

LETTER OF TRANSMITTAL

BOARD OF TRUSTEES OF THE
FEDERAL OLD-AGE AND SURVIVORS INSURANCE
AND DISABILITY INSURANCE TRUST FUNDS,
Washington, D.C., April 2, 1992

HONORABLE DAN QUAYLE
President of the Senate
Washington, D.C.

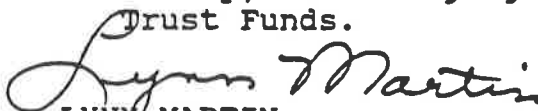
Dear Mr. President: It is our duty to report on the financial outlook for the Disability Insurance Trust Fund, in compliance with section 709 of the Social Security Act. The 1992 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds indicates that the Disability Insurance Trust Fund is expected to be exhausted in 1997 and could possibly be exhausted as early as 1995.

Under section 709, we are required to report to each House of the Congress when the reserves of any trust fund are expected to become less than 20 percent of annual expenditures. The enclosed report by the Board of Trustees, Balance Ratio Estimates for the Disability Insurance Trust Fund, describes these findings, as required by section 709. This report is also being sent to the Speaker of the House.

Respectfully,



NICHOLAS F. BRADY, Secretary of the
Treasury, and Managing Trustee of the
Trust Funds.



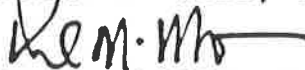
LYNN MARTIN,
Secretary of Labor, and Trustee.



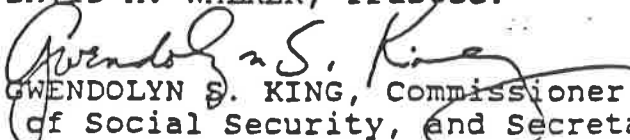
LOUIS W. SULLIVAN, M.D., Secretary of
Health and Human Services, and Trustee.



STANFORD G. ROSS, Trustee.



DAVID M. WALKER, Trustee.



GWENDOLYN S. KING, Commissioner
of Social Security, and Secretary,
Board of Trustees.

Balance Ratio Estimates
for the Disability Insurance Trust Fund

A Report by the Board of Trustees,
Federal Old-Age and Survivors Insurance
and Disability Insurance Trust Funds

Background

Section 709 of the Social Security Act requires the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (the Board) to submit a report to each House of the Congress when it determines that the balance ratio of a trust fund for any calendar year may become less than 20 percent. The balance ratio is the ratio of assets, at the beginning of a year to expenditures during that year.¹ Section 709 further requires that the report include:

. . . recommendations for statutory adjustments affecting the receipts and disbursements of such Trust Fund necessary to maintain the balance ratio of such Trust Fund at not less than 20 percent, with due regard to the economic conditions which created such inadequacy in the balance ratio and the amount of time necessary to alleviate such inadequacy in a prudent manner. The report shall set forth specifically the extent to which benefits would have to be reduced, taxes . . . would have to be increased, or a combination thereof, in order to obtain the objectives referred to in the preceding sentence.

The Disability Insurance Trust Fund

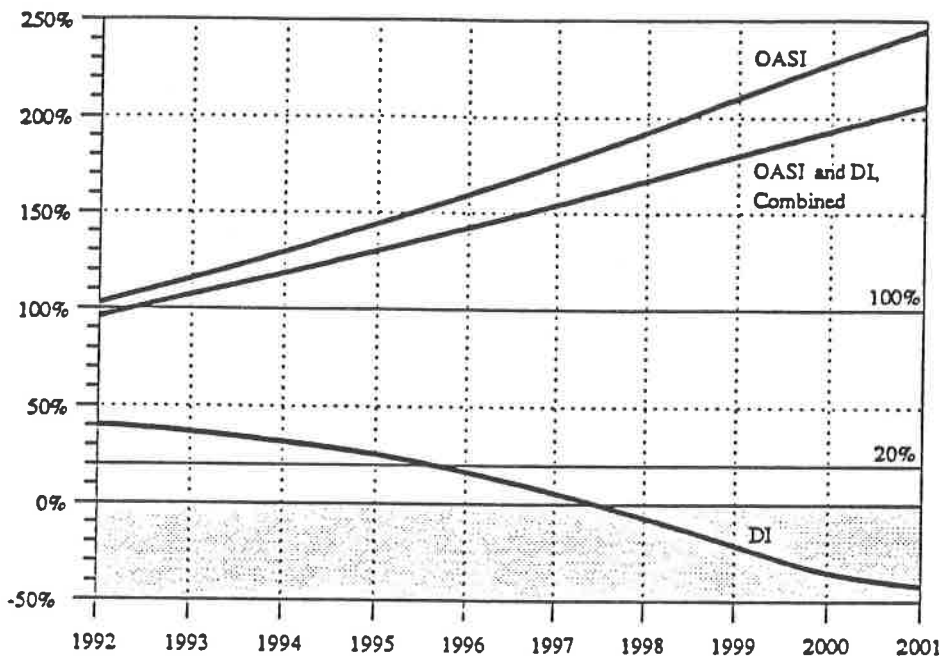
Each year, the Board prepares a report, commonly referred to as the Trustees Report, on the financial outlook for the Social Security trust funds. The Trustees Report provides projections under three alternative sets of economic and demographic assumptions. Under intermediate assumptions (those representing the Trustees' best estimate of future economic and demographic trends) in the 1992 Trustees Report, the assets of the Disability Insurance (DI) Trust Fund are expected to be less than 20 percent of annual expenditures at the beginning of 1996 and are estimated to be exhausted in 1997.

Estimates in the 1992 Trustees Report also show that, although the DI Trust Fund does not meet the short-range test of financial adequacy, the Old-Age and Survivors Insurance (OASI) and DI Trust Funds on a combined basis pass the short-range test of financial adequacy by a wide margin.

¹ This ratio is also called a trust fund ratio in the 1992 Trustees Report.

The following figure shows the estimated balance ratios for the combined OASI and DI Trust Funds and for each fund separately.

Balance ratios for the OASI and DI Trust Funds, separately and combined, under present law based on intermediate assumptions, 1992-2001



The Board is reporting the expected future decrease in the balance ratio for the DI Trust Fund at this time, since the 20-percent reserve level is estimated to be reached within the next 10 years, in accord with the statutory requirement to give due regard to the amount of time necessary to alleviate the inadequacy in a prudent manner.

Maintaining a Balance Ratio of at Least 20 Percent

The following table shows the minimum amounts necessary to keep the DI balance ratio from falling below 20 percent. The amounts of (1) additional tax income, (2) benefit reductions, and (3) a combination of equal amounts of tax income and benefit reductions are shown for each year over the next 10 years. This period was chosen to coincide with the short-range projection period employed in the Trustees Report and because nominal dollar amounts become increasingly less meaningful with longer projection periods.

The additional tax amounts required to meet the 20-percent goal differ somewhat from the reductions in benefit amounts. Tax rate changes affect assets (the numerator of the balance ratio) but not expenditures (the denominator); benefit changes affect both assets and expenditures simultaneously. Under the combined approach, one-half of the amount shown would be raised through additional tax income and one-half would be implemented through benefit reductions.

The decrease in required amounts from 1999 to 2000 reflects the effect of the reallocation of tax rates between OASI and DI that is scheduled under present law for the year 2000. Under this schedule, the DI tax rate is set to increase from its current level of 0.60 percent (for employees and employers, each) to 0.71 percent.

Amounts of change required from present law to prevent
the DI balance ratio from declining below
the 20-percent minimal level under intermediate assumptions
(In billions)

| <u>Calendar year</u> | <u>Additional tax income only</u> | <u>Benefit reductions only</u> | <u>Total amounts of additional tax income and benefit reductions, under combined approach</u> |
|--------------------------|---|--|---|
| 1993 | -- | -- | -- |
| 1994 | -- | -- | -- |
| 1995 | \$1.4 | \$0.5 | \$0.9 |
| 1996 | 4.9 | 4.7 | 4.8 |
| 1997 | 6.5 | 6.3 | 6.4 |
| 1998 | 8.2 | 7.5 | 8.0 |
| 1999 | 10.1 | 11.8 | 10.9 |
| 2000 | 3.7 | 3.7 | 3.6 |
| 2001 | 4.8 | 4.0 | 4.4 |
| Total, 1993-2001 | 39.6 | 38.5 | 39.0 |

A trust fund level of 20 percent of annual expenditures would be sufficient to enable the timely payment of benefits but would not provide an adequate reserve against adverse contingencies. A more stringent measure of trust fund strength is the test of short-range financial adequacy. This test was officially adopted and used for the first time in the 1991 Trustees Report. To meet this test, the estimated balance ratio must remain over 100 percent if the current ratio is over 100 percent.

If the current ratio is under 100 percent, then the estimated balance ratio must reach 100 percent by the beginning of the sixth year and remain at or over 100 percent throughout the remainder of the 10-year short-range period. In addition, estimated assets must be sufficient to pay all estimated benefits over the entire 10-year period. The test is applied on the basis of the intermediate assumptions.

Compliance with this test should be an important goal for any statutory adjustments designed to strengthen the financial condition of the DI Trust Fund.

Because the estimated DI balance for 1992 is 41 percent, the financial adequacy test requires that the fund achieve a 100-percent ratio by the beginning of 1997, and remain at or above 100 percent through 2001. For purposes of illustration, estimates were prepared of the changes that would be required to move steadily from the 41-percent balance ratio up to 100 percent at the beginning of 1997 and to remain at 100 percent through the year 2001.

The following table shows the resulting estimated amounts of (1) additional tax income, (2) benefit reductions, and (3) a combination of equal proportions of tax income and benefit reductions.

Amounts of change required from present law for DI
to meet the short-range test of financial adequacy
under intermediate assumptions
(In billions)

| <u>Calendar year</u> | <u>Additional tax income only</u> | <u>Benefit reductions only</u> | <u>Total amounts of additional tax income and benefit reductions, under combined approach</u> |
|-----------------------------|---|--|---|
| 1993 | \$7.3 | \$4.2 | \$5.0 |
| 1994 | 8.8 | 6.1 | 8.1 |
| 1995 | 10.7 | 9.0 | 9.4 |
| 1996 | 12.8 | 10.1 | 11.7 |
| 1997 | 7.4 | 11.7 | 12.5 |
| 1998 | 9.2 | 8.2 | 3.6 |
| 1999 | 11.1 | 9.6 | 14.6 |
| 2000 | 4.7 | 11.8 | 8.3 |
| 2001 | 5.8 | 5.3 | 2.5 |
| Total, 1993-2001 | 77.9 | 76.0 | 75.7 |

Recommendation

Based on the intermediate estimates in the 1992 Trustees Report, the assets of the DI Trust Fund would be below 20 percent of annual expenditures at the beginning of 1996 and would become exhausted in 1997 in the absence of corrective legislation. Legislative action should be taken to remedy the inadequate future assets of the DI Trust Fund.

During the history of the Social Security program, inadequate assets in either fund have frequently been remedied by reallocating part of the tax rates from the more adequately financed fund to the less adequately financed fund. This has provided additional income for the inadequate fund without requiring an increase in overall tax rates. On the other hand, a reallocation decreases the adequacy of the long-range financing for the fund that has its tax rate reduced.

Alternatively, the Congress could choose: to increase revenues to the DI Trust Fund in another manner; to reduce expenditures through an adjustment to the disability program; or to use a combination of methods to strengthen the financial condition of the trust fund.

Legislative changes that improve the short-range financing of the DI program by at least \$40 billion over the next 10 years are likely to be necessary to assure that the DI Trust Fund balance ratio stays over the 20-percent level. The Board believes that a careful analysis of the program, including the allocation of the OASDI tax rate, should be undertaken before any legislative recommendations are submitted. Therefore, the Board has asked the Department of Health and Human Services to report back the results of its examination of this issue so that the Board will be able to consider appropriate statutory adjustments and make appropriate recommendations to the Congress by December 31, 1992.

APPENDIX

STATEMENT BY THE PUBLIC TRUSTEES

We believe that the Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance (DI) Trust Funds, has taken the appropriate action by submitting this report to the Congress for its consideration.

We think that the severe financial inadequacy of the DI Trust Fund, and its estimated exhaustion in 1997 under the intermediate assumptions of the 1992 Annual Report, requires the Board to make the report mandated by section 709 of the Social Security Act.

As the public members of the Board, we have signed the report and endorse its content. At the same time, we have serious reservations about becoming participants in the process of developing specific legislative recommendations for the Congress to consider to remedy the situation. Because the other members of the Board are also members of the Administration, the proposals they develop necessarily will be within the context of Administration goals and policies. To participate in that development would, we believe, be contrary to the independent role of the Public Trustees.

For that reason, we do not believe it would be appropriate for us to participate in the development of the specific legislative recommendations to be provided to the Congress by the ex officio Board members.

We remain, as always, ready to consult with the Congress concerning the financial status of the Social Security and Medicare programs.

Stanford G. Ross
Trustee

David M. Walker
Trustee