the program?
- Does the reform enhance equity or fairness?
- Can the reform reasonably be expected to work?

The first question is critical. It is the size of the economy that ultimately determines the nation's ability to support a growing elderly population with fewer workers. In the macro sense, which mechanism is used to transfer resources from the working population to retirees matters little. What matters most is how much the working population creates—how big the pie is relative to the piece devoted to retirees.

What does that mean in the context of Social Security reform? A point of agreement among many economists involved in the Social Security debate is that increasing national saving raises productivity and increases economic growth. Given the broad agreement among economists that paying down the debt has a positive impact on saving and economic growth, perhaps that should be the standard against which all other proposals are measured. That is, do proposals to increase federal spending, reduce taxes, or purchase equities raise production and economic growth more than paying down the debt?

Few generalities apply, and not all alternatives are equal. The impact of any alternative to paying down the debt would have to be carefully examined. The details matter, as does the current state of the U.S. and international economies. Some programs that appear on the spending side of the federal budget might help productivity, as might a number of tax measures. The analysis must be based on interest rates, for example, that are determined in world markets.

Second, what is the reform's impact on the long-term outlook for the program? The Social Security and Medicare programs face long-term pressures from demographic changes and rising health care costs, although the buoyant outlook over the near term will help delay the onset of serious fiscal problems. The large and rising surpluses projected for the next 10 years will be replaced with mounting pressures as the baby-boom generation begins to draw benefits from Social Security and Medicare, the average life span increases, and the costs per beneficiary of federal health care programs continue to rise. Put another way, does the President's proposal for Social Security actually contain reforms—changes to the program's structure so that it is on sound fiscal footing?

Third, what are the implications of reform for the perceived equity of the program? Admittedly, many concepts and measures could be used to assess fairness. One that is commonly understood in this context is the relationship between what people pay in payroll taxes and what they receive in benefits.

Addressing the fourth question—whether reform can be expected to work—includes considering practicality, ease and cost of administration, protection against severe losses, and the extent of regulation. Is the program feasible? Does the government have the wherewithal to administer it? Will it be subject to increased fraud? Will it involve more invasion of privacy? Can it be insulated from political influence, as Chairman Greenspan noted?

PROGRAMMATIC ISSUES

The Administration's framework for Social Security also raises several important questions about the structure of the Social Security program and the federal budget.

First, would breaking the link between payroll taxes and benefits eliminate an important mechanism of program discipline? In the past, the projected depletion of trust fund balances has often provided the impetus for taking painful steps to increase taxes or scale back scheduled benefits. The imminent exhaustion of the Social Security trust funds spurred action in 1983, and shortfalls in the Hospital Insurance Trust Fund served a similar function in 1997. Although such deadlines may be artificial from an economic point of view, they can have real consequences. The President essentially substitutes general fund solutions for programmatic solutions. I understand that the Comptroller General will have more to say about that.

Second, would a massive infusion of nonpayroll taxes in Social Security significantly change the way the program is viewed? Heretofore, using payroll taxes has

been considered integral to maintaining Social Security as a social insurance program. The program is financed by a nearly universal tax on earnings, and a person's benefits depend on the earnings on which taxes were paid. The use of general revenues could potentially undercut one or more elements of that carefully balanced system.

Third, is accumulating balances in the Social Security trust funds a potentially effective way of encouraging more saving by the government? Put another way, will these changes in accounting prevent the funds from being used for other purposes? Whether this approach would work for long is open to question. The recent past in the United States and the experience in other countries is not promising in this regard.

Last, is the direct purchase of equities by the federal government appropriate?

TRUST FUND ACCOUNTING

However valid the reasons may have been to establish the accounting conventions the federal government currently uses for trust funds, those conventions confuse almost everyone: the Congress, the media, government officials, and most of all, the public.

I believe the main source of that confusion is the fact that the federal government's trust funds are not trust funds in the traditional sense; that is, they do not set aside current income for future use. Excess income over outgo for any given trust fund is invested, in a certain sense, in special Treasury securities, which are as safe and secure as all other Treasury debt. But the Treasury securities held by federal trust funds are nothing more than the government's IOUs to itself. Look at it this way: if the government had truly invested trust fund net income for future use, the Treasury would currently be holding hundreds of billions of dollars of real assets that could be liquidated in the future to pay for future obligations. But the Treasury does not hold any net assets; in fact, all that remains from the so-called investment of trust fund surpluses is net *debt* to the public of \$3.7 trillion.

Although there is no money in the Treasury to pay for future obligations, the obligations to people eligible for Social Security benefits are real. And most important, those obligations are a direct result of federal law, not a consequence of whatever may or may not be credited to the trust funds. In particular, the size of the balances in the Social Security trust funds—be it \$2 trillion, \$10 trillion, or zero—does not affect the obligations that the federal government has to the program's beneficiaries. Nor does it affect the government's ability to pay those benefits.

This fact is explicitly recognized in the President's budget for fiscal year 2000 in the same words used in previous budgets. To quote page 337 of the Analytical Perspectives volume: "The existence of large trust fund balances, therefore, does not, by itself, have any impact on the government's ability to pay benefits." The fact that trust fund balances are unrelated to the government's obligation or ability to pay benefits needs to be recognized before any proposals to address the Social Security and Medicare trust funds can be analyzed. In other words, look first to the impact of proposals on increasing national saving and raising real growth and then to the impact on paying down the debt held by the public.

Let me apply those principles to the Social Security trust funds. In their most recent report, the Social Security trustees estimate that the trust funds will not be exhausted until 2032. However, the report also includes the fact that starting in 2013, Social Security taxes will not be sufficient to meet obligations. If the Social Security trust funds were trust funds in the traditional sense, their assets could be sold to cover the shortfall. However, as stated above, the surpluses in the trust funds have been loaned to the federal government, and although special bonds have been issued to indemnify the funds, the bonds are nothing more than the federal government's IOUs to itself. Starting in 2013, the program's expenditures will exceed payroll taxes, and the government will eventually have to go further in debt, raise taxes, cut spending, or infuse more general revenues to be able to send out Social Security checks. We must look beyond the balances in the trust funds to be able to properly evaluate any proposal.

MAJOR ELEMENTS OF THE ADMINISTRATION'S PROPOSALS

Both the Administration and the Congressional Budget Office project that under current laws and policies, the federal budget will record a total surplus of more than \$100 billion in fiscal year 2000 and more than \$200 billion in 2004. Excluding the framework for Social Security, the proposals in the President's budget are intended to leave the surplus unaffected. That is, the cost of proposals to increase spending or lower taxes is said to be fully offset by spending cuts or tax increases elsewhere in the budget. Although we will have more to say about that after we have finished

reestimating the President's budget, by using only the data available in that budget and including the Social Security framework, the surplus is smaller in all years.

Proposed Budget Surpluses and Reduction of Debt Held by the Public

A primary feature of the Administration's Social Security framework is that it attempts (under scoring by the Office of Management and Budget) to keep the total federal budget in surplus under the traditional accounting. Excluding its Social Security framework, the Administration projects cumulative total budget surpluses of \$828 billion over the 2000–2004 period. That is, the federal government will collect a total of \$828 billion more from the public than it will spend in transactions with the public. That figure comprises Social Security surpluses of \$719 billion, a Postal Service deficit of \$5 billion, and on-budget surpluses of \$114 billion (see Table 1).

In its Social Security framework, the Administration proposes to use \$258 billion, or 31 percent, of the projected total surpluses over the next five years for new spending on goods and services (\$138 billion), financial assets (\$96 billion for the new Universal Savings Accounts), and additional debt-service costs (\$24 billion). Taking those items into account, the remaining surplus would total \$569 billion. Table 1 shows that the President's proposals clearly lower the debt held by the public by \$380 billion in fiscal year 2004 and by more than \$2.5 trillion in 2014 relative to where the debt was expected to be at the end of 1999.

But under the Administration's current-services baseline projections, debt held by the public would drop from \$3,670 billion at the end of 1999 to \$2,927 billion at the end of 2004 and would be totally paid off by about 2014. Under that computation, as Table 2 shows, debt held by the public under the Administration's policies would be \$3,290 billion in 2004, or \$362 billion higher than it would be if the policies in the budget for fiscal year 2000, including the proposed Social Security framework, were not implemented. So the President's proposals lower the debt relative to where it is now but increase it relative to no new action at all. In addition, as Table 3 shows, relative to saving the Social Security surpluses over the period, the President's proposals increase the debt held by the public—that is, some of the Social Security surpluses are used for non-Social Security spending—by \$334 billion in 2004.

General Revenue Payments

The second major element of the Administration's framework consists of general revenue payments from the Treasury to the Social Security and Medicare Hospital Insurance trust funds. Over the 2000–2004 period, the Administration would credit an additional \$445 billion to Social Security and \$124 billion to Hospital Insurance, above and beyond the payroll taxes, interest, and other income that would be credited under current law. Social Security currently receives hardly any general revenues; income taxes on Social Security benefits represent less than 2 percent of the program's income. Medicare's Supplementary Medical Insurance Trust Fund, however, gets three-quarters of its income from general revenues. Even if general revenue payments were made in an amount sufficient to make the Social Security trust funds actuarially sound for everyone over 15 years old today—\$8.4 trillion—those payments would have no effect on the surplus or deficit in any year.

Although the Administration describes the proposed general revenue payments as a use of the budget surplus, those payments would not alter the total surplus as traditionally measured. In fact, they would not affect the surplus no matter how large or small they were. General revenue payments are purely intragovernmental—a transaction between one government account and another. The general revenue payments to Social Security would move the government's on-budget accounts from surplus into deficit over the 2000–2004 period, but they and the payments to Medicare would not affect federal transactions with the public and would therefore have no effect on the economy.

The Administration's proposal further confuses the situation by treating the general revenue payments as a reduction in the total budget surplus, although not as a net outlay to the public. That approach can be viewed as an attempt to protect the surplus by making it seem to disappear, but it is not consistent with the principles of federal budgeting that were set forth by the President's Commission on Budget Concepts and that have been followed for the past 30 years.

That approach has, however, been proposed before. In the context of the fiscal year 1991 budget, President Bush asked for a similar change for a similar reason—to "save" the "surplus" of a trust fund. The Congress did not approve the request; the change to budget accounting was criticized by Members of both parties at that time.

Some observers have worried that the proposed general revenue payments, plus interest, would substantially increase gross federal debt and debt subject to statu-

tory limit (see Table 4). That concern, however, is misplaced. The increase in the amount of debt held by the Social Security trust funds would be merely a book-keeping transaction and would not represent an increase in the net liabilities of the federal government. The government's liability for Social Security and Medicare is the obligation to pay future benefits, and, as stated above, those benefits—and therefore the government's liability—would be unaffected by the proposed payments of general revenues and unaffected by any “balance” in the trust fund.

Purchase of Equities

As a third element of its framework, the Administration proposes that one-fifth of the general revenues credited to Social Security be used to purchase corporate equities or other private financial instruments. Like the proposed general revenue contributions, this element of the Administration's framework is designed to increase the balances in the Social Security trust funds, but it, too, would have little economic effect. For each dollar to be invested in equities, the federal government would have to borrow an additional dollar from the public. After the transaction, the private sector would hold fewer equities and more debt, but total national wealth and national saving would not be appreciably affected. Moreover, the technical problems cited by Chairman Greenspan might turn the President's economically neutral proposal into one that could harm the economy.

The CBO staff and I will be happy to provide additional analysis of the Administration's proposal, Mr. Chairman, as more details become available.

Table 1.—Debt Held by the Public Under The President's Budget and Current Levels

[End of year, in billions of dollars]

	1999	2000	2004	2014
President's Budget	53,670	3,604	3,290	1,168
Current Levels	3,670	3,670	3,670	3,670
Change	0	-66	-380	-2,502

Table 2.—Debt Held by the Public Under the President's Budget and Current Services

[End of year, in billions of dollars]

	1999	2000	2004	2014
President's Budget	3,670	3,604	3,290	1,168
Current Services	3,670	3,573	32,927	0
Change	0	32	362	1,168

Table 3.—Debt Held by the Public Under the President's Budget and Saving the Full Social Security Surplus

[End of year, in billions of dollars]

	1999	2000	2004	2014
President's Budget	3,670	3,604	3,290	1,168
Save Full Social Security Surplus	3,670	3,561	2,956	961
Change	0	43	334	207

Table 4.—Total Federal Debt

[End of year, in billions of dollars]

	1999	2000	2004
Relative to Current Levels President's budget	5,615	5,831	6,776
Current services	5,615	5,615	35,615
Change	0	216	1,161
Relative to Current Services President's budget	5,615	5,831	6,776

Table 4.—Total Federal Debt—Continued
 [End of year, in billions of dollars]

	1999	2000	2004
Current services	5,615	5,711	5,874
Change	0	120	902

NOTE: The statutory debt limit is \$5,950 billion.

[Attachments are being retained in the Committee files.]

Mr. SHAW. Thank you, Mr. Anderson.
 Mr. Frenzel.

STATEMENT OF HON. BILL FRENZEL, CO-CHAIR, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET; AND FORMER MEMBER OF CONGRESS; ACCOMPANIED BY CAROL COX WAIT, FOUNDER AND PRESIDENT, COMMITTEE FOR A RESPONSIBLE BUDGET

Mr. FRENZEL. Thank you, Mr. Chairman.

I am here representing the Committee for a Responsible Federal Budget, an oxymoronic group. The cochairman is former Congressman Tim Penny. I am accompanied by Carol Cox Wait, founder and president of the organization.

She will not make a presentation unless I make some conspicuous error here.

First of all, I think the testimony that you've heard has been very revealing. I challenge nothing that has been said by the three previous speakers. I feel the same way. The President has done us a favor of sorts in emphasizing Social Security and spotlighting the need for reform.

The President suggests that he wants to pay down debt held by the public and create some kind of a framework that will spawn reform, and he pleads with you to cooperate in helping with that reform. As you saw today, his administration does not have a lot of great ideas about how to do it. Nothing has been put forward.

There are problems with this budget, and specifically with the Social Security part of the budget. In the first place, it diverts tax receipts from Social Security taxes to non-Social Security programs. You've heard that from each of the other witnesses. I'm not going to elaborate further.

You've also heard that it reduces the debt less than current law, and that's the point I want to make and to stress. In the words of the Director of OMB, it extends the solvency of the trust fund, but that doesn't mean anything.

It doesn't increase resources available to pay when those claims are demanded by the annuitant—or the potential annuitant beneficiaries, nor does it reduce any of the benefits to which they may be eligible. It creates the illusion that over \$800 billion of surpluses in the next 5 years covers \$1.5 billion in new commitments in this budget.

And that's the reason for all this tortured shell game that you're being subjected to, the double speak of where the money is going, who's moving what in which direction.

The net of it is that when the benefits exceed the tax receipts in the year 2013 or thereabouts, you're going to be left with the same choices that you have today: you're going to have to raise taxes, you're going to have to cut spending, or you're going to have to borrow or print the money.

And the sooner you do it, the better. This budget doesn't tell you anything about how you might make those changes. What it does do is make reform more difficult because it creates the illusion that we can keep the program solvent and avoid hard choices.

And everybody knows we're going to have to make those hard choices.

Our Committee believes that reducing the public debt is an efficient way to increase net national savings and the right way to deal with some of the problems that are before you. We believe that the Ways and Means Committee should be very careful about temptations for new spending and even new tax cuts. And I have seldom met a tax cut I didn't like.

We recommend that you use all of the surplus to pay down the public debt. Every nickel's worth. Anything you can find. If you cannot resist temptation entirely, use at least the total Social Security surplus to pay down the public debt.

We don't recommend the President's plan. It doesn't go anywhere near far enough. Every year that you wait on changing the Social Security program is going to make it more difficult for you in the future. You've seen some of the numbers on that, and I don't want to belabor them.

The Ways and Means Committee also has something to do with the management of the Treasury, which is going to be the equity investor if the President's plan, as proposed, goes through. Our Committee believes Allan Greenspan had the issue of government owning equities dead right: "It isn't the bureaucracy we fear, we fear the Congress. Just as the State of California and the State of Texas meddle in their ownership of private interests, so would you."

We believe that the USA accounts, which will be another matter before this Committee, are not a wise idea. We held our conferences on making hard choices around the country, and we found that three-quarters of the people that attended those conferences want some kind of individual accounts.

But they didn't ask for a government subsidy, and they didn't ask for a new Federal entitlement, another little EITC is what it is now being called. That is not a worthwhile program for your Committee to get into.

We believe that eventually you're going to have some kind of individual accounts. And there are lots of good ideas around. But when you do them, deposits to individual accounts ought to be proportional to the contributions from the people in the system. Individual accounts ought not to become another statutory entitlement in disguise.

They ought to provide for personal choice by the person in whose name they are being invested. And you need to find a way to pay for them, and that is going to be the toughest job of all.

There are also other increased benefits in the President's budget for widows. And I suppose if I want a bad name, I need to come out against those, so we will. You don't have any way to pay for them. You haven't figured out how to pay for the benefits already on the books over the next couple of decades and certainly not over the next half century.

How can you possibly go ahead and invent new benefits? I say the same thing for the increased Medicare benefits. Until you can pay for them, forget them. We are suggesting that you pay down as much of the debt as possible. Devote at least the Social Security surplus to debt reduction, preferably the whole surplus.

Don't use Social Security receipts for non-Social Security benefits. And don't use general revenues for Social Security benefits. Once you sever that link between the payroll tax and Social Security benefits, it's going to be "Nelly bar the door" on those benefits or at least the demands made against them.

Isolate Social Security from the operating budget. We realize that Congress has been trying to do that for a lot of years unsuccessfully. That's not very easy.

And we further believe that if you subscribe to this budget, you are growing government. If you grow government, particularly as the mandatory programs for the elderly and Medicare grow, you may not have to raise taxes, but your successors will surely have to do so.

Good luck. And may I inquire how you drew the short straw to get to be Committee Chair?

[Laughter.]

[The prepared statement follows. Attachments are being retained in the Committee files.]

Statement of Hon. Bill Frenzel Co-Chair, Committee for a Responsible Federal Budget, and former Member of Congress

Mr. Chairman, Mr. Rangel, Members of the Committee, I am delighted to appear before you on behalf of the Committee for a Responsible Federal Budget. I am Republican Co-Chairman of the Committee. Tim-Penny, my Democratic counterpart, cannot be here; but he and the other members of our Board join me in thanking you for the opportunity to share our views with you, our former colleagues and friends. My testimony addresses the President's proposed framework for Social Security reform.

The President's framework for Social Security reform proposes to:

1. Transfer 57 percent of cumulative projected 15-year budget surpluses¹ to the Social Security Trust Fund.

2. Invest 20 percent of the amounts transferred in private equities (in the hope that increased earnings will extend the "solvency" of the Social Security Trust Fund.)

3. Add new tax credits to subsidize individual savings accounts (Universal Savings Accounts or USAs) intended to supplement Social Security benefits in retirement.

4. Acknowledge the need for program changes to be developed through bipartisan cooperation.

Over the next few decades, our nation faces dramatic demographic and economic change. The President is to be commended for emphasizing the need for Social Security (and to a lesser extent Medicare) reform. Today's projected surpluses, a growing

¹ 62% when surpluses used for additional interest costs are not counted, but 57% of \$4.9 billion total projected 15-year budget surpluses.

economy and favorable demographics create the best possible conditions to focus on making those popular programs more affordable for future generations.

One important element of the President's proposed framework for Social Security reform—buying down debt held by the public—could help address issues the country will face in the future. But the President's proposals would neither reform Social Security nor reduce projected burdens that this program will impose on future taxpayers.

WHAT THE PRESIDENT'S PROPOSAL DOES

First and foremost the proposals contained in this year's President's budget continue to focus attention on the need for long-term reforms. The President has helped to heighten public awareness and intensified the pressure on all politicians to work toward building a national consensus around approaches to reform.

Reducing public debt, is by far the most important element of the President's proposed Social Security reforms. Reducing debt would provide significant benefits to the economy and the budget.

Under current laws and policies, publicly-held debt would go down more rapidly than under the President's proposals. The Administration, however, argues that absent their proposals, Congress would divert budget surpluses to offset the cost of tax cuts instead of reducing the debt.

Is it possible to hide Social Security Surpluses?

The President's budget engages in a complicated and confusing set of transactions that we and other budget experts criticize as gimmickry. The Administration defends the gimmickry as a necessary means to a worthy end.

We find this budget gimmick objectionable from several perspectives. (See Figure 1, next page. There is a more detailed description of the gimmick in the attachment at the end of this testimony.)

- It creates the illusion that you have more resources available for new priority spending and tax cuts than in fact exist.
 - It artificially inflates balances in the Social Security and Medicare Trust Funds.
- This could produce three very unfortunate results:

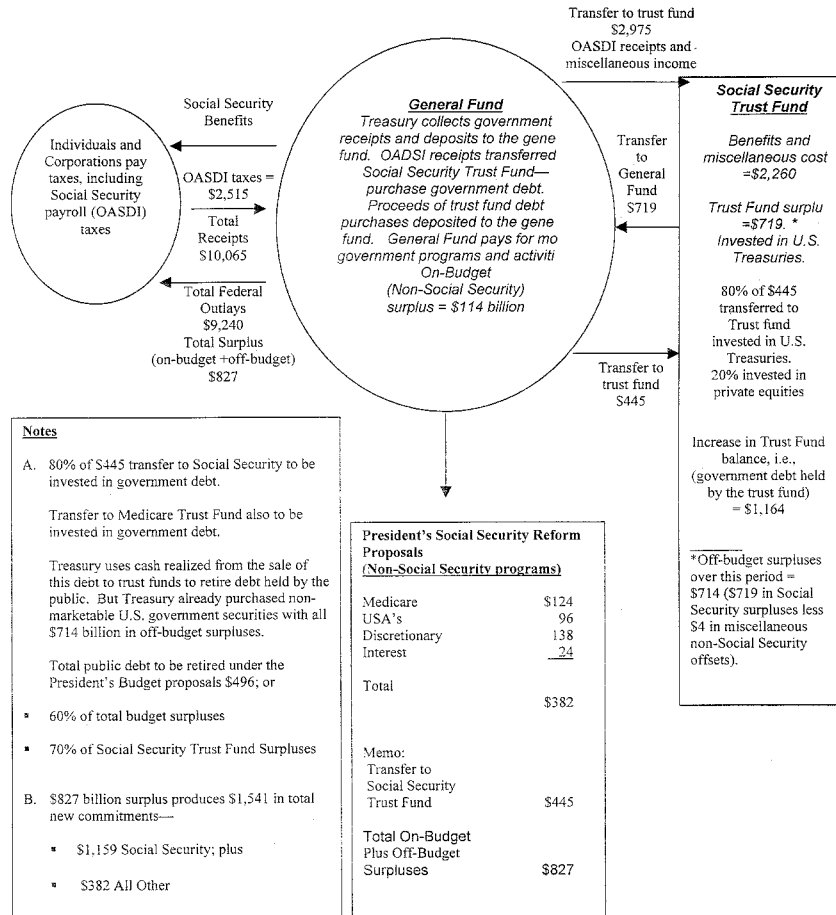
1. It could reduce pressure for Social Security and Medicare reform.
2. It will may encourage proponents of new and expanded benefits, especially in Medicare, to use the money transferred to Trust funds for those purposes rather than retire debt.
3. Proposing to spend some Social Security resources for non-Social Security purposes, the Administration may actually encourage the very behavior they designed this gimmick to preclude, i.e., Republicans in Congress may be tempted to imitate the Administration approach to "pay for" large popular tax cuts.

The Committee for a Responsible Federal Budget understands that nothing can guarantee that the President and Congress—much less future political leaders—will use large budget surpluses to buy down debt held by the public. We are convinced, however, that goal best is served if you separate Social Security from the rest of the budget.

History proves how difficult it is to fence off, or "save," Social Security surpluses. Congresses and Presidents have tried twelve ways from Sunday to insulate Social Security from other budget pressures. Seven laws enacted since 1983 attempt to protect the program in many ways.²

²The Social Security Act Amendments of 1983, The Emergency Deficit Reduction and Balanced budget Act of 1985, The Balanced Budget and Emergency Deficit Control Act of 1985, The Balanced Budget and Emergency Deficit control Act of 1987, The Budget Enforcement Act of 1990, the Omnibus Budget Reconciliation Act of 1993, and the Balanced Budget Act of 1997.

Figure 1. It's Magic! \$827 Billion Surplus Produces over \$1.5 Trillion in New Initiatives
(FY 2000-2004: \$ billions)



- Move Social Security Trust Fund receipts and outlays off-budget;
- Take OASDI trust funds out of budget enforcement calculations;
- Create points of order against changes to trust fund programs as part of reconciliation legislation;
- Prohibit passage of legislation that would reduce Trust Fund Balances; and
- Require super-majority votes to overturn such points of order in the Senate, and otherwise seek to protect the program

All of those efforts failed spectacularly! The President's FY 2000 budget continues to show consolidated receipts, outlays and deficits, which receive far more attention than the on-budget totals required by law. Congressional Budget Resolutions comply with the letter of the law; but almost all discussion is around the consolidated budget totals.

The proof of the pudding is in the eating; and we would not be discussing the disposition of budget surpluses today if efforts to take Social Security off budget had succeeded. The fact is, there are no on-budget surpluses this year; OMB projects there will be no on-budget surpluses for two more years; CBO forecasts a \$6 billion on-budget surplus in 2001, growing in the "out years".

The Administration believes their proposed Social Security gimmick will succeed where statutory provisions have failed. The trouble is that Congress is smart enough to figure out the gimmick does more than reduce publicly-held debt. It also

allows the President to use Social Security surpluses to help fund Administration priorities well beyond the five-year period covered by the budget. (The budget proposes to use \$145 billion in Social Security surpluses to fund non-Social Security programs and initiatives between FY 2000 and FY 2004.) If the President can do that, why shouldn't Congressional Republicans use the same gimmick to pay for their priorities?

The President's proposal also would sever the link between work (payroll tax contributions) and benefits. Although individual Social Security benefits are not tied directly to payroll tax contributions, the benefits reflect work history. The proposed transfers of unified budget surpluses would subsidize Social Security with non-payroll tax revenues. This may or may not be entirely appropriate, but it would alter fundamentally a basic program feature—the notion that benefits are “earned” through payroll tax contributions.

WHAT THE PRESIDENT'S PROPOSAL DOES NOT DO

The President's proposed framework does not change the projected cost of future Social Security benefits. The budget seeks to focus on financing mechanisms rather than program design or affordability. The principal focus is to extend the actuarial solvency of the Social Security Trust Fund.

The proposal makes it look like Social Security is more affordable, but the budget itself recognizes that trust fund balances are available to finance future benefit payments—“only in a bookkeeping sense.”³ Henry Aaron points out that the Administration could have filled the trust fund with sufficient U.S. Treasury paper to ensure solvency indefinitely. But trust fund balances will not finance benefits. Cash is needed to meet benefit commitments. You can free up cash by cutting Social Security or other programs. You can tax or borrow. There are no other options. Trust fund balances are irrelevant in any real economic sense.

Extending Social Security and Medicare trust fund solvency also has a perverse effect. It reduces pressure to enact program reforms—exactly the opposite of the President's stated objectives. Additional resources could be used to secure larger, fundamental program changes. But the President's proposal is sure to ruin the country's appetite for substantive reform. The Chairman of the Senate Budget Committee has suggested in recent hearings that the Administration's proposed transfers to Medicare are unlikely to reduce costs. Instead, Senator Domenici argues those amounts almost certainly would be used to pay for new or expanded benefits (e.g., pharmaceutical coverage and buy-in for people under the age of 65). This would make Medicare reform more difficult by increasing the cost of benefits in future years.

CBO estimates the cost of current law benefits will increase by amounts equal to 2 percent of GDP between now and 2030. In today's terms, that is about \$175 billion per year. CBO also predicts Medicare and Medicaid benefits, under current laws and policies, will triple as a percent of GDP, over the same period. The President's proposal would not change these projections at all. Future taxpayers will be faced with those bills unless Congress and the Administration act to cut promised benefits.

No free lunch

In 2013, Social Security outlays are projected to exceed trust fund receipts. The President's Budget does not address that problem. Government could use non-payroll tax revenues or borrow to close the gap. But, as Federal Reserve Chairman Alan Greenspan warned Congress, Social Security reform requires benefit reduction and/or tax increases. A return to deficit finance could delay the day of reckoning, but nothing can alter that stark reality.

The next five years are crucial

Few here today will be in Congress in 2030. But you don't need to look out forty years to see the handwriting on the wall—and a progressive narrowing of options available to you with the passage of time. CBO projects that the “big three”⁴ entitlement programs will grow by 3 percent of GDP over the next decade—to consume 55 percent of total federal outlays in 2010. Given current pressures to increase defense, education and other discretionary programs, is it realistic to suggest Congresses and Presidents will cut other spending to sufficiently offset the growth in big entitlement elderly entitlement programs?

³Budget of the United States Government Fiscal Year 2000, Analytical Perspectives, p.337.

⁴Social Security, Medicare and Medicaid

Given twenty-five years' history of deficit reduction efforts, surely it is clear that nobody can accomplish massive changes in Federal fiscal policy from one year to the next. If we want to reduce the growth in popular programs ten years from now, and/or reduce other spending to accommodate that growth, it is imperative for Congress and the Administration to act soon. Small changes today can produce savings on that order of magnitude over the next decade; but the odds against changing fiscal policy to cut total Federal outlays (or shift priorities) by amounts equal to 3 percent of GDP, without considerable lead time are somewhere between slim and none.

PROJECTED BUDGET SURPLUSES ARE MERELY PROJECTIONS

OMB and CBO project large and growing surpluses well into the next century. As recently as May 1996, CBO projected deficits rising nearly to \$400 billion within 10 years. Today, the country faces similarly large surpluses. For politicians, projected budget surpluses may be more fun, but no less difficult to address than escalating budget deficits.

Table 1.—Baseline Budget Deficits (–) /Surpluses (+)
[\$ Billions]

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
CBO											
Off-budget	127	138	145	153	161	171	183	193	204	212	217
On-budget	–19	–7	6	55	48	63	72	113	130	143	164
Unified Total	107	131	151	209	209	234	256	306	333	355	381
OMB											
Off-budget	121	129	134	142	151	158	173	180	190	198	205
On-budget	–41	–12	0	45	31	50	58	103	130	156	188
Unified Total	80	117	134	187	182	208	231	283	320	354	393

Source: CBO Economic and Budget Outlook: Fiscal Years 2000–2009. OMB, President's FY 2000 Budget.

The Committee for a Responsible Federal Budget, like most economists and other experts⁵, cautions against irrational exuberance—to borrow a phrase from Alan Greenspan.

We believe that the outlook generally is rosy for the U.S. economy and the budget. But minor changes in the economic environment can have major budget impacts. The only thing we know for certain about economic forecasts is that they will be wrong. The further out in time—the greater the potential for error.

It would be very arrogant for this Congress and this President to assume you can anticipate every need the country will face over the next fifteen years. Even assuming somebody could tell you exactly what resources government will have, over such a long period of time, our Committee thinks you should leave something on the table for future politicians whose priorities will be different as conditions surely will change.

In short, we think the goal of today's policies should be to free up resources for the future—not to increase the mortgage on future economic output, and the burden on future taxpayers, represented by existing Federal programs and policies. Elderly entitlements, and the baby boom generation's pending retirement, cause most of the concern about future fiscal policy. We therefore recommend very strongly that this Congress and this President focus on ways to control growth in those programs—or pay for current law benefits. Use the respite current surpluses can provide to enhance our future. Control the urge for instant gratification in the form of spending increases or tax cuts—whether to meet Presidential priorities or your own.

If Congress approved the President's proposed transfers to Medicare, and those amounts were used as Senator Domenici has suggested, economic benefits the Administration projects their proposal would produce would be diminished substantially.

CONCLUSION

The Committee for a Responsible Federal Budget supports using budget surpluses to buy down debt. That would make Social Security and Medicare reform easier. That is the surest approach to increase saving, productivity and economic growth,

⁵ See "Uncertainty in Budget Projections," The Economic and Budget Outlook: Fiscal Years 2000–2009, Congressional Budget Office, Washington DC, January 1999, pages 81–90.

and better position the country to meet the challenges we will face when the baby boom generation retires.

Realistically, the Committee realizes that Congress and the President almost certainly will use some surpluses to assuage current constituent demands. That being the case, we commend to the Committee, Congress and the Administration an approach we call "surplus lite".

Surplus Lite

We recommend, in the strongest possible terms, that Congress and the President agree to use 100% of Social Security Trust Fund surpluses to buy down debt held by the public. That is the way to save Social Security Trust Fund surpluses; and that strategy can help to make real Social Security reform more manageable.

Surplus lite has both economic and political advantages.

- It would produce greater real economic benefits than any alternative except using 100% of consolidated budget surpluses to retire debt.

- Politically, it would draw a line in the sand that just might be sustainable. Fencing off Social Security surpluses proved to be impossible in an era of record high deficits. Given projected surpluses, however, it just might be possible to "save" Social Security taxes for Social Security.

We do not mean to argue there is any magic in saving the exact amounts of Social Security Trust Fund surpluses. But, once you use a \$1 dollar of Social Security taxes to "pay for" non-Social Security programs or tax changes, it is very difficult to imagine another place to draw the line—to guard against 100% of projected surpluses being used to pay for popular priorities.

We are submitting for the record, copies of an Interim Report and the Dallas results, from a joint the project Building a Better Future: An Exercise in Hard Choices, which included more than 1500 people in cities around the country. Large majorities favor some combination of individual accounts and tax-financed benefits in Social Security reform. Our group can support individual accounts, if there is sufficient financing for both the new accounts and traditional Social Security. But using surpluses to set up individual accounts, without restraining the growth in traditional benefits or raising taxes, would make the crunch more excruciating when surpluses disappear. Please, having finally balanced the unified budget, let us not make matters worse than they are before turning to real Social Security and Medicare reform.

Thank you. I would be happy to answer any questions you may have.

Mr. SHAW. My job is to ask the questions, not to answer them at this particular point, but I appreciate the sympathy that you are reaching out to me with.

Mrs. Johnson.

Mrs. JOHNSON of Connecticut. I think your unanimous focus on the fact that the amount of publicly held debt would diminish more under current law than under the President's budget is very helpful. It is also true and no secret, although not admitted in documents, that the current budget is not workable in defense and in certain other areas.

Our 5-year predictions aren't going to hold. So it would be very helpful if we could get some help. Or at least it would be helpful to me to get some help.

And knowing that spending does have to go up a little bit in the budget, you know, what kind of latitude do we realistically have to keep that public debt growth down to a level that will enable us to address the problems that we face?

Then second, I'd like to ask you the question that I asked the preceding panel and really got no answer to. You know, what is—what are three or four of those ideas—five or six, seven or eight, nine or ten—beyond the sort of obvious of cut benefits, increase taxes or increase retirement age that we should be looking at?

Because the other—the options that we relied on in 1982 do have some very significant disadvantages for us now that they didn't have as significantly in 1982.

So I'd just be interested in your ideas, but also how you can help us better focus on the fact that this year—if we stayed at this year's budget, if we adhered to our 5-year budget plan because of what we did under emergency spending last year, we'd have to cut spending to a degree that, frankly, I don't believe we can.

Plus, we have problems in the defense budget and some other areas that I think are going to require some new spending. So given some sort of basics, I can see what you're saying about the President's budget. And certainly he increases spending dramatically, and taxes and fees and everything supposedly to support it.

But we do have a budget problem, an immediate, short-term budget problem; but we also have a long-term options problem and I'd like to hear your comments on both of those issues.

Mr. WALKER. I'll start. On behalf of the General Accounting Office, two things. First, we do provide virtually every year to the Congress a compendium of potential spending reduction items that might help to be able to stay within the caps or to be able to minimize the amount that you have to modify the caps.

We have that project under way and we will be issuing a report on that in the near future.

Second, with regard to options for fundamental Social Security reform, we have done a lot of work in this area and have a number of projects underway to try to be able to help the Congress there. I would also mention that there are a number of reform proposals that have already been put forward by various external groups.

For example, the Center for Strategic and International Studies' National Retirement Policy Commission, which included members of government, including the Senate and the House, and the private sector; and in the interest of full and fair disclosure, also including myself.

There were 24 individuals on that including Senator Breaux, Senator Gregg, Congressman Stenholm, Congressman Kolbe, a number of former executive branch officials including myself, and chief executive officers from the private sector. They came up with a proposal that is not perfect by any means, but it passed as a package 24-0, and it gets the job done.

So I would commend that to you as one example. The Committee for Economic Development, the various proposals that came out of the Advisory Council on Social Security—we would be happy to help the Congress in summarizing some or all of these if necessary in order to let you know what the different options are and what the impact is on solvency and sustainability.

Any way that we can be helpful, we'd like to know.

Mrs. JOHNSON of Connecticut. Thank you.

Thank you, Mr. Chairman.

Mr. SHAW. Thank you.

Mr. COLLINS.

Mr. COLLINS. Thank you, Mr. Chairman.

I listened with interest as you gentlemen made your comments, and you didn't have to be corrected by Ms. Wait. That's commend-

able, as I know that she probably has some of the same feelings and concerns that you all do.

You mentioned caps, and you've mentioned some ideas of reduction in spending within the caps. I'd like to refer to the cap. That is, the total spending. And then the caps under the cap where you can move funds around. And hopefully Mrs. Johnson and some of us can work together to find some of those areas that we can transfer funds around to cover some of the needy programs that she's referring to.

I know, Mr. Walker, you're familiar with the word "s'posin." It's a good southern word for supposing. Supposing we had the discipline to hold the line on the budget and by doing so, interest rates remained low for everyone. And I think that's been one of the strongest points of today's economy because people have more funds to spend on consumer goods due to lower interest rates and less financial cost.

So s'posin we were able to hold our discipline and keep the budget cap in place. And that zero of public held debt—or that public held debt reached zero earlier than 2014 and we were still building the surpluses in the trust funds or the area that I call "encumbered funds" because they're owed at some point in time in the future.

How would you invest those funds then if the government had no need to borrow?

Mr. WALKER. Under the President's projections, he gets to the point where the U.S. is lending money to others, presumably, and generating interest income, which I have a hard time seeing how that would really happen.

I think one of the real questions is what you could do then is to wall off that money. We could learn from the experiences of some of the other countries that have faced similar challenges. In my statement I include several examples of what other countries have done in order to set up separate and distinct trust funds with hard assets that are dedicated for the purpose of meeting certain longer range commitments due to demographic challenges or other challenges, if you will.

So there are several things you could do that are referred to in my statement, but I'd be happy to provide additional information if you'd like.

Mr. COLLINS. Well, I just find it interesting that, at some point in time, if we maintain our control on our spending habits, that we could actually totally eliminate the public-held debt and then all we would have would be government-held debt.

What would you do with those funds then? I've never heard the question asked, so I don't know the answer. And I'm just curious if you had a suggestion.

Mr. Frenzel, you're reaching for your microphone.

Mr. FRENZEL. In the first place, if you paid the debt off to zero in the year 2013, you still have nothing in the Social Security Trust Fund but some paper. But you've got to pay claims. And claims will exceed dedicated taxes in that year.

Mr. COLLINS. Yes, sir.

Mr. FRENZEL. And so, you know, you probably don't have much.

Mr. COLLINS. But you've missed a key word.

Mr. FRENZEL. On the other hand, if you ever get to a point where you own assets that you need to manage, then you haven't treated your taxpayers right and you should have given them back some money before that happens.

Mr. COLLINS. You've just hit the nail on the head, Mr. Frenzel. Thank you, very much.

Mr. SHAW. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. I'll be brief. But I want to thank the four witnesses on this panel. Certainly—and especially in contrast to the last panel, you represented a breath of fresh air. Your candor and your counsel are both refreshing and appreciated.

I especially appreciate the testimony of the cochairman of the Committee for a Responsible Federal Budget, who happens to be my esteemed predecessor and mentor, and who everybody on this panel knows, respects and loves for his longtime service on this Committee, as well as the full House.

I appreciate seriously the work that your group does and your leadership, Ms. Wait, as well.

Let me just very quickly ask either of you, Ms. Wait or Bill. Certainly I think, if anything, you're kind in your critique about the proposal to transfer general revenues into the trust fund and delink payroll contributions from benefits.

Isn't it absolutely critical and shouldn't it be nonnegotiable that we maintain the link between work and benefits?

Mr. FRENZEL. It is, in my opinion, and I let Carol speak for herself. We have had that link during the lifetime of Social Security.

There may come a time when you'll choose to have other taxes pay for Social Security benefits. But, in my judgement, you should be very careful when you do that. For instance, the President's suggestion gives the Social Security annuitant a draw on personal income taxes. We have, over the years, reduced the personal income tax rolls by taking people off the bottom. They still pay a lot of Social Security taxes. It's a pain because it's a very regressive tax. On the other hand, I don't think you want a situation where you let people who aren't paying an income tax be able to demand benefits from an income tax pool.

That's what I mean when I say linkage. And I think you got that right.

Carol.

Ms. WAIT. I would agree with what Bill said and I would go further. I would say that if you ever decide to delink the Social Security tax from the Social Security benefits, cut Social Security taxes. They are a very burdensome tax; a much more burdensome tax for the vast majority of the population than any other tax they pay.

If you're going to cut that knot, why don't you do it in a way that provides real tax relief for a very large number of people? I'm not saying it's a good idea. I'm just saying rather than doing it by overtly subsidizing Social Security benefits from Federal general revenues, do it in a way that may put some downward pressure on benefits and provide some real tax relief to people.

Mr. RAMSTAD. Yes, please.

Mr. WALKER. I think to the extent that you grant these additional securities, which is what the President proposes, this in ef-

fect, represents an explicit, general fund subsidy of Social Security, and you take away from primary self-financing through payroll taxes, you move away from the insurance concept.

You move toward more of a welfare structure. You create a slippery slope that may be more difficult to establish the necessary fiscal discipline over. Let me give you an example, Congressman.

When the SMI program was created, the Supplemental Medical Insurance, Part B of Medicare—well, that is funded through general revenues. But when it was originally created, 50% of the cost was paid for through premiums. Now it's down to 25%.

In addition, if we look at the HI Program, which is still primarily payroll taxes, things have been done over the years to transfer money from Social Security into Medicare because Social Security was in good shape but Medicare was not, to move programs out of the payroll tax into the program which is Part A to Part B to help prop up Part A.

I think it creates a very slippery slope.

Mr. RAMSTAD. Well, thank you again to all five of you for helping lead us out of the wilderness. We certainly need your continuing counsel and appreciate your being here today.

Yield back, Mr. Chairman.

Mr. SHAW. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman.

And I do want to thank the panel for a much more honest assessment of where we are. And I think this was a very helpful exercise. I wish everybody were here to hear it.

Ms. Wait, I want to thank you all for having the Exercise in Hard Choices in my district.

Mr. Frenzel, you couldn't come out for it, but we had a vigorous debate over a lot of these issues with about two or three hundred people in a room in a town meeting format then broke out into working groups and solved all the problems before us.

And of course, none of those solutions were politically palatable, but it was a good exercise. I think you did that along with AARP, the Concord Coalition, and a lot of other groups.

Mr. Walker, my colleague from Georgia waited until you were done talking to determine whether or not he liked what you said to claim you as a Georgian, and I told him you must have been born in Ohio and then worked your way down to Georgia. But welcome aboard.

And I think this is very helpful to have a Comptroller General who has this background and experience as we go—

Mr. SHAW. If the gentleman would yield for 1 second, I would like to tell the gentleman from Georgia that Mr. Walker's mother and father now live in Gainesville, Georgia. [Laughter.]

Mr. PORTMAN. Is that accepted?

Mr. COLLINS. That's accepted.

Mr. SHAW. Florida transplants, by the way, and that's very unusual.

Mr. PORTMAN. But I think GAO is going to play, from what I've seen from your testimony and just reading through it quickly, also a more aggressive role in this. Which is great, because we've got two huge challenges obviously for the next century, and these are Social Security and Medicare.

And the demographics don't lie. And with the 76 million baby boomers starting to retire around 2010, 2013 and with people living longer, this is going to be the big issue, I think, for this Congress and for future Congresses.

So I'm glad that you are on board and I hope you will continue to be assertive in giving us the straight scoop and, frankly, taking on the administration where you think they are not giving us the information we need to make intelligent choices for our grandchildren and great grandchildren, which is really the issue here.

I have a couple of questions I'd love to run by you. I wish we had a couple of hours here. But one is this whole notion of the debt held by the public versus the debt held by the government.

Am I to understand that, in analyzing the President's budget—and Mr. Crippen, jump in here, too—you all believe that the debt held by the public, which is, of course, the part that Secretary Rubin and today Mr. Lew and others have focused on, will actually be higher than it would be without the kinds of changes that they're proposing in the budget?

Mr. WALKER. Yes.

Mr. PORTMAN. OK, that's a surprise to me because, I mean, I listened with great interest to Secretary Rubin's testimony a couple of weeks ago and then today to Mr. Lew's, and it seems to me the strength of their budget, if anything, would be that there is a shift away from public debt toward government and that that somehow is better.

And I can understand from an analyst point of view as you look at credit worthiness of a company or look at even a government that the public debt number is important and different in the private—than the so-called intragovernmental debt.

But you're saying that even the public debt would increase more rapidly than it would without the changes that are proposed in the President's budget.

Mr. CRIPPEN. Or put another way, it wouldn't decrease nearly as much. The debt held by the public would go down on its own under current law if the Congress didn't meet for the next 10 years.

If you enact the President's budget, on the other hand, it wouldn't go down as much. In economic terms, as an economist, the jargon is keep your eye on net national savings. Are we actually saving more money or not? And by looking at this number and this number alone, you can tell whether the Federal Government is saving more or not.

And under current law, we would save more than under the President's proposal. He's proposing to save some of the surplus, but he's not proposing to save it all. Whether it's 57% or 62%, we'll know more as we get more detail from them; but there is a third or so that's not being saved, this \$1,168 billion by 2014 goes somewhere else and we're not sure where yet, but it's not saved.

Mr. PORTMAN. Because it hasn't been spelled out yet in the budget documents or—because we also know that there is a percentage allocated to Medicare. I think it's 15%. Is that correct? And then is it 14% for the USA accounts and then an increase in defense spending?

Mr. WALKER. Well, they give some information in the budget documents, but particularly when one goes out 15 years—no other budget has ever gone out 15 years.

Mr. PORTMAN. Right.

Mr. CRIPPEN. And the detail provided in the President's budget document for the proposals that go out 15 years are condensed into one table. And so there's just very limited information available. And even I think earlier today there was acknowledgement about USA accounts and a variety of other things that the proposals haven't been prepared yet.

Mr. PORTMAN. Yeah, we did get into that.

Yes, Ms. Wait.

Ms. WAIT. If I may, in Bill's testimony there's a graphic that looks like this that attempts to describe what the President's budget proposes to do in Social Security reform. One of the things that it tells you, as Barry has said, there isn't a lot of detail, but they do give you 5-year numbers.

And over 5-years, you would reduce debt about—by about 60% of total budget surpluses or about 70% of Social Security trust on surpluses. That clearly is not 100% of anything.

Mr. PORTMAN. Right. But really, when you look at the President's proposal, and this is the bigger picture that we have to grapple with here, the 62% figure, if you take that as the Republican and Democrat agreed upon number, it is—62% happens to be, as I understand, over 15 years roughly the amount of payroll taxes that would otherwise have gone into the trust fund.

Is that accurate?

Ms. WAIT. Yes.

Mr. PORTMAN. Or do you dispute that number even?

Mr. COLLINS. No, unfortunately, it's not accurate.

Mr. PORTMAN. Would it have to be more than 62% even to come up with a number that makes some sense over the 15-year period?

Just so people who are watching this can understand maybe a little more of what we're talking about, you've got a situation now where the surplus this year is only because there is payment through FICA taxes, payroll taxes, that exceeds benefits being paid out.

That money is being borrowed by the government when it ends up in the trust fund. So in fact, one could argue, assuming a trust fund is really a trust fund, there is no surplus this year and that your projections, I think, at CBO are that, indeed, that can be used for at least the next 2 years.

Is that correct, that there would be no surplus other than Social Security Trust Fund surpluses?

So that really, by taking only 62% of the surplus, you're not even accounting for Social Security over the short time. And then I had thought that over 15 years it evened out. In other words, the projections would show that 62% of the surplus over 15 years happened to be the amount that would otherwise have ended up in the trust fund.

But that's not even accurate?

Mr. WALKER. My understanding—and I would yield to CBO. But my understanding is about 57% of the surplus over a 15-year pe-

riod—of the unified surplus is attributable to Social Security. In the early years, it's a much higher percentage.

Because keep in mind the Social Security surplus—you turn a deficit in 2013, so it's actually going to be a drag starting in 2013. That's my understanding, but I'd yield to CBO.

Mr. COLLINS. I think it actually gets worse. First of all, if you just look at the Social Security surpluses, over 15 years the President's budget does not save the Social Security surpluses, as that chart indicates. It uses some of the Social Security surpluses for spending on other programs.

By the way, they don't provide any detail on exactly that amount. Those estimates are very crude estimates that we made. And we will have more in about a week or so, but they're very crude.

But second,—

Mr. PORTMAN. Is this because your projections at CBO are different than OMB's projections—

Mr. COLLINS. No.

Mr. PORTMAN [continuing]. Or is it because they have their own projections?

Mr. COLLINS. There is that, too.

Mr. PORTMAN. OK.

Mr. COLLINS. But the reason for it is really because they just don't provide the detail.

Mr. PORTMAN. Yeah.

Mr. COLLINS. One needs the year by year numbers in order to do this, and they don't have that detail.

But the second thing, and that's the thing I really wanted to point out to you, is that 62% has sort of gotten a life of its own. And it is frequently described as you've described it, and I heard earlier today it being described, too: 62% of the unified surplus is saved for Social Security.

Mr. PORTMAN. Right.

Mr. COLLINS. No, that's not what their figures reveal. They take the unified surplus and then they reduce it by something called financing cost. That is the debt service on the new spending that they have in the President's budget. Then, of this amount, unified surplus less financing cost,—

Mr. PORTMAN. Right.

Mr. COLLINS [continuing]. Then they save or transfer 62% of that lower amount for the transfers to Social Security. The importance of this is twofold. First of all, if it were the way they stated it, 62% of—or a percentage of the unified surplus, the number wouldn't be 62%, it would only be 57% or something like that.

Second of all, even if one adheres to a certain percentage such as 62%, the actual dollar figure can be varied because of the back loading or front loading of the spending or tax proposals one uses. And I recall—maybe you do, too—that back loading and front loading of proposals can have a big—a major impact on what those proposals are.

Mr. PORTMAN. Absolutely.

Mr. COLLINS. So one needs to look at that 62% very carefully, I would suggest, before one adopts it.

Mr. PORTMAN. Well, you know, it's interesting. Having again heard from the administration on this and heard their description in general terms several weeks ago really when they first starting talking about the State of the Union and the budget, and then more recently with the budget testimony, they are giving us different information as to both the public debt issue and as to the significance of the 62% figure and really what it does in terms of putting the trust fund over time essentially off budget so that the unified budget would not reflect that.

So this is troubling and makes it even again more difficult for us to get at our task, which is to start with the same facts and then move forward with some tough exercise and hard choices.

Let me ask you another question that relates to this.

Mr. Chairman, I appreciate your indulgence and I'll try to be fast here.

Mr. SHAW. My indulgence is running short. Go ahead.

Mr. PORTMAN. This gets to a question—and again, there's a lot more on the debt I'd love to talk about, but I want to be sure and get one more question out here to this distinguished panel, and that is this notion of individual accounts and how it could affect the long-term solvency of Social Security.

Mr. Frenzel said, as many of us have said, you know, it's a mistake to move away from having the payroll taxes exclusively fund the entitlement program because it becomes, as Mr. Walker said, more like a welfare program or because, in the end, you don't have the kind of integrity and budgeting that you need long term to deal with the demographic shifts that are occurring.

If you were to have individual accounts and tie them back into Social Security with a floor, but a reduced benefit for those who chose to save their money—let's say 2% of payroll tax—doesn't long term—and when I say long term, I'm talking out 40, 50, 60, 70 years that add to the solvency of the Social Security system.

By essentially refunding at least a part of the Social Security system—right now it's a pay as you go system. There's no funding, there's no account for me, there's no account for you.

But if you did, in fact, have some percentage, and this is 2% really of 12.4% being the 6.2% for the employee and the 6.2% for the employer—if you could take 2% of that out, invest it through a highly regulated government system where you could only invest in certain funds, not pork belly futures or your uncle's real estate, and that came back into Social Security in the sense that when you retired, indeed you would have a reduction in your benefit, although a safety net benefit or a floor benefit, doesn't that begin over time to really help to fund the system—in other words, have a partially funded mechanism—that indeed is, I would think, something that we could leave as a legacy for future generations, or does that not help the system long term because of the enormous transition costs that are incurred in getting to that point?

Mr. WALKER. It depends. What I would commend to you, if you look at—as one example, if you look at the Center for Strategic and International Studies' National Retirement Commission Report, you'll find that they proposed a 2% carve out for individual accounts for individuals below the age of 55, but you have to pay for that in order to deal with the transition costs.

And there were a number of program reforms that they propose to implement in order to do that. For example, to gradually increase the normal retirement age to 70 from the current scheduled 67; to make the benefit formula more progressive; to also increase the number of years that it would take to earn the maximum benefit.

At the same point in time, they propose to do some things that actually were very progressive, and that is to provide a minimum benefit equal to the poverty level for individuals that worked at least 40 years, which does not exist right now; to strengthen certain survivor benefits.

So you've got to figure out how you're going to pay for it. And the other thing is, to the extent that you end up using—creating individual accounts, that's money you don't have to pay down publicly held debt unless you figure out some way to pay for it.

And in conclusion, I think one of the things that we've got to do is recognize we need to figure out what's fiscally responsible to do with regard to the surplus. We need to get on with Social Security program reform.

And we need to recognize that, in the end, that the kind of reform that makes policy sense and that is politically feasible is a combination of a bunch of different elements that as a package makes sense; whereas individually you could shoot holes in any individual proposal, but as a package it makes sense, it's understandable, it's salable to the American people.

Mr. PORTMAN. And Mr. Chairman, if I could just get a couple other answers to that question just to rethink the point. His indulgence is wearing thin, but he's a great Chairman, let me tell you. And he didn't get the short straw, he got the long straw because—

Mr. SHAW. Ask your question.

Mr. PORTMAN. Thank God he's there. [Laughter.]

If, indeed, we are interested in getting higher rates of return, there are basically two ways to do it. One is the government to invest, which none of us left on the panel here today support. And I know at least a couple of the panelists here have already expressed concern about it, and I would think all of you would have concern about the government being the largest investor and so on even with the President's proposal.

The other way to do it is for the individual to direct that investment. And this is where—Mr. Walker, the question I'm getting at really—I understand what you're saying about the transition cost.

On the other hand, if you look over the last 50 years, the average would be that you're going to get at least a doubling of the rate of return, 2.9% on Treasury specials right now versus at least a 6% return. And many think, you know, you don't look—50 years look like 15 years, you get a higher rate of return, far higher.

That, in the end, helps the Social Security system if you tie it into the benefits upon retirement. And that's my question to you, is obviously there is a transition cost and whether that's not paying down as much public debt or whether that's being able to simply pay benefits during this period when the baby boom generation is retiring.

But in the end, you get a benefit to the system of Social Security, I would think, which is increased solvency through having again a partially funded system with real money that's in there depending on how you work out the quid pro quo at the end. And that's my question to you all, is that you—that you all looked at and would agree with?

Ms. WAIT. If you go back and look at the exercise we did in Loveland, you'd find the answer to your question. I'm sorry, it is a lot like the Comptroller General suggested. You have a size-16 woman you're trying to put in a size-12 dress.

Beefing her up to size 18 doesn't solve the problem. Mr. Frenzel says it makes things more interesting because you don't know when the seams are going to pop. If you want to take part of the 12.4% payroll tax that goes to pay for retirement benefits today, you must cut something you're paying for with that tax today before you can divert it to something else without having a very serious problem.

And that is exacerbated because the Social Security system is so much more than just a retirement system today, as you well know. You all write the laws. You have disability benefits, you have survivor's benefits, you have all these other things.

There's a massive income transfer that occurs in the system. And the people who are most likely to want and be able to take their 2% and invest it for themselves are not apt to be the people who are going to need those transfers on the other end.

In the last instance, you have to pay for the whole program. You have to pay for whatever residual benefits you leave in the tax financed Social Security program, plus the 2% that you're diverting to individual accounts.

If that's not paid for, if you diminish the benefits Dan and others described as a result of buying down debt held by the public, which increases net national savings, productivity and growth. You're giving up the growth dividend in the short term. It's hard to imagine getting a long-term benefit sufficient to offset that loss.

The concern is that you balance in the transition period the money you divert and the changes you're willing to make in current benefits or the taxes you're willing to increase to pay for them so that you don't diminish the growth benefits that otherwise would flow from debt reduction, increased saving investment, and growth.

Mr. PORTMAN. I would just mention also that, at that level and session, 70% of the people supported individual accounts.

Ms. WAIT. But they had big cuts in benefits.

Mr. PORTMAN. Well, but I'm saying it's not necessarily big cuts in benefits, it's whatever the quid pro quo is at the end of your working life. I mean, if you're willing to take 2% out and take—I'm sorry, Mr. Chairman—and take lesser of a benefit less than that 2% equivalent, which I would be—anybody under 40 would be nuts not to—it indeed does help the Social Security system long term.

It depends what—it depends what the transfers at the end.

Ms. WAIT. If you change the benefits on the other side, that's all.

Mr. FRENZEL. That's the point we want to make. All these things have a cost. Paying down the debt, makes those costs easier to

manage. Keeping the separate accounts gives you some extra cost. And then you lose the 2%. So what do you do?

Are you going to reduce benefits? I mean, are you going to extend the age of retirement? Are you going to cut the COLAs or are you going to means test the program? There are a lot of ways you can do that. But what you're doing is introducing quite a change into the system, and I don't think any of us here would disagree that getting a higher return on an investment is getting better than getting a lower return.

But you really have to be careful because you have a program here that doesn't contemplate that kind of investment. You're going to overlay this old fashioned—I call it an entitlement program. What do you call it? I certainly wouldn't call it a pension program.

And then you're going to stick an investment program in on top of it. It's going to take an enormous amount of care. And I know the gentleman from Ohio has been working on this program and been a leader, and I wish you lots of luck.

I think it's promising, but it is exceedingly difficult.

Mr. SHAW. Mr. Walker, I have a question for you. The President is talking about taking this surplus, funneling it through the Social Security Trust Fund and then coming out the other side, leaving an IOU or a Treasury bill as indebtedness to the trust fund by the Federal Government, and then talking those funds and reducing the debt. Obviously what the President is doing sounds good because it looks like he's building up the trust fund. In reality it's just more paper, more promises, more calls upon future taxpayers, which we know is out there anyway if we do nothing.

If we were to take those same funds and just simply reduce the debt, looking out to the year 2015, 2016, the people that are going to be taking care of paying my Social Security, does it make any difference whether you ran it through the trust fund or whether you just paid down the debt?

Mr. WALKER. I assume, Mr. Chairman, you're talking about the additional grant, the 62% of the surplus?

Mr. SHAW. Right.

Mr. WALKER. That does not have to be inherently linked. From a future economic capacity standpoint, what's important is paying down the publicly held debt.

So once you do that, what the President proposes to do, which is to issue this grant, actually restrains our options for the future. It basically represents a commitment of future general revenues above and beyond the excess cash flows of Social Security, which reduces our flexibility in the future.

Mr. SHAW. So following that through, I mean you could take that same 62% grant and run it through three or four times.

Mr. WALKER. I wouldn't recommend it, Mr. Chairman.

Mr. SHAW. In the end the accounting process would simply just continue to build up the trust fund, but that year 2013 would not move.

Mr. WALKER. 2013 would be unaffected.

Mr. SHAW. And that is the date we have to zero in on. People talk about extending the trust fund out to 2050, 2060, 2070. Well, you can run that money through there enough times and buildup

enough IOUs that you can extend it way out, but you haven't changed the ball game.

The people that are paying taxes after 2013 are going to have to be paying taxes to be able to accommodate the people in retirement at their present benefit levels. I mean, it's just as plain and simple as that.

The people forget that it's a matter of "watch the cash flow". Never take your eye off the cash. When you take your eye off of the cash flow, then all of these other things seem to make sense until you start thinking it through and say wait a minute, in 2013 we're still going to have to come up with the bucks to pay the people that are going into retirement.

It's absolutely no different. It makes no difference. So I think this whole panel has agreed that there's a good thing in paying down the debt. But let's not run it through the trust fund and create some type of subterfuge like we're really doing something when we're really not.

I think it is very important that we do reduce the debt and that we do use a great deal of the surplus to do that. But the plain and simple answer is: if we're not going to change the benefit level, which we're not, and we're not going to change the level of taxation, which neither party is willing to do, then what are you going to have to do?

You're going to have to find some way to increase the return, the return on the moneys that are paid into the trust fund other than just coming up with some IOUs.

Mr. Herger read a provision that was out of the President's budget on page 337, and I'm going to read it again because I think it is something that, even though Mr. Lew backed away from it and said he wished it wasn't in there, is just as true today as it ever was.

It says, "These balances," in speaking of the trust fund, "are available to finance future benefits and other trust fund expenditures, but only in a bookkeeping sense. These funds do not consist of real economic assets that can be drawn down in the future to fund benefits.

"Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances therefore does not, by itself, have any impact on the government's ability to pay benefits."

So that simply is saying to forget how many times you run this surplus through the trust fund, and that it's not going to make a bit of difference. But I would like to say, and to try to end on a positive note, that I think the President has moved the agenda forward.

And I for one, as Chairman of the Social Security Subcommittee, appreciate that. He's introduced into the mix the reality that we're going to have to increase the return on our investment, which means investment in the private sector.

Although there is great disagreement on the Republican side, that we feel this should not be done by the trust fund but should be done by putting together individual savings accounts for the

American worker. But he has advanced that in the USA accounts that he has put forward.

This idea certainly could be folded into this mix and it is putting out a concept. Mr. Lew said that they're working through the details on that. We'll be very anxious to see them because I'm sure we'll pick up some things in there that we could use in order to be sure that the security of these individual funds is not jeopardized by bad judgement or total lack of judgement, that they can't be drawn down, that there are some guarantees. One of the greatest things about this country, which is in great trouble right now, is the Social Security system, and it is incumbent upon the Congress to fix it.

And I, for one, am still very confident that we will get great bipartisan support and tremendous cooperation from the White House in the end to accomplish our mutual goal.

And with that positive comment, I will now pronounce that the hearing is now adjourned.

[Whereupon, at 7:27 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Alan S. Blinder, Gordon S. Rentschler Memorial Professor of Economics, Princeton University

Mr. Chairman, Members of the Committee, I am grateful for the opportunity to appear before you this afternoon to offer my views on the President's plan for putting Social Security on a sounder financial basis.

WHAT NEEDS TO BE DONE AND WHY

It is truly remarkable that we are sitting here today, in February 1999, discussing this subject—not in the abstract, but with legislative intent clearly in mind. After all, Social Security is hardly in crisis right now. The System is currently taking in much more revenue than it is paying out in benefits, and the Social Security surplus is expected to grow, not shrink, for years to come. The eventual funding crunch is a generation or more away—well beyond the political event horizon. And the program is wildly popular with the American people. These are not the conditions that normally spur Congress into action.

And yet last month the President proposed several major initiatives designed to shore up Social Security's shaky financial foundations, and Congress is now carefully considering his ideas. As a citizen, I can only praise both the Administration and Congress for their willingness to take on this difficult problem so far in advance. As you know, the payoff to delay is very likely to be negative. Frankly, fixing Social Security's finances is not that hard a problem—either economically or politically—if we take action soon. But if we wait until the funding crisis is imminent, some nasty things will have to be done.

What, then, should be the major objectives of Social Security reform at this stage?

First, *we need to reduce the long-run funding gap*. As members of this committee well know, the benefits stream promised under current law greatly exceeds projected receipts over the 75-year period used to appraise Social Security's actuarial balance. Policy changes are needed to bring these two streams into alignment, and there are only four choices:

1. reduce benefits
2. raise the payroll tax
3. increase the rate of return earned by the Trust Fund
4. find some other revenue source for Social Security.

The funding gap has two distinct aspects, which are sometimes confused. One is the need to balance Social Security's books, because benefits can be paid only from prescribed sources. This is partly an economic problem, but partly a bookkeeping problem. The other, and more fundamental, problem is *the need to generate more national saving*—and that should be the second objective of Social Security reform. I say this for two reasons. One is that our national saving rate is quite low, leading us now to borrow enormous sums from the rest of the world. The other is that by saving more today we will build more capital for the future, which will make future

American workers more productive. The same payroll tax *rates* will then bring the Social Security System more *revenue*.

Third, and finally, there seems to be agreement in both parties that *payroll tax increases should be used little, if at all*, to solve the problem.

THE PRESIDENT'S PROPOSALS

The President's plan scores quite highly on these three criteria. Working backward, it does not propose to raise the payroll tax at all. Second, it would boost national saving enormously by saving most of the looming budget surpluses. Third, the vastly lower interest burden brought about by the disappearing national debt would make room in the budget for future Social Security benefits. And the unusual new bonds to be issued to the Trust Funds would strengthen the pledge of future revenue to the System. All in all, it's a pretty good package—though definitely not a full solution, as the Administration acknowledges.

However, I can also understand why some people have attacked the plan for double-counting. My initial reaction was the same, and it took some hard work with paper and pencil to convince myself that the charge is beside the point.

When you cut through all the complexities, as I will do shortly, what you see is that, while the Administration's rhetoric and exposition are clumsy, the plan itself is sound. At bottom, it does three things:

1. *It saves the lion's share of the projected budget surpluses*—\$3.45 trillion over 15 years—and assigns that money to the Social Security and Medicare Trust Funds. Running large budget surpluses is the surest way we know to boost national saving, and it is in my view the plan's strongest feature. It also appears to be what most people in both parties want done.

2. *It invests a modest share (about 21%) of the money accruing to Social Security in equities*, which should increase the Trust Fund's returns. This additional revenue reduces the benefit reductions or tax increases that will ultimately be needed to restore actuarial balance.

3. Most controversially, *it creates a new accounting device that would convert what is now an implicit promise to Social Security into an explicit, contractual pledge*. The motive here is more political than economic. The new bonds that the Administration proposes to give to Social Security have given rise to a charge of double counting. But they really amount to a bookkeeping and legal device designed to stiffen the backs of future Congresses, so they will not "raid" the Social Security surpluses to fund other programs or tax cuts. On this matter, you ladies and gentlemen are better judges of the proposal than I am.

Let me take up these three hallmarks of the plan in turn.

1. *Saving most of the surpluses*

The President's plan would take the projected \$4.85 trillion in unified budget surpluses over the next 15 years and spend only \$1.4 trillion on tax cuts and new programs,¹ saving \$3.45 trillion or 71% of the total. (See Chart 1.) Is that a lot or a little? It all depends on what alternative you compare it with. Compared to a fiscally irresponsible policy that would use the entire \$4.85 trillion to fund tax cuts and new programs, the increase in national saving is enormous—\$3.45 trillion. But compared to a Midas-like policy of saving every dollar of the unified surplus, the President's plan spends \$1.4 trillion more.²

Perhaps a more natural baseline is a policy that would save the Social Security surpluses and use the rest for new spending and/or tax cuts. Compared to that alternative, the President's plan raises national saving by an additional \$750 billion over 15 years. I applaud that change. The nation needs the saving. As you consider ways to modify the plan, I hope Congress will not lower this national saving target.

Now, what happens to the \$3.45 trillion that is saved? Under the President's plan, \$2.87 trillion is used to reduce the national debt. The rest, \$0.58 trillion, goes into equity purchases by the Social Security System. So perhaps I should take up this aspect of the plan next.

2. *Investing in equities*

¹About \$0.4 trillion of this spending is for debt service. White House presentations subtract this debt service from the \$4.85 trillion in surpluses and speak of spending \$1 trillion out of \$4.45 trillion. I find my accounting treatment clearer. But there is no issue of substance here.

²Just over half of this \$1.4 trillion, including the associated debt service, goes to USA accounts, which are designed to spur private saving. The Administration has not yet released the details of this proposal.

The motivation for investing part of the Social Security Trust Fund in the stock market was already mentioned: It boosts the Trust Fund's rate of return, thereby reducing the need to either cut Social Security benefits or raise payroll taxes in the future. That is the idea's chief merit. Higher Trust Fund returns mean that fewer benefit cuts and tax increases will be waiting for us in the future.

But, of course, every dollar that the Trust Fund invests in equities is one dollar less that it invests in government bonds. Holding everything else constant, this means that the Treasury must sell one additional dollar of bonds to private investors, thereby incurring greater interest costs. So part of the gain to the Social Security Trust Fund (the dividends and capital gains it earns) is paid for by higher interest charges against the General Fund. In a word, investing part of Social Security's assets in the stock market can be viewed as an indirect way to transfer money from the General Fund to the Social Security Trust Fund. I am not opposed to that on principle, but people should understand that that is the essential effect.

The proposal to invest roughly \$580 billion in equities over 15 years has been attacked on the grounds that government-controlled investments in the stock market will inevitably lead to politically-motivated investment decisions. I respectfully disagree. I am not so naive as to assert that political interference is impossible. But I do believe that the following quadruple layer of insulation can push politics so far away from investment decisions that interference is extremely unlikely:

First, Social Security's investments should be overseen by a board with as much political independence as the Federal Reserve Board. I was Vice Chairman of the Fed in 1994–95, a time when our policy of raising interest rates was under attack by Republicans and Democrats alike. But we technocrats did it anyway because we thought it was the right thing to do, and the country has reaped rich dividends. I do not believe that political independence is impossible in Washington. It's just difficult to maintain, and must be jealously guarded.

Second, Social Security's investment board should be empowered to hire professional fund managers from the private sector, not to pick stocks.

Third, those fund managers should be instructed to invest mainly, and probably exclusively, in indexed funds—and the government should not vote its shares.

Fourth, any President or Member of Congress who attempted to breach these three lines of defense should be called to public account by an ombudsman or whistle-blower. Again, you ladies and gentlemen are the politicians, not I. But what elected official would run the risk of being publicly upbraided for undermining the pension security of every single American? Social disapprobation and bad press strike me as quite powerful sanctions in this context.

In sum, I would sleep quite peacefully at night, unconcerned about my Social Security investments, if these four layers of insulation were in place. And the first three of them are very similar to the President's plan.

3. *Enhancing the pledge by giving bonds to the trust funds*

I come now to the controversial accounting device mentioned earlier—and to the charge of double-counting. (See Chart 2.) Under the President's plan, the Treasury would grant to the two trust funds, as outright gifts, some \$2.87 billion in new special purpose bonds. (\$2.18 trillion of these new bonds go to Social Security, \$0.69 trillion to Medicare.) These pieces of paper create assets for the trust funds and equal liabilities for the Treasury. The hope, however, is that these pieces of paper will have real *political* significance.

The idea, as I understand it, is this. Under current law, Congress has promised to pay a certain stream of Social Security benefits, but the payroll tax will not bring in enough revenue to fund this stream. Thus Congress has *implicitly* pledged to balance the books by enacting some combination of benefit cuts and payroll tax increases in the future. By giving the trust funds \$2.87 trillion in new bonds, the President takes part of that implicit pledge and inscribes it *explicitly* on pieces of paper called bonds. These bonds, of course, have legal force: Future governments will be compelled to pay interest and principal as promised. So at least this part of the money that Social Security has been promised *must* be delivered. In that sense, the pledge is strengthened.

And notice a second change. The money to pay off the bonds will presumably come from general revenues or from spending cuts in on-budget programs (including interest payments), not from payroll taxes or cuts in Social Security benefits. Thus, if Congress accepts this accounting device, it is implicitly signing on to partial general-revenue financing of Social Security. As I have said already, I see no strong objections to doing so, but I know others hold a different view. The much lower national debt, by the way, will free up funds that would otherwise be needed for interest payments, so the General Fund will be better able to bear the burden.

Finally, let me explain how the charge of double-counting arises. The \$2.87 trillion in new bonds and the \$0.58 trillion to be invested in stocks are outright gifts to the trust funds.³ They add up to \$3.45 trillion, which is precisely the amount that is to be saved over 15 years. This is no coincidence. The Administration proposes a change in scorekeeping rules that would count such gifts from the Treasury to the Trust Funds as outlays in the unified budget. It does so to “use up” the surplus and thereby create a “balanced budget.”

This is surely unorthodox bookkeeping. After all, the government’s left hand is merely conveying funds to its right hand. The reason is, once again, to build a political wall around Social Security. By counting the \$3.45 trillion in gifts as spending, the unified budget is declared “balanced,” leaving no “surplus” available for use by future Congresses. So this proposed new accounting device is really an attempt to get the present Congress to deter future Congresses from tampering with the decision to save the \$3.45 trillion.⁴

Politically speaking, is this idea foolish or clever? I’ll let you be the judge of that. But it has had at least one unfortunate consequence. The fact that the \$3.45 trillion “gift” exactly matches the \$3.45 trillion that is saved has given rise to the charge that the Administration is double counting.⁵ But there is no second \$3.45 trillion to be parceled out. The same number, \$3.45 trillion, appears *once* in the plan as national saving—which it is—and *again* as a “gift” to the trust funds. But the latter is just an accounting device designed to say “hands off.” It amounts to a pledge to provide that much more money for Social Security in the future—somehow. But it does not specify the sources. Thus, by itself, it does not fill any of the funding gap. If this strikes you as double counting, don’t count it! The policy remains the same.

CONCLUSION

There is a simpler and more intuitively appealing plan which, had the President proposed it, would, I believe, have generated less confusion and raised fewer objections. (See Chart 3.) That would be to dedicate the \$2.70 trillion in Social Security surpluses over the next 15 years to debt reduction, and therefore to national saving—and to forget about the new gift bonds and odd scorekeeping rules. The unified budget would therefore show consistent surpluses as the national debt declined.⁶

Compared to this simple plan, the President’s proposal consists of three significant policy changes, and you can consider each of them independently of the others:

1. It adds an additional \$750 billion to national saving over 15 years.
2. It invest \$580 billion of Social Security money in the stock market.
3. It creates \$3.45 in gift bonds and the accounting device that treats them as spending.

As I have explained, I heartily endorse the first two changes and leave it to Members of Congress to judge the political merits of the third. But please do not reject it on the grounds that it constitutes “double counting,” when it is actually an attempt—whether awkward or skillful—to build a political wall around funds that will one day be needed for Social Security.

Thank you all for listening.

³It is my understanding that the precise budgetary mechanics for the \$0.58 trillion are yet to be worked out.

⁴I use the verb “deter” rather than “prevent” because no Congress can truly bind a future Congress. Both the law and accounting procedures can be changed.

⁵The Social Security portion of this \$3.45 trillion is \$2.76 trillion, which is the amount that has often been talked about as “double counted.”

⁶Under the President’s proposed accounting change, the national debt will decline even though the budget is “balanced”!

Chart 1: Follow the Money

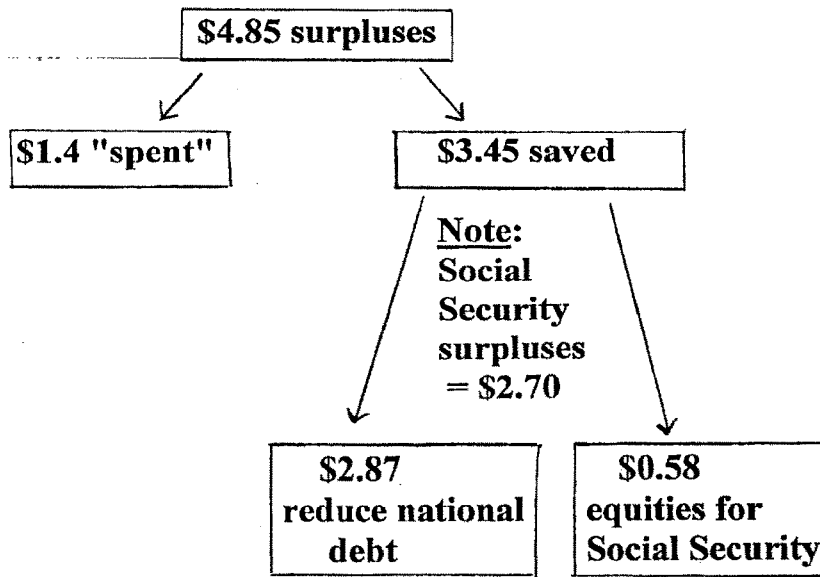


Chart 2: The Accounting Device

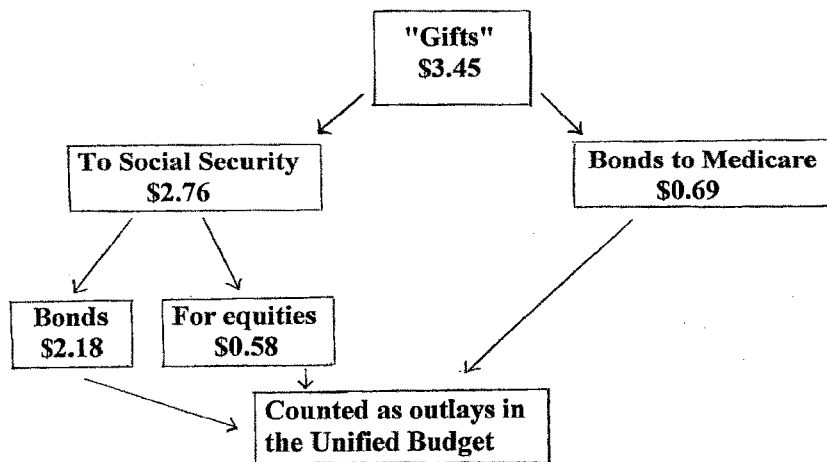
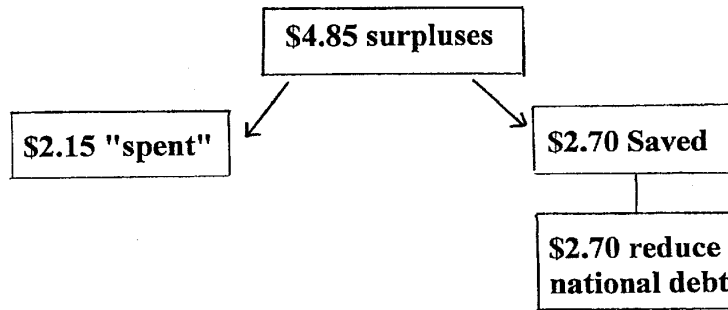


Chart 3: A Simpler Plan



Statement of Peter Orszag and Robert Greenstein,¹ Center on Budget and Policy Priorities

FEDERAL DEBT: WHAT MATTERS AND WHY

The Clinton Administration's proposal to dedicate a portion of the projected unified budget surplus to Social Security and Medicare has generated a confusing debate over its impact on the federal debt.

•President Clinton noted in his State of the Union address that, "If we set aside 60 percent of the surplus for Social Security and 16 percent for Medicare, over the next 15 years, that saving will achieve the lowest level of publicly-held debt since right before World War I, in 1917."

•Representative Bill Archer, in a Congressional hearing February 11, stated that "the Administration's proposal increases the *total* Federal debt by \$1.2 trillion between 1999 and 2004 and it *increases* the debt held by the government by \$1.5 trillion over the same period."

An interested observer would understandably be perplexed by these apparently contradictory statements. The purpose of this short paper is to examine different measures of "federal debt" and to clarify the effects of the Administration's proposal on them.

The two most commonly used measures of federal debt are:

•*Debt held by the public.* Debt held by the public reflects the government's borrowing from the private sector (i.e., from banks, pension plans, private bond-holders, foreign investors, and others).² Changes in debt held by the public have important economic implications. These changes can affect national saving, private-sector investment, interest rates, and economic growth.

•*Gross Federal debt.* Gross Federal debt includes debt held by the public plus debt that various parts of the government hold. In other words, it includes debt that one part of government owes to another part. For example, Social Security surpluses are currently used to help finance other parts of the government; in exchange, the Social Security trust fund is given an IOU from the rest of the government. Such IOUs, held as Treasury bonds, increase the gross Federal debt but do not affect the debt the government owes to outside entities (i.e., the debt held by the public). The ma-

¹Peter Orszag is President of Sebago Associates, Inc., an economics consulting firm, and lecturer in economics at the University of California at Berkeley. He previously was special assistant to the President for economic policy and senior economist on the Council of Economic Advisers. Robert Greenstein is executive director of the Center on Budget and Policy Priorities.

²Debt held by the public includes debt held by the Federal Reserve Banks. In 1998, debt held by the public amounted to \$3,719.9 billion. The Federal Reserve Banks held \$458.1 billion of that total. Many economists believe the Federal Reserve Banks should be included as part of the government and remove the portion held by the Federal Reserve Banks from debt held by the public.

majority of debt that one part of the federal government owes to another part is debt the Social Security and Medicare trust funds hold in the form of Treasury bonds that reflect the recent surpluses in these programs.

Debt that the Treasury issues and other parts of the government hold does not directly affect national saving and investment. Since this debt reflects money the Treasury has borrowed from other parts of the government rather than from private credit markets, it does not directly place upward pressure on interest rates or affect the amount of private capital available for business investment.³ Government-held debt does not have the economic effects that “publicly held debt” has.

•Another common term is “debt subject to limit.” This refers to the debt that is subject to the debt ceiling, or debt limit, established by statute. “Debt subject to limit” is essentially the same as the gross Federal debt.⁴

The two principal definitions of Federal debt thus are quite different from each other. Most economists and fiscal analysts agree that debt held by the public is the much more meaningful and important measure. David Walker, the Comptroller General of the United States (i.e., the head of the General Accounting Office), explained in Senate Finance Committee testimony on February 9, 1999 that “Debt held by the public and debt held by trust funds represent very different concepts. Debt held by the public approximates the Federal government’s competition with other sectors in the credit markets. This affects interest rates and private capital accumulation. Further, interest on debt held by the public is a current burden on taxpayers. In contrast, debt held by the trust funds performs an accounting function. . . . [it does not] have any of the economic effect of borrowing from the public. It is not a current transaction of the government with the public; it does not compete with private sector funds in the credit market.”⁵

The difference in the economic effects of these two kinds of debt can be seen by examining what happens in the economy when each kind of debt increases. When debt held by the public rises, the government must compete with private borrowers to a greater degree for the capital (or saving) from which one can borrow. That dissipates the amount of capital available that private borrowers can invest in the private economy. With the government soaking up more of the capital available, less remains for investment in new plants and equipment and start-up businesses. Stated another way, some of the money that otherwise would be available for private investment is used instead to purchase the increased volume of bonds the Treasury is issuing.

Increased government borrowing from entities outside government (i.e., increases in debt held by the public) discourages private investment in part through higher interest rates. Since the increase in government borrowing results in more competition for the capital available in private credit markets, the amount that lenders can charge to lend funds—i.e., interest rates—can rise. Higher interest rates make it more costly to buy a home or car and discourage business investment.

Conversely, when debt held by the public decreases, the government is borrowing less in private credit markets, leaving more capital for private investment. By boosting private investment, this creates a basis for higher levels of productivity and hence a larger economy in the future. (The economy should have more modern and efficient plants and equipment as a result of the increased investment.)

By contrast, changes in the amount of debt the trust funds hold (i.e., the amount of Treasury bonds they hold) do not have direct economic implications, as the Comptroller General’s testimony explained. Rep. Archer also has noted this distinction. In his recent statement, he acknowledged that debt held by the public is the “debt that hurts the economy by crowding out private savings,” whereas debts owed one

³The surpluses in specific government programs, reflected in trust funds for those programs, may have indirect effects on national saving and interest rates if they cause policymakers to change their behavior. For example, if a larger trust fund induced policymakers to raise spending or cut taxes (i.e., to run smaller budget surpluses) to a greater degree than they otherwise would, the debt held by the trust funds would have indirect effects on national saving and investment. Even such indirect effects, however, would manifest themselves through changes in debt held by the public.

⁴At the end of 1998, gross Federal debt amounted to \$5,478.7 billion. Debt subject to the statutory limit amounted to \$5,439.4 billion. This small difference—a difference of less than one percent—arises because of debts issued by the Federal Financing Bank that are included in gross Federal debt but not in the debt subject to limit, debt issued by federal agencies that is included in the debt limit but not in the gross Federal debt, and differences in the treatment of discounts and premiums on bonds when issued. The statutory maximum on the debt subject to limit was raised to \$5,950.0 billion on August 5, 1997.

⁵David Walker, “What the President’s Proposal Does and Does Not Do,” Testimony before the Committee on Finance, U.S. Senate, February 9, 1999, page 4. For a similar statement by Robert Eisner, former president of the American Economic Association, see Eisner, the Misunderstood Economy: What counts and How to Count It, Harvard Business School Press, 1994, p. 92.

part of the government to another “do not hurt the economy nor do they crowd out private savings.”⁶

There also is one other important difference between debt held by the public and debt held by the trust funds. Interest payments on debt held by the public are a government expenditure. In fiscal year 1998, they consumed \$230 billion, or about one dollar in every seven in the federal budget. By contrast, interest payments on debt held by the trust funds are not an expenditure—they are simply a transfer of funds from one part of the government to another. (The actual expenditure occurs when Social Security and Medicare pay benefits, not when an intra-government fund transfer is made.) Reducing or eliminating debt held by the public thus cuts government costs; under the Administration’s proposal, for example, federal expenditures for interest payments on the debt held by the public would drop from 14 percent of the budget in 1998 to just two percent by 2014. Increases or decreases in the debt held by the trust funds have no similar effect—they do not raise or lower government expenditures.

TRENDS IN FEDERAL DEBT AND THE ADMINISTRATION’S PROPOSAL

Table 1 shows both debt held by the public and gross Federal debt as percentages of the Gross Domestic Product, the basic measure of the size of the economy. As the table shows, under the Administration’s proposal, debt held by the public would fall from 44 percent of GDP in 1998 to 30 percent in 2004. It would continue to decline thereafter, reaching seven percent of GDP by 2014, its lowest level since 1917. This reduction would occur because budget surpluses would largely be saved and used to pay down debt held by the public. This reflects the primary economic benefit of the Administration’s approach.

Despite the decline in publicly held debt under this proposal, gross Federal debt would rise in nominal dollars (see Table 2) because of the additional debt issued to the Social Security and Medicare trust funds. Under the Administration’s plan, for every dollar of publicly held debt retired, a dollar of additional Treasury bonds would be deposited in the Social Security or Medicare trust funds.

⁶Chairman Bill Archer, Opening Remarks, Hearing on Social Security, Committee on Ways and Means, U.S. House of Representatives, February 11, 1999.

UNDERSTANDING FEDERAL DEBT THROUGH AN ANALOGY TO A FAMILY

An analogy to a family may be helpful in understanding the differences between debt held by the public and gross Federal debt and how the Administration's proposal would affect them. As with any analogy, this one does not capture every facet of reality but should be helpful.

Consider a family of four that has a mortgage on its house and includes a child who will be unable to work when he or she grows up because of a serious disability. Other family members have promised to subsidize the child's income when the child becomes an adult.

In our analogy, debt held by the public corresponds to the family's mortgage; it reflects the debt that is owed to someone outside the family. The gross Federal debt corresponds to the family's mortgage *plus* any legally binding promises that family members have made to the child who will be unable to work in the future.

The family's overall economic well-being (i.e., its total spendable income and wealth) is affected by the size of its mortgage but *not* by how much one member of the family has pledged to another. Internal debts affect the *distribution* of the family's resources among the various family members but not the financial position of the family as a whole. Only the mortgage owed to the bank affects the family's financial well-being as a whole.

This analogy can be used to help understand the Administration's proposal to dedicate a portion of the projected unified budget surpluses to Social Security and Medicare. Assume the family has made promises to the child who will not be able to work but these promises have not been placed in a document that would make them a legally binding obligation. These promises would not be included in the family's equivalent of gross Federal debt. Assume also that a member of the family receives a large, unexpected pay raise. The family member receiving the raise announces she will use the additional income to pay off part of the mortgage. She also announces she will turn into a legal commitment a part of the promise the family has made to help support the child who will be unable to work. She decides that for each dollar of the mortgage she pays off, she will sign a legally binding IOU for \$1 to the child.

The family's analogue to debt held by the public — its mortgage — would decline. At the same time, the family's *total* debt, including both its mortgage and the legal commitments to the child who will be unable to work, would not fall; the family's total debt would remain unchanged. Even though its total debt would not change, however, the family would clearly be better off. Moreover, while the family's financial commitment to the child who will not be able to work would be recognized in a more formal manner, the commitment to the child would not necessarily be any larger than it was before (although the child would have more assurance that the commitment would be fully honored).

The additional debt that would be issued to the trust funds in the form of these Treasury bonds would not increase the costs of these programs. The costs of the programs are the costs of providing Social Security and Medicare benefits; those costs are not raised by providing more Treasury bonds to the trust funds. Rather, the issuance of additional debt to the trust funds would help narrow the gap that already exists between the future costs of honoring the benefit commitments these programs have made and the revenues the trust funds are scheduled to receive to meet those costs.

Stated another way, the additional debt that would be issued to the trust funds would reduce the unfunded liability in these programs. The Administration's proposal would make explicit, in form of additional debt the trust funds would hold, a part of the implicit debt the government faces as a result of these unfunded liabilities. Since these unfunded liabilities are not included in the measure of gross Federal debt, however, converting part of the unfunded liabilities into funded liabilities through the issuance of more Treasury bonds to the trust funds causes the gross Federal debt measure to rise.

It should be noted that while gross Federal debt would increase in dollar terms, it would decline as a percentage of GDP between 1998 and 2004 (see Table 1). Under the Administration's proposal, gross Federal debt would fall from 65.2 percent of GDP in 1998 to 62.7 percent in 2004. Most economists believe that variables like debt are best evaluated relative to the size of the economy, not in absolute dollar terms. On that basis, gross Federal debt would decrease.

Table 1

Federal Debt As A Percentage of GDP Under the Administration's Proposal			
	Debt held by the public	+ Debt held by government accounts (trust funds)	= Gross Federal debt
1960	45.7%	10.4%	56.1%
1970	28.1%	9.7%	37.8%
1980	26.1%	7.3%	33.4%
1990	42.4%	14.0%	56.4%
1993	50.2%	17.0%	67.2%
1998	44.3%	20.9%	65.2%
2004	30.4%	32.2%	62.7%

Source: Office of Management and Budget, FY 2000 Budget, Historical Tables, Tables 7.1 and 10.1; FY 2000 Budget, Table S-14, and authors' calculations

The increase in gross Federal debt is thus not meaningful economically for two reasons. First, and more important, gross Federal debt does not affect economic performance; debt held by the public does. Second, the dollar increase in gross Federal debt is misleading; relative to GDP, gross Federal debt declines between 1998 and 2004.

Because the President's approach would lead to a large reduction in publicly held debt without raising Social Security and Medicare costs, it would result in a healthier long-term fiscal outlook than an approach that left publicly held debt at relatively high levels. If the nation can largely or entirely eliminate the publicly held debt over the next two decades, we will enter the baby-boom retirement period free of substantial annual costs for interest payments on the publicly held debt. Indeed, Social Security costs over the next several decades (including the period of the baby boomers' retirement), measured as a share of GDP, are projected to be at or below today's expenditures levels for Social Security and interest payments. In fiscal year 1999, Social Security and interest costs are projected to equal 7.4 percent of GDP; if the publicly held debt is essentially eliminated, as would occur in about 2018 under the Administration's plan, combined Social Security and interest costs should remain below 7.4 percent of GDP for several decades. Stated another way, elimination of the debt held by the public would produce large interest savings that could create room in the budget for anticipated increases in Social Security benefit costs during the next few decades.

THE QUESTION OF WHICH BASELINE TO USE

Comparing debt projections under the Administration's plan to the historical record shows the plan would result in a sharp drop in debt held by the public. Some analysts, however, compare the debt projections not to the historical record but to a budget baseline that assumes the unified budget surplus will be used solely to reduce debt held by the public. Such a baseline assumes that none of the surplus will be used for tax cuts, for increasing discretionary spending above the current discretionary spending caps, or for expansion of any entitlement programs. This baseline also assumes that none of the surplus is used to make additional transfers to the Social Security and Medicare trust funds. Debt held by the public would fall by more—and gross Federal debt would rise by less—under such a baseline than under the President's proposal. (It may be noted that even under such a baseline, gross Federal debt rises; see Table 2.⁷)

⁷The increase in gross Federal debt under the baseline reflects a variety of accounting issues. Perhaps most important, the Federal Credit Reform Act of 1990 changed the budgetary rules governing direct loans and loan guarantees. Under the new rules, only the estimated subsidy cost of a direct loan is scored as an expenditure. But the government must finance the full value of the loan. Therefore, the unified budget surplus (which reflects only the subsidy cost of a direct loan) is larger than the reduction in debt held by the public (which reflects the full value of the direct loan). Similarly, the on-budget surplus does not exactly match the change in gross Federal debt. Other accounting discrepancies have similar effects.

Table 2

Federal Debt in 1998 and 2004 Under the Baseline and Under the President's Proposal (in billions of dollars)			
	1998	2004	
		Baseline	President's proposal
Debt held by the public	\$3,719.9	\$2,926.4	\$3,289.6
Debt held by government accounts	\$1,758.8	\$2,947.9	\$3,486.3
Gross Federal debt	\$5,478.7	\$5,874.4	\$6,776.0
Debt subject to limit	\$5,439.4	\$5,841.6	\$6,743.2

Source: Office of Management and Budget, *FY 2000 Budget, Historical Tables*, Table 7.1; *FY 2000 Budget, Table S-14*; and *FY 2000 Budget, Analytical Perspectives*, Table 12-5.

Gross Federal debt would be higher under the Administration's proposal than under such a baseline for two reasons. The primary reason is that under the Administration plan, additional debt would be issued to the Social Security and Medicare trust funds. The other reason is that under this plan, a modest share of the projected surpluses would be used to boost discretionary spending and provide tax cuts in the form of universal savings accounts, rather than to pay down the publicly held debt. As a result, debt held by the public would be somewhat higher under the Administration's proposal than under this baseline.

It should be noted that any proposal to use the unified budget surplus for new spending or tax cuts would raise gross Federal debt as compared to this baseline. Such plans would raise the gross Federal debt compared to this baseline because those plans would use part of the surplus for tax cuts or new spending rather than for retiring debt held by the public. As explained above, the Administration's proposal would itself raise the gross Federal debt, but it would do so primarily because it would increase debt held by the trust funds, rather than debt held by the public. (Recall that gross Federal debt is the sum of debt held by the public and debt held by the trust funds.) Thus, two different policies that generate increases of equivalent size in the gross Federal debt can have very different economic effects if one policy raises the gross debt because it swells debt held by the public while the other policy raises the gross debt because it increases debt held by the trust funds.

CONCLUSION

Debt held by the public affects saving and investment. Relative to current levels, the Administration proposal would lead to a substantial reduction in debt held by the public, boosting saving and spurring investment. Federal Reserve chairman Alan Greenspan and various other economists have lauded these aspects of the Administration plan.⁸

The Administration's proposal would make explicit a part of the government's existing, but implicit, obligation to Social Security and Medicare. It would do so by issuing more Treasury bonds to the Social Security and Medicare trust funds. As a result, gross Federal debt in dollar terms would rise even though debt held by the public would fall sharply. Nevertheless, gross Federal debt would fall as a percentage of GDP, and its increase in dollar terms would be economically benign; it would not reduce saving and investment. Nor would it increase the costs of paying future Social Security and Medicare benefits. Alternative proposals to use budget surpluses for tax cuts or spending increases also would raise gross Federal debt but could do so in an economically injurious manner if the proposals significantly raised the publicly held debt.

⁸ In testimony before the House Ways and Means Committee on January 20, Greenspan stated: "The advantages that I perceive that would accrue to this economy from a significant decline in the outstanding debt to the public and its virtuous cycle on the total budget process is a value which I think for exceeds anything else we could do with the money."

**Statement of Hon. Edward M. Gramlich, Member, Board of Governors of
the Federal Reserve System**

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you today to discuss Social Security reform. I speak for myself, as past chair of the 1994–1996 Quadrennial Advisory Council on Social Security, and not in my current status as a member of the Federal Reserve Board.

As you are all well aware, the U.S. population is aging. Today there are 3.4 workers per retiree; by 2030 it is projected that there will only be two. This fundamental change in the demographics of our population poses a large challenge: how can we provide adequate health and retirement benefits to our retired population, without imposing undue burdens on tomorrow's workers?

Clearly, the answer to this question is that we must act now to increase the total amount of resources to be available in the future. By increasing the size of our economy, we can devote a greater share of output to the retired population, without reducing the consumption of the working population. The only way to achieve this critical objective is for us to build up the stock of productive capital by increasing our rate of national saving. Indeed, in the current expansion, investment has expanded at a rapid clip, without inducing a rise in interest rates. This investment boom, and the accompanying step-up in the growth of the capital stock, is partly attributable to an increased rate of national saving. Between 1992 and 1998, national saving increased from 3.7 percent to 7.5 percent of net national product. While private and state and local government saving actually dipped during this period, this decline was more than offset by increased saving by the federal government through deficit reduction.

The stellar performance of the economy over recent years provides the nation a unique opportunity to begin to tackle its long-run problems. In particular, the large budget surpluses that are projected over the next 15 years or so, if they are permitted to materialize, will significantly improve our fiscal and economic position as the baby boom starts to retire. From the government's perspective, using those surpluses to pay down the federal debt will reduce future interest payments and free up future tax revenue; from the macroeconomic perspective, the increase in national saving represented by the increase in government saving will lead to a larger capital stock, higher productivity, and an improved standard of living.

From this standpoint, the broad objective of the Clinton Administration's budget—that is, to preserve most of the projected surpluses—seems to me both responsible and appropriate. The Administration would devote about \$1.4 trillion of the projected \$4.9 trillion of current law surpluses over the next 15 years to new spending, and use the remainder to pay down our national debt. According to the Administration's calculations, the ratio of debt held by the public to GDP would fall from its current 44 percent to 7 percent by 2014. If such an outcome were to materialize, it would represent a dramatic improvement in the fiscal position of the nation.

Under current law, the Social Security revenues exceed outlays, creating surpluses that are credited to the Social Security trust fund. Without any legislative changes, the Social Security trust fund will continue to accumulate funds, reaching a peak in 2020 of \$3.8 trillion, or almost 16 percent of GDP. These surpluses both reduce the national debt and improve the long run fiscal condition of Social Security. This claim does not stem from any accounting gimmickry: By reducing future interest payments, these surpluses do indeed free up future revenues.

In addition to this accumulation already scheduled under current law, the Administration is also proposing to transfer an additional \$2.8 trillion of general revenues to the Social Security trust fund. While the Administration's rationale for these transfers is to ensure that the surpluses actually materialize, the transfer of general revenues represents a major shift from past practice, under which Social Security has been financed almost entirely from dedicated payroll taxes.

During the deliberations of the 1994–1996 Social Security Advisory Commission, we considered whether general revenues should be used to help shore up the Social Security program. This idea was unanimously rejected, for a number of reasons. First, using general revenues to fund Social Security puts the Social Security system in competition with other spending programs during the budget cycle. But Social Security is a long-range program—people pay dedicated taxes today toward benefits that may not be received for 30 or 40 years—and many feel that it should not be part of an annual budgetary allocation process.

Perhaps more importantly, using general revenues to fund Social Security undermines the fiscal discipline imposed by the need to ensure that income earmarked for Social Security is sufficient to meet the entire cost of the program, both in the

short run and long run. Without a long-range budget constraint on Social Security, it will be much more difficult to limit future benefit growth. And, notwithstanding the large surpluses being projected, some reductions in benefits are almost certain to be necessary as the U.S. population ages.

It is important to remember that the aging of the population will bring pressures to programs other than Social Security. The trustees of the Medicare trust fund project that Medicare expenditures as a share of GDP will more than double—from 2.7 percent today, to over 5.8 percent in 2030, and Medicaid spending on long-term care likely will face similar increases. Because under the current budget system, Medicare Part B and Medicaid are financed with general revenues, there is much less pressure to take measures now to improve their long-run financing. But these programs too will put significant demands on government resources in the future. If we use the projected surpluses as a rationale for not making hard choices in Social Security, finding the resources to provide Medicare and Medicaid to our aging population will prove that much harder.

Thus, there are serious drawbacks to relaxing Social Security's long run budget constraint through general revenue transfers. I would prefer Social Security reforms that maintain the link between dedicated taxes and benefits, and maintain the value of long-range actuarial analysis. This discipline is essential if we are to limit the impending explosion of entitlement spending. The President's budget proposal, by preserving future surpluses and paying down our national debt, makes an important contribution to raising national saving. But to me the proposal looks even better without the general revenue transfer.

