TESTIMONY OF
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BEFORE THE
TASK FORCE ON SOCIAL SECURITY
COMMITTEE ON THE BUDGET,
U.S. SENATE

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Mr. Chairman and Members of the Task Force, thank you for this opportunity to discuss the President's plans to safeguard Social Security in the context of the Federal budget. Let me:

- provide some background on the budget and the economy, and how they will help us to make Social Security financially sound for the next century;
- describe the longer-range budget outlook, as it is discussed in this year's budget; and then
- describe the President's policy to "Save Social Security First."

The President Needed to Address the Structural Deficit Before He Could Address the Generational Deficit

When President Clinton took office, the unified deficit for the fiscal year just ended, 1992, was $290 billion (see chart), or 4.7 percent of the GDP — the largest dollar deficit in the history of the nation, one of the largest non-recessionary deficit shares of the economy, and clearly an unsustainable burden. For the 12 years up to then, annual deficits totaled $2.3 trillion. Alarmingly, the ratio of the nation's debt to its GDP had virtually doubled — from 25.8 percent at the end of 1981 to 48.8 percent at the end of 1992. Never before had the Nation witnessed such an explosion of public debt — like a family doubling its mortgage with no increase in its income.

The President recognized in 1993 that the financial solvency of Social Security would be a major budgetary challenge. However, before he dealt with that generational deficit, he had to rein in the exploding unified budget deficit. In January of 1993, CBO projected the unified budget deficit for 2003 at $653 billion, or 6.8 percent of GDP. The Administration's projections were almost identical — $639 billion, or 6.6 percent of GDP. Without changes in policy, these and other public and private forecasters projected that the deficit would keep rising, potentially pushing total public debt, future interest costs, and deficits into an upward spiral without limit.

In the face of this danger, the Administration set out, first and foremost, to cut this massive deficit and to put the budget and economy on a sound, sustainable footing.

Reducing the Deficit, 1992 Through 1997

To that end, the President proposed, and the Congress enacted, the Omnibus Budget Reconciliation Act in 1993 as a solid first step toward fiscal responsibility. It has proved to be much more.

While the overall budgetary situation may be familiar in light of the recent release of the Administration's FY 1999 budget, it is a vital element in our efforts to preserve Social Security for the next century, and so I will review the basics briefly here.

The Administration Has Exceeded Its 1993 Deficit Reduction Pledge:

- Upon OBRA's enactment, the Administration projected that it would reduce the accumulated deficits from 1994 to 1998 by $505 billion. Clearly, it will greatly exceed that goal. As you see on the same chart, we will save a total of $4 trillion by 2003 -- through a combination of the previous deficit-reduction steps that we've taken and the President's 1999 budget.

- Just through 1999, as the next chart shows, our cumulative savings will total $1.6 trillion. These budget savings begin a virtuous cycle of deficit reduction, by reducing debt and future debt-service costs. In 1999, net-interest costs are expected to be almost $80 billion below the estimates from before the President's 1993 deficit-reduction program.

The Administration Has Reversed the Debt Buildup of the 1980s:

- As the next chart shows, because we have reduced the deficit so dramatically over the last five years, we have added much less to the total national debt than the last two Administrations.

- Had this Administration done nothing, the debt would have exceeded $7 trillion, or 75 percent of GDP, by 2003. Instead, working with Congress, the Administration reversed the debt build-up as a share of GDP. As the next chart shows, OMB now projects that debt will fall to just 35 percent of GDP in 2003.

However, this projection assumes the continuation of the policy in the President's budget — which involves unified budget surpluses over the remainder of the ten-year budget window. If we dissipate those surpluses instead, debt will remain higher — leaving us far more vulnerable to the pressures of the baby boom and population aging in the next century. I will have more to say on this crucial issue later on in my testimony.

The Balance Between Spending and Revenue Savings:

- By 1992, Federal spending had reached 22.5 percent of GDP, topping its average of 21.9 percent from 1980 to 1997 (see chart). We have reached unified budget balance by both cutting outlays and increasing revenues. Revenues have increased through strong economic growth and changes in the tax law in 1993. However, the 1993 budget legislation also cut taxes for millions of Americans, as did the 1997 bipartisan budget agreement.

- As the next chart shows, the total deficit reduction that we have accomplished since 1993 has come 52 percent from spending, and 48 percent from revenues.

This budget continues the President's record of proposing budgets each year that are smaller, as a share of GDP, than <u>any</u> budget enacted during the previous two Administrations.

I present this background because solving the budget problem the right way has helped our prospects for safeguarding Social Security — both directly, and through a stronger economy.

The Near-Term Budget Outlook

A Balanced Budget and a Strong Economy Go Hand-in-Hand:

The prospects for the budget in the next five years — and for our ability to preserve Social Security — are rooted in a strong economy.

Over the last five years, we have enjoyed rapid job growth and low inflation. But there is one aspect of our economic performance that is especially important in the context of the future of Social Security.

When the President announced his 1993 economic plan, long-term interest rates fell. After Congress enacted the plan, though rates fluctuated as they always do, they have remained low. Those lower rates spurred a chain reaction of lower financing costs, and business and personal investment growth at unprecedented rates.

- As the next chart shows, in inflation-adjusted terms, business equipment investment has grown at over 11 percent a year under this Administration — almost three times faster than under President Reagan, and almost six times faster than under President Bush.

Investment growth is especially important for two reasons:

- New equipment embodies advanced technology, making workers who use the equipment more productive. Higher productivity permits larger wage increases without threatening higher inflation.

- Investment adds to the economy's productive capacity, and a larger economy generates more income, leading to higher average living standards. In the final analysis, a stronger economy is a prerequisite to meeting the retirement costs of the baby-boom generation without unduly burdening future workers. In essence, greater investment is what our society can do to "pre-fund" its own future retirement costs.

The Budget Outlook:

Now, let me turn to the budget outlook.

- Fueled by this strong economy, the Administration projects that the budget will reach unified balance in 1999 -- ending an era of continuous deficits that has lasted 30 years (see chart).

- The budget outlook has improved since last summer, when OMB and CBO both projected that the Balanced Budget Act (BBA) would not produce a balanced unified budget until 2002. Since then, economic growth has continued to exceed expectations, and inflation has remained low. The resulting changes in the Administration's economic and technical projections are responsible for the earlier expected budget balance (see chart).

- The 1999 surplus is projected at $10 billion — marking the first balanced budget in 30 years; the seventh consecutive year of deficit reduction / surplus increase under one President; and $127 billion better than projected one year ago. If projections hold, 1999 will be the seventh consecutive year of decline in the ratio of Federal spending to the GDP. The 1999 surplus will also yield the sixth consecutive year of a reduction of the ratio of the debt held by the public to the GDP.

These projections refer to the ***unified*** budget, which includes all Government operations. However, the Congress has mandated that the budget also focus on the ***non-Social Security*** deficit. The non-Social Security budget will help to determine whether the Federal Government can meet its Social Security responsibilities in the future. It also helps to show the extent to which the current Social Security surpluses are being used to increase the nation's savings — and thereby to build the stronger economy we will need to meet those future responsibilities.

In fact, the Clinton Administration has made tremendous progress on this front. In 1992, the non-Social Security deficit was 5.5 percent of GDP — the second-highest figure on record (second only to 1983, at 6.1 percent of GDP). By 1997, however, the non-Social Security deficit had fallen to 1.3 percent of GDP — the lowest figure since 1974. Even in nominal dollar terms, the non-Social Security deficit in 1997 was the lowest since 1981. This great improvement shows that the budget is steering our resources toward making the Social Security surplus real, and increasing the nation's savings. In 2007, by our projections, the non-Social Security budget will enter surplus.

We must focus on both the unified and the non-Social Security budget results because as Social Security surpluses retreat, it will be necessary for the rest of the budget to provide for a sound fiscal policy in the next century.

The Long-Range Budget Outlook

In last year's budget, the Administration projected that, assuming Congress enacted its policy proposals, the budget would not only reach balance, but remain there until 2020. Later, the deficit would rise, but to only 3.5 percent of GDP by 2050 — that is, below the level it had reached when the President took office.

Since last year, the economy has remained strong, and the President and Congress adopted new deficit-cutting policies in the BBA. As a result, the Administration now projects that the budget will reach unified balance sooner and remain in balance longer.

Still, these figures demonstrate that a long-run deficit problem remains. Of course, even more than for a five- or 10-year forecast, 75-year projections are sensitive to underlying assumptions. They fall into two basic classes: external factors, and policymaking behavior.

- Assuming a simple extension of current budget policies, unified budget surpluses can persist until 2054 (see chart). (Under alternative assumptions, the period of surplus might end in 2032.) Compared with projections in past years — particularly before this President took office — this is strikingly good news. In 2050, there is a projected surplus of 0.7 percent of GDP — rather than the 3.5 percent of GDP deficit projected last year.

- But in just the last 16 years (2055-2070) of our basic projection of the current-policy outlook — within the customary Social Security 75-year actuarial window — the deficit grows to 5.2 percent of GDP, or higher than it was when President Clinton took office. Debt held by the public rises back to the level it held more than 60 years before, and is growing rapidly. This shows the enormous force of the very demographic pressures that threaten Social Security.

These projections are obviously subject to large errors due to the underlying assumptions and the length of the period estimated. In addition, even these unified budget projections mask the 13 percent of GDP deficit in Social Security and Medicare reached in 2070.

Finally, as you know, since the emergence of the prospect of Federal unified budget surpluses, there have been numerous proposals for how to spend them. It is important that we understand the consequences of such proposals.

As I noted earlier, we have made tremendous progress in stopping the nation's buildup of debt. However, the debt remains at a dangerously high level — still almost twice as high a share of GDP as it was in 1980. If we spend every penny of budget savings that might otherwise become surplus, we leave our debt at a very high level.

The unified budget is in surplus only because Social Security is in even larger surplus. So dissipating the unified surplus before assuring Social Security's long-term solvency is distinctly contrary to Social Security's long-term interest.

- If the surplus is spent on continuing tax cuts or programs that become built into the base and grow over time, the budget will remain in surplus through only 2011 — the year when the oldest of the baby boomers reach 65 years of age (see chart). By 2070, the deficit would be 18 percent of GDP (even under the rigid assumptions of the current-services scenario). Thus, the budget would have precisely nothing to spare at just the time when it would need the greatest financial strength.

Please note that behavior regarding future budget surpluses is one aspect of the long-range outlook that is totally under policymakers' control. If we choose not to take advantage of our prosperous years before the retirement of the baby-boom generation, we will have only ourselves to blame when we find ourselves ill-prepared for the budgetary pressures that inevitably follow.

For the last 15 years, Social Security has run growing trust fund surpluses, and many have argued that those funds were used to mask the overall deficit. According to our projections, however, the situation 15 years from now will be precisely the reverse. The trust fund will be drawn down, and our projected overall budget surpluses continue only because the general fund's surplus masks the trust fund's shortfall. (Note that the interest on the trust fund's balance will appear to show continued trust fund surpluses for another seven years or so; but that interest payment is an intra-governmental transfer that does not affect government borrowing from the rest of the economy.)

So even though the unified budget may be sound into the more distant future, the key trust fund programs that are most vulnerable to the impending demographic pressures will fail to be self-financing and create fiscal problems much sooner. That is one reason why it is important that we act now, and not allow ourselves to be lulled into complacency by the improved outlook for the unified budget.

The opposite side of this coin is that policies that improve the soundness of Social Security in the long run also help to fend off the deterioration of the unified budget that will occur under current policies, as shown in this analysis. Thus, the President's call for Social Security reform promises dual benefits: soundness for Social Security, and continued sustainability for the unified budget even after the retirement of the baby boom generation.

The President's "Save Social Security First" policy

The challenge of ensuring the financial solvency of Social Security and Medicare, on which tens of millions of Americans rely, faces us now.

In the public and private sectors, meanwhile, prospects for a budget surplus are spurring a wide array of ideas about how to use it. At this point, the Government has not yet reached the surplus milestone, and the President believes strongly that "we should not spend a surplus that we don't yet have."

More specifically, he believes the Administration and Congress should not spend a budget surplus for any purpose until we have a solution to the long-term financing challenge facing Social Security. With that in mind, the budget proposes a reserve for the projected unified surpluses for the years 1999 and beyond, to implement the President's position, enunciated in his State of the Union address and repeated in the budget, to leave those surpluses untouched until Social Security is made financially sound for the 21st century.

Protecting the surpluses in this way is essential. Saving Social Security is of the highest priority, and it will require the financial strength that we have built by balancing the unified Federal budget.

Americans are living longer, and are having fewer children. With more people retired, and fewer working, the burden on the Social Security system will grow. Now, there are about 3.3 workers for every beneficiary. Early in the next century, there will be only 2.0 workers per beneficiary. This development was not caused by politics, and it should not be a political issue. But it cannot be ignored; we must face up to it.

If we spend the surplus now — by enacting continuing tax cuts, or by building up the spending base — those costs will grow in future years. They will cut down on our budgetary maneuvering room.

If, instead, we refrain from depleting our revenue base and adding to our spending base, there will be more resources available in the future. The Treasury bonds in the Social Security trust fund will be more easily redeemed. Those who may be adversely affected by Social Security changes that save money for the system might be made whole. It might also be possible to find ways for future budget surpluses to be used directly to shore up the system.

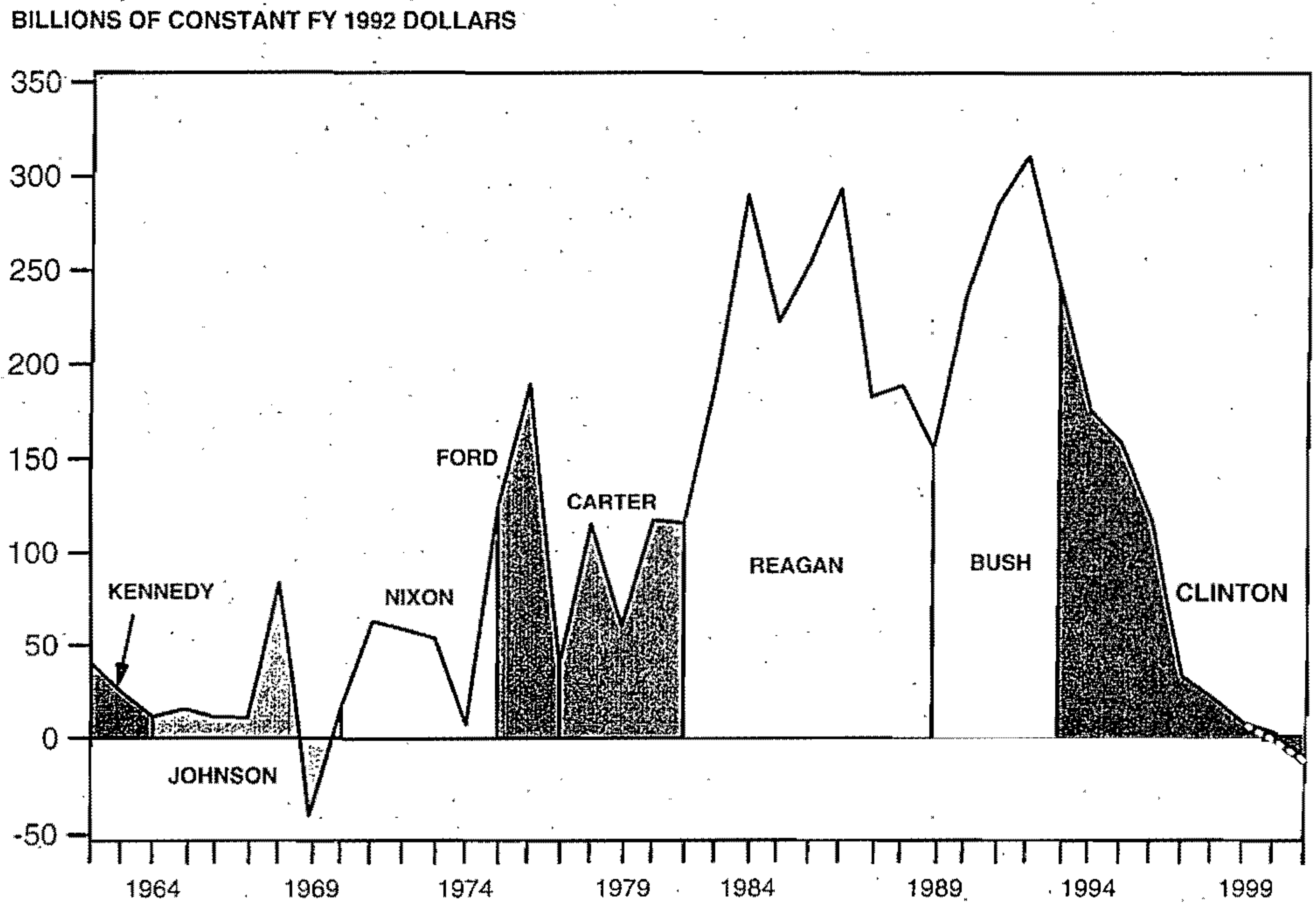
Budget surpluses that we achieve before the enactment of long-term reforms can also help Social Security. Surpluses instead of deficits now mean less debt, and less debt means lower future interest costs. Lower debt service means still more maneuvering room in future budgets to fix Social Security.

Conclusion

Thus, this year's budget makes clear that we have an important opportunity to make Social Security financially sound for the next century, and to begin an era of fiscal responsibility.

We have already seen what balancing the budget can mean for the performance of the economy; and we know that a strong economy will make it easier to safeguard Social Security for the long term. However, the budget will remain within these bounds only if policymakers walk a narrow line of fiscal discipline. If we choose instead to enjoy the surpluses through continuing commitments of spending or tax cuts, those surpluses will be short-lived indeed; and growing budget deficits will reemerge just as the demographic pressures of population aging and the retirement of the baby boom strike us early in the next century. The choice is ours. The President's plan — with a national dialogue on Social Security this year, and a bipartisan process to enact reform legislation — provides all of us a road map for making this important decision.

ERA OF BIG GOVERNMENT IS OVER: ADDITIONS TO NATIONAL DEBT



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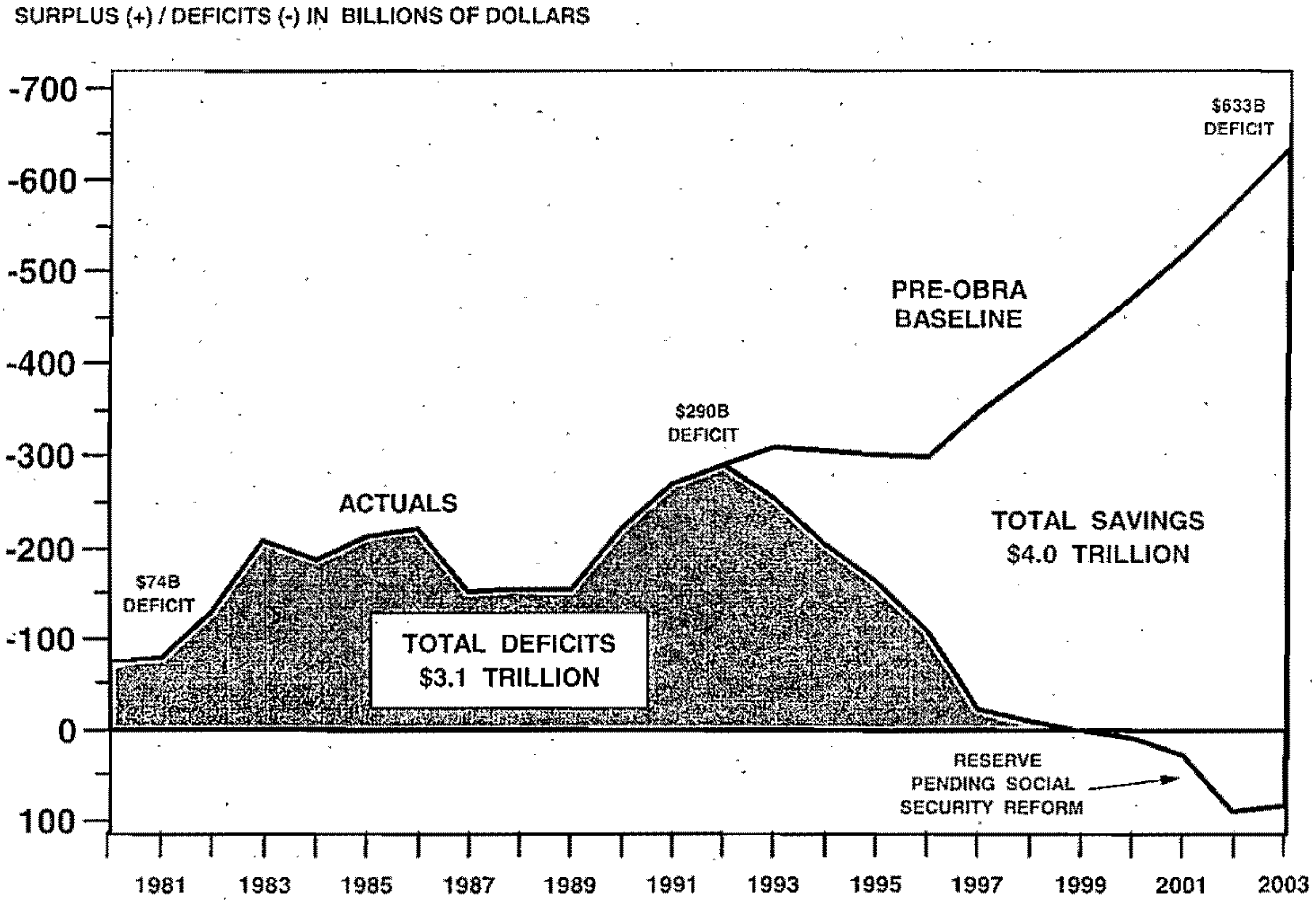
FINISHING THE JOB:
BALANCING THE BUDGET AFTER DECADES OF DEFICITS



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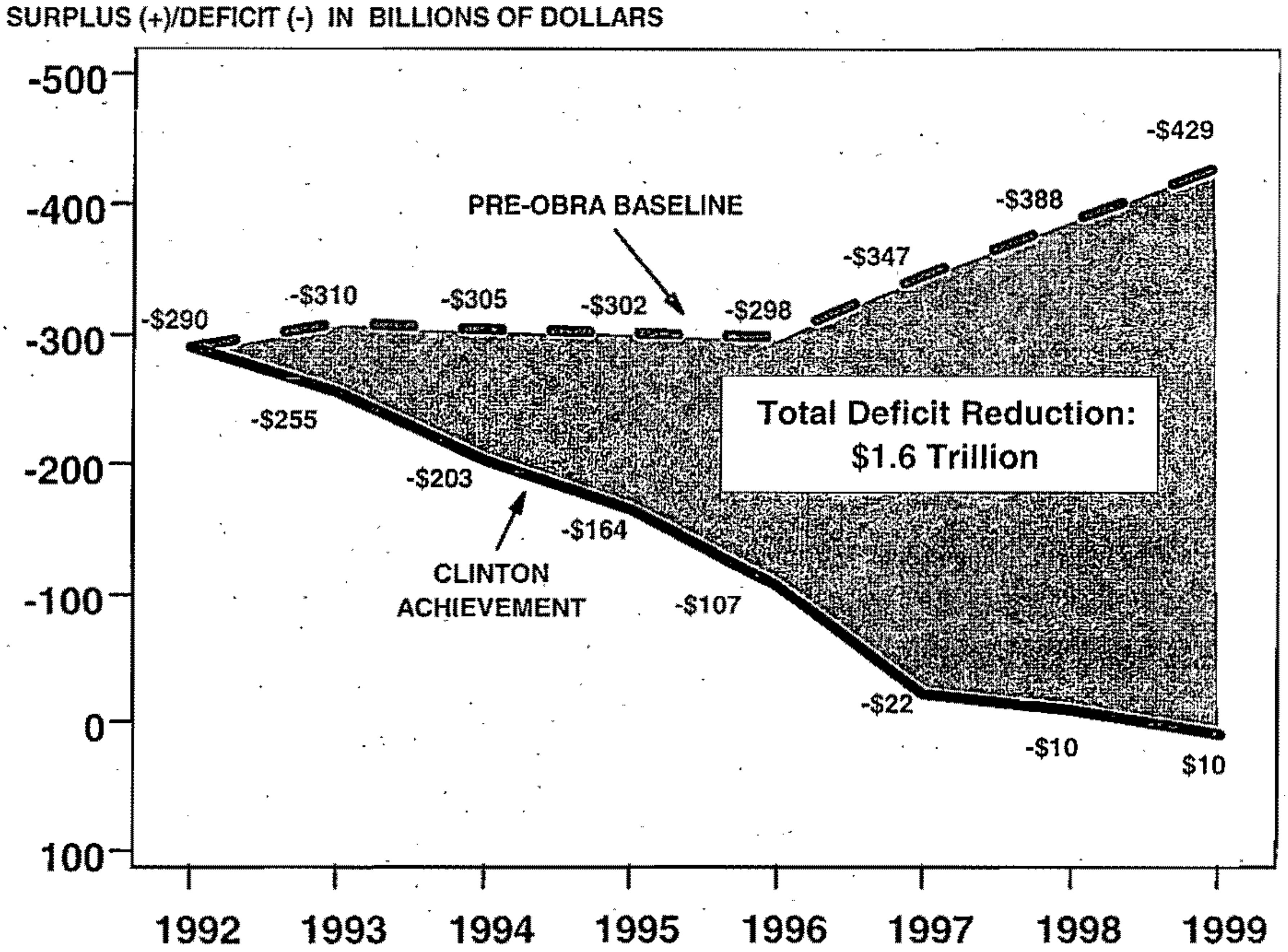
REDUCING THE DEFIC... THE CLINTON RECORD



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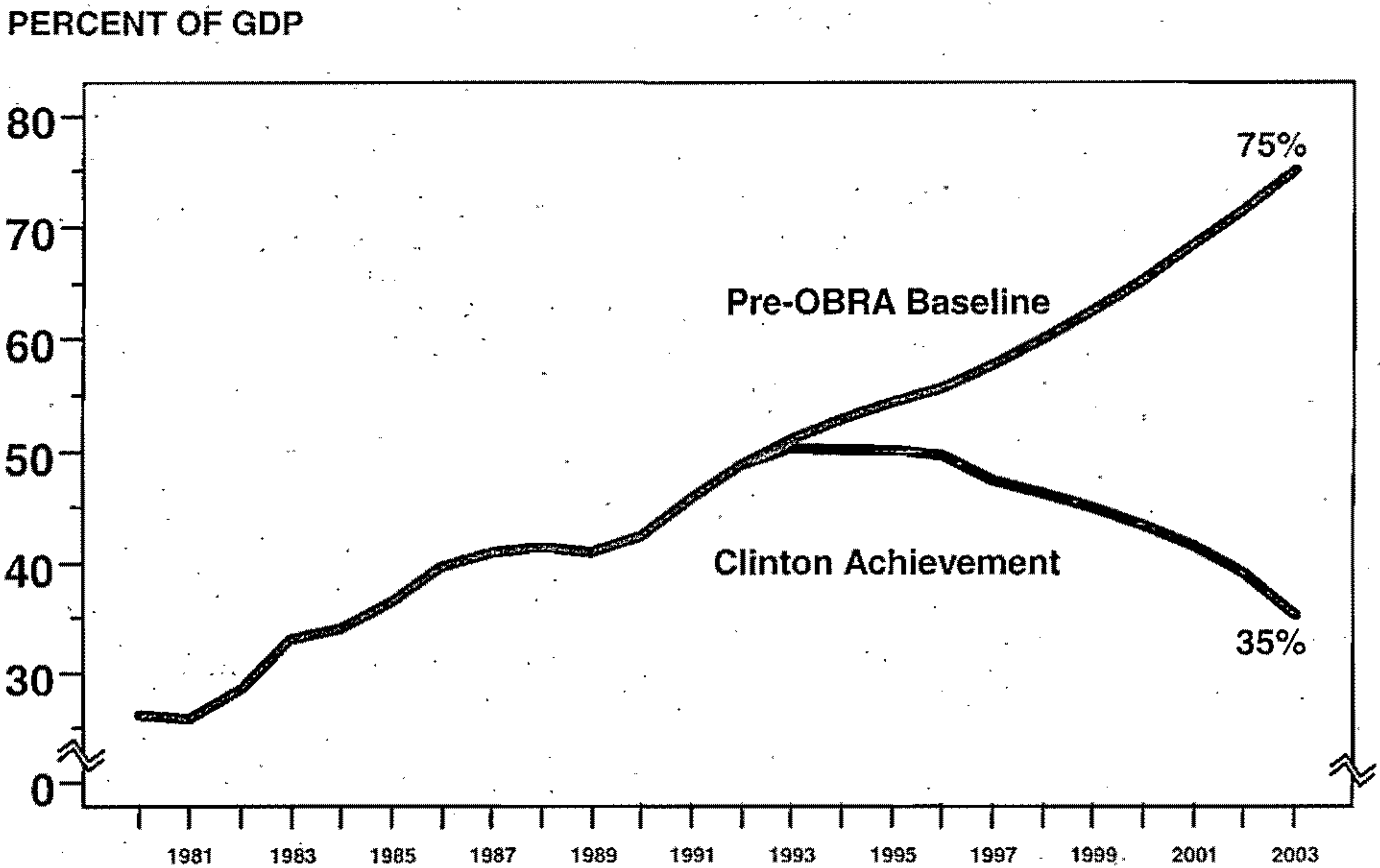
DEBT HELD BY THE PUBLIC



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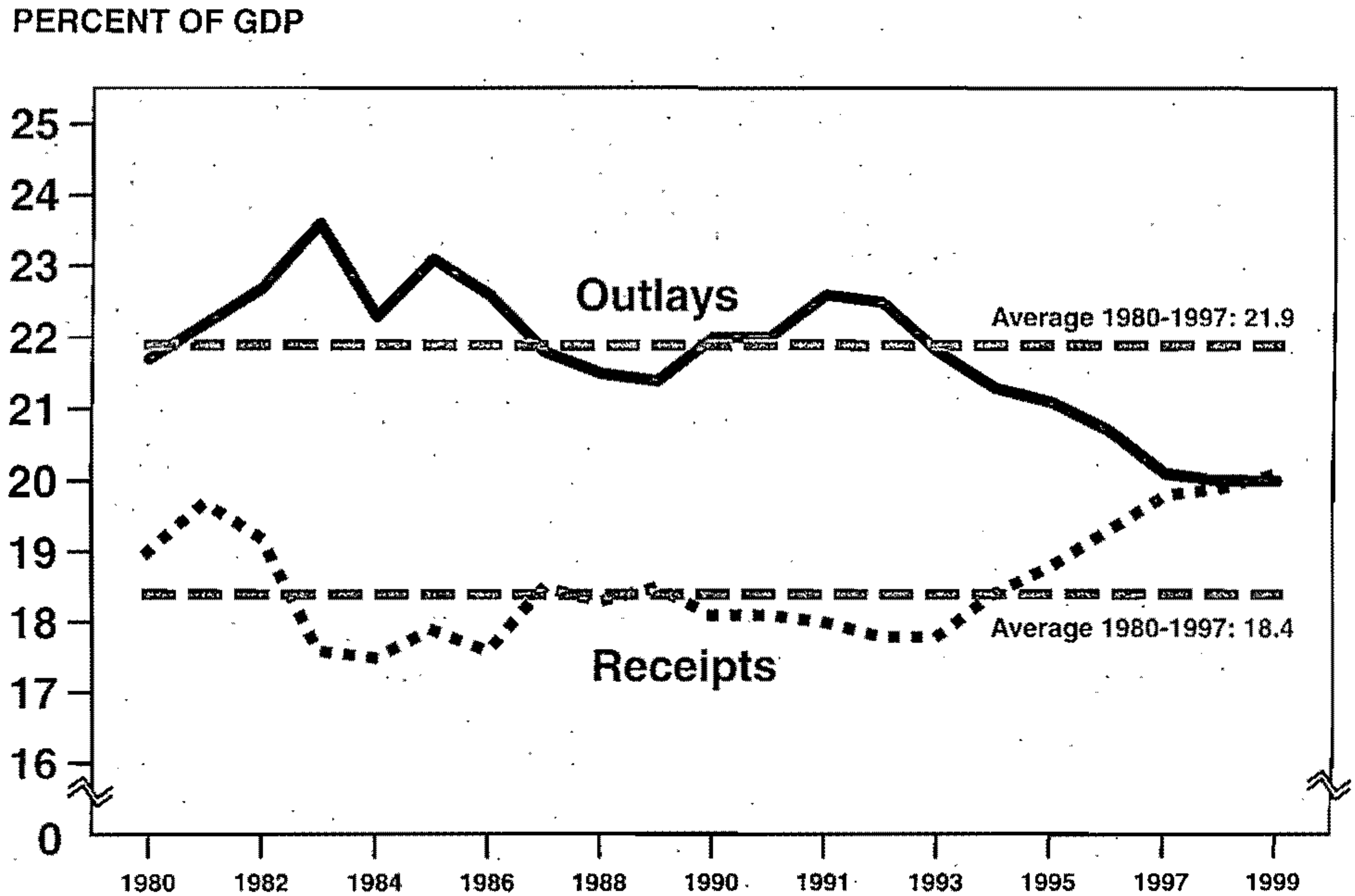
TRENDS IN RECEIPTS AND OUTLAYS



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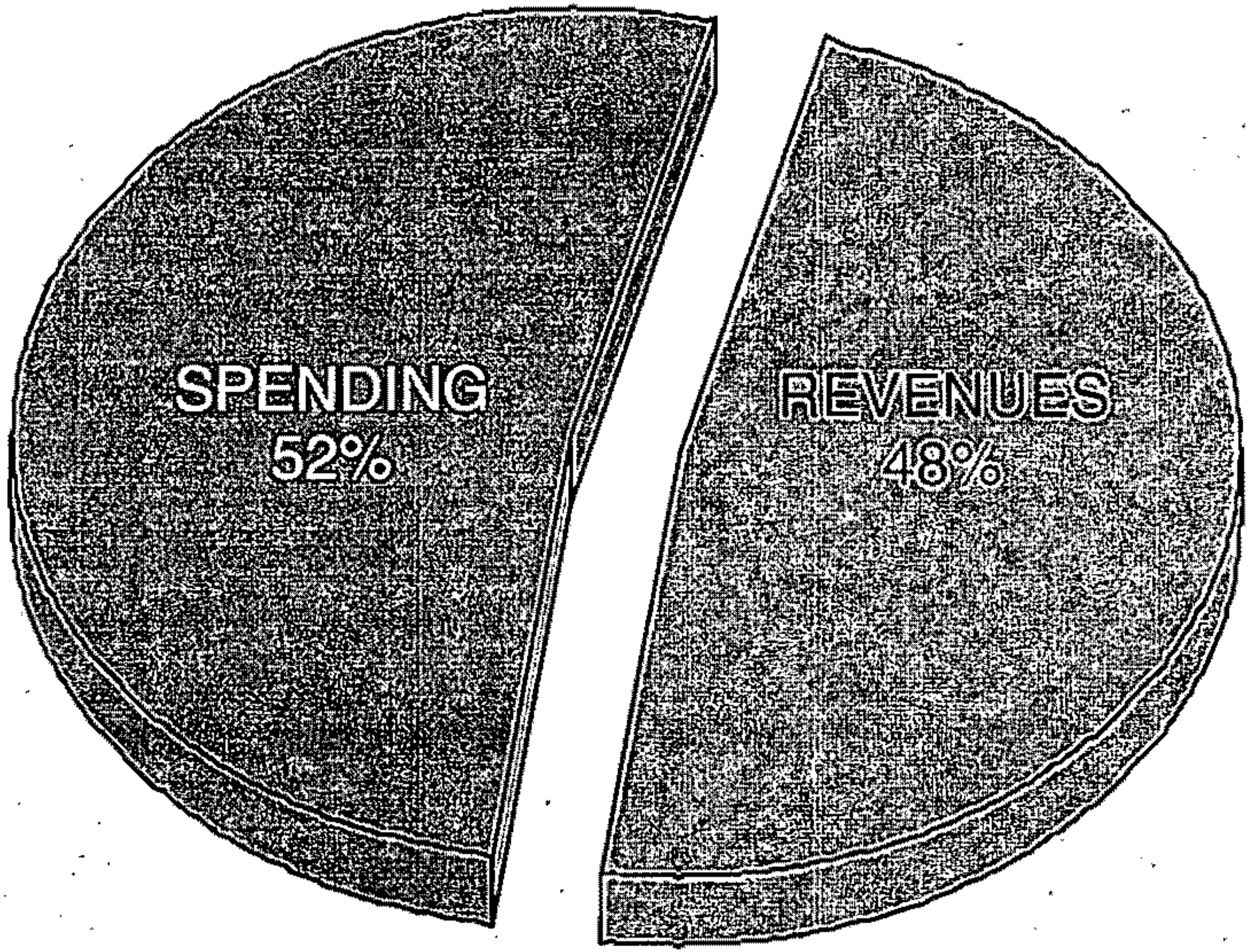
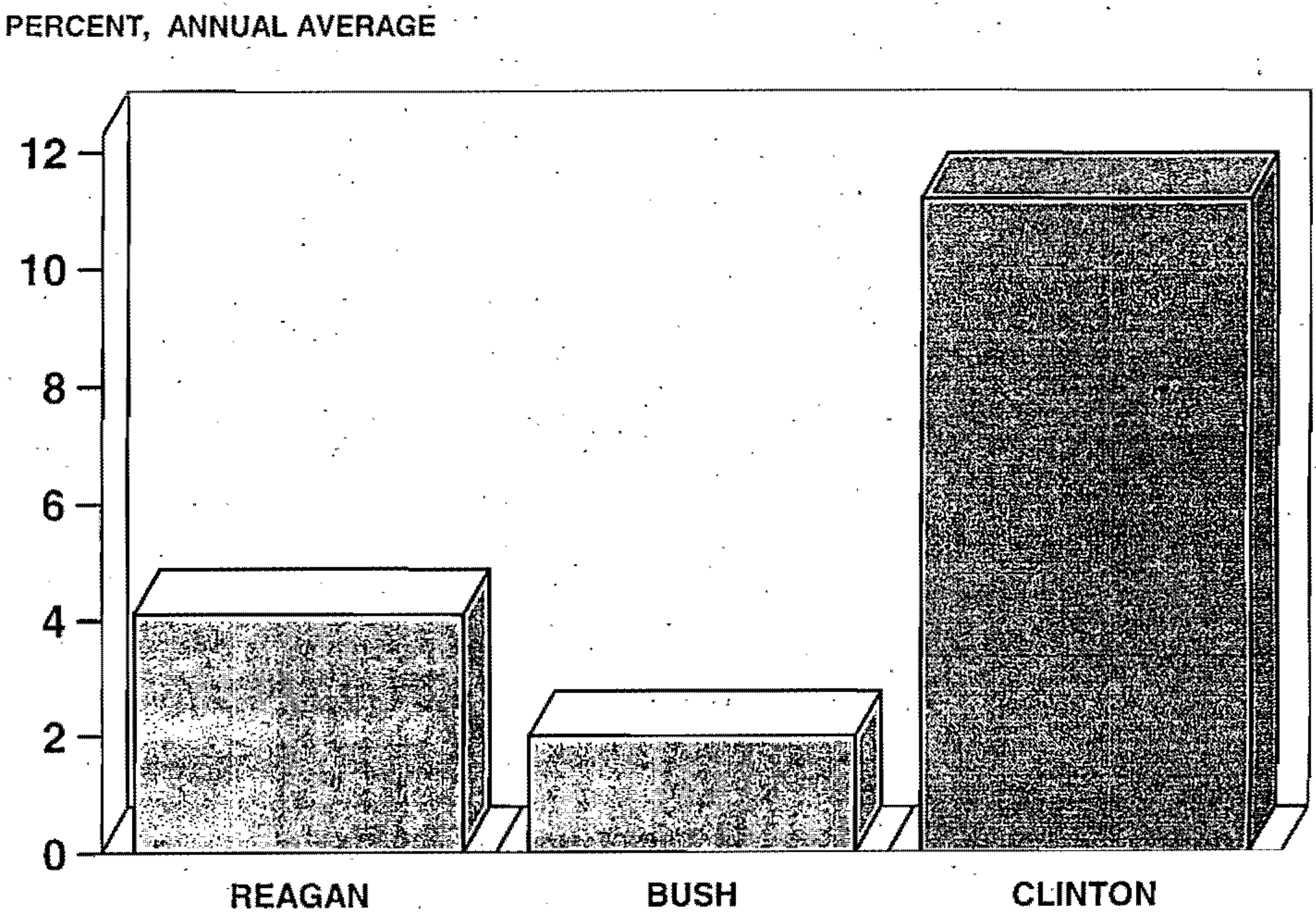
REDUCTION IN DEFICITS SINCE 1992
(as a % of GDP)



TOTAL REDUCTION = 4.8%

GROWTH OF REAL EQUIPMENT INVESTMENT



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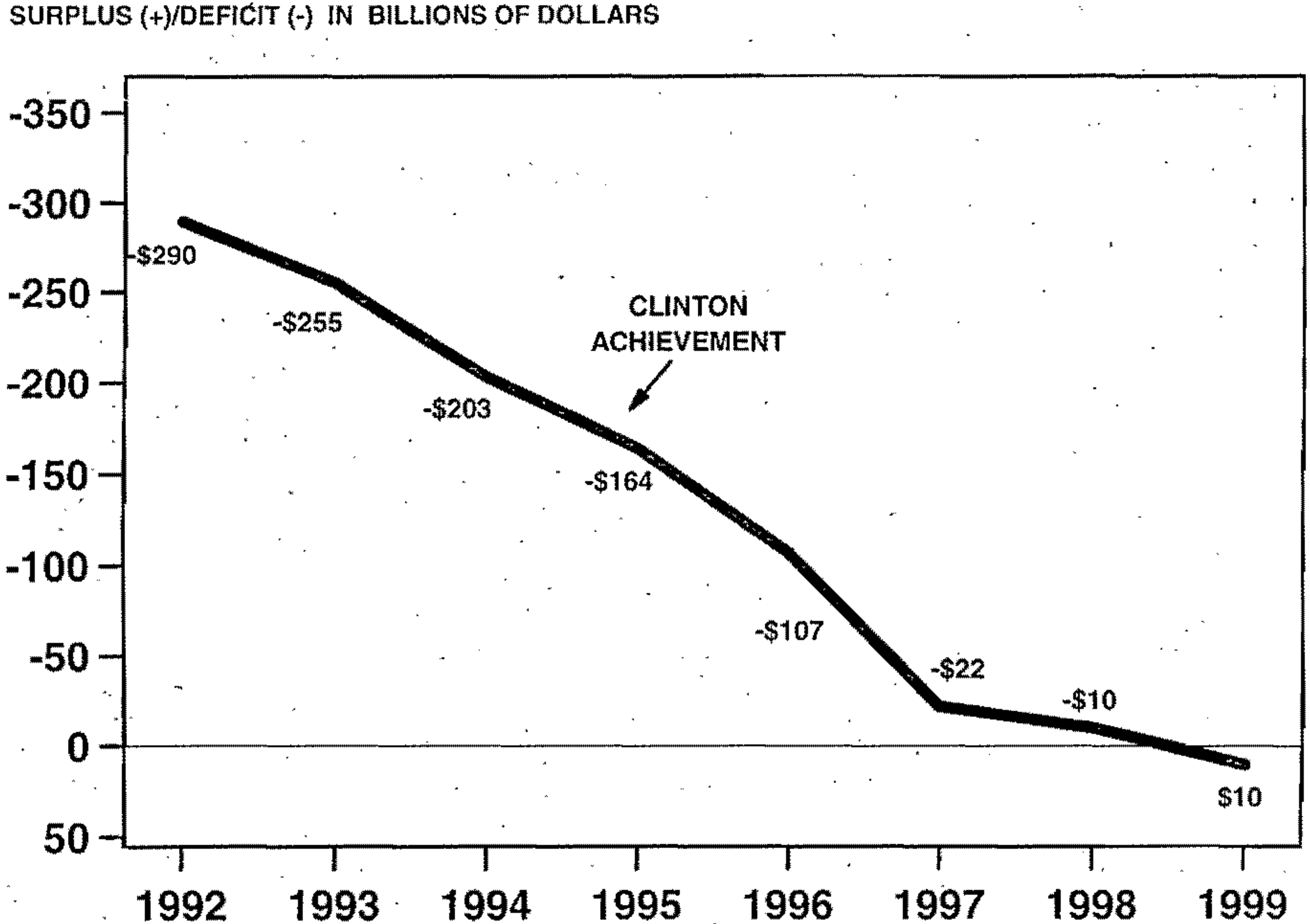
REDUCING THE DEFICIT: THE CLINTON RECORD



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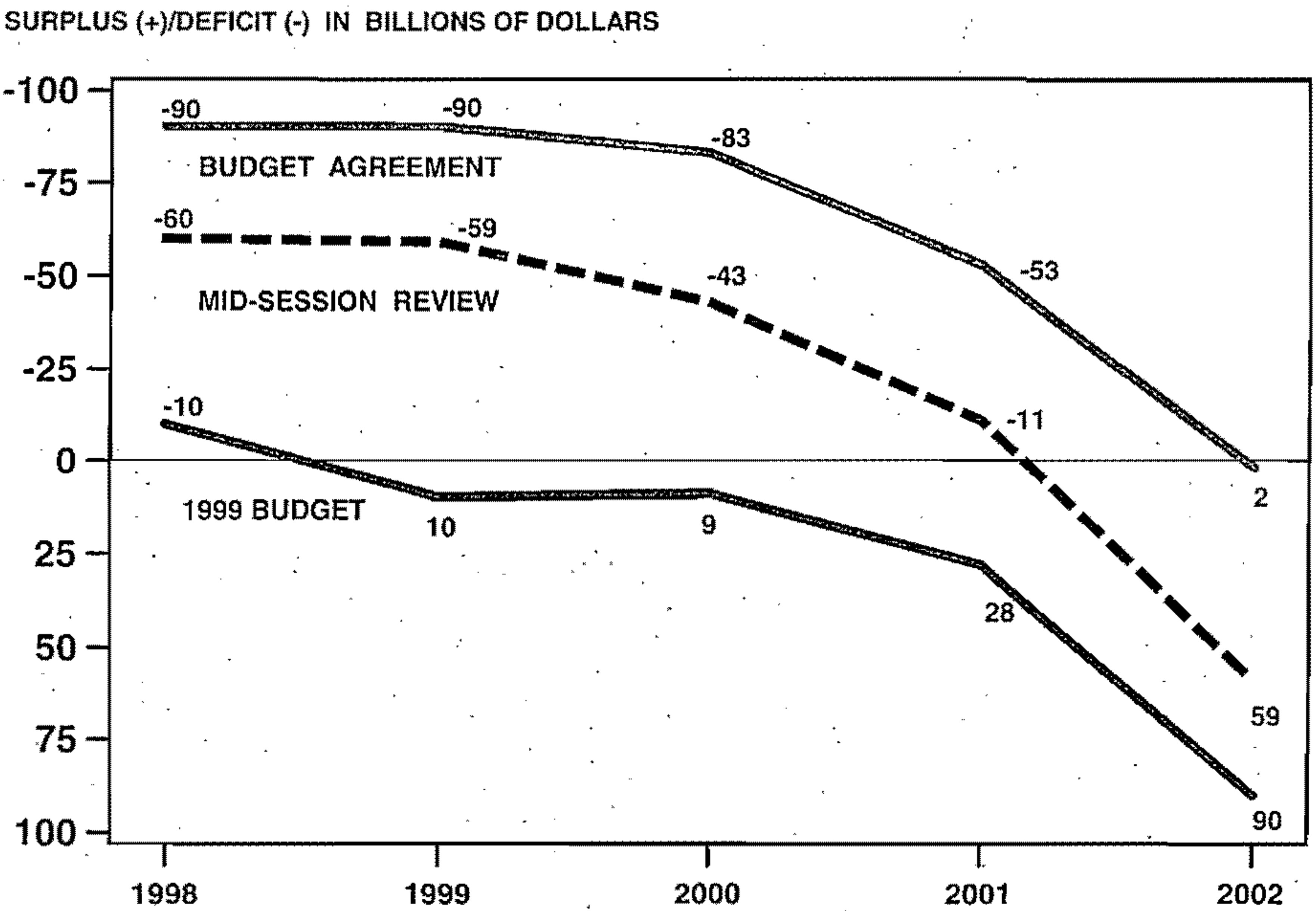
CHANGES IN THE ESTIMATES OF THE BUDGET DEFICIT



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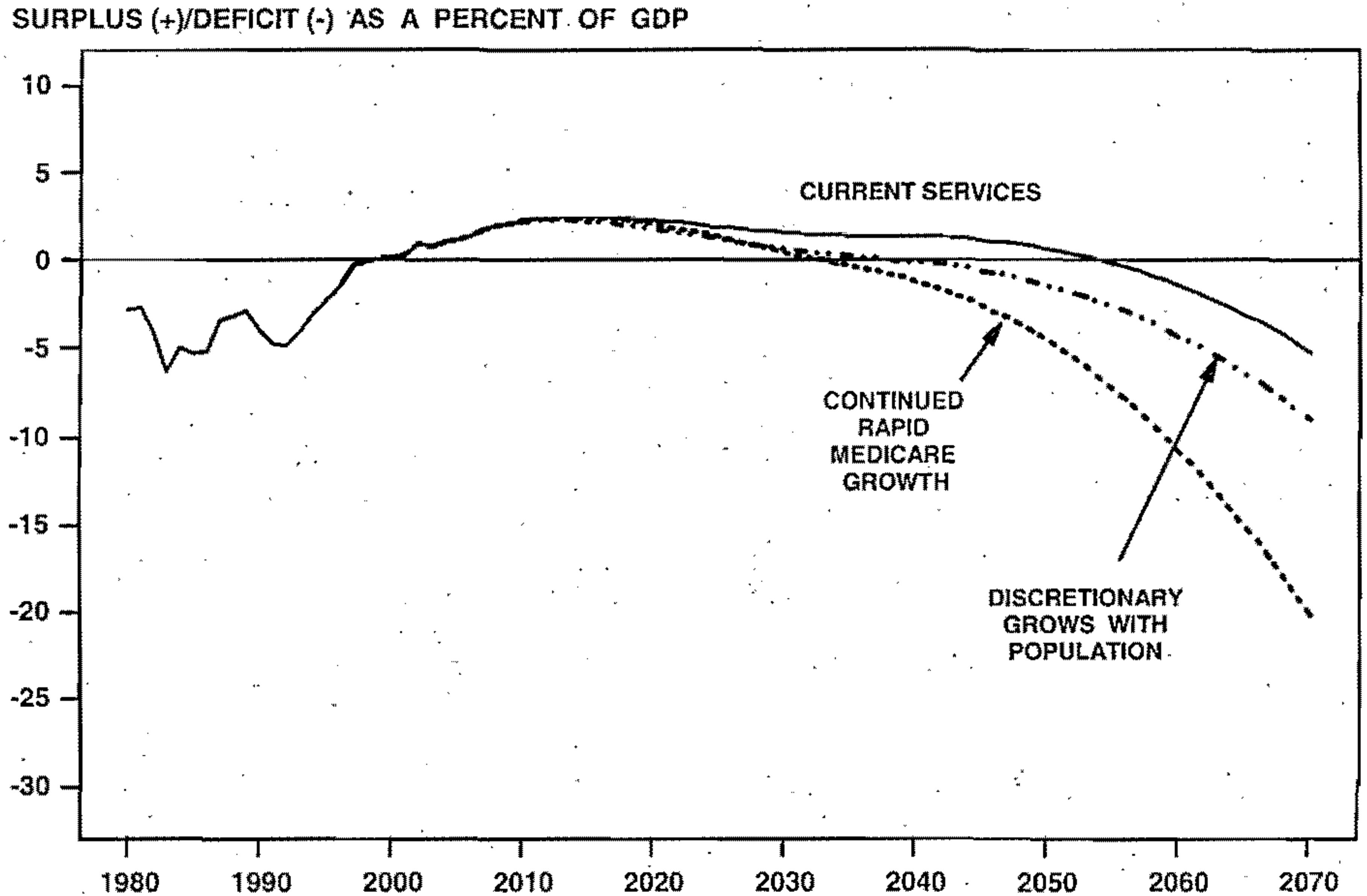
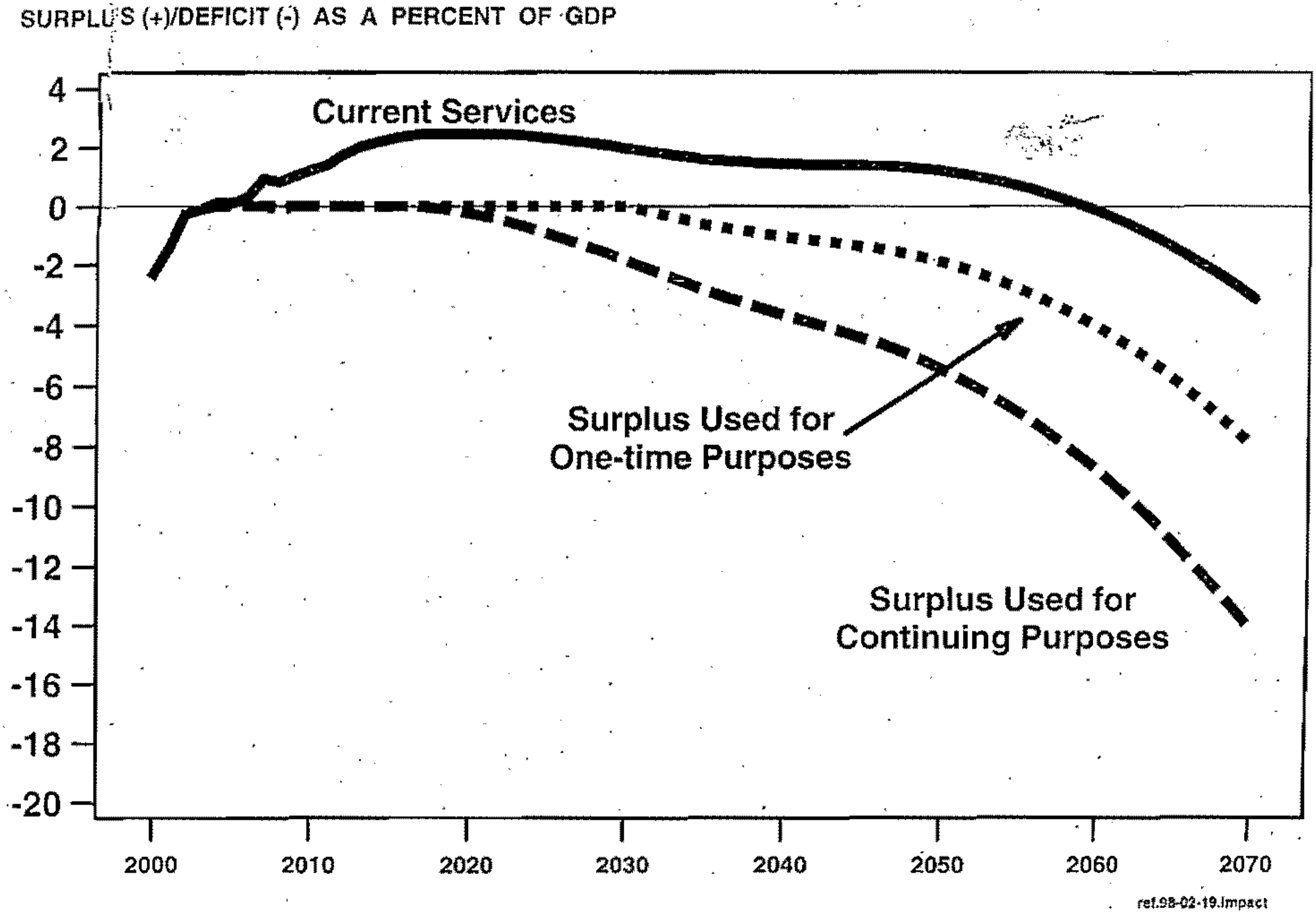
LONG-RUN DEFICIT PROJECTIONS



IMPACT OF SPENDING THE SURPLUS



JACOB J. LEW
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TESTIMONY BEFORE THE
COMMITTEE ON THE BUDGET
OF THE
UNITED STATES SENATE

FEBRUARY 2, 1999

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 budget I present to you today 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 two weeks ago, 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 combined income and payroll taxes as a share of its income than in any year since 1977. Taken alone, its income tax as a percentage of income will be the lowest 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.

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 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 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." This proposal includes seed money for Federal contributions, plus additional funds for matching contributions if individual workers contribute their own money. The matching contributions will provide a larger percentage inducement for low-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. In last October's negotiations on the Omnibus appropriations for fiscal year 1999, Congressional leaders argued that our National defense needs had outgrown the existing discretionary spending caps — and, indeed, defense received the largest share of the additional emergency funds made available in that legislation. Likewise, the American people have recognized that the quality of their children's education will determine how they progress in life — and also the strength of the future economy. The President's budget is a sound, disciplined way to provide the additional resources for these priorities that both sides recognize will be needed if our country is to survive and prosper in the next century.

The President's framework for Social Security reform and long-term fiscal discipline works

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 -- without accounting for 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 deposit assets in the Social Security trust fund to pay these obligations, and reduce by an equal amount the debt borrowed from the public. 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 Social Security trust fund 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.

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.

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.

We must balance fiscal discipline with prudent investments for the future

In addressing these priorities, the FY 2000 budget builds upon the investments in our people and our technology that were set in motion by past budgets.

Last year's budget implemented the Balanced Budget Act of 1997, maintained fiscal discipline — reserving the surplus until we save Social Security first — and provided a strategy of targeted investments to help sustain economic growth. For example, last year's budget provided resources for:

- **The first year's investment to reduce class size by hiring 100,000 new teachers.** Smaller classes ensure that students receive more individual attention, a solid foundation in the basics, and greater discipline in the classroom. In this year's budget, the President proposes investments in this area, ultimately to reduce class size in the early grades to a national average of 18.

- **Investments to protect our economic interests at home by responding to international economies in turmoil.** The disruption in financial markets last year lead to economic dislocation in Asia, Latin America and the Soviet Union. This, in turn, hurt American exporters, farmers and ranchers, who found that markets overseas were beginning to dry up. With President Clinton's leadership, Congress approved nearly $18 billion for the International Monetary Fund, a stabilizing force in the world economy.

- **A guaranteed, record-level investment for the next five years in the Transportation Equity Act for the 21st Century to continue rebuilding America's highways and transit systems, which are essential to continue the growth of modern commerce.** This legislation also funds programs for highway safety, transit and other surface transportation, while safeguarding air quality, and helping former welfare recipients get to their jobs.

Over the past six years, the President also worked with the Congress to establish and build upon significant investments in education and training, the environment, law enforcement and other priorities to help raise the standard of living and quality of life for average Americans both now and in the future. For example, the President's commitment to fund key domestic investments has:

- Advanced cutting-edge research, putting the National Institutes of Health on a path to doubled funding for research including intensified work on diabetes, cancer, genetic medicine, and the development of an AIDS vaccine.

- Established the children's health care initiative, the largest investment in health care for kids since Medicaid was created. Last year, 47 states began programs designed to provide meaningful benefits to as many as five million uninsured children.

- Increased Head Start's ability to provide greater opportunities for disadvantaged children to participate in a program which prepares them for grade school. Last year, a boost in Head Start funding put 835,000 children into the program, making further progress toward the President's goal of putting a million children in Head Start by 2002.

- Invested in public schools to help States and communities raise academic standards, strengthen accountability, connect classrooms and schools to the information superhighway, and promote public school choice by opening 900 charter schools.

- Protected and restored some of the Nation's most treasured lands, such as Yellowstone National Park, and the Everglades; provided the funds to conserve others; and accelerated toxic waste clean-ups.

- Built the COPS program to support community policing. This year COPS will reach the goal of putting 100,000 more police on the streets of America's communities. COPS has helped reduce violent crime for six straight years. The 21st Century Policing Initiative proposed in this budget will expand on the number of police and provide other law enforcement tools to the community.

This year's budget builds on the President's efforts to invest in the skills of the American people. It continues his policy of helping working families with their basic needs — raising their children, sending them to college, and expanding access to health care. It also invests in education and training, the environment, science and technology, law enforcement and other priorities, to help raise the standard of living and quality of life of Americans.

Families and Children: For six years, the President has sought to help working families balance the demands of work and family. In this year's budget he proposes a major effort to make child care more affordable, accessible and safe — by expanding tax credits for middle-income families, and for businesses to expand their child care resources; by assisting parents who want to attend college meet their child care needs; and by increasing funds with which the Child

Care and Development Block Grant can help more poor and near poor children. The budget proposes an Early Learning Fund, which would provide grants to communities for activities that improve early childhood education and the quality of childcare for those under age five.

Education: The President has worked to enhance access to, and the quality of, education and training. The budget takes the next steps by continuing to help States and school districts reduce class size by recruiting and preparing thousands more teachers and building thousands more new classrooms. The President proposes improving school accountability by funding monetary awards to the highest performing schools that serve low-income students, providing resources to States to help them identify and change the least successful schools, and ending social promotion by funding additional education hours through programs like the 21st Century Learning Centers. The budget also proposes further increases in the maximum Pell Grant to help low-income undergraduates complete their college education, and more funding for universal reemployment services to help train or find jobs for all dislocated workers who need help.

Environment: This Administration proposes a historic interagency Lands Legacy initiative to both preserve the Nation's Great Places, and advance preservation of open spaces in every community. This initiative will help address sprawl and air and water pollution, through land acquisition, preservation efforts, environmental protection and local growth management. The Administration also proposes a new financing mechanism, Better America Bonds, to further creation of open spaces in urban and suburban areas. The Better America Bonds initiative is an example of our use of targeted, paid-for tax cuts to achieve the Nation's priority goals. In addition, the budget would restore and rehabilitate national parks, forests, and public lands and facilities; expand efforts to restore and protect the water quality of rivers and lakes; continue efforts to double the pace of Superfund clean-ups; and better protect endangered species.

Defense: The President is committed to maintaining world military leadership to provide for the safety of American citizens and the primacy of American Armed Forces. To ensure America's Armed Forces are fully prepared to meet the challenges of the next century, the President proposes a long-term, sustained increase in defense spending to enhance military readiness, improve recruitment and retention, and provide the most modern and effective weapons. In addition, these resources will reinforce the ability of the Defense Department to counter emerging threats such as terrorism, reduce threats from weapons of mass destruction, maintain the nation's nuclear deterrent, and provide humanitarian and disaster assistance.

Health Care: The President has worked hard to expand health care coverage and improve the Nation's health. The budget gives new insurance options to hundreds of thousands of Americans aged 55 to 65, and it advocates bipartisan national legislation that would reduce tobacco use among the young. The President's budget proposes initiatives to help patients, families and care givers cope with the burdens of long-term care; and it helps reduce barriers to employment for individuals with disabilities. The budget also enables more Medicare recipients to receive promising cancer treatments by participating more easily in clinical trials. And it improves the fiscal soundness of Medicare and Medicaid through new management proposals, including programs to combat waste, fraud and abuse.

Embassy Security: The bombings of U.S. embassies in Kenya and Tanzania highlight the dangers faced daily by Americans who work in U.S. facilities abroad. The budget proposes an increase to the State Department's operating budget to ensure protection of embassies and other facilities, and the valuable employees who work there. The budget also includes a request for $3 billion in advance appropriations for a multi-year security construction program.

The 2000 Budget saves the surplus until we fix Social Security first

The President's FY 2000 budget is fully paid for, in compliance with the discretionary caps and the pay-as-you-go budget rules. The budget allows for appropriations for important domestic and national security priorities by limiting other discretionary spending and achieving mandatory savings. Offsets to discretionary spending include the President's tobacco policy (which would reimburse the Federal Government for tobacco-related discretionary health care costs), FAA user fees, health care savings, Superfund receipts, student loan savings and the recall of additional federal fund reserves at lending guaranty agencies, and reform of the existing harbor maintenance excise tax. With the use of these offsets, in keeping with longstanding budget practice, the 2000 budget complies with the discretionary spending caps.

The budget provides targeted tax reductions, financed by the elimination of tax loopholes, and inefficient or obsolete tax subsidies. Important tax cuts and incentives, in addition to the President's USA retirement savings program, include the tax credit for long-term care needs, the public school construction and modernization bonds, the expansion of the child and dependent care tax credit, the new Better America Bonds, extension of the R&E tax credit, the work opportunity tax credit, the welfare-to-work tax credit, and the tax incentives for reductions of carbon emissions that cause global warming. Important mandatory initiatives include child care, the Medicare buy-in, disability and cancer clinical trials programs, and extension of health-care programs to immigrants. Taking all of these policy steps together, the budget complies with the pay-as-you-go rules, and the tax cuts and mandatory initiatives are fully paid for.

We need adequate resources for a strong defense and critical domestic priorities

For future years, the budget includes the discretionary resources contemplated as a part of the plan for Social Security reform. While these funds will only be available if Social Security reform is enacted, the Administration's policy is categorically defined including those resources. Social Security reform is one of the President's highest priorities for this year and we must work on a bipartisan basis to accomplish this important goal. The comprehensive framework for allocating the surplus will also provide these critical discretionary resources.

The President believes that his discretionary priorities are important to economic growth, and to the Nation's well being and quality of life. Some have disagreed, and have argued that Federal spending in general is too high. This debate requires some perspective.

First, and perhaps most fundamentally, consider the record. Over the years 1980-98, Federal spending averaged 21.9 percent of GDP. But Federal receipts averaged only 18.5 percent of GDP. Thus, the Federal budget averaged a deficit of about 3.4 percent of GDP. When this Administration set out to cut the budget deficit that we inherited, our original plan called for roughly equal spending cuts and revenue increases (with spending cuts in fact slightly larger). While the results of this plan have been far beyond what we ourselves anticipated — with the deficit falling by more than twice as much as our original estimates — they did maintain the balance between spending cuts and revenue increases.

In balancing the budget, this Administration has controlled Federal spending well beyond the record of its predecessors. As a percentage of GDP, spending in *every* year for which President Clinton submitted a budget has been lower than in *any* year of the two preceding Administrations. In *every* budget year from 1994 through 1998, Federal spending as a percentage of GDP fell. Spending as a percentage of GDP in 1998, at 19.7 percent, was the lowest in almost a quarter century.

Some argue that "Federal spending is still going up." In the simplest terms -- total dollars with no discounting for inflation, no allowance for the growth of the economy, and no allowance for the growth of the population government serves -- that is true. But even in this format, the analysis tells a great deal about the record of Federal spending under this Administration.

From 1993 through 1998, 31 percent of the simple dollar increase in Federal outlays came because more elderly people retired on Social Security benefits, and prior retirees received cost-of-living increases; 26 percent arose because of additional beneficiaries and higher costs under Medicare; 18 percent arose because, even with a rapidly declining budget deficit — and by 1998, a budget surplus — there was more debt to service, and so net interest costs went up; and 10 percent came from increased costs under Medicaid, more than two-thirds of which went for the expenses of the indigent elderly, blind, disabled, and mentally retarded, many of those in long-term care.

Thus, there has been almost no spending growth in programs other than Social Security, Medicare, Medicaid, and net interest. Spending of the entire remainder of the Federal Government over 1993 to 1998 shrank by 5.4 percent in inflation-adjusted dollars, and fell from 11.5 percent to 8.8 percent of the Nation's GDP.

This shrinking of core government operations cannot go on forever if government is to accomplish the missions assigned to it. We all take for granted the obligation to maintain critical core functions like the FAA, the FBI, and the administration of Medicare. As we consider how to budget in this era of surpluses, we must consider carefully the resources available for these often-anonymous functions that the Nation has a right to expect its government to perform well.

A key element in the Administration's ability to expand strategic investments, while balancing the budget, is the reinvention of government — doing more with less. Efforts led by Vice President Gore's National Partnership for Reinvention have streamlined government, reduced its workforce, and focused on performance to improve operations and delivery of service. And these efforts, by reducing the cost of government operations, have improved the bottom line and contributed to our strong economy.

Since 1993, the Administration, working with Congress, has evaluated and eliminated hundreds of unnecessary programs and projects. The Administration has cut the size of the Federal civilian work force by more than 365,000 people, creating the smallest work force in 35 years and, as a share of total civilian employment, the smallest since 1931.

The Administration, however, is working to create not just a smaller Government, but a better one — a Government that best provides services and benefits to its ultimate customers, the American people. It has not just cut the Federal work force, it has streamlined layers of bureaucracy. It has not just reorganized headquarters and field offices, it has ensured that those closest to the customers can best serve them.

For 2000, this Administration once again is turning its efforts to the next stage of "reinventing" the Federal Government. It plans to dramatically overhaul 32 Federal agencies to improve performance in key services, such as expediting student loan processing and speeding aid to disaster victims. It also plans to tackle critical challenges, such as ensuring that Government computers can process the year 2000 date change, and making more Government services available electronically.

Under the 1993 Government Performance and Results Act, Cabinet departments and agencies have prepared individual performance plans that they will send to Congress with the performance goals they plan to meet in 2000. These plans provided the basis for the second Government-wide Performance Plan which is contained in this year's Budget. For the first time in 2000, agencies will submit to the President and Congress annual reports for 1999 that compare actual and target performance levels and explain any difference between them.

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.