Committee On Finance

Max Baucus, Ranking Member

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Contact: Russ Sullivan/Wendy Carey
202-224-4515

Statement of U.S. Senator Max Baucus
United States Senate Finance Committee Hearing on "Proposals That Achieve Sustainable Solvency, With and Without Personal Accounts"

"Thank you, Chairman Grassley, for holding this important hearing. When President Roosevelt signed the Social Security Act, he said: '[W]e have tried to frame a law which will give some measure of protection to the average citizen and to his family against . . . poverty-ridden old age.'

And Social Security has provided that critical measure of protection for millions of American families. For 1 out of 5 seniors, Social Security is their sole source of income. For 2 out of 3 seniors, Social Security provides most of their income. And Social Security helps millions of families if a breadwinner dies or becomes disabled.

We need to address Social Security's long-run financing. But we do not need to make drastic changes. The nonpartisan Congressional Budget Office -- which is the official Congressional scorekeeper -- projects that under current law, Social Security can pay full benefits through 2052. After that, annual Social Security revenues are sufficient to pay about 80 percent of benefits.

We need to make changes to ensure that Social Security can pay full benefits after 2052. And we should make these changes sooner rather than later. But we do not need to privatize Social Security to save it.

Unfortunately, the President has called for privatizing Social Security. The President proposes to allow workers to divert 4 percent of their earnings into private savings accounts. Common sense teaches us that when you want to get out of a hole, first you stop digging. But the President's plan would dig Social Security into a deeper hole. As I mentioned earlier, according to CBO, Social Security can pay full benefits until 2052. Under the President's plan, that date comes 11 years earlier in 2041.

And where does the money come from to put into these private accounts? The federal government would have to borrow it. Borrow more -- at a time when, for the second fiscal year in a row, the federal budget deficit hit an all-time record: $412 billion.

Indeed, under the President's plan, the federal government would have to borrow roughly $5 trillion more during the first 20 years of his plan. Today, the entire debt held by the public is roughly $4½ trillion. The President's plan would more than double that to almost $10 trillion. How much is $10 trillion? That's $34,000 for every person in the United States today.

And much of that money would be borrowed from foreign investors and foreign central banks. What difference does it make who we as a nation borrow from? What does that mean for our foreign policy? Do we want to put ourselves in the potentially precarious position of engaging in diplomacy with our nation's creditors? What happens if those foreign central banks and foreign investors suddenly started selling their holdings of U.S. securities?

Now the President has not publicly taken a position on how to eliminate Social Security's long-run shortfall and how to make up for the additional shortfall caused by his privatization plan. But the President and his spokespeople have implied that there is a benefit cut proposal that they might support.

First – as you may recall - the President, indirectly through his 2001 Social Security Commission and a memo by a high-ranking White House official - considered 'price-indexing' initial benefits. That proposal would deeply cut benefits for everyone and would – according to CRS – eventually eliminate Social Security as we know it. As you can imagine, once those details were understood, the President and White House stopped talking about price-indexing.

More recently, the President and White House officials have praised a proposal called 'progressive price-indexing.' At a March 16 press conference, President Bush said some positive things about an idea that has been suggested by one of today's witnesses, Robert Pozen. The President said: 'One of the interesting ideas was by the fellow — by an economist name of Pozen. He came to visit the White House — he didn't see me, but came and tossed some interesting ideas out, talking about making sure the system was progressive.'

Under this proposal, low-income workers are left untouched but everyone else has their Social Security benefits cut. Instead of eventually eliminating Social Security – most workers would eventually receive the same Social Security benefit regardless of the amount of money contributed to the program. Both of these proposals are bad policy and fundamentally alter important features of Social Security. Unfortunately, the benefit reductions under Mr. Pozen's plan would be deep. And they would keep getting deeper as we move further into the future.

Consider someone retiring in 2080 with earnings 60 percent greater than average earnings, as defined by the Social Security Administration. This earnings level is only $59,000 in 2005. According to the Center on Budget and Policy Priorities, this person's benefits would be cut by 42 percent. That's a 42 percent cut for workers who earn $59,000 – hardly the idle rich. This plan is not a 'compromise' and this plan is not 'progressive.' The Pozen price indexing proposal would cut benefits deeply for retirees who rely on them.

But people may ask: What about the income that retirees would get from their private accounts? Wouldn't the earnings in the private account be greater than the reductions in benefits? The answer is no. Even though retirees get to keep the money in their private accounts, they have to give most of it back, maybe all of it, and maybe even more than all of it, back in the form of a second cut in their Social Security benefits.

This second cut is on top of the benefit cut from switching to price indexing. The size of the President's second cut would be equal to the contributions that were made to the worker's private accounts, plus earnings on those contributions of 3 percent, plus the rate of inflation.

In effect, this second cut is a privatization tax. Because of this privatization tax, if we adjust the projected rate of return on stocks for risk as required by CBO, participating in the private accounts would do you no good. Put another way, the private accounts do not offset any of the losses from the price-indexing plan that the President thinks is a good idea.

But what if stocks were not adjusted for risk? Would workers be able to make up for the cuts? Our analysis shows that the stock market would need to earn at least 10.9 percent over the next 40 years for workers to be able to make up for the cuts due to price-indexing and the privatization tax. However, most experts agree that a 10.9 percent return on stocks over the next 40 years is highly unlikely. The Social Security Administration actuaries assume that stocks will return 9.5 percent. Top Wall Street economists – according to an article by the Wall Street Journal in February – are expecting stock returns over the next 40 years to be around 7.6 percent.

Let me also say a few words about the plans of our other witnesses. Peter Orszag, in conjunction with Peter Diamond, has produced a plan that would not privatize Social Security. It would make Social Security solvent beyond 75 years with no gimmicks. I do not favor Mr. Orszag's plan. But I want to thank him and Mr. Diamond for constructing their plan and putting it into the public debate.

In contrast, Mr. Ferrara's privatization plan sets back the debate. His plan includes enormous, but unspecified, spending cuts in the federal budget, as well as other gimmicks. Without these spending cuts and gimmicks, his plan would raise federal debt held by the public to $26 trillion at the end of 75 years.

And Mr. Tanner's privatization plan is also extremely problematic. It includes full price-indexing for workers who choose to not to have a private account, which would lead to benefit cuts of about 50 percent for an average earner retiring in 2075.

These privatization schemes, like the President's plan, would undermine that 'measure of protection to the average citizen' that President Roosevelt signed into law those nearly 70 years ago.

Mr. Chairman, to address Social Security's long-run financing, we first need to reject this drastic change. First, the President needs to leave privatization behind. First, he needs to stop digging that hole. Then, and only then, can we move on to strengthen that critical 'measure of protection' that is Social Security."

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