

**PERSPECTIVES ON DEFICIT REDUCTION:
SOCIAL SECURITY**

HEARING

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE**

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

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MAY 10, 2011
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PERSPECTIVES ON DEFICIT REDUCTION: SOCIAL SECURITY

TUESDAY, MAY 10, 2011

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus, (chairman of the committee) presiding.

Present: Senators Kerry, Stabenow, Carper, Hatch, Grassley, Snowe, and Thune.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Claire Greene, Detailee, Social Security; Alan Cohen, Senior Budget Analyst; Tom Klouda, Professional Staff Member, Social Security; and Joseph Scovitch, Detailee. Republican Staff: Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; Preston Rutledge, Detailee; Aaron Taylor, Professional Staff; and Tony Coughlan, Tax Counsel.

The CHAIRMAN. The committee will come to order.

Before we actually proceed, at the request of Senator Kerry, I will turn over the introduction of our first witness to him. The first witness is Mr. Roosevelt. Senator Kerry is one of the senior, very valuable members of our committee. Unfortunately, he has another hearing he has to chair, and so I will turn the hearing over to Senator Kerry.

OPENING STATEMENT OF HON. JOHN F. KERRY, A U.S. SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you. That is very generous of you. And I thank Senator Hatch also for the privilege of doing that. We have a hearing starting at the same time on Afghanistan and Pakistan, so I appreciate your willingness to let me do this. I will just be very, very brief.

We have a terrific panel here today, and I regret that I am not going to be able to be here to listen to it, but I will certainly follow the testimony. But I particularly wanted to commend to the committee the testimony of Jim Roosevelt.

Jim is a long-time friend of mine, and of many of us engaged in public policy. He is the president and CEO of the Tufts Associated Health Plans. He is here in his personal capacity to talk about Social Security. It happens to be a topic, I guess one could say, that is in his DNA. His grandfather, President Franklin Delano Roosevelt, created the program.

But Jim has, himself, been deeply, deeply immersed in health care issues and in Social Security and social insurance issues all of his career, and I think he will be able to speak to us with a special understanding of the challenge of how we keep Social Security strong, but at the same time keep faith with the values that are contained in it. So I want to thank him for taking time to come down here today and share testimony. I thank all of the witnesses, and I hope you will forgive me for being a little bit Massachusetts-centric and chauvinistic this morning.

Thank you, Mr. Chairman.

Mr. ROOSEVELT. Thank you very much, Senator Kerry.

The CHAIRMAN. Thank you, Senator, very much. We are glad you were able to take some time away to come here. Thank you very much.

**OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR
FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. According to FDA advisor Luther Gulick—I think Mr. Roosevelt was aware of this—President Roosevelt offered this perspective about Social Security and its relationship to the Federal budget: “We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions. With those taxes in there, no damn politician can ever scrap my Social Security program.”

It is fitting that we have President Roosevelt’s grandson with us today as we consider deficit reduction and Social Security. Today we will ask, should Social Security be included in the legislation to reduce the deficit or should it be left unchanged as we consider deficit reduction?

Should Social Security’s long-term financial imbalance be addressed in separate legislation? There are certainly different views on the answers to these questions, but one thing nearly everyone agrees on is that Social Security has been a hugely successful program.

Social Security benefits will help 54 million Americans this year, Americans like Carol Lawen from Stanford, MT. Carol worked at the telephone company for more than 30 years, and she recently wrote me and said this: “I worked hard and was considered a good employee, gave up holidays with my family. I went in early and stayed late when various crises occurred in our country. My family sacrificed time together so that I might be able to provide money to care for them. I paid in every paycheck for my Social Security without complaint. It is now my turn.”

Americans like Carol count on Social Security to be there when they retire. Social Security is dependable. It is fully portable from job to job, and it automatically increases as the cost of living increases. Unlike most other sources of retirement income, you cannot outlive your Social Security benefits.

Social Security provides benefits to help folks get by if something happens to a breadwinner in their family. It helps workers who become disabled and families of workers who have died. This year, Social Security will provide benefits to 2 million children whose parents have passed away. Social Security has been a major force in ending widespread poverty among the elderly.

Social Security is the only source of income many seniors in Montana, and across the country, have to survive. Without Social Security, about one-half of seniors would be living under the poverty line. In fact, for 15 percent of seniors, Social Security is their only income. For 1 in 4 elderly Americans, Social Security provides 90 percent of their income.

What we cannot forget in this debate is that Social Security benefits are modest. Ninety-five percent of retired workers receive monthly benefits of less than \$2,000. In fact, the average Social Security benefit for retirees is \$1,175 a month, or about \$14,100 a year. That is only \$267 a month above the poverty line.

Not only are benefits modest, but they are already scheduled to be reduced. The full retirement age, which is currently 66, will rise to 67 in the coming years. These increases in retirement age have real consequences. A 1-year increase in the retirement age is roughly equal to a 7-percent reduction in benefits.

By law, Social Security must remain separated from the rest of the Federal budget, and the program cannot borrow money from the general Federal budget. Social Security benefits are financed only through payroll taxes and through the trust fund. Social Security is not responsible for the deficits we face in the general fund today.

Therefore, I believe Social Security should not be part of our efforts to reduce these deficits. Since 1983, workers have been contributing more than Social Security has been paying in benefits, and as a result there is currently \$2.6 trillion in the trust fund, and this balance is expected to grow.

The assets in the trust fund mean Social Security will pay full benefits until 2037, and, even after that, payroll tax revenues will be able to pay 78 percent of benefits. Of course, we do not want that to happen, to have benefits paid at that low level.

This is not a crisis. It is a long-term issue, to be sure. It is an issue that should be addressed sooner rather than later to give workers time to plan for any changes. But the current situation does not necessitate a rushed or severe action.

Our deficit and debt, on the other hand, is clearly a crisis. The deficit is currently 9.3 percent of our economy. We do need to act to address our deficits and debts, and do it soon. As we consider how to address our deficits and debt, however, let us remember people like Carol Lawen who worked hard all their lives and count on Social Security to keep a roof over their heads and food on the table. We must remember President Roosevelt's promise to insure a legal, moral, and political right to the benefits that America's workers have earned.

[The prepared statement of Chairman Baucus appears in the appendix.]

The CHAIRMAN. Senator Hatch?

**OPENING STATEMENT OF HON. ORRIN G. HATCH,
A U.S. SENATOR FROM UTAH**

Senator HATCH. Thank you, Mr. Chairman, for calling this morning's hearing. It is a third in a series of Finance Committee hearings designed to address deficit reduction efforts as they relate to

the committee's broad jurisdiction. This committee does have broad jurisdiction.

Today's topic is Social Security and what role does it play in our current fiscal calamity. What role, if any, should it play in moving the Federal Government out of the deficit and debt ditch that it is in?

A few weeks ago, the sometime political philosopher and full-time comedian Jay Leno discussed Social Security. Mr. Leno said, "It's the 75th anniversary of the introduction of Social Security checks. For the younger viewers who don't know what a Social Security check is, you will never see one in your lifetime, so don't worry about it." Well, the latest Social Security trustees' report tells us that the program will be insolvent, as the distinguished chairman has said, by the year 2037. That is about 25 years from now.

If you assume the current retirement age of 67 sticks, it would mean that the younger viewers Mr. Leno is talking to are 42 years and younger. For all of you Americans 42 years of age or younger, if Social Security remains as it is, as New Yorkers say, "Fuhget about it!"

Twenty-five years from now may seem like a long way away. As the old saying goes, in politics a year can seem like eternity. By the way, I do not know how folks can look their constituents age 42 or under in the eye and say there is no problem. For that matter, how do folks look at their constituents, even over 42, who hope to still be alive in 2037, and say there is no problem?

So let us be clear about this. There is a scheduled benefit reduction come 2037. This is not just a problem of how to finance the benefits that are scheduled for 2037 and beyond. Rather, under current law Social Security benefits are scheduled to have an approximate reduction of 24 percent in 2037. That is right: there will be a 24-percent reduction in Social Security benefits under our current law. That is something that we all have to take into consideration as we consider this.

Some might ask, what does that have to do with the current fiscal picture? Take a closer look at the facts and figures from the last trustees' report. We have found that a good chunk of the 25 years of delay of reckoning depends on a fundamental assumption. For many years, the Social Security trust fund ran surpluses. Under the unified budget, these surpluses financed the size of the deficits the Federal Government was running. By law, the so-called trust fund was made whole by the issuance of Treasury IOUs to the trust fund to reflect the surpluses and interest.

In the late 1990s, under the Republican Congress and Democratic President, that trend reversed briefly, but returned back to normal under Congresses and Presidents of both parties. Now, these notes can be serviced in only three ways, and these three ways are higher taxes, spending reductions, or more debt. You can see that recent fiscal history shows a direct relationship between Federal deficits, debt, and the trust fund.

The Social Security trust fund surpluses reduced the apparent size of the deficit, but pressed up on the debt limit. That all changed last year. Last year, payroll taxes and other revenues were less than payments out of the Social Security trust fund. The

trust fund ran a cash flow deficit for the first time since the major Social Security reform of 1983.

We can sit here like the proverbial three monkeys: one of us can place his hands over his eyes and say he sees no fiscal evil; another of us can place her hands over her ears and say she hears no fiscal evil; another of us can place his hands over his mouth and mumble he says no fiscal evil.

But be sure, these IOUs sitting in the Parkersburg, WV offices of the Treasury's Bureau of Public Debt are claims against the Federal Government. They have to be paid. How will they be paid if the trust fund comes to rely on them? If someone wants to tell me that question has nothing to do with the current deficits and debt, I think I have an old bridge, like in Manhattan and Brooklyn, that I would like to sell to them.

The trustees' report is as plain as day on the long-term fiscal problems with Social Security. Social Security trust fund surpluses hid the magnitude of the damage of recent fiscal practices. With the trust fund reversing itself, the day of reckoning is drawing near. Now that, Mr. Chairman, is why we are here. We need to look at the role of Social Security with respect to the origins and continuous causes of the unsustainable deficits and debt.

It is only proper that this committee air these issues out and look at them as sincerely and as credibly as we can. It is only proper that this committee explore the options for Social Security solvency. The President so far has missed the opportunity and does not make a bold commitment to entitlement reform and deficit reduction. Social Security has been once again treated as the third rail of politics. Unfortunately, eventually the financial electricity of that rail will run out if it is not reformed.

So I am in particular looking forward to the witnesses' testimony today. I have to leave early, so I apologize if I have to leave before this is all finished. But I look forward to hearing from each one of you. These are serious problems. I hope we can work them out. The distinguished chairman and I, and others on this committee, will do our best to do something.

The CHAIRMAN. Well, thank you very much, Senator. I appreciate that.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. I would now like to introduce our witnesses. We have quite a distinguished panel. Senator Kerry has already introduced our first witness, Mr. James Roosevelt. Thank you, Mr. Roosevelt, for attending.

Our second witness is Dr. Chuck Blahous, who is a research fellow at Hoover Institute and a public trustee of the Social Security and Medicare trust fund. Dr. Blahous, thank you for being here.

Next, Nancy Altman, co-director of the Strengthen Social Security Campaign, chair of the board of the Pension Rights Center, and the top assistant to Chairman Alan Greenspan in his capacity as chairman of the 1983 Greenspan Commission, a commission that many of us refer to quite frequently.

Finally, Alex Brill, a research fellow at the American Enterprise Institute. Good to see you, Mr. Brill. I know we saw you a few years ago in another capacity. Good to see you back.

Each witness will present their views on how Social Security will be treated. Thank you all for coming. I look forward to your views. I know you are not going to pull any punches, you are going to say what you think. Your statements will automatically be included in the record, and I urge you to summarize your statements for about 5 or 6 minutes or so.

Mr. Roosevelt, you are first.

STATEMENT OF JAMES ROOSEVELT, JR., J.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, TUFTS HEALTH PLAN, WATERTOWN, MA

Mr. ROOSEVELT. Good morning, Chairman Baucus and members of the committee. Thank you for inviting me to testify here this morning.

I would like to begin with another quote from my grandfather, President Franklin Delano Roosevelt. A little over 75 years ago, he spoke these words: "We can never insure 100 percent of the population against 100 percent of the hazards and vicissitudes of life, but we 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. This law, too, represents a cornerstone in a structure that is being built but is by no means complete. It is a law that will take care of human needs and at the same time provide for the United States an economic structure of vastly greater soundness."

Social Security has been the most successful government program of the past 75 years, as the chairman has noted. No program has touched more American lives and benefitted more American families. Today, approximately 52 million Americans receive Social Security benefits each month. Even those who have not drawn a single Social Security check or direct deposit have benefitted. While it was forged in the heat of the Depression, Social Security remains every bit as relevant and important to Americans today.

With only minor adjustments, this program will be there for Americans who have not yet been born. Social Security has truly transformed American society. In 1959, 35 percent of Americans aged 65 and older had family incomes below the poverty line. Today that figure is 10 percent, marking more than a 70-percent reduction in the proportion of elderly Americans living in poverty.

In my grandparents' day, old age was something to be feared. Today, despite financial challenges such as the high cost of prescription drugs, Social Security provides retirees with much greater financial security and peace of mind. If we took away Social Security benefits, it is estimated that nearly half of elderly Americans would have incomes below the poverty line.

We associate Social Security with retirees, but nearly 1 in 5 recipients of Social Security benefits are children under the age of 18, survivors. Supposedly it is the enormous bulge of retirees from the baby boomer generation that will sink Social Security once and for all. And indeed the generation of Americans born between 1946 and 1964 who drew their first retirement checks from Social Security in 2008 will place heavy demands upon the system as they reach their retirement years.

But this is also the generation that has been paying into the system since they started working in the early 1960s. In fact, the projected deficit of Social Security beginning in 2037 is not really a result of the baby boomers. Forward-thinking Social Security Administration actuaries had already accounted for them. Instead, changes in the projected deficit have more to do with factors such as economic and wage growth, productivity, and disability rates.

But these important parts of the story are usually left out. Instead, the purveyors of fear want you to believe that the baby boomers are retiring on the backs of their children and grandchildren. If you buy this premise, then they pull out their frightening statistics showing a declining number of contributors supporting a rising number of beneficiaries to “prove” that the program is unsustainable.

Now let us take a true measure of where we are. Social Security has not only been the most effective government program, it has been the most responsible government program. Social Security costs are funded out of its own dedicated revenue stream. It does not, and cannot, borrow money to finance its operations. It has not added one cent to the deficit. There is no deficit financing. Social Security, furthermore, returns more than 99 cents to beneficiaries of every dollar collected. I dare anyone to find a private retirement plan that can claim that level of efficiency.

By the end of calendar year 2010, the Social Security trust fund will have a positive balance of \$2.6 trillion. It is estimated that Social Security revenues, including interest on the trust fund, will continue to exceed expenditures through 2024.

As a result of interest earned on the trust fund balances, the trust fund surplus will continue to expand to an approximate \$4.3 trillion in 2023. After that year, it is projected to balance and the fund will begin to decline, and still reserves will be sufficient to pay full benefits, as the chairman has mentioned, through 2037. After 2037, Social Security would still be able to pay 76 percent of benefits. I think if Americans understood the true financial picture, the poll numbers that are sometimes cited suggesting that people are not counting on Social Security in the future would be reversed. Doubt would give way to confidence, fear would give way to security.

As the May 2010 report of the Senate Special Committee on Aging concluded, there are any number of small, incremental measures that would keep Social Security fully solvent for the next 75 years.

I am not here to advocate for one solution or the other. What I am here to say is that there are many people who have figured out how we can make modest changes to Social Security that will keep benefits flowing to Americans for decades to come.

The United States does not have a Social Security crisis. It never did. What we do have is fear of a crisis. It is a fear that has been fed by the propagation and accumulation of myths about the program. If we let our fears rule our judgment, we will undo the greatest government program in our history, one that has eliminated poverty for millions of Americans and supported millions of families in time of need.

By law, the receipts and disbursements of the Social Security trust funds are excluded from the President's budget and the budget resolution passed by Congress. Social Security has its own revenue source. It is prohibited from borrowing funds or going into debt and can only pay benefits from its own funds. Since Social Security has not contributed in any way to the deficit, it makes no sense to consider it as part of the solution. Our support for Social Security is rooted in the obligations that we have to each other as Americans. Social Security embodies my grandfather's determination to free us from fear by securing the American people against some of the hazards and vicissitudes of life.

In conclusion, it would be tragic if that nameless, unreasoning, unjustified terror which paralyzes needed efforts to "convert retreat into advance," to use his words, was manipulated to destroy his greatest legacy.

Thank you. I will be happy to take questions.

The CHAIRMAN. Thank you very much, Mr. Roosevelt.

[The prepared statement of Mr. Roosevelt appears in the appendix.]

The CHAIRMAN. Dr. Blahous?

**STATEMENT OF DR. CHARLES BLAHOUS, RESEARCH FELLOW,
HOOVER INSTITUTE, WASHINGTON, DC**

Dr. BLAHOUS. Thank you, Mr. Chairman, Mr. Ranking Member, and members of this distinguished committee. It is an honor to appear before you today to discuss Social Security. As suggested, I am going to skip over most of the material in my written statement and just make three relatively quick points, I hope, in my spoken remarks.

First is that, by any measure, we have a financing shortfall to deal with in Social Security. Now, the way it would manifest itself under current law is that, over the next several decades—the next 2 decades in particular—costs in the program would rise relatively sharply to the point where, by the 2030s, the annual cost of paying benefits would be roughly 1 out of every 6 taxable dollars that American workers earn. If we have a no-action scenario, then in 2037, as has been said already, benefits would be reduced by 22 percent upon trust fund exhaustion.

The second point is that costs are growing for very specific reasons. The first reason is simply that we have an aging population, a lot of baby boomers entering the retirement rolls over the next several decades.

Second, we have a system that is predominantly financed on a pay-as-you-go basis. The vast majority of expenditures at any given time are financed from incoming payroll taxes. So financing in a system like that is relatively sensitive to changes in the worker-to-collector ratio. Before the baby boomers began to enter retirement, that ratio was a little over 3:1. It will be down to about 2:1 by the mid-2030s.

The third reason the costs rise is rooted in program amendments in the 1970s. If we still had the benefit formula in place that President Roosevelt established, we actually would not have a financing shortfall right now. But there were a series of program amendments in the 1970s, changes made to the benefit formula, such that

initial benefits grow in proportion to the average wage index, which over time tends to be somewhat faster than inflation.

So you put these three factors together—the fact that we have a lot more elderly to support, we have a system that is mostly pay-as-you-go financing, and the rise in per capita benefit levels—those three factors together add up to costs that grow faster than the underlying tax base.

My third and final point, Mr. Chairman, is that delay in dealing with this shortfall does bear specific adverse consequences, and for real individual people on Social Security. If we acted today, the best case scenario, we would face choices that are difficult, but at least comparatively benign. We would not have to change benefits for people now in retirement or on the verge of retirement. We would not necessarily have to raise taxes, although we could certainly do that as part of the solution.

We could allow, even if we did not raise taxes, for an increase in the per capita benefit levels going forward relative to inflation, whereas, as I indicated before, the worst-case scenario is the no-action scenario where you have a sudden 22-percent benefit reduction in 2037. But I would submit that this illustration of the generic cost of delay in some ways understates the practical consequences of delay, and those arise because we have a pretty firm bipartisan agreement that it is undesirable to cut benefits for people after they start collecting them.

So, it is more likely that when we do a solution we are going to want any changes to benefits to be prospective rather than to affect people in retirement. So, if you look at this 2037 illustration I just gave, that 22-percent benefit reduction would hit people already in retirement, and we probably do not want to do that.

So if we ask, how big would the benefit reductions have to be in that year if we confine them to new retirees, well, it turns out that, even if we cut off benefits entirely to new retirees in that year, we still would not have the system in balance. So you start working through the problem backwards and asking, well, how soon would we have to act if we did not want to have unprecedented tax burdens or affect people within, say, 5 years of retirement? We would really need to act in just the next couple of years.

Finally, Mr. Chairman, I would say that there is an even potentially more compelling reason as to why delay in resolving the shortfall is costly. That is simply that it is difficult to get people to agree on how to fix Social Security. Republicans and Democrats have different views about how to do it, and it is hard to breach those differences. It becomes harder as time goes by, and the adverse consequences for affected parties become sharper and more severe as a consequence of delay.

For a good reference point, I would ask you to look at the 1983 reforms where we literally came within a few months of the benefit checks not going out. In order to keep the system afloat, we had to do some pretty severe things. We had to delay COLAs, we had to apply new income taxes to benefits, we had to accelerate an increase in the payroll tax, and we brought in new Federal employees. That was a very difficult negotiation.

But, if we were to similarly wait in the 21st century to the point where the trust funds are in the process of being depleted before

acting, we would face a far, far more severe situation, and even the short-term measures we would have to take would be several times greater—in fact, more than 3 times greater—than the ones we enacted in 1983. It is certainly open to question whether or not we would be able to accomplish that on a bipartisan basis so as to preserve Social Security’s self-financing nature.

So in closing, I would just end with some sentences from a paper I recently co-authored with Bob Greenstein of the Center on Budget and Policy Priorities. “Social Security faces a significant shortfall which policymakers would be better off addressing sooner rather than later. Reasonable and well-intentioned people will have differences over the best way to do it. We share a common interest, however, in taking action to do so at the earliest possible time.”

Thank you.

The CHAIRMAN. Thank you, Dr. Blahous, very much. That was interesting.

[The prepared statement of Dr. Blahous appears in the appendix.]

The CHAIRMAN. Ms. Altman, you are next.

STATEMENT OF NANCY ALTMAN, CHAIR, PENSION RIGHTS CENTER, AND CO-CHAIR, STRENGTHEN SOCIAL SECURITY CAMPAIGN, WASHINGTON, DC

Ms. ALTMAN. Thank you. Chairman Baucus, Senator Hatch, distinguished members of the committee, I would like to make four points. First, by law, Social Security cannot add a penny to the deficit, and cutting Social Security’s benefits does not subtract a single penny from the Federal debt.

For those who are used to thinking about Social Security as just another spending program and about Social Security contributions as just another tax, the fact that cutting Social Security does not cut the Federal debt may be hard to believe, but this is the unambiguous operation of the law.

The key is that Social Security is a defined benefit pension plan with its own separate income, outgo, and reserve fund. The law requires that Social Security’s income only be used for the payment of benefits and associated administrative costs. Any surplus must be invested and held in trust until needed.

The law prohibits Social Security from paying benefits unless it has sufficient income to cover the cost, and Social Security has no borrowing authority to acquire that income. It does not borrow, it does not deficit spend. Cutting Social Security’s benefits increases its reserve, but does not change by a penny the amount of debt the Treasury must issue to operate the government.

Second, some Senators are proposing to control Federal spending by enacting a so-called universal cap, but it is important to understand that, unlike the general fund, Social Security already has an automatic spending cap. If Social Security’s revenue ever were insufficient to cover its costs, benefits would be reduced automatically across the board.

Third, including Social Security within deficit legislation, even if the goal is stated to be solvency, not deficit reduction, risks the appearance of raiding Social Security. Many Americans believe that politicians have stolen their Social Security money. The reason is

easy to understand. The American people are constantly bombarded with irresponsible rhetoric about Social Security.

Some politicians casually refer to the interest-bearing Treasury bonds purchased by Social Security as just IOUs without acknowledging that all Treasury obligations backed by the full faith and credit of the United States could be labeled just IOUs. Some warn ominously that Social Security's reserves have already been spent, again, not acknowledging that, whenever a corporation or governmental entity issues bonds, the issuer spends the money and repays the investor with future revenue.

Even more disturbing, some have argued for cutting Social Security by quoting Willie Sutton, the notorious bank robber who, when asked why he robbed banks, replied, "Because that's where the money is." The quip presents an unintended picture: bank robbers and politicians, eager to steal the money of hardworking Americans.

To consider Social Security in deficit legislation, even with the explanation that the inclusion has nothing to do with the deficit, risks reinforcing the widespread belief that Congress is improperly commingling Social Security's dedicated monies with the government's general operating fund revenue.

To avoid even the appearance of impropriety, Congress should keep discussions about Social Security totally divorced from general budget discussions and considered in its own legislative vehicle after debt reduction legislation is done.

My final point. When Congress does take up the issue of Social Security, it should follow the will of the American people who are overwhelmingly united on the issue. With all due respect to Dr. Blahous, our polling shows—and many polls show—Republicans, Democrats, independents, people identified as Tea Partiers, people who have union members in their household, all feel the same way outside of Washington.

Poll after poll indicates that the American people, by overwhelming percentages, want Social Security's projected deficit closed solely by increasing its revenue, ideally progressively and not by cutting benefits, including strong opposition to raising the retirement age.

A great many experts, including the late Robert M. Ball, whom many on this committee knew, believe that that is exactly the right policy. This is one of those fortunate moments when the best politics is also the best policy.

I see I am out of time, so let me conclude by saying that Social Security can be restored to actuarial balance through the normal legislative process with open hearings and debate, as it always has been, as long as Congress is committed to its basic structure that has stood the test of time and works with those experts who believe that the American people have it right. Thank you.

The CHAIRMAN. Thanks, Ms. Altman. That was a very strong statement, very effective.

[The prepared statement of Ms. Altman appears in the appendix.]

The CHAIRMAN. Mr. Brill?

STATEMENT OF ALEX BRILL, RESEARCH FELLOW, AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, DC

Mr. BRILL. Thank you, Chairman Baucus, Ranking Member Hatch, and members of the committee. My name is Alex Brill, and I am a research fellow at the American Enterprise Institute. Thank you for the opportunity to appear before the committee this morning to testify on Social Security and our country's deficit and debt challenges. While the U.S. continues to experience troubling and large annual Federal deficits, I will focus my testimony on our long-range fiscal outlook this morning.

As confirmed by the Congressional Budget Office, without substantive legislative action, large deficits will continue for years to come. This means that we are imposing an ever-increasing burden on future generations who must service that debt.

Some policymakers will argue that Social Security is separate from our broader fiscal challenges. I disagree. Immediately addressing the challenges facing the Social Security program offers an opportunity to improve our country's fiscal soundness, lift an undue burden from future generations, and strengthen our economy's long-run growth prospects. As many experts, including the Social Security actuaries and the Congressional Budget Office, have warned, Social Security is on an unsustainable path.

While there is some uncertainty about the exact year when the trust funds will be depleted, there is no plausible scenario in which they are not depleted in the coming decades. Any near-term legislative agenda to address the Federal Government's long-term deficit and debt challenges should include some Social Security policies geared at least at mitigating the projected shortfall without harming the U.S. economy.

In short, Congress should simply take a first step, pursuing incremental policy options for Social Security, and it can begin now. One sizeable step forward could do much toward delaying trust fund depletion and help future retirees better anticipate the benefits they will actually receive. In fact, recent research has confirmed how Social Security can crowd out private savings and lead to less labor market participation by older workers. While performing a critical function, Social Security also imposes certain costs.

I encourage the committee to consider three incremental policies. First, raising both the normal retirement and the early retirement age. Such a policy could both narrow the Social Security financing gap and foster economic growth. As proposed by the President's Fiscal Commission, this policy eliminates almost one-third of the 75th-year financing gap. In addition, raising the early eligibility age from 62 to 65 could increase Gross Domestic Product by about 5 percent.

Second, modifying the benefit formula to slow future benefit growth. Improved solvency could be achieved through a variety of reforms to the benefit formula, including modifying the formula's second and third rate, adjusting the indexing of the bend points, or establishing a fourth bend point that reduces benefits for workers with high lifetime average incomes.

Third, adopt an index for the annual Social Security cost of living adjustment that better reflects inflation. Under current law, the

metric used to adjust benefits for inflation may be over-estimated and can be more accurately measured using a chain-weighted Consumer Price Index. This change is estimated to eliminate about one-sixth of the financing gap in the 75th year, and was also included in the President's Fiscal Commission's recommendations.

With any reform we consider, we must not forget the most vulnerable among us. Strengthening benefits for low-income individuals would exacerbate the trust fund imbalance modestly, but, combined with any of the options outlined above, the program's long-term financing could be enhanced while benefits for low-income retirees are increased. For example, President Obama's Fiscal Commission proposed a minimum benefit of 125 percent of poverty for any individual with 25 years of work.

In closing, I would urge the committee to acknowledge the significant expected shortfall in Social Security and to consider taking at least one step now to mitigate this problem. Reform options do exist that are both pro-growth and fiscally sound.

Thank you. I would be happy to answer any questions.

The CHAIRMAN. Thank you, all of you.

[The prepared statement of Mr. Brill appears in the appendix.]

The CHAIRMAN. I think it is fair to say that Social Security probably is in a little better shape than is commonly believed. I think that is a point you made, Ms. Altman, and personally I agree with you. Second, it is clear that, on an actuarial basis, for at least the next 75 years, Social Security is going to have to be faced up to, and we have to make some changes.

But I think the question of the day really is, to what degree do Social Security payments in and out, the trust fund, et cetera, contribute to the current deficit and debt questions? The big question today in, certainly, Washington, is the debt limit and how we increase the debt limit, by how much, and so forth, and to what degree that is joined with efforts to reduce the debt and deficit. There are lots of ideas around here on that point. But I would just like to settle, as much as I possibly can—maybe I am naive—the degree to which Social Security does, today, contribute to our debt and deficit and the degree to which it does not.

Now, Ms. Altman, you made a very strong statement in that regard. You say it does not, categorically. One penny saved in Social Security does not reduce our national deficit by one penny. Essentially that is what you said. I would like to ask Dr. Blahous whether you agree, and, if you do not agree, why. I want to just try to settle this. To what degree does it add to the deficit or does it not add to the deficit?

A separate question would be—to the degree to which it does or does not—when to address the question of Social Security. Then the question after that is, when this body addresses it, what should some of the changes be? But first, does it or does it not add to the Federal budget deficit today?

Dr. BLAHOUS. Can I give you a 2-part answer?

The CHAIRMAN. Answer any way you want.

Dr. BLAHOUS. There was actually much that Ms. Altman said that I agree with from a technical perspective, even though I am coming to different conclusions. I think I would agree with her with respect to Social Security's impact on the gross Federal debt, be-

cause the gross Federal debt includes debt that is issued to the Social Security trust fund.

So, to the extent that you reduce a Social Security benefit payment, it results in an increase in the Social Security surplus, which in turn creates an increase in the debt paid to Social Security. And so the gross Federal debt remains unchanged. You would reduce the publicly held debt by doing that, but not the gross Federal debt. So I agree with her technical point.

From a unified annual Federal budget deficit standpoint, I think my emphasis would be a little bit different. It is important not to conflate the deficit and the debt. Certainly net in the aggregate since the 1980s, Social Security has not added net, on average, to our national deficit and debt. The present value of the surpluses that Social Security ran in the 1980s, 1990s, and 2000s exceeds the size of the operating deficit that Social Security is running now. So I agree with that point.

In terms of its actual annual impact this year, I would say it is adding to the annual deficit. Right now the amount of tax revenue coming in to fund Social Security benefit payments is less than the cost of those benefit payments.

The CHAIRMAN. But you are excluding interest.

Dr. BLAHOUS. Right. But the interest payments do not affect the unified Federal deficit. They increase the balance of the trust funds, so the trust fund continues to rise, but basically the cash flow deficit in 2011, under CBO's latest report, is about \$130 billion, and then \$85 billion of that would be made up from a general revenue transfer to reimburse the trust funds for the payroll tax reduction. That is a general revenue transfer. That does not affect the unified budget deficit. Then the other \$45 billion of that cash deficit would be made up through an interest payment. Those payments increase the balance of the trust funds but they do not have an impact on the unified Federal deficit. So I agree on some points, and I would emphasize others somewhat—

The CHAIRMAN. Ms. Altman, we will give you a chance to respond.

Ms. ALTMAN. Thank you. The law is unambiguous. So let me read it: Social Security "shall not be counted for purposes of the congressional budget." Dr. Blahous talked about a unified budget, and that is perfectly appropriate for economists to talk about. You are trying to figure out those fiscal effects, and so forth. But with Social Security, by law, there is no unified budget. Social Security is not part of the budget. So that \$14.3 trillion debt that we are at, the limit that you are going to have to raise—or at least have to vote on whether to raise in a few months—if you cut Social Security, that \$14.3 trillion does not change. It does not put any room into the debt limit.

The CHAIRMAN. All right.

Do you agree with that, Dr. Blahous?

Dr. BLAHOUS. I do agree with that.

The CHAIRMAN. All right. My time has expired. Thank you. Senator Hatch?

Senator HATCH. Thank you.

Let me ask Dr. Blahous this. Now, I am concerned about those on the bottom level who barely get by on Social Security who may

not have much in the way of savings. Let me just have you approximately estimate. Let us say we have a couple. Both of them are over 70 years of age, and both of them have elected to take Social Security at age 70. The husband worked, and let us say he is the sole breadwinner and has made approximately \$150,000 to \$200,000 every year. The wife does not work. What would be the combined Social Security payment, approximately? You do not have to be exact, but approximately what would be their annual total Social Security from the trust fund?

Dr. BLAHOUS. So the husband is the primary wage earner?

Senator HATCH. He is the primary wage earner. The wife may have worked early in her life, but only maybe 1 or 2 years.

Dr. BLAHOUS. So we will assume maybe she is getting the 50-percent non-working spouse benefit.

Senator HATCH. Right.

Dr. BLAHOUS. And the husband's wage profile—he is a medium wage earner? What is his—

Senator HATCH. Well, he is at \$150,000 to \$200,000 a year.

Dr. BLAHOUS. Oh. All right. So he is \$150,000 to \$200,000. So he would be, for Social Security purposes, a maximum wage earner.

Senator HATCH. Right.

Dr. BLAHOUS. Very approximately, we are talking, he would probably get a replacement rate of somewhere around 30 percent based on the wage cap. So we are talking in the neighborhood of \$30,000 a year, plus a 50-percent bonus for her non-working spouse benefit.

Senator HATCH. So you are talking about \$40,000 to \$45,000.

Dr. BLAHOUS. Right. Now, past a certain point they are going to run up against the family maximum.

Senator HATCH. And when would that be?

Dr. BLAHOUS. Off the top of my head, I do not know the family maximum, but they would be bumping up against it. I mean, certainly, if they are getting \$40,000 or so a year, they would be on the very high end of Social Security.

Senator HATCH. Well, there are a lot of people who are on that high end getting \$40,000 to \$45,000 a year. The average wage in this society is what?

Dr. BLAHOUS. The average wage index is about that amount now.

Senator HATCH. Yes. Well, why would we be paying Social Security to those who really are not working and making a good living, and paying that much money in Social Security to people like that, even though they waited until age 70, when we have people who are getting \$16,000 a year out of Social Security? Now, they paid in more, they naturally should make more. But do we not have the wrong system of having that continue to go up and up on the top level and not making very much headway on the bottom level?

Dr. BLAHOUS. I think you are hitting upon a very important point.

Senator HATCH. Well, I think it is important, because I cannot imagine why we would be paying people who have been, not wealthy, but nevertheless very comfortable, almost as much, if not as much, as the average wage in this society, while leaving those at the bottom with very little. They could not live on \$16,000 a year, whatever it is. Why do we do that?

Dr. BLAHOUS. Well, historically the reason is that, in the 1970s, there were changes made to the benefit formula that pegged the initial benefit formula to the growth in average wages.

Senator HATCH. No, I agree that we made the changes. But why do we keep doing that? Do you not have a recommendation that there is a limit to what—should we not have a slower growth on the top level, faster growth on the bottom level? Would that not be a better approach to take?

Dr. BLAHOUS. Well, if I could take off my trustee's hat for a second and not be speaking for the trustees—

Senator HATCH. Yes. I do not hold you to your trustee role.

Dr. BLAHOUS. But certainly—and I agree with Alex—constraining the growth of benefits on the high-income end in excess of inflation should be an important part of any Social Security solution.

Senator HATCH. I think it is immoral for us to be paying people who clearly are making a good living and clearly are fairly well-to-do compared to the average person who is down at that lower level. And we keep raising them up in what I consider to be excessive rates. I am just trying to be fair here. I mean, I guess if you are 70 years of age and you are making \$150,000 or \$200,000 a year, you are going to be very glad that you are getting another \$40,000 to \$45,000 a year from Social Security, when Social Security is potentially going to have some difficulties, and is right now having some difficulties.

Dr. BLAHOUS. A potentially useful set of figures is in a report that CBO did in 2003, where they basically said that, of the projected cost growth in Social Security, 55 percent is as a result of population aging, the other 45 percent is the result of the per capita growth in benefit levels. So this phenomenon you are talking about is pretty significant from a fiscal perspective.

Senator HATCH. My time is up, Mr. Chairman. But I just wanted to make that point, because it just seems to me that it is out of whack right now.

The CHAIRMAN. Not to be argumentative, but is it not also true that about 95 percent of benefits go to beneficiaries who receive \$2,000 a month or less? You are talking about a narrow group of people, 5 percent maybe.

Senator HATCH. I think it is more and more. I think it is more than 5 percent. But even 5 percent. Why would we be paying these people?

The CHAIRMAN. Yes.

Dr. BLAHOUS. Well, sir, the actual number of people who actually are lifetime maximum wage earners is relatively small. Actually, historically—it might be more in the future—it has actually been about 1 percent. That often catches people by surprise, but a lot of people will have zeroes in their earnings history, so the number of people who are actually steady maximum wage earners over an entire career is a pretty small percentage. But certainly the point is well-taken that there is a significant amount of benefit growth that is in excess of inflation to people—

Senator HATCH. There are a lot of people who are more than the 1 percent, or 5 percent, whatever that may be, in the middle who

are getting quite a bit out of Social Security while those on the lower—

The CHAIRMAN. Senator Grassley?

Senator HATCH. Those are real problems, I think.

The CHAIRMAN. Thank you.

Senator GRASSLEY. Mr. Chairman, I intend to use my time not to ask questions, but to make a statement on this subject.

The CHAIRMAN. This is getting to be a trend of yours.

Senator GRASSLEY. Well, do not count on anything when you are in Congress as a trend. [Laughter.]

**OPENING STATEMENT OF HON. CHUCK GRASSLEY,
A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. As is often noted, Social Security is one of the three legs of a 3-legged stool for financial security. Mr. Roosevelt notes in his testimony that this grandfather also believed this when he championed the program. The other legs include personal savings and employer-sponsored retirement programs. We worked hard in the year 2006 to strengthen the employer-sponsored leg with the Pension Protection Act, and, as statistics from the last few years show, individuals are doing their part to improve their personal savings.

However, the Social Security leg is still quite wobbly and needs fixing to give 21st-century retirees 100 percent of the monthly benefits that we get today so that they can count on it once they leave the workforce. A Wells Fargo/Gallup poll from February of this year shows that non-retirees do not expect to rely on the Social Security leg much when they retire.

While they expect it to be a major source of income in retirement, there are five other sources that they expect to rely on before Social Security. Specifically, these sources are: (1) individual retirement accounts, including 401(k) plans; (2) individual stock and mutual fund investments; (3) a work-sponsored pension plan; (4) home equity; and (5) other savings, including savings accounts or certificates of deposit. Those five, before Social Security.

The same poll shows that retirees will rely on these same sources of income but will rely on each of these sources in a completely different manner. For retirees, Social Security will be the second-largest source of retirement income, second only to work-sponsored pension plans.

I mention this poll because some believe that we can put off fixing the Social Security leg of the financial security stool. Those in this camp argue that the Social Security trust fund can pay promised benefits until 2037. They also argue that Social Security is not adding to the deficit right now, so it should not be part of a current deficit reduction debate.

But, as this poll shows, today's workers are not fooled. They know that the longer we wait, the harder it gets. The aging population is shifting. The ratio of workers to beneficiaries decreases from 3:1 to 2:1. As supporters of delaying reform acknowledge, waiting until 2037 to address the problem ensures that beneficiaries will see a more than 20-percent decrease in benefits. There are only three ways to save Social Security from future insolvency: (1) raise taxes; (2) adjust benefits either by adjusting the formula

for calculating benefits or increasing the retirement age; and (3) earning a higher rate of return.

There are two ways to raise taxes: we can increase the amount of the premium that workers and employers pay by increasing the tax, and we can increase the amount of wages subject to the tax. Currently, workers and employers each pay 6.2 or 12.4 percent on incomes up to \$106,800.

As we all know, Social Security is a pay-as-you-go system, so today's workers are paying this tax to provide benefits to today's retirees. In other words, these taxes that today's workers are paying are not going to pay their own benefits. The benefits for today's workers will be paid by taxes that their children and grandchildren pay. Workers are also impacted by tax increases on employers.

Economists agree that employers' share of the Social Security tax is passed on to workers through lower wages. Those who argue that Social Security reform should not be part of a deficit reduction need to keep in mind that my colleagues, particularly on the other side of the aisle, seem to think that income tax increases rather than spending reductions are needed to manage the deficit problem. As long as income tax increases are part of the debt and deficit conversation, Social Security reform must also be a part of the conversation, as long as Social Security tax increases are considered as a solution to Social Security solvency.

We should not consider such tax increases without considering the overall burden on individuals, from higher taxes to lower income. We need to think about whether it is fair asking workers to fork over more of their hard-earned dollars for little or no increase in retirement benefits. Social Security is the most successful government program ever. All workers, current and future, should be guaranteed some level of benefits from Social Security, but we need to ensure that we do this as fairly as possible.

That is the end of my statement. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Carper?

Senator CARPER. Thanks, Mr. Chairman.

To all of our witnesses, good morning and welcome. It is nice to see you all. Thanks for joining us, and for your thoughts.

I was State Treasurer of Delaware after I got out of the Navy. When I got to be State Treasurer, in our State we had no pension trust fund. None at all, just a cash deal. No monies had been set aside to pay benefits. One of the things I got when I was elected in 1976, one of the things our legislature focused on, was creating a real pension trust fund. It is one that is fully amortized, has been for a long time, and we are very proud of that.

I got to Congress in 1983. The first thing they told us on January 3, 1983, after we had raised our right hand and taken that oath to defend our country and Constitution, they said, by the way, Social Security is going to run out of money this year. And they did not say, we are going to see some imbalance between monies coming in and going out; they said we are going to run out of money. They did not say, we are going to reduce Social Security checks by 25 percent or so; they said we are going to run out of money, and you need to do something about it.

Fortunately, we had some really smart people. The Blue Ribbon Commission, as you will recall, chaired by Alan Greenspan, came up with a variety of benefit cuts and revenue enhancements that enabled us to put Social Security on pretty safe footing for a number of years.

I said at the time, I never want some future Congress to be in the situation that we were in. I never want to be there, looking over that precipice. If we are smart, whenever we see things turning the wrong way in terms of monies coming in and monies going out of these trust funds, we will make some very modest adjustments—very modest adjustments—in order to get us on a sound footing for a long, long time, for like 75 or 100 years.

On the argument on the deficit, I am one of those people who do not think we use Social Security to balance the budget, but I do think we can make some tweaks in Social Security that are fairly modest and put it on a sound footing for certainly the rest of my life, and I think maybe for the lives of my sons who are 21 and 22. They do not think it is going to be there for them. I would like to make sure that it is there for them, and for their children as well.

There are a number of fairly, I think, modest changes that have been proposed. This is from my briefing notes for today. There are about four or five things that we can do to put Social Security on very sound footing for, certainly the rest of this century. Number one is to gradually phase in some progressive changes to benefit formulas by 2050, and that would reduce somewhat the benefits for upper-income and higher-earning folks. That is one thing. Another is to gradually increase the taxable maximum to cover about 90 percent of earnings by 2050. Right now, I think we are at about 83 percent. The third is to apply the chained CPI, the COLA, so that the market basket more reflects what folks in their 70s, 80s, and 90s are actually buying. A fourth is to pretty much pursue the formula suggested by the Deficit Commission, to raise the full retirement age to 68, very gradually, by 2050, raise it to 68 and very gradually raise it on up to 69 by 2075. The last one will be to cover newly hired State and local workers after 2020. Some are not covered, some are, but to gradually cover new-hire workers and local workers by 2020. Those are the five.

If we eventually get all those things, we would end up raising enough money to pay—over-pay—for any shortfall, I think, by about 130 percent. We only need 100 percent, so we would end up with about 30 percent left over. We would have a big surplus then, at least in Social Security.

Let me just ask you to react to those ideas, each of you, if you would. Why do we not just start right here. Is it Mr. Brill?

Mr. BRILL. Thank you, Senator Carper. I agree with everything you said this morning. It was consistent with my testimony, which suggests a variety of incremental changes. Not all of the ideas that you mentioned just now were included in my testimony. Perhaps the only difference in my remarks was that I have emphasized the importance of just making any step forward.

So, while certainly it is the case that, combined, those five would over-solve the problem in a sense, that would not be a bad situation to be in. I am advocating this morning that we even just make a dent in it, with any of those five on the benefits side. I have some

concerns on the tax max proposal, but any of the other proposals would certainly be steps in the right direction.

Senator CARPER. Thank you.

Ms. Altman?

Ms. ALTMAN. Senator, let me start by saying that the question about Social Security and how to restore the actuarial balance is a political question, not an economic one. We can afford it. The question is, at what level and what changes do we make.

So going through yours, let me take them a little bit out of order. The 90 percent, restoring the maximum to what Congress intended it to be, that should be done today. That is something that every commission has—

Senator CARPER. I am going to ask you to move along quickly.

Ms. ALTMAN. That one is fine. Newly hired State and local workers: it makes good policy sense. Politically, it is very tough, especially with what is going on with State and local pension plans. The phase-in of benefits: I think that is a terrible idea, quite frankly. It is a very careful balance of equity and fair return, and you would really hurt middle-class Americans and the benefits they receive, really reducing their benefits substantially. They would not get a fair contribution.

Chained CPI: as you know, beneficiaries have not gotten a CPI the last 2 years under the current CPI. Chained CPI is less than that. A lot of people think the current CPI is too low. There is a CPI-Elderly which focuses on that population and that weights health care costs much more because they have more substantial health care costs. So, rather than chained CPI, I think you should be going with CPI-E.

Senator CARPER. All right. Let me just thank you for those. I am running out of time, so let me ask our last two witnesses to just briefly respond.

Would you, please?

Dr. BLAHOUS. I would just say that, if I were king for a day, there are obviously some of those provisions that I like less than others, but none of us gets to be king for a day. The question is, is that a balanced package of reforms that might conceivably get bipartisan support? It tracks pretty closely to a lot of things the Simpson-Bowles Commission put together. It is roughly 50/50 on taxes and expenditures. I think it would be a reasonable bipartisan compromise.

Senator CARPER. Good. Thanks so much.

Mr. Roosevelt?

Mr. ROOSEVELT. Yes, Senator Carper. Thank you. I would like to point out that Social Security benefits that are received are taxed on a progressive basis in the income tax. That has not been mentioned so far, so that deals with some of the question of high-income retirees. I would support definitely increasing the cap on taxable wages right away.

I would associate myself with Ms. Altman's comments. I would oppose raising the retirement age unless we also deal with the disability system, which now requires total disability, essentially, and affects people in different occupations, desk-bound versus physical labor, in very different ways.

Senator CARPER. All right. Good.

Mr. Chairman, I would just make an observation. First, thank you all for those comments. One of the things, in talking to some folks who have done a lot on these issues even more than I have, they said at the end of the day if we could put Social Security on sound footing for the next 75 or 100 years, and the other part of the agreement is to somehow encourage our Republican colleagues to support revenues as part of the package going forward, that would not be a bad trade. So I would just lay that at everybody's feet, and I thank you for giving me this much time.

The CHAIRMAN. You bet. Thank you very much.

Senator Stabenow?

Senator STABENOW. Well, thank you very much, Mr. Chairman. I first want to thank you for holding this hearing and proceeding to focus on Social Security in and of itself. I strongly believe that we should be doing this within the context of looking at Social Security separate from other critical issues that need to be dealt with to address the deficit, but we all know that Social Security is in a very different spot and needs to be addressed for the long term, for 75 years. But I very much appreciate you doing this in the way that you are doing it, Mr. Chairman.

Let me also just say that I think Social Security is a great American success story. Prior to Social Security, half of the seniors in America were in poverty. Mr. Roosevelt, thanks to your family's leadership, your grandfather's leadership, we now have 10 percent of the retirees in America in poverty. I wish it was not 10 percent, but it is a whole lot different than 50. It is my understanding that, without Social Security today, we would be right back at least at 45 percent of seniors in poverty. So I consider that a great American success story that we should all be very proud of.

The other piece I would just say for the record that we have not talked about is that Social Security really is three things, all of which are very important to families. It is retirement, it is a pension system, and thank goodness that pension system was not in the stock market a couple of years ago. I shudder to think what would have happened to retirees if it had been. Second, it is disability. It is a disability insurance policy. Third, it is a survivor's policy. We all know people whose breadwinner passed away when the children were little, and they survived, moms and kids, because of Social Security. So I view those, again, as a great American success story, and really part of the best of America in terms of our values.

So when we look at going forward, I also think it is very important again, Mr. Chairman, for the record, just to say what Ms. Altman said, but to say it again: Social Security is self-financed, cannot borrow, spends less than 1 percent on administrative costs, and has a surplus. Frankly, I wish more Federal programs were that fiscally responsible. We would be in a very different spot right now if that were the case.

But we do know that, starting in 2037, Social Security will only be able to make 78 percent of its obligations if we do not move ahead and make some responsible improvements. So I also believe that small changes now are important for the future, to be able to guarantee that integrity and success story.

So one of the things, Mr. Roosevelt, I wanted to ask you to speak more about is the question of raising the eligibility age, and there has been a lot of discussion about proposals from colleagues. In your statement you said raising the eligibility age could create unacceptable hardship for whole groups of workers. I wonder if you might talk about whom you believe would be hardest hit as a result of that and what that might do as well to elderly unemployment going forward.

Mr. ROOSEVELT. Yes. Thank you very much, Senator. If you work in an occupation like mine as a lawyer or a health insurance executive, raising the retirement age would not impose undue hardship. I can sit behind a desk for quite a few more years. If you work in daycare, running after little kids, or if you work in construction or many other physical occupations, raising the retirement age is an unthinkable proposition.

That is why, if we simply raise the retirement age, we are imposing undue hardship on many Americans. If we revamp the disability system, which has both operational and categorical problems right now, we could come to a more equitable way of addressing that. That is a very difficult problem to address, however.

It is important to recognize that when we talk about the increase in life expectancy, when life expectancy was calculated at the time Social Security began and 65 was set as the retirement age, many, many infants died of childhood diseases and were included in that calculation. Those are curable today. So, in fact, life expectancy has only increased for people who reach age 65 by about 3 years over the time the Social Security system has been in place.

So given that we are already on a path to raising the retirement age to 67, we need to look at that in a very sophisticated way and not make a simplistic adjustment in that age that would be unfair to many people.

Senator STABENOW. Thank you.

Ms. Altman, I wonder also if you might speak to that, as to what groups you think would be impacted with raising the retirement age. Do you think a hardship provision would effectively protect the people whom we are talking about?

Ms. ALTMAN. What people do not understand, because of the way—it is very complicated. Because of the way Social Security's benefit formula works, actually raising the retirement age, as Chairman Baucus said in his opening remarks, is the equivalent of a 7-percent across-the-board cut in benefits. It is mathematically indistinguishable. So, someone who has to retire early gets the biggest reduction.

In addition, though, with respect to the hardship exemption, in 1983 when Congress increased the age to 67, they asked the Social Security Administration to look at a hardship exemption. It sounds like the right approach, and yet it is a very, very complicated thing to do.

For example, you have caregivers, usually women, who often have to leave the workforce early because they are caring for a sick husband. Is that hardship or is that not hardship? You have a recession where a lot of people become unemployed. There has been a spike in EEOC age discrimination claims. Is that a hardship or

not? We already have a disability program that has a very large backlog. A hardship exemption is likely to do the same thing.

The beauty of Social Security is that it is universal, that we all have the same rules. The idea is to make adequate benefits for everyone. We are in the middle of an experiment now with raising the retirement age, and I agree with Mr. Roosevelt, we should not be raising it further.

Senator STABENOW. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman. Thank you for putting this issue on our radar screen. I think it is one we need to be talking about and hopefully doing something about. I want to thank our panelists for your ideas about that today.

I would like to come back, if I might, because one of the big discussions you hear around the country, or you hear at least here in Washington, is that we do not need to do anything on this until 2037 because that is the drop-dead date when the so-called trust fund would be depleted. I am interested in just more the timing of when we deal with this and what happens if we do not deal with it.

So, if you would perhaps shed some perspective on what happens to benefits, for example, in 2037 if we do not reform Social Security today, and how does this really bear on the whole issue of deficits and debt? I think that has been covered a little bit. It sounds like, Dr. Blahous, you addressed that in your remarks earlier. But there is a sense around here that we really do not have to do this now, there is no urgency attached to this because of the "2037" date. I am interested in your perspective on that. Yes, please.

Dr. BLAHOUS. I am strongly of the view that time is of the essence, probably more so than your typical Social Security expert. We are in a very different situation from where we were in 1983. In 1983, we came to a point where we had a crisis in the trust fund, but the trust fund balances, until that time, had been kept pretty small.

So at the point we reached trust fund depletion, or the threat of it, annual operations in Social Security were still pretty close together. They did not have that big of an immediate crisis to deal with in terms of the money coming in and the money going out.

We are in a very different situation now. We have this very big \$2.5-trillion trust fund. So if we say we are going to ride that trust fund for the next several decades and just raise general revenues to redeem those bonds and then deal with Social Security, by the time we would be dealing with Social Security then, annual income and annual outgo would be far, far further apart than they were in 1983.

So the size of the adjustments we would have to make just to preserve self-financing in the program and keep the program going in the short term would completely dwarf anything our political system has been able to do in the past. So not only would the changes we would have to do be more wrenching, I am substantially skeptical that our problem would be politically solvable while retaining Social Security's historical character as a self-financing program.

Senator THUNE. What happens to benefits, though? I mean, what would happen just in terms of 2037?

Dr. BLAHOUS. Well, there would be a 22-percent sudden benefit reduction. That would affect people already in retirement, not just new retirees. So that would actually affect some people who are on the rolls already.

Senator THUNE. Or the other alternative would be, you would have to have a huge, massive payroll tax increase to bring benefits up to what they would need to be.

Dr. BLAHOUS. Right. It would have to go up to a 16-percent payroll tax.

Senator THUNE. What is the rate of return on an individual putting their money in Social Security today? Does anybody know the answer to that?

Dr. BLAHOUS. It depends on whether benefits are cut as you suggest, or we raise taxes. But generally speaking, we are talking an internal real rate of return of somewhere at 2 percent or below. Somewhere between 1.5 and 2 percent would be my guess. I do not want to be held to the precision of that, but somewhere around there.

Senator THUNE. Some of the measures that are being considered are measures that would deal with inflation. You talked a little bit about indexing and how benefits are determined. If you consider measures of inflation used to calculate benefits, are benefits more or less generous in real terms today than they were when the program was started?

Dr. BLAHOUS. In real terms they are substantially more generous. That is because of changes to the benefit formula that were enacted in the 1970s.

Senator THUNE. All right. And of all the prescriptions that have been thrown out, and you have heard a number of them—and I heard you, Ms. Altman, say that you thought getting to the 90-percent level of taxable income would be the first suggestion. If you had to rank them in terms of—I know you probably look at this the way we look at it, in terms of what is politically feasible. What would be the first, simplest, least painful thing that we could do that would at least prevent what I think is, if we wait too long, a real problem from getting much, much worse?

Ms. ALTMAN. If you increase or restore the maximum wage base to 90 percent and you do it gradually over about 30 years, it translates to, for someone making \$106,800, about \$120 a year in additional contributions for which they will get a higher benefit. So it is a very modest change, and it eliminates about a third of the shortfall.

So as I say, as a freestanding bill, I mean, I am very concerned that this not be part of the deficit debate and debt reduction because of the perception of it. But that is something that, as I say, you do not have to do anything else. You do that and you have already moved the ball out maybe 5, or 6, or 7 years. That is something that all the commissions have gone for.

Senator THUNE. Yes.

Mr. Roosevelt, you expressed resistance to raising the retirement age, and I heard your rationale for that. But that, around here at least, is typically something thrown out that is considered to be one

of the more immediate solutions, assuming it is phased in, obviously, over a period of time.

But I am interested in the other panelists' and your ideas about the retirement age and whether or not it would make sense to increase retirement age from 67 where it is today. Dr. Blahous?

Dr. BLAHOUS. Well, I would just say for perspective, consider when Social Security was first established. You could not claim benefits until age 65. We added afterwards the ability to claim benefits at age 62, and that is when most people claim. That has had a very significant impact on labor force participation. Now, people claim at 62 not primarily because of physical incapacity.

In the 1950s, for example, you had 57 percent of males in their late 60s in the workforce. By the 1970s, that was down to 32 percent. It was not that we had all become that much frailer or we had all moved into manual labor jobs, it was simply, we were basically paying people to leave the workforce at an earlier age.

Now, the Simpson-Bowles recommendations would have increased both the early eligibility age and the normal retirement age gradually over time. Again, just for perspective, they would have done that at a rate that is actually slower than the normal retirement age increase under current law.

In the last decade, normal retirement age went up by a year from 2000 to 2005. What Simpson-Bowles recommended was a further increase in that, but actually at a slower rate than the one we have already been through. So I think my first question would be, have we seen a substantial increase in hardship for people in physical labor jobs as a result of the retirement age increase that has already taken place, and use that as a basis for evaluating whether a further one is problematic.

Ms. ALTMAN. As a policy matter, I think raising the retirement age is exactly the wrong way to go. It is mathematically indistinguishable from the across-the-board benefit cut. I have a chart on the last page of my testimony that really shows, even if you work till age 70, you would get less. It is a time when benefits are already being cut, when 401(k)s, when traditional pensions are disappearing, and people are going to be even more reliant on Social Security.

As a political matter, I think there is a disconnect. You say there is consensus about raising the retirement age. In the country, there is consensus against raising the retirement age, so I think that should not be part of the solution.

Senator THUNE. I mean, I would argue that the country—there is probably a consensus against most of the things that are—

Ms. ALTMAN. No, that is not true. If you scrap the cap—we talked about raising it to 90 percent.

Senator THUNE. Yes.

Ms. ALTMAN. About two-thirds of the population say, just eliminate the cap. If you do that, you are done. You do not have to do anything else. In fact, if you do it and keep benefits where they are, you can actually increase benefits, and it brings in more revenue than you need.

Senator THUNE. All right.

Thank you, Mr. Chairman. Thank you all.

The CHAIRMAN. Thank you, Senator.

The question that came to my mind is, back in 1983—Ms. Altman, I suppose you are closest to this—we had a deadline facing us. Your commission, the Greenspan Commission, found ways to decrease benefits and increase taxes, basically. I think it is roughly 50/50; I really do not know. But it was close to the deadline. The changes made were significant, but they were not so large that it caused a huge consternation in the country.

Now, the current system will allow benefits to be paid up through 2037, and then at a lower rate. Most everybody agrees with that. I think you all agree with that. If we were to move forward—there are a couple of ways to ask you this question. What if, instead of making those changes the commission made in 1983, the commission had made those changes, say, roughly 26 years earlier? That would be 2011 to 2037. If they made those changes, the changes that we needed—let us put it that way—made those same changes 26 years earlier, just generally how much less great would those changes have been back then?

But then really the deeper question, the more important question I am asking is, I do not think Congress is going to address Social Security this year, basically because I think most members of Congress agree that it is probably not appropriate to deal with Social Security at the same time that Congress is dealing with debt and deficit reduction. We will deal with Social Security separately.

So it would be interesting to see a chart—maybe my assumption is incorrect; it is kind of the point that Dr. Blahous is making—which would show how much greater taxes would have to be, or how much benefit reductions would have to be over the next 26 years as you approach 2037. I suppose that there are charts that show, some combination that shows, how much greater those actions would have to be over time. I am assuming they would be less dire today, but 10 years from now maybe a little more significant, and maybe 25 years from now quite significant.

Am I correct in assuming that over time those changes would become much more significant than they would be if Congress were to act today? Congress is not going to act today for the reason I mentioned, but I think Congress is going to address Social Security fairly soon. It may not be for a couple of years. But, anyway, can one put together a graph that shows that?

Ms. ALTMAN. Let me start. I think this is responsive. Let me start with something and then answer your question—

The CHAIRMAN. Sure.

Ms. ALTMAN [continuing]. And that is that Social Security is currently in surplus.

The CHAIRMAN. Right.

Ms. ALTMAN. This year it is a \$113-billion surplus. So, if you put changes in today, what you are doing is you are building up the surplus because the funds are not needed for current benefits.

The CHAIRMAN. All right.

Ms. ALTMAN. So the first question—and one thing I talk about in my statement—is to make sure everybody is on the same page about your goal, because, to the extent people do not think the trust fund is real, they do not think these are true government obligation, all you are doing is you are building up that reserve that

people are going to say does not exist. So that is an important first point. It is what happened in the 1990s: we built up.

But the second point is the kind of changes you can put in. If there is a rate increase today, you can put in a lower rate now than if you waited until 2036, as Dr. Blahous says. For certain kinds of changes, like increasing the retirement age—or you could put a rate increase out in 2025; you do not need to do it now—you could enact it now, have it take place in 2025. So they are not all the same.

But the first question is, how high do you want the reserves to be, whether you want those to be a permanent source of revenue for the trust funds, and so forth. There are some preliminary questions even before we get to solutions. I do not know if that is really responsive.

The CHAIRMAN. No, that is helpful.

Does anybody else want to respond? Dr. Blahous?

Dr. BLAHOUS. I think you have hit upon something that is really important here, and that is why I want to leap in, which is that it is important for policymakers to understand sort of arithmetically what are the costs of delay.

What is difficult for people in our position is that quantifying it in a way that is useful to you is often a little tricky. For example, what the trustees' report has annually in it is a little illustration that says, here is how much you would have to change benefits across the board, here is how much you would have to change taxes across the board if you were to take instant action this year.

Now, if you, as a Senator, were looking at that from your staff, you might look at it and say, well, this does not do me much good because I am not going to cut 14 percent this year from someone's benefits who is already in retirement. I need to know how big of a change it is going to be when you factor in the fact that we are going to do benefit changes prospectively, and other little nuances that are hard to quantify but would reflect political realities.

This is also why I mentioned in my remarks there is also the very real issue of, what is the amount of traffic our political system can handle? We could do illustrations saying, well, here is how big the long-term 75-year shortfall is by 2037. But, if in practical reality there is a limit to how much short-term pain the system is willing to impose, then that is something policymakers need to know as well.

The CHAIRMAN. I understand. Right.

Mr. Roosevelt? Then I am going to have to wrap up here. Go ahead.

Mr. ROOSEVELT. All right. Just very quickly, Mr. Chairman. Another way to look at it is that, as Senator Thune mentioned, if you wait until 2037, or as was mentioned in response to a question, you would need a 2-percent increase: 1 percent from employer, 1 percent from employee. If you did that now, you could do a 1.1-percent increase in the tax—

The CHAIRMAN. Total?

Mr. ROOSEVELT. Total, because of the way you have built up the trust fund. But it is important to remember that, if you do nothing, there is, as Dr. Blahous said, a 22-percent cut in benefits in 2037. The Simpson-Bowles recommendations are a one-third cut in bene-

fits, so that is worse than doing nothing. So, I think that is important to remember.

The CHAIRMAN. I would say I really should go, but what is the magic of 75 years? A lot can happen in 75 years either way.

Dr. BLAHOUS. That is very true. The economy can perform better or worse, we can find the elixir of youth, and so on and so forth. So it is very true that 75 years is not magic. It is a useful standard because it is a way of estimating the time that people are in the workforce and receiving benefits.

The CHAIRMAN. Ms. Altman?

Ms. ALTMAN. And if I could say, actuaries historically have used a valuation period as short as 30 years and as long as 80 years, and they have settled onto the 75 years. But it is important to understand that it actually is very conservative. No private pensions use that kind of long valuation period, and most other countries in the world do not. I think Germany uses about 30 years for their Social Security program. So there is nothing magical about 75 years.

The CHAIRMAN. It is just plucked from thin air?

Ms. ALTMAN. No. The idea is that someone joining the workforce at age 20 would be 95 at the end of the valuation period, so the idea is, you are reassuring workers that there will be benefits for their entire work history.

The CHAIRMAN. All right. Good. I am glad I asked the question. Thank you. You all have been very, very helpful. Thank you very much.

The hearing is adjourned.

[Whereupon, at 11:37 a.m., the hearing was concluded.]

A P P E N D I X

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

STATEMENT OF NANCY J. ALTMAN, J.D.
CO-DIRECTOR, SOCIAL SECURITY WORKS
CO-CHAIR, THE STRENGTHEN SOCIAL SECURITY COALITION

HEARING ON
PERSPECTIVES ON DEBT REDUCTION: SOCIAL SECURITY

UNITED STATES SENATE
COMMITTEE ON FINANCE

MAY 10, 2011

Chairman Baucus, Ranking Member Hatch, and Members of the Committee:

Thank you for holding today's hearing on how Social Security relates to the federal debt subject to a statutory limit which will be reached in a matter of months.¹ Social Security is of vital importance to the American people, and its relationship to the federal debt is crucial to understand, yet widely misunderstood.

As co-director of Social Security Works, I co-chair the Strengthen Social Security Campaign, a broad-based coalition of over 300 national and state organizations representing 50 million Americans, including seniors, workers, women, people with disabilities, children, young adults, people of low-income, people of color, communities of faith, and others. I also chair the Board of Directors of the Pension Rights Center, and serve on the Board of Directors of both the National Academy of Social Insurance and the Foundation of the National Committee to Preserve Social Security and Medicare.

In 1982, I had the honor to serve as the top assistant to Alan Greenspan in his capacity as the Chairman of the so-called Greenspan commission, whose recommendations formed the basis for the Social Security Amendments of 1983. Prior to that, I had the privilege to serve as a legislative assistant to Senator John C. Danforth (R-MO.).

Social Security is a Pension Plan whose Income and Assets, like Those of Private Pensions, are Legally Required to be Segregated from Those of the Plan Sponsor

Those arguing for the inclusion of Social Security in comprehensive deficit legislation often seek to justify their position by asserting that "everything" should be "on the table." But that facile phrase fails to recognize that Social Security is a pension plan. For sound

¹ While economists sometimes artificially divide the federal debt into subcategories, such as debt held by foreign entities, pension trusts, individuals, the public, and so on, the law does not. The category of debt which is recognized by the law is the government's total debt which is subject to a statutory limit. That is the amount of debt which the United States cannot exceed without an Act of Congress raising the debt limit. That is the category of debt on which this statement focuses.

reasons, the law requires that private employers who sponsor pension plans keep plan income and assets segregated from the company's general operating fund. For the same sound policy reasons, the law requires that Social Security's income and assets be kept segregated from the general operating fund of its plan sponsor, the federal government.

Both private pensions and Social Security are required to keep plan assets in pension trusts overseen by plan trustees. Like any prudent plan sponsor, the federal government carefully accounts for those plan assets. Several dozen civil servants at the Department of Treasury and the Social Security Administration keep precise and meticulous track of the income and assets of Social Security. Every year, the trustees of the Social Security trust funds are required by law to report to Congress on the program's current and projected operations. In addition to those measures, Congress has required that Social Security's income and outgo not be part of the federal budget. The law unambiguously states that Social Security "shall not be counted . . . for purposes of – (1) the budget of the United States Government as submitted by the President, [or] (2) the congressional budget. . . ."²

Social Security's primary revenue has always been pension contributions of employers and employees. Today, those contributions are sometimes referred to as payroll taxes, but they are, more accurately, pension insurance contributions. This is precisely why the statute mandating these payments is entitled the Federal Insurance Contributions Act (FICA).

That title is no political spin. Congress enacted the Federal Insurance Contributions Act in 1939, well before the current fashion of Madison Avenue-styled legislative titles like the "Economic Growth and Tax Relief Act" or "Repealing the Job-Killing Health Care Law Act." In stark contrast, Franklin Roosevelt named his bills plainly and straightforwardly. His tax bills were labeled "Revenue Act", his legislation to protect the right of workers to unionize, the "National Labor Relations Act", and his "Federal Insurance Contributions Act" specifies the contributions workers must make in exchange for pension annuities, life insurance, and since 1956, disability insurance. From the beginning, contributions not needed for current benefits and related administrative costs have been invested and kept in trust as a reserve for the exclusive purposes of paying benefits and associated administrative costs.

By Law, Social Security Cannot Add a Penny to the Deficit

The injection of Social Security into the broader deficit debate obscures the fact that by law Social Security lacks the authority to add to the federal deficit.³ By law, it can only pay benefits, if it has sufficient revenue to cover the costs. Its budget must be balanced, but Social Security cannot accrue the revenue needed to balance its budget through borrowing, because it has no borrowing authority. Social Security lacks the legal

² Pub. L. 101-508, title XIII, Sec. 13301(a), Nov. 5, 1990, 104 Stat. 1388-623.

³ Appended, for the Committee's information, is a statement signed by 276 academics and other Social Security and budget experts seeking to dispel confusion about this often misunderstood point.

authority to deficit-spend, and so, cannot run a deficit. Because it cannot run a deficit, it cannot add to the federal deficit⁴

Cutting Social Security Does Not Reduce the Federal Debt Subject to Limit

As the members of this Committee know, the federal government will reach the limit on federal debt, or debt limit, in a matter of months. In that regard, it is crucial to understand that cutting Social Security does not reduce the United States' debt subject to that limit. This sharply differs from cuts to agricultural subsidies, defense, or other expenditures from the government's general fund.

If a program paid for from general-fund revenue were cut by \$100 billion and nothing else changed, the federal government's borrowing needs would go down by \$100 billion. As a consequence, the federal debt subject to the debt limit would also go down (or more realistically, given the current large deficits, would go up less than it would have, without the cut). If the savings from that hypothetical cut were offset dollar-for-dollar by a cut in income taxes or an increase in other expenditures funded from general revenues, the federal debt subject to limit would be unchanged.

In stark contrast, if Social Security benefits were cut by \$100 billion, the federal debt subject to limit or total debt would remain unchanged. If the \$100 billion savings from cutting Social Security benefits were offset dollar-for-dollar by a cut in income taxes or an increase in general-revenue spending, the total federal debt would increase!

For those who are used to thinking about Social Security as just another spending program and about Social Security contributions as just another tax, the relationship between Social Security and the federal debt may be counterintuitive. To grasp that relationship, it is important to see that Social Security is a defined benefit pension plan with its own separate income, outgo, and reserve fund.

The following thought experiment may help. Imagine a private pension plan whose assets are invested solely in Treasury obligations. Imagine further that the plan sponsor, Company XYZ, cuts the benefits the plan provides, but does not decrease the plan's funding in any way. In that case, the plan would have more income in relation to its expenses than it had before plan benefits were cut. The plan accordingly would use that additional income to purchase additional Treasury obligations (or to pay plan costs, if that were necessary). The plan's increased income would have no effect on the federal deficit or debt. The federal government would have exactly the same general-fund income and outgo, and so, the same borrowing needs, irrespective of the cuts to the pension plan benefits. Consequently, the Department of Treasury would issue debt instruments totaling the exact same value, irrespective of the actions of the pension plan.

⁴ The so-called "payroll tax holiday," enacted last December and set to expire on December 31, 2011, is a temporary change in the self-funded nature of Social Security. The provision substitutes, in 2011, general revenue for a portion of Social Security's dedicated worker contributions. Many Social Security experts, including me, opposed the change because we believed it to be poor Social Security policy.

In the exact same way, if Social Security's plan sponsor, the federal government, cuts the benefits Social Security provides but does not decrease the level of contributions employers and employees are required to make under FICA, Social Security's income would increase in relation to its expenses, and Social Security, accordingly, would purchase additional Treasury obligations. Social Security's additional income and its purchase of additional Treasury bonds would have no effect on the federal deficit or debt. The federal government would have exactly the same general-fund income and outgo, and so, the same borrowing needs, irrespective of the cuts to Social Security. Consequently, the Department of Treasury would issue debt instruments totaling the exact same value, irrespective of the changes to Social Security.

Cutting Social Security's benefits, like cutting the benefits of a private pension plan, does not reduce by even a penny the federal deficit or the total value of debt instruments issued by Treasury. The only way to reduce the amount of federal debt Treasury issues is to reduce the expenditures of the government's general operating fund or increase its income.

Current Law Already Includes an Automatic Cap on Social Security Spending

Some policymakers are proposing a so-called universal cap as a mechanism to control federal spending. It is important to understand that unlike the general fund, Social Security already has an automatic spending cap. If Social Security were ever to lack sufficient revenue to cover the cost of scheduled benefits, the law provides that those benefits be reduced automatically.

In order to allow Congress ample time to avoid Social Security's automatic trigger, the law requires that Social Security's Board of Trustees report annually regarding the program's financial operations, projected over a 75 year valuation period. According to the most recent Trustees Report, issued last August, Social Security is projected to have a surplus in 2011 of \$113 billion, and to be able to meet all scheduled obligations, even with no Congressional action whatsoever, for the next quarter of a century. If no action were taken by then, Social Security's cap on spending would automatically cut its expenditures across-the-board so that beneficiaries would receive, according to the actuaries' projections, only 78 percent of their scheduled benefits at that point.

Including Social Security within Deficit Legislation – Irrespective of the Rationale -- Risks the Appearance of Improperly Raiding Social Security

Notwithstanding the fact that Social Security does not and cannot contribute to the deficit, the proposal put forward by the co-chairs of the president's National Commission on Fiscal Responsibility and Reform included changes to Social Security, though the report explains that Social Security was included "for its own sake, and not for deficit reduction." The president and others have similarly discussed a so-called "parallel" track for Social Security. This approach is ill-advised.

Including Social Security in a comprehensive deficit package, irrespective of the rationale, is highly likely to create deep suspicion, and perhaps even anger, among the American people. The suspicion and anger that would ensue from including Social Security in deficit reduction legislation – no matter the rationale for its inclusion -- is foreseeable and understandable.

By law, Social Security's income can only be used for benefits and associated administrative costs. That requirement is not just the operation of law; it represents the solemn, long-standing, fiduciary responsibility of the government, as the plan sponsor. Historically, Congress has been extremely diligent and careful in executing its fiduciary responsibility with respect to Social Security's income and assets. From the program's origin, Congress has required Social Security's trustees to invest all surpluses in the safest, most conservative investment possible – interest-bearing debt instruments backed by the full faith and credit of the United States. Congress has also required those trustees to report annually, no matter the circumstances, even during World War II and other times of war, on those contributions and those surpluses which are in reserve, available whenever the monies are needed to pay scheduled benefits. Currently Social Security has an accumulated reserve of \$2.6 trillion.

Diverting Social Security's dedicated income and assets from their intended purpose is legally and morally wrong. Not surprisingly, numerous polls indicate that the American people do not want their Social Security contributions diverted to debt reduction or governmental purposes other than Social Security. Yet, polling and focus group data from a number of sources, including our own, reveal that many Americans believe that the government has already stolen their contributions or fear that it will. Too many Americans are convinced that their Social Security contributions have been stolen. Too many others are uncertain or worried that Congress will steal Social Security's income and assets to use for other unauthorized purposes.

The reason for this widely-held anxiety is easy to understand. The American people are constantly bombarded with irresponsible rhetoric about Social Security. For example, some policymakers casually refer to the interest-bearing United States Treasury bonds purchased by Social Security as "just IOUs." These policymakers fail to acknowledge that the expression could be used for all Treasury obligations backed "just" by the full faith and credit of the United States. Similarly, some elected officials have warned ominously that Social Security's reserves have already been spent, again not acknowledging that whenever a corporation or governmental entity issues bonds, it does so to raise needed funds, which it plans to spend; investors understand and expect that the funds will be spent and repaid out of future revenue. Even more reprehensibly, some policymakers have argued for cutting Social Security by quoting Willie Sutton, a notorious bank robber, who, when asked why he robbed banks, replied, "because that's where the money is." The quip presents an unintended but revealing picture – bank robbers and politicians, all eager to grab the money that hardworking Americans trustingly hand over every payday to what they believe is a safe institution.

All of this casual, irresponsible rhetoric is a serious disservice to the American people and explains why so many Americans believe that their contributions have been stolen. Past policymakers have understood their fiduciary responsibility for the funds which are held in trust for the trusts' beneficial owners, American workers and their families. With the notable and disastrous exception of 1981,⁵ a time that should serve as a cautionary tale to all politicians, policymakers have understood that, to avoid even the appearance of impropriety, deliberations over Social Security's future solvency should be kept completely separate from broad deficit-reduction efforts.

To include Social Security in deficit legislation, even with the explanation that the inclusion has nothing to do with deficit reduction, risks reinforcing the widespread belief that Congress is improperly commingling Social Security's dedicated monies with the government's general operating fund.

The foreseeable suspicion and anger on the part of the American people can easily be avoided by addressing Social Security in legislation devoted to it alone, at a time after the current deficit debate is concluded, so that Social Security deliberations are totally divorced from general budget discussions. This approach will avoid the appearance of wrong-doing. As discussed below, it is likely to produce better policy outcomes, as well.

Congress Should Address Social Security After The Current Deficit Deliberations have been Concluded and After the Debt Ceiling has been Raised

In addition to the advantage of avoiding even the appearance of wrong-doing, prudence suggests waiting until after the deficit deliberations are concluded to take up the issue of Social Security. As part of the current deficit deliberations, this Committee has jurisdiction over, and so responsibility for, important programs funded by general revenue, as well as over income taxation and other forms of general revenue.

Social Security is too complicated and too important to the American people to be addressed as part of other complicated legislation, when full attention will necessarily be diverted, and when there is no compelling or urgent reason to do so. There is no need for haste in addressing Social Security. The latest Trustees' Report projects that Social Security can pay all benefits on time and in full until 2037, without any Congressional

⁵ Past Congresses have consistently kept Social Security's income and assets separate from broad deficit-reduction efforts – with the notable and disastrous exception of 1981, during President Reagan's first year in office. Just like today, the federal government had an actual deficit, while Social Security was projecting a deficit. In those two deficits, the Reagan administration saw an opportunity. Reagan's OMB director, David Stockman, who later referred to Social Security as "closet socialism," explained confidentially at the time to journalist William Greider that the deficits "will permit the politicians to look like they're doing something for the beneficiary population when they are doing something to it." The Reagan administration badly miscalculated. The conflation of the two deficits in budget reconciliation legislation, followed by a proposal which would have drastically reduced early retirement benefits, set off a firestorm. Seeking to quell the storm and get through the 1982 election, President Reagan established the Greenspan commission. The Commission, on whose staff I served, decided at the outset, to divorce Social Security deliberations from concerns about the deficit or Medicare. Focused exclusively on Social Security, the Greenspan commission was ultimately able to reach agreement.

action whatsoever. While Social Security's projected deficit should be eliminated in a timely manner, waiting until after the current debate over deficits and the debt ceiling is both timely and prudent, given the program's complexity and importance.

Social Security, which has been carefully crafted over its 75 year history, provides vital economic security to virtually every American – not only to the more than 54 million beneficiaries who receive monthly benefits but also to the more than 165 million workers who contribute and who, together with their families, are insured against the loss of wages in the event of disability, death, or old age. Current beneficiaries include millions of widows, widowers, seniors, children who have lost parents, and people with disabilities, as well as their children and spouses.

Our brave soldiers wounded in Iraq and Afghanistan receive Social Security benefits, as do their spouses and children. So do the families of soldiers who have given their lives in defense of the nation. Though little noted, Social Security continues to provide benefits to the families of those who lost their lives in the 9/11 attacks. Social Security's benefits are crucial to the vast majority of its beneficiaries and the communities in which they live and spend.

Because Americans in the last few years have lost trillions of dollars in home equity and retirement savings, it is more important than ever that proposed changes to Social Security be addressed deliberately, thoughtfully, and in the sunshine. The importance of Social Security to virtually the entire population demands that proposals for change receive thorough consideration, with public participation by representative groups, so that the implications of all changes are closely examined and clearly understood. Any kind of expedited procedure or omnibus vehicle would be a disservice to the American people.

Congress Should Use Regular Order in Addressing Social Security, as All Past Congresses Have Done

Throughout Social Security's long history, Congress has always relied on regular order when considering Social Security. Starting with its enactment in 1935, Social Security legislation has always had the benefit of (1) full hearings before the House Ways and Means Committee and the Senate Finance Committee; (2) executive sessions which provided all members the opportunity to offer amendments; (3) unlimited debate and opportunity for amendments in the Senate; and (4) debate and amendment in the House of Representatives, consistent with its rules.

This was the procedure that was followed in the enactment of the Social Security Amendments of 1977, when Social Security faced a larger and more immediate projected deficit than it does now. Then-President Jimmy Carter proposed legislation that was considered carefully, with the benefit of full hearings before both the House Ways and Means Committee and the Senate Finance Committee. Regular order was also followed in 1983, when Congress largely followed the recommendations of the so-called Greenspan commission.

An issue as far-reaching as Social Security demands that it be addressed only after careful consideration by this Committee, where the expertise resides. Past Congresses have always dealt with Social Security responsibly and in the sunshine. There is no reason that this Congress cannot, as well.

This Committee Should Clearly Define and State the Goal Before It Begins to Address Social Security's Projected Shortfall

Historically, policymakers deemed Social Security solvent if its income and outgo were in actuarial balance or even close actuarial balance for a prescribed valuation period. Social Security's actuaries have used valuation periods as short as 35 years, and as long as 80 years, but since 1965, the valuation period has been 75 years.

Recently, some have advocated even tougher tests of solvency. Some argue that, in addition to projecting balance for three-quarters of a century, Social Security must be found to be sustainable in the 75th year or, even more extreme, that Social Security be solvent over an infinite time horizon.

Others appear to reject the entire concept of actuarial balance and instead want to require that the annual cash flow from Social Security's income from outside the federal government equal or exceed its expenditures. The effect of this goal would be to ignore Social Security's investment income and reserves – in essence, to have the government effectively default on legal instruments backed by the full faith and credit of the United States. This approach represents the precise sort of diversion of worker contributions which Congress should take great pains to avoid and indeed to vociferously discredit.

To provide perspective on what the appropriate goal should be, it is important to recognize that three quarters of a century is a longer valuation period than that used by private pensions and, indeed, by most other nations with respect to their Social Security programs. Moving the goal posts even further away – requiring an infinite time horizon or even sustainability in the 75th year – simply makes the job of policymakers harder, without commensurate gain in security, because the farther out one projects, the less trustworthy those projections become. Even more pernicious is the so-called cash flow argument. Social Security has always had a reserve to smooth out differences between contributions and benefits. Between 1958 and 1983, for example, Social Security drew on its investment income or drew down principal in fourteen different years to cover the cost of benefit payouts. It is the effort to negate the existence of these reserves and the accompanying claims that Social Security is in deficit – when it actually is in surplus when all of its income is appropriately counted – that has understandably caused Americans to be suspicious and angry toward politicians whom they suspect of stealing their Social Security contributions.

Before policymakers begin to focus on solutions, they should be in clear agreement on how they wish to define solvency. In particular, unless the cash-flow argument is clearly and vociferously put to rest, Congress will be unable to convince the American people

that Social Security is solvent, even if legislation is enacted which the actuaries project restores Social Security to long-run actuarial balance.

Most fundamentally, it is important to remember that solvency is not the ultimate goal. The goal is the provision of some measure of economic security to the American people. Deciding how to finance that goal is crucial, but simply the means to that end.

In Addressing Social Security, Congress Should Follow the Will of the People

Social Security's scheduled benefits are completely affordable. The gap between Social Security's projected benefits over the next 75 years and its projected income is just 0.7 percent of GDP. At its most expensive, once the baby-boom generation is fully retired, Social Security is projected to cost just 6.1 percent of GDP, considerably less than the current percent of GDP that a number of industrialized countries are spending today on their counterpart old-age programs. The issue of how to eliminate Social Security's projected deficit is a political question, not one of economics.

There is much polarization in the country today, but Social Security is a program about which the American people are united. Poll after poll indicates that the American people by overwhelming percentages support Social Security and do not want it to be part of deficit discussions. They overwhelmingly believe that Social Security's benefits, if anything, are too low, and want its projected deficit closed by increasing its revenue, ideally progressively. They do not want benefits cut, and they do not want the retirement age increased – an approach which is mathematically indistinguishable from an across-the-board cut in benefits for retirees, even with respect to workers who work until age 70 or beyond.⁶

According to polling we have conducted, as well as polls of other organizations, these are the views held by Democrats, Independents, Republicans, union households, tea partiers, the young, the old, and every other age and demographic.

Some policymakers seem to believe that Social Security spending is out of control, but as discussed above, it is subject to its own spending cap. It would be paradoxical to cut Social Security deeply now to avoid less deep cuts in the future, as the co-chairs of the president's commission and others have proposed.

What most Americans support – eliminating Social Security's manageable shortfall solely through increased revenue – is the best policy solution, as well. Social Security's benefits are modest by virtually any standard, yet vitally important to the vast majority of American workers and their families. Moreover, Social Security's administrative costs comprise less than one penny out of every dollar spent, a much higher efficiency than that experienced by private sector retirement plans. In addition, with the termination and freezing of traditional pension plans and the documented serious shortcomings of 401(k)

⁶ I have appended a chart which shows the monetary impact on monthly benefits of an increase in the statutorily-defined "Retirement Age."

plans, Social Security is likely to be an increasingly important source of retirement income for the vast majority of Americans in the future.

Some on this Committee knew the late Robert M. Ball who, at the time of his death in 2008, was the world's foremost expert on the U.S. Social Security system. He devoted seven decades of his life to the protection and improvement of Social Security. His words and recommendations are still highly relevant today. In an Op Ed in the Washington Post published shortly before his death, Ball stated unequivocally that in today's world, it is "the essence of responsibility to insist on no benefit cuts." That same view is shared by numerous other experts. I have appended a letter, for the Committee's information, signed by 276 academics and other Social Security experts who "recommend strongly that Social Security's manageable shortfall, still decades away, should be eliminated without cutting benefits, including without raising the retirement age."

Fortunately, the best politics with respect to Social Security is also the best policy.

In Addressing Social Security's Projected Shortfall, Congress Should Retain Social Security's Fundamental Features Which Have Stood The Test Of Time

Social Security has often been called the nation's most successful domestic program. Its ingenious structure explains the success. Social Security has always embodied basic American values: reward for work, shared responsibility, prudent conservative management, compassion, focus on the family, and the recognition that after a lifetime of hard work, Americans have earned an old age of independence and dignity.

From the moment of its enactment, Social Security has carefully balanced the twin concerns of equity and adequacy. From the start, Social Security's benefits sought to provide a fair benefit for contributions. The higher a worker's wages and contributions, the higher the benefit a worker receives in absolute dollars. Simultaneously, from the beginning, the benefit structure has provided larger proportionate benefits to those whose lifetime earnings are lower, in recognition that they have less discretionary income and so need more of their wages replaced. It has provided benefits as a matter of right. In recognition that we are one people, it treats everyone the same. No matter one's economic status, everyone who contributes to Social Security for the requisite number of quarters receives, as a matter of right, a fair benefit in the event that insured wages are lost as a result of disability, death with family left behind, or old age.

I urge the members of this Committee, in evaluating proposals for changes to Social Security, to be especially alert to proposals which would change this fundamental, time-tested structure. An affluence or means test would end the universality of Social Security. Scaling back on benefits for better-off workers would undercut the fairness of the system, which so carefully calibrates the relationship between contribution input and benefits received.

The soundest way to strengthen Social Security is to build on the foundation that has been constructed over the last three-quarters of a century. Social Security is a legacy and trust which deserves to be addressed with the utmost care and deliberation, so it can be passed along as a legacy to future generations.

STRENGTHEN SOCIAL SECURITY

...don't cut it.

April 12, 2011

President Barack Obama
The White House
Washington D.C. 20500

Dear Mr. President:

As experts on Social Security, the federal budget or the economy, we write to correct a commonly held misconception – that Social Security somehow contributes to the federal government's deficit. In fact, Social Security's Old Age and Survivors Insurance Trust Fund and its Disability Insurance Trust Fund are prohibited from paying benefits unless those funds have sufficient income and assets to cover the cost, and they have no borrowing authority to acquire the requisite income and assets. Consequently, Social Security is prohibited by law from deficit-spending and thus contributing to the federal deficit.

We also write to point out that Social Security's benefits are modest both compared to those of other industrialized countries and in absolute terms. Its administrative costs are also modest, amounting to less than a penny of every dollar expended. The modest size yet increasing importance of Social Security's life insurance, disability insurance, and old age annuities, given the trends in private sector retirement arrangements, savings, home equity and stock values, leads us, as a policy matter, to recommend strongly that Social Security's manageable shortfall, still decades away, should be eliminated without cutting benefits, including without raising the retirement age.

Sincerely,

1. Henry J. Aaron, Ph.D., Senior Fellow, Economic Studies, Brookings Institution
2. W. Andrew Achenbaum, Ph.D., Professor of Social Work and History, University of Houston
3. Randy Albelda, Ph.D., Professor, University of Massachusetts, Boston
4. Carolyn Aldana, Ph.D., Professor Emeritus of Economics, California State University, San Bernardino
5. Sylvia A. Allegretto, Ph.D., Economist, Institute for Research on Labor and Employment, University of California, Berkeley
6. Nancy J. Altman, J.D., Co-director, Social Security Works, top aide to Alan Greenspan in his position as Chairman of the 1982-83 Social Security Commission
7. Edwin Amenta, Ph.D., Professor of History and Sociology, University of California, Irvine

8. Nancy Amidei, M.S.W., Director, Civic Engagement Project, Emeritus Faculty, University of Washington School of Social Work
9. Alice H. Amsden, Ph.D., Barton L. Weller Professor of Political Economy, Department of Urban Studies and Planning, Massachusetts Institute of Technology
10. Greg Anrig, Vice President of Policy and Programs, the Century Foundation
11. Richard Arenberg, M.A., Adjunct Lecturer in Public Policy and American Institutions, Brown University; Adjunct Lecturer in Political Science, Northeastern University
12. William Arnone, J.D., Independent Consultant; Partner Emeritus, Ernst & Young, LLP; Founding Member, National Academy of Social Insurance
13. Michael Ash, Ph.D., Associate Professor, University of Massachusetts, Amherst
14. M. V. Lee Badgett, Ph.D., Director, Center for Public Policy & Administration; Professor of Economics, University of Massachusetts, Amherst
15. Dean Baker, Ph.D., Co-director, Center for Economic & Policy Research
16. Erdogan Bakir, Ph.D., Assistant Professor of Economics, Bucknell University
17. Radhika Balakrishnan, Ph.D., Professor of Women's and Gender Studies, Rutgers University
18. Stephen Baldwin, Ph.D., Economist, Retired
19. Robert Jonathan Ball, L.C.S.W., Ed.D., Social Security Works Advisory Committee
20. Nina Banks, Ph.D., Associate Professor, Bucknell University
21. Edward Berkowitz, Ph.D., Professor of History and Public Policy and Public Administration, George Washington University
22. Alexandra Bernasek, Ph.D., Professor, Colorado State University
23. Merton Bernstein, J.D., Professor Emeritus, Washington University, St. Louis
24. Tom Bethell, Independent Social Insurance Policy Analyst, Editor and Co-author with Robert M. Ball of *Straight Talk About Social Security* and other publications
25. Deepak Bhargava, Executive Director, Center for Community Change
26. Cyrus Bina, Ph.D., Distinguished Research Professor of Economics, University of Minnesota (Morris Campus)
27. Josh Bivens, Ph.D., Economist, Economic Policy Institute
28. Robert Binstock, Ph.D., Professor of Aging, Health, and Society, Case Western Reserve University
29. Barry Bluestone, Ph.D., Dean, School of Public Policy and Urban Affairs, Northeastern University
30. Mark Blyth, Ph.D., Professor of International Political Economy, Brown University
31. Eileen Boris, Ph.D., Hull Professor and Chair, Department of Feminist Studies, Director, Center for the Study of Women and Social Justice, University of California, Santa Barbara
32. Roger Bove, Ph.D., Associate Professor, Retired, West Chester University
33. Gerard Bradley, M.A., Research Director, New Mexico Voices for Children
34. Ruth A. Brandwein, Ph.D., Dean and Professor Emeritus of Social Welfare and former Director, Social Justice Center, Stony Brook University
35. Bobbie Brinegar, M.S.W., Executive Director, OWL-The Voice of Midlife and Older Women
36. Byron Brown, Ph.D., Professor of Economics, Michigan State University
37. Clair Brown, Ph.D., Professor of Economics, University of California, Berkeley

38. E. Richard Brown, Ph.D., Professor, University of California Los Angeles, School of Public Health
39. John Burbank, M.P.A., Executive Director, Economic Opportunity Institute
40. Barbara Burt, M.Ed., Executive Director, Frances Perkins Center
41. Donna Butts, Executive Director, Generations United
42. Al Campbell, Ph.D., Professor Emeritus of Economics, University of Utah
43. Martha Campbell, Ph.D., Associate Professor, Economics, State University of New York, Potsdam
44. Jim Campen, Ph.D., Professor Emeritus of Economics, University of Massachusetts, Boston
45. Nancy K. Cauthen, Ph.D., Sociologist and Independent Consultant
46. Gamze Cavdar, Ph.D., Assistant Professor, Colorado State University
47. Charles Chittle, Ph.D., Professor, Bowling Green State University
48. David Coates, Ph.D., Worrell Professor of Anglo-American Studies, Wake Forest University
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50. Laura Coker, Ph.D., Associate Professor, Wake Forest University School of Medicine
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53. David Crary, Ph.D., Associate Professor, Eastern Michigan University
54. J. Kevin Crocker, M.A., Undergraduate Program Director and Lecturer, University of Massachusetts, Amherst
55. James Crotty, Ph.D., Professor Emeritus of Economics, University of Massachusetts, Amherst
56. Yanira Cruz, D.P.H., M.P.H., President & CEO, National Hispanic Council on Aging
57. Jeff Cruz, Executive Director, Latinos for a Secure Retirement
58. Bill Cunningham, Associate Director of Legislation, American Federation of Teachers
59. Anita Dancs, Ph.D., Assistant Professor, Western New England College
60. Paul Davidson, Ph.D., Editor, Journal of Post-Keynesian Economics; Chair of Excellence, Professor Emeritus, University of Tennessee
61. Charles Davis, Ph.D., Professor of Labor Studies, Indiana University
62. Susan Davis, Ph.D., Associate Professor, Economics & Finance, Buffalo State College
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65. G. William Domhoff, Ph.D., Research Professor in Sociology, University of California, Santa Cruz
66. Peter Dorman, Ph.D., Faculty in Political Economy, Evergreen State College

67. Kirstin Downey, author of *The Woman Behind the New Deal* (Random House, 2009); and former economics reporter for the *Washington Post*
68. Richard Du Boff, Ph.D., Professor of Economics Emeritus, Bryn Mawr College
69. Lloyd Dumas, Ph.D., Professor of Economics, University of Texas at Dallas
70. Peter Eaton, Ph.D., Director, University of Missouri-Kansas City Center for Economic Information
71. Ross Eisenbrey, J.D., Vice President, Economic Policy Institute
72. David Ekerdt, Ph.D., Professor of Sociology, University of Kansas
73. Justin Elardo, Ph.D., Economics Instructor, Portland Community College
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75. Sharon Erenburg, Ph.D., Professor of Economics, Eastern Michigan University
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79. Karen Ferguson, J.D., Executive Director, Pension Rights Center
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94. Colleen Grogan, Ph.D., Professor, University of Chicago, School of Social Service Administration
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106. Stephen Herzenberg, Ph.D., Director, Keystone Research Center
107. Cynthia Hess, Ph.D., Study Director, Institute for Women's Policy Research
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117. Jon Jucovy, Ph.D., Chairman, History Department, Ramaz School
118. Karen Kahn, M.S.W., Mental Health Clinician, University of Medicine and Dentistry of New Jersey
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125. Jennifer Klein, Ph.D., Professor of History, Yale University
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168. William Milberg, Ph.D., Professor, The New School
169. John Miller, Ph.D., Professor of Economics, Wheaton College
170. Gwendolyn Mink, Ph.D., Social Policy Scholar
171. Lawrence Mishel, Ph.D., President, Economic Policy Institute
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174. Fred Moseley, Ph.D., Professor of Economics, Mount Holyoke College
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178. Peggy B. Musgrave, Ph.D., Emerita Professor of Economics, University of California, Santa Cruz
179. Alan Nasser, Ph.D., Professor Emeritus, Economics, The Evergreen State College
180. Paul Nathanson, J.D., M.C.L., Executive Director, National Senior Citizens Law Center
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183. Annelise Orleck, Ph.D., Professor of History, Dartmouth College
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185. Rudy Oswald, Ph.D., Retired, AFL-CIO
186. Christine Owens, J.D., Executive Director, National Employment Law Project
187. Aaron Pacitti, Ph.D., Assistant Professor, Siena College

188. Michael Perelman, Ph. D., Professor of Economics, California State University, Chico
189. Kenneth Peres, Ph.D., Economist, Communications Workers of America
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194. Robert Pollin, Ph.D, Professor, University of Massachusetts, Amherst; and Co-Director, Political Economy Research Institute
195. Shirley Porterfield, Ph.D., Associate Professor, University of Missouri-St. Louis
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197. Mark Price, Ph.D., Labor Economist, Keystone Research Center
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200. Edith Rasell, Ph.D., Minister for Economic Justice, United Church of Christ
201. Elton Rayack, Ph.D., Professor Emeritus, University of Rhode Island
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203. Michael Reich, Ph.D., Professor of Economics, University of California, Berkeley
204. Nola Reinhardt, Ph.D., Professor of Economics, Smith College
205. Bruce Roberts, Ph.D., Professor, University of Southern Maine
206. Malcolm Robinson, Ph.D., Professor, Thomas More College
207. Charles Rock, Ph.D., Professor of Economics, Rollins College
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209. William M. Rodgers II, Ph.D., Professor of Public Policy and Chief Economist, Rutgers University
210. Leah Rogne, Ph.D., Associate Professor, Minnesota State University, Mankato
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215. Michèle Saunders, D.M.D, M.S., M.P.H., Professor & Director, South, West & Central Consortium Geriatric Education Center of Texas, University of Texas Health Science Center
216. Steven Savner, J.D., Director of Public Policy, Center for Community Change
217. Susan Scanlan, Chair, National Council of Women's Organizations
218. Arthur Scarritt, Ph.D., Assistant Professor, Boise State University
219. Robert E. Scott, Ph.D., Economist, Economic Policy Institute
220. Peter Schaeffer, Ph.D., Economics Professor, West Virginia University
221. James Schulz, Ph.D., Emeritus Professor of Economics, Brandeis University
222. Eric Schutz, Ph.D., Professor, Rollins College
223. Stephanie Seguino, Ph.D., Professor of Economics, University of Vermont

224. Jean Shackelford, Ph.D., Professor, Bucknell University
225. Nina Shapiro, Ph.D., Professor of Economics, Saint Peter's College
226. Heidi Shierholz, Ph.D., Economist, Economic Policy Institute
227. Richard Shirey, Ph.D. in Economics, Professor Emeritus, Siena College
228. Laurence Shute, Ph.D., Professor Emeritus of Economics, California State Polytechnic University, Pomona
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230. Curtis Skinner, Ph.D., Director of Family Economic Security, National Center for Children in Poverty
231. Theda Skocpol, Ph.D., Victor S. Thomas Professor of Government and Sociology, Harvard University
232. Margaret Somers, Ph.D., Professor of Sociology and History, University of Michigan
233. Peter Spiegler, Ph.D., Assistant Professor, University of Massachusetts, Boston
234. Janet Spitz, Ph.D., Associate Professor, College of St. Rose
235. Case Sprenkle, Ph.D., Retired Professor, University of Illinois, Urbana-Champaign
236. James Ron Stanfield, Ph.D., Emeritus Professor of Economics, Colorado State University
237. Howard Stein, Ph.D., Professor, University of Michigan
238. Mary Stevenson, Ph.D., Professor Emeritus of Economics, University of Massachusetts, Boston
239. Jeffrey Stewart, Ph.D., Independent Social Insurance Policy Analyst
240. Jay Stone, Ph.D., Teacher, Ramaz School
241. Frank Stricker, Ph.D., Professor Emeritus, California State University, Dominguez Hills
242. Myra Strober, Ph.D., Professor Emerita of Education, Stanford University
243. Simona Sung, Ph.D., Professor of Economics, College of Saint Rose
244. Paul Swanson, Ph.D., Professor of Economics, William Paterson University
245. Peter A. Swenson, Ph.D., C.M. Saden Professor, aND Director of Undergraduate Studies, Department of Political Science, Yale University
246. Jose Tapia, Ph.D., Assistant Research Scientist, University of Michigan
247. Peter Temin, Ph.D., Professor Emeritus, Massachusetts Institute of Technology
248. David Terkla, Ph.D., Associate Dean, College of Liberal Arts, University of Massachusetts, Boston
249. Frank Thompson, Ph.D., Lecturer in Economics, Research Investigator, University of Michigan
250. Emanuel Thorne, Ph.D., Chair, Department of Economics, Brooklyn College of City University of New York
251. Mariano Torras, Ph.D., Professor of Economics, Adelphi University
252. Mayo Toruno, Ph.D. Professor and Chair, California State University, San Bernardino
253. John Tower, Ph.D., Professor Emeritus of Economics and Management, Oakland University
254. Lynn Unruh, Ph.D., Professor of Health Management and Informatics, University of Central Florida

255. William Van Lear, Ph.D., Professor of Economics, Belmont Abbey College
256. Katherine van Wormer, Ph.D., Professor of Social Work, University of Northern Iowa
257. Ben Veghte, Ph.D., M.P.A, Social Policy Scholar
258. Marcela Velasco, Ph.D., Assistant Professor, Colorado State University
259. Paula Voos, Ph.D., Professor, Rutgers University
260. Jeff Waddoups, Ph.D., Professor, Department of Economics, University of Las Vegas
261. Robert P. Watson, Ph.D., Professor of American Studies and Coordinator of the American Studies Program, Lynn University
262. John Weeks, Ph.D., Professor of Economics, University of London
263. David Weiman, Ph.D., Elena Wels Hirschorn Professor of Economics, Barnard College
264. Scott A. Weir, Ph.D., Economics Instructor, Wake Technical Community College
265. Thomas Weisskopf, Ph.D., Professor Emeritus of Economics, University of Michigan
266. Cathleen Whiting, Ph.D., Associate Professor of Economics, Willamette University
267. Howard Wial, J.D., Ph.D., Fellow, Brookings Institution
268. Gary Williams, Ph.D, Associate Professor of Sociology (retired), Belmont Abbey College
269. Robert G. Williams, Ph.D., Voehringer Professor of Economics and Chair, Economics Department, Guilford College
270. John Williamson, Ph.D., Professor of Sociology, Boston College
271. David Wilsford, Ph.D., Professor of Political Sciences and Director of Graduate Studies, George Mason University; and Visiting Senior Fellow, London School of Economics
272. Martin Wolfson, Ph.D., Associate Professor of Economics, University of Notre Dame
273. Yavuz Yasar, Ph.D., Associate Professor, University of Denver, Department of Economics
274. Laurie Young, Ph.D., Director of Public Policy and Government Affairs, National Gay and Lesbian Task Force
275. David Zalewski, Ph.D., Professor of Finance, Providence College
276. Henry Zaretsky, Ph.D., President, Henry W. Zaretsky & Associates, Inc.; Adjunct Professor, University of Southern California

Cuts in Retirement Benefits Resulting from Raising the Retirement Age to 69

Age at which worker starts receiving benefits	Statutory "Retirement Age" of 65	Statutory "Retirement Age" of 67	Statutory "Retirement Age" of 69	Percent decrease by changing from age 65 to 67	Percent decrease by changing from age 67 to 69	Percent decrease by changing from age 65 to 69
62	\$800	\$700	\$610	12.5%	12.9%	23.8%
63	\$867	\$750	\$655	13.5%	12.7%	24.5%
64	\$933	\$800	\$700	14.3%	12.5%	25.0%
65	\$1,000	\$867	\$750	13.3%	13.5%	25.0%
66	\$1,080	\$933	\$800	13.6%	14.3%	25.9%
67	\$1,160	\$1,000	\$867	13.8%	13.3%	25.3%
68	\$1,240	\$1,080	\$933	12.9%	13.6%	24.8%
69	\$1,320	\$1,160	\$1,000	12.1%	13.8%	24.2%
70	\$1,400	\$1,240	\$1,080	11.4%	12.9%	22.9%

Explanatory Note: This chart illustrates the impact on monthly benefits that results from changing Social Security's statutory "Retirement Age." It is based on a hypothetical worker whose wage record entitles him or her to \$1,000/month at the statutory "Retirement Age." The dollar amounts will vary with a worker's particular wage record, but the percentage reductions shown are the actual reductions for all workers. They do not vary with earnings. The dollar amount shown is the benefit paid monthly for the rest of the worker's life, adjusted only for inflation once it has begun to be received.

Age 65 is the statutory "Retirement Age" for beneficiaries born prior to 1938; age 67 is the statutory "Retirement Age" for beneficiaries born 1960 or later. 42 U.S.C. §416(i). The earliest age a worker can claim Social Security old age benefits is age 62. 42 U.S.C. §402 Fiscal Commission Co-Chairs Erskine Bowles and Alan Simpson have proposed increasing the statutory "Retirement Age" to age 69. Although their proposals stipulate that the earliest eligibility age will be increased to 64, for illustrative purposes this chart assumes that it will remain age 62 even if the statutory "Retirement Age" is raised to age 69.

42 U.S.C. §402(q) and §402(w) specify the actuarial adjustments when benefits are claimed before or after the statutory "Retirement Age." §402(w)(6)(D) provides that for workers reaching age 62 after 2004, benefits are increased by two-thirds of 1% for every month of work, up to age 70, after the statutory "Retirement Age," and that is the adjustment factor used in the chart. As a matter of historical fact, the transition to a larger adjustment factor and to a higher statutory "Retirement Age," meant that when the statutory "Retirement Age" was 65, the adjustment factors varied with year of birth, in accordance with §402(w)(6)(A), (B), and (C).

Source: The benefit amounts in the chart were calculated by Nancy J. Altman, Co-Director, Social Security Works. They have been reviewed for accuracy by the Chief Actuary, Social Security Administration.

Questions for Ms. Nancy Altman
Finance Committee Hearing
“Perspectives on Deficit Reduction: Social Security”
May 10, 2011

Question for the Record from Senator Baucus

1. Ms. Altman, I think the heart of the matter for a lot of workers is that they paid more payroll taxes than necessary for many years in order to build up the trust fund. Now that the trust fund is being cashed in – something that was always part of the deal – some in Congress are calling for benefits to be cut! Even when the trust fund is still growing! It kind of sounds like workers have been duped since 1983. It strikes some of them as a bait and switch. What do you think?

It is perfectly understandable that many workers believe that their contributions have been diverted from their lawful purpose and that the contributors have been subject to a fraudulent bait and switch. The dominant rhetoric of the current debate – that the trust fund reserves have been spent and that the only assets are “just IOUs,” – implies that kind of misbehavior.

Past Congresses appropriately chose to build the reserves of the Social Security trust funds in anticipation of the aging of the baby-boom generation. In 1983, Congress recognized that the 1990s would be a low-cost period for Social Security, because the people reaching retirement age were born during the Great Depression and World War II, both of which were low birth-rate periods and the baby-boom generation would be in its peak earning years. That low-cost period would be followed by a higher cost period when the baby-boom generation would be retiring. Rather than continuing Social Security on an exclusively current-funded basis, which would have called for lower contributions in the 1990s followed by higher contributions thereafter, Congress chose to smooth out the funding by having the baby-boom generation, in essence, partially advance fund its own Social Security costs.

The law requires that those contributions be used exclusively for Social Security. Workers and their employers understood that the monies withheld from pay and matched by employers were for Social Security. If this Congress were to change the rules at this point by ignoring the reserves and cutting benefits, it would indeed be perpetuating a fraud on the American people, a kind of bait and switch.

In 1936, Republican presidential contender Alf Landon charged that workers’ contributions would be stolen by a future Congress. President Roosevelt responded:

When they imply that the reserves . . . will be stolen by some future Congress, diverted to some wholly foreign purpose, they attack the integrity and honor of American Government itself. Those who suggest that are already aliens to the spirit of American democracy.

If Congress ignores the extra contributions paid in the 1990s, it will be guilty of just what Landon warned and what FDR believed the nation's elected representatives would always have too much integrity and honor to do.

2. Some people believe that Social Security benefits for future retirees can be decreased. The premise for their view is that Social Security benefits are sufficiently large so that there is room for such decreases. I think that this premise is wrong. Doesn't Social Security provide much of the income for many elderly individuals and households? Wouldn't it be a sacrifice for these elderly individuals and households to have their Social Security benefits significantly reduced?

You are correct. Social Security's benefits are modest by virtually any standard, averaging, for all beneficiaries, just around \$13,000 a year, less than full-time, minimum wage work. Yet the benefits are vitally important to the vast majority of Americans who receive them. Two-thirds of seniors rely on Social Security for half or more of their incomes. One-third rely on those benefits for ninety percent or more of their incomes. The benefits are especially important to women, people of color, and others who have been disadvantaged in the labor market.

The image of large numbers of wealthy seniors is a myth. The median income of Americans aged 65 or older from all sources was just \$19,157 in 2009, and many of those are still working. The median incomes of those aged 80 and older was just \$15,856. Indeed, 39 percent of those aged 70 and older have incomes at or below 200 percent of the poverty line.

Benefits for current workers will be lower than today's benefits, as a percentage of pre-retirement wages, yet are likely to represent even higher percentages of retirees' incomes. Future retirees are likely to need Social Security's protections even more, in light of the declining numbers of traditional private sector pensions and the well-documented failure of private accounts to provide most Americans with meaningful retirement income.

It is important to remember that Social Security is much more than a program for the elderly. It also provides extremely important life insurance and disability insurance protection for workers and their families. Nearly nine percent of the nation's children either receive Social Security themselves or live in families where part of the household income is from Social Security. It is of particular importance to children in low-income and minority households. Social Security is the largest source of income for grandparents raising grandchildren. It is the nation's largest disability program. It provides half or more of the income to 70 percent of those with disabilities. Without that monthly check, 55 percent of disabled workers and their families would live in poverty.

3. Ms. Altman, it seems whenever benefit changes are proposed to Social Security or Medicare, it is often done so that the changes do not apply to people 55 and older. I think that is the right thing to do. But it seems like some Members of Congress and some past Presidents have used that feature to try to convince seniors they have nothing to worry about because their benefits will be untouched. They hope that this will take them out of the debate. But many seniors with children and grandchildren worry about what type of country America will be in the future. Has that been your experience, that even though

changes do not apply to them, seniors are very concerned about changes to our social security?

I speak frequently to groups of seniors, and my anecdotal experience, as well as polling data I have reviewed, indicate that seniors care deeply that their children and grandchildren have the benefit of the economic security that Social Security and Medicare provide today. It is worth noting that the effort to convince seniors that they should ignore changes to Social Security that don't directly affect them was spelled out as a clear strategy in a [1983 article](#) that appeared in the Cato Journal. The article, "Achieving a 'Leninist' Strategy," stated:

Calming Existing Beneficiaries

The sine qua non of any successful Social Security reform strategy must be an assurance to those already retired or nearing retirement that their benefits will be paid in full. . . .

From a purely political standpoint, it should be remembered that the elderly represent a very powerful and vocal interest group. . . .

The political power of the elderly will only increase in the future. . . . So any proposal aimed at cutting benefits will face increasingly stiff opposition from the elderly. . . . Any plan to change the system must therefore be neutral or (better still) clearly advantageous to senior citizens. By accepting this principle we may succeed in neutralizing the most powerful element of the coalition that opposes structural reform.

In contrast to the article's cynical approach, my experience is that America's seniors are not just thinking about themselves. Even when they understand well that their benefits will not be affected, they will fight against changes which weaken Social Security, because their lifetime of experience tells them that Social Security is vital and they want its economic protection for their loved ones. During the 2005 privatization debate, for example, the Washington Post quoted a 69 year old privatization opponent who explained, "I'm a parent as well as a grandparent. . . . It's everybody's concern what happens in this country." Indeed, many would like to see those benefits increased, which I and many other experts believe is the right policy.

4. Several economists and deficit reduction plans suggest that because of increased life expectancy and a growing population that is at or nearing retirement age that we should raise the retirement age. However, a November 2010 GAO study concluded that increasing the retirement age would result in more workers applying for and receiving Disability benefits and postpone or lower monthly benefits, creating financial hardship for workers who can no longer work. Do you believe that raising the retirement age is a good option, or that there are unintended consequences, such as an increase in disability applications, that have not been considered? Do you believe that some minorities, women or individuals working in arduous positions will be more negatively impacted by raising the retirement age?

I believe that raising the statutorily-defined "Retirement Age" is not only the wrong way to go, but its impact is not well understood. To many non-experts, raising the retirement age sounds like a work incentive or an appropriate offset in light of increased longevity, but it is neither. It

is mathematically indistinguishable from an across-the-board cut in benefits, even for workers who work until age 70 and beyond.

Although people speak about Social Security's "retirement age," Social Security does not have a single retirement age. One can think of Social Security as having a band of retirement ages. The earliest age at which a worker can claim retirement benefits is age 62. For every month that workers delay past age 62, their benefits are increased by an actuarially-determined amount in recognition of the later age at which benefits are first claimed. The idea is that early or late retirement should be neither penalized nor subsidized; rather, the choice of when to claim benefits should be economically neutral. (After age 70, there are no additional actuarial adjustments, so there is no economic reason to delay the receipt of benefits after that age.) Increasing the statutorily-defined "Retirement Age" doesn't change the actuarial adjustments; it simply reduces the amount received at every age, even for a worker who works until aged 70 or beyond, as shown in the table attached to the last page of my written statement. For every one year that the statutory "Retirement Age" is increased, old-age benefits are cut by between six and seven percent.

This across-the board cut is hardest for those who must claim those actuarially reduced early retirement benefits. In 2000, when the statutorily-defined "Retirement Age" was still age 65, those claiming benefits at age 62 received **only 80 percent** of a full benefit. When the currently legislated "Retirement Age" of 67 is fully phased in, those retiring at age 62 will receive **only 70 percent** of a full benefit. If the statutorily-defined "Retirement Age" were raised to age 69, those retiring at 62 would receive **only 61 percent** of a full benefit, and if the age were raised to 70, those claiming benefits at 62 would receive **only 57 percent** of a full benefit.

Millions of Americans find it impossible to delay retirement, because of the nature of their work, because they have significant health problems, because they have to care for sick family members, because they are unemployed and they are unable to find new employment, or for other reasons. Those workers, disproportionately low-income and minorities, have the fewest options and therefore will suffer economically the most, if the "Retirement Age" is increased further.

Questions for the Record from Senator Hatch

1. This is a question for each member of the panel. Since the 1983 Social Security reforms, and until 2010, payroll taxes have exceeded benefit payments from the Social Security Trust Funds. By law, the surplus receipts have been invested in interest bearing, non-marketable, special-issue government securities, which represent loans to the U.S. Treasury. At the end of 2010, the Trust Funds had assets of \$2.6 in US government debt instruments. When the Social Security Trust Funds invested the excess payroll taxes in U.S. Government debt, the Treasury placed the money in the general fund.
 - (a) What did the Treasury do with the money received in exchange for the government securities?

The U.S. Treasury did what it does with respect to all of its government obligations. It carefully accounted for and paid the interest owed. It redeemed the bonds when they became due, and transferred the redeemed funds to the investor, in this case, the Old Age, Survivor, and Disability Trust Funds. It used the proceeds invested with it for the operating expenses of the United States. (As a point of clarification, the law does not require that the securities be non-marketable, special issue, but the trustees have deemed that those are the most prudent forms of investment at this time.)

- (b) Where will Treasury get the money to repay the Social Security Trust Funds back when the Trust Funds need to redeem the securities to raise money to pay benefits?

Treasury has borrowed \$14.3 trillion from all investors, and cannot borrow more unless and until Congress raises the statutory limit on borrowing. Of that \$14.3 trillion, \$2.6 trillion has been borrowed from Social Security, with the debt instruments held in trust for American workers and their families. All of the outstanding debt instruments issued to those who invested the \$14.3 trillion have the same priority under the law. The government is legally obligated to redeem all of those obligations on their maturity dates (or, in the case of Social Security, whenever the request is made, irrespective of their maturity dates, a significant way in which those special-issue bonds are preferred to other Treasury instruments.) Treasury can refinance those obligations or it can simply redeem them out of then-current income. A robust economy makes the cost of redemption easier to absorb, because it provides a larger base on which to assess taxes and reduces the necessity of providing governmental assistance to struggling companies or individuals. The best way that the government can foster a robust economy is through a careful use of fiscal policy, monetary policy, and investment, such as on infrastructure and education.

2. This is a question for each member of the panel. According to the Trustee Report issued in August 2010, Social Security program costs exceeded tax revenue in both 2010 and 2011 creating a deficit, and are expected to follow that trend again from 2015 onward until 2084, the end of the actuarial 75-year projection. Each year there is a deficit, the program covers the deficit with interest earned from the Treasury securities held by the Trust. That won't last forever, and I'd like the panel to address the question of when the Trust principal invested in U.S. Government debt securities will need to be tapped to cover the shortfall, assuming no changes in payroll taxes or benefits. Please update your answer, as appropriate, to reflect the information in the Trustees Report scheduled for publication on May 13, 2011.

With no action whatsoever, Social Security's income will continue to exceed its expenses and its reserve will continue to grow until around 2023, according to the most recent actuarial projections contained in the 2011 Trustees Report. If Congress takes no action before 2023, Social Security will have to begin to draw down principal around 2023, according to the actuarial projections contained in the Report. I, as well as many other experts, believe that Congress should increase and stabilize Social Security's overall income before that point, so that the reserves are never drawn down but simply become a stable source of investment income, as private pensions strive to have.

May 10, 2011

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding Long-Term Plans for Social Security
As prepared for delivery

According to FDR advisor Luther Gulick, President Roosevelt offered this perspective about Social Security and its relationship to the federal budget:

“We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions...With those taxes in there, no damn politician can ever scrap my Social Security program.”

It is fitting that we have President Roosevelt’s grandson with us today as we consider deficit reduction and Social Security.

Today we will ask, “Should Social Security be included in legislation to reduce the deficit?” Or should it be left unchanged as we consider deficit reduction? Should Social Security’s long-term, financial imbalance be addressed in separate legislation?

There are certainly differing views on the answers to these questions. But one thing nearly everyone agrees on is that Social Security has been a hugely successful program.

Social Security benefits will help 54 million Americans this year – Americans like Carol Lawen from Stanford, Montana. Carol worked at the telephone company for more than 30 years. She recently wrote me and said:

“I worked hard and was considered a good employee. I gave up holidays with my family. I went in early and stayed late when various crises occurred in our country. My family sacrificed time together so that I might be able to provide money to care for them. I paid in every paycheck for my Social Security without complaint. It is now my turn.”

Americans like Carol count on Social Security to be there when they retire.

Social Security is dependable. It is fully portable from job to job. And it automatically increases as the cost of living increases. Unlike most other sources of retirement income, you cannot outlive your Social Security benefits.

Social Security provides benefits to help folks get by if something happens to a breadwinner in their family. It helps workers who become disabled and families of workers who have died. This year, Social Security will provide benefits to two million children whose parents have passed away.

Social Security has been a major force in ending widespread poverty among the elderly.

Social Security is the only source of income many seniors in Montana and across the country have to survive. In fact, for 15 percent of seniors, Social Security is their only income, and for one in four elderly Americans, Social Security provides 90 percent of their income.

What we can't forget in this debate is that Social Security benefits are modest.

Ninety-five percent of retired workers receive monthly benefits of less than \$2,000. In fact, the average Social Security benefit for retirees is \$1,175 a month, or about \$14,100 a year. That's only \$267 a month above the poverty line.

Not only are benefits modest, but they are already scheduled to be reduced.

The full retirement age, which is currently 66, will rise to 67 in the coming years. These increases in retirement age have real consequences. A one-year increase in the retirement age is roughly equal to a seven-percent reduction in benefits.

By law, Social Security must remain separated from the rest of the Federal budget and the program cannot borrow money from the general Federal budget.

Social Security benefits are financed only through payroll taxes and the Trust Fund. Social Security is not responsible for the deficits we face in the general fund today. Therefore, I believe Social Security should not be part of our efforts to reduce those deficits.

Since 1983, workers have been contributing more than Social Security has been paying in benefits.

As a result, there is currently \$2.6 trillion in the Trust Fund, and this balance is expected to grow. The assets in the trust fund mean Social Security will pay full benefits until 2037. And even after that, payroll tax revenues will be able to pay 78 percent of benefits.

This is not a crisis. It is a long-term issue. It is an issue that should be addressed sooner, rather than later, to give workers time to plan for any changes. But the current situation does not necessitate rushed or severe action.

Our deficit and debt, on the other hand, is clearly a crisis. The deficit is currently 9.3 percent of our economy. We do need to act to address our deficits and debt, and do so soon.

As we consider how to address our deficits and debt, let us remember people like Carol Lawen who worked hard all their lives and count on Social Security to keep a roof over their heads and food on the table. And let us remember President Roosevelt's promise to ensure a legal, moral, and political right to the benefits that America's workers have earned.

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Statement of Charles P. Blahous
Research Fellow, Hoover Institution and Public Trustee for Social Security
Before the
U.S. Senate Committee on Finance
May 10, 2011

Thank you, Mr. Chairman, Mr. Ranking Member, and all of the members of this distinguished committee. It is an honor to appear before you today to discuss the Social Security program -- a cornerstone of retirement security for millions of Americans -- and its relation to our larger fiscal challenges. My written testimony begins with some basics of Social Security operations before proceeding to a discussion of the program's projected financing shortfall.

Social Security Taxes, Trust Funds, Benefits and Financing Issues

Taxes: Under current law, the vast majority of financing for Social Security benefit payments is provided by a payroll tax upon covered wages. The total payroll tax rate is 12.4%.¹ Though nominally divided into two 6.2 point halves assessed respectively upon employer and employee, most economists agree that the entirety of the 12.4% tax is levied on the worker's wage compensation. Wage earnings subject to this tax, as well as any benefit credits based on those earnings, are both capped. This cap reflects Social Security's historical design as a floor of protection in the event of income loss due to old-age, disability, or death of a primary household wage earner. The current cap is \$106,800 annually, and is indexed to grow generally with the national Average Wage Index (AWI). In addition to payroll taxation, a much smaller amount of program revenue (about 3%) is generated via income taxation of Social Security benefits.

The Trust Funds: Beyond revenue generated from current taxation, further authority and resources to finance benefit payments are provided by the Social Security Trust Funds.² The economic significance of the Trust Funds is a source of persistent controversy. But though there is controversy over the Trust Funds' economic meaning, there is much less so over what the Trust Funds literally contain; specifically, special-issue Treasury bonds. These bonds are on the one hand real assets to the Social Security program, backed by the full faith and credit of the

¹ Recent legislation has temporarily reduced the payroll tax rate to 10.4%, with general revenues being used to restore the foregone revenue to the Trust Funds.

² There are separate Trust Funds for the OASI (Old-Age and Survivors) and DI (Disability) programs, though public discussions often refer to the combined operations of the Funds.

federal government, while on the other they are equally a real obligation of the general budget accounts. If we look at the bonds from the perspective of the Trust Funds, they are assets. If we look at them from the perspective of the unified federal budget, they are a net wash. The total amount of the Trust Funds, now roughly \$2.6 trillion, represents the interest-compounded value of past annual program balances, including the many years of surpluses since the 1980s.

Benefits: Americans tend to think of retirement benefits first when thinking of Social Security. This is understandable given that the majority of benefit payments (about 63%) are made to retired workers. But Social Security also provides for a number of other forms of benefits as well, including disability benefits, spousal benefits, and benefits for widows, widowers and survivor children. Although there are differences in the methods of computing benefits for these respective populations, they all hinge in some fashion on the basic retirement benefit formula. The total value of one's Social Security benefit is not solely a function of one's own contributions. One's benefit is instead a function of a formula written into the law. Social Security redistributes income in a variety of ways: from higher earners to lower earners; from shorter-lived to longer-lived; from two-earner couples to one-earner couples; and from younger generations to older ones, among other trends. An overriding problem we face is that the total amount of projected benefit obligations that would result under current formulas is significantly higher than the amount of revenues that the program would receive under current law. One way or the other, this imbalance between revenues and scheduled benefits must be corrected.

The financing shortfall: Specific measurements of Social Security's projected financing shortfall vary from report to report. I will focus primarily on the projections contained in the 2010 Social Security Trustees' report.³ The updated 2011 Trustees' report is scheduled for release later this week. As this committee is aware, the Congressional Budget Office has released more recent figures showing a further deterioration of near-term finances relative to the 2010 Trustees' projections. I will nevertheless draw upon the Trustees' report's projections for long-term finances because they contain some additional details about program operations, and because the Trustees' report embodies the projection mechanism sanctioned by the Social Security Act.

Social Security expenditures began in 2010 to exceed incoming program tax revenue for the first time since the last major Social Security repairs in 1983. CBO recently estimated the FY 2010 cash deficit to be \$37 billion; the Trustees' updated estimate is scheduled for release on May 13.⁴ Some of the cost growth that resulted in this deficit arose from the long-anticipated event of the large Baby Boomer generation beginning to enter retirement. The date of these annual deficits'

³ Although I currently serve as a Public Trustee, the 2010 report was published prior to my confirmation to serve.

⁴ CBO's 2011 projections are somewhat more complex due to the recently-enacted payroll tax rate reduction and accompanying general revenue transfers. In FY 2011, program tax income is expected to fall short of payment obligations by \$130 billion (the net unified budget impact), of which \$85 billion would be made up with general revenue transfers, resulting in a \$45 billion primary program deficit before interest payments are considered.

arrival was further accelerated by the recent recession, which both depressed payroll tax collections and stimulated additional benefit claims, especially disability benefit claims. For multiple reasons, therefore, Social Security is now experiencing cash-flow shortfalls earlier than anticipated in any Trustees' report issued since the 1983 reforms.

Despite this shortfall of tax income relative to benefit obligations, Social Security is still able to meet benefit payments due to the positive balance in its Trust Funds. We are currently in a somewhat unusual period in that the nominal balance of the Trust Funds continues to rise even as program tax income lags behind benefit obligations. This occurs because the annual interest credited to the Trust Funds, combined with the general revenues transferred to compensate for the temporary payroll tax reduction, together exceed the program's annual cash shortfalls. As a result, part of the general government accounts' annual payments of interest are now tapped immediately to pay current benefits, while the remainder adds to the balance of the Trust Funds.

Though the nominal balance of the Trust Funds is still rising, there are important caveats to bear in mind. One is that the combined Trust Funds' ability to finance benefits is already in decline, as evidenced by the combined Trust Fund Ratio having peaked at 358 in 2008.⁵ This is because the cost of paying benefits is rising proportionally faster than the Trust Funds' nominal value, resulting in a progressively shortening duration of the benefits the Funds can finance. Also, while interest payments and general revenue transfers increase the balance of the Funds, they do not reduce the unified budget deficit. Accordingly, Social Security operations are currently adding to the unified federal deficit and will add substantially more in the years to come.

By any measure, Social Security faces a significant long-term financing shortfall. The 2010 Trustees' report projected that the net excess of benefit obligations over incoming tax revenue over the following 75 years would equal \$7.9 trillion in present value. Even after \$2.5 trillion⁶ of general revenues is paid to redeem the assets in the Trust Funds through 2037, this would still leave Social Security with a 75-year shortfall of \$5.4 trillion. This shortfall further increases beyond the 75-year period.

Such summary figures over long spans of time are inherently imprecise and can obscure the more salient issue of program cost growth over time. As a number of bipartisan technical panels and advisory councils have noted, it is insufficient for Social Security merely to be in average balance over long spans of time, if that average aggregate balance consists of impracticable

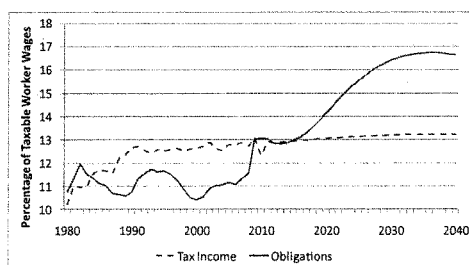
⁵ The Trust Fund Ratio (TFR) indicates the duration of benefit payments that can be financed by the Trust Funds. A TFR of 100 would mean that there are sufficient assets in the Trust Fund to finance one year's worth of benefits.

⁶ The Trust Funds' balance on January 1, 2010, the date used for the calculations in the 2010 Trustees' Report.

annual *imbalances* in different years of the valuation period.⁷ This is one reason why for over a decade now Social Security Administration evaluations of Social Security financing proposals have included measures not only of their averaged effects over 75 years, but also of whether they lead to sustainable annual program balances within the 75-year period.

Figure 1 shows the projected growth of annual program revenues and costs under current law as a percentage of each worker's taxable wages, in comparison with rates over previous decades.⁸ The cost of paying Social Security benefits absorbed roughly 11.5% of such wages in 2008, on the eve of the recession and the retirement of the Baby Boom generation. Costs will grow dramatically over the next two decades, resulting in a cost rate of roughly 16.7% by the mid-2030s. In other words, the cost of paying benefits under existing formulas in this one program alone would amount to roughly one out of every six taxable dollars that American workers earn.⁹

Figure 1: Social Security Tax Income and Obligations
(2010 Trustees' Estimates)



Under current law, this cost growth would mean dramatically rising pressures on the general budget from today through the mid-2030s. By 2020, annual program deficits would be larger,

⁷ In theory, program surpluses in some years could effectively offset deficits in other years if a foolproof mechanism could be established to ensure that excess revenues in surplus years were always saved. This has not been the case in practice.

⁸ "Obligations" on this graph include scheduled benefit obligations beyond 2037, even though due to projected Trust Fund depletion in 2037, benefits would under current law be suddenly cut by 22% in that year. More recent projections from CBO indicate that the small program surpluses projected in 2012-14 on this graph will not materialize. The Trustees are scheduled to update these projections later this week.

⁹ Under current law such costs would be met by a combination of payroll taxes, benefit taxes and general revenues.

relatively speaking, than in the program's so-called crisis years of 1977 and 1982, when urgent reforms were necessitated. Even if these rising costs were successfully shouldered within the general budget, Social Security benefits would still be suddenly cut by 22% in 2037 due to Trust Fund exhaustion in the absence of a legislative correction.

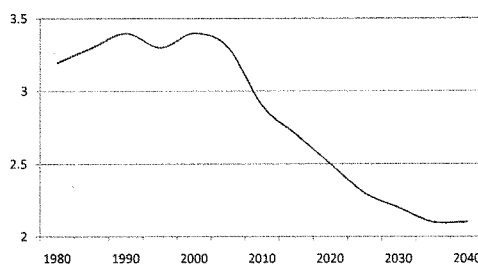
Why Social Security Costs Grow

The rapid cost growth projected through the 2030s is predominantly a function of three factors:

- 1) The aging of the population;
- 2) Pay-as-you-go financing;
- 3) The current Social Security benefit formula.

Social Security costs will grow, first, because there will be many more beneficiaries to support. In 2008, the total number of Social Security beneficiaries topped 50 million for the first time. There were 3.2 taxpaying workers to support each beneficiary, the same ratio that existed in 1975. But these numbers are changing dramatically as the Baby Boomers leave the ranks of workers to join the ranks of retirees. The 2010 Trustees' report projected that there will be 90 million beneficiaries by 2036, and only 2.1 taxpaying workers to support each beneficiary.

Figure 2: Ratio of Workers to Beneficiaries
(Past and Projected)

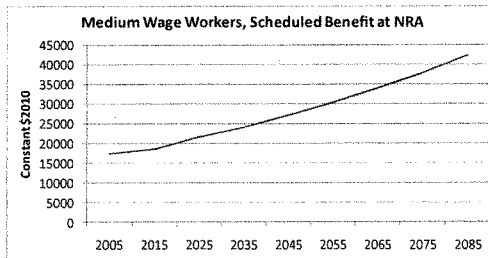


The second reason that costs rise is that the program is financed on a pay-as-you-go basis. Benefits are paid from tax contributions made by current workers, rendering program finances very sensitive to changes in the worker-collector ratio. If, hypothetically, Social Security had

been constructed as a savings program -- in which each generation always constrained its own consumption and put aside savings sufficient to fund the entirety of its own future benefits -- its finances would be less susceptible to demographic shifts. Instead, Social Security has been operated on a pay-as-you-go basis in the sense that workers' tax contributions are not saved. Most of these contributions finance current benefit payments, while any surplus finances ongoing federal government consumption. The consequence is that the entire rising cost of paying benefits shown on Figure 1 must be met by future contributing taxpayers.

The third reason that costs rise is rooted in program amendments in the 1970s. It was then that a benefit formula was put in place that pegs the growth of initial benefit payments to increases in the national Average Wage Index (AWI). The rationale behind this benefit formula was to maintain constant "replacement rates" -- i.e., benefits as a percentage of pre-retirement wages. Because wages tend to grow faster than prices over time, this formula results in the payment of higher benefits, relative to inflation, to younger generations of retirees.

Figure 3: Growth of Initial Benefit Payments Relative to Inflation



It is the combination of these three factors that causes Social Security costs to grow faster than the underlying tax base. An equation may be helpful in understanding this phenomenon. Under a financing method like that in Social Security, the following equation governs:

(Per-capita benefits as a % of worker wages)

$$\frac{\text{(Per-capita benefits as a \% of worker wages)}}{\text{(Ratio of workers to beneficiaries)}} = \text{(Worker tax burden, as a \% of wages)}$$

(Ratio of workers to beneficiaries)

Accordingly, if the ratio of workers to beneficiaries declines, then tax rates must rise to fund benefits that grow as rapidly as wages. Alternatively, to avoid a tax increase as the population ages, per-capita benefits must grow more slowly than wages. With our demographics we can afford a rate of per-capita benefit growth somewhat faster than price inflation, but not as fast as wage growth, without raising taxes. This benefit growth in excess of inflation will no longer be affordable within stable tax rates, however, after several more years of legislative inaction.

The Costs of Delay for Program Participants

Were a solution enacted today, we could repair Social Security's projected shortfall while facing comparatively benign choices. We would be able to honor current benefit obligations to those now in retirement and on the verge of retirement. We could ensure that future retirees receive benefits that are at least as high as today's retirees receive relative to inflation, and we could do so without a tax increase. This would still require changes to the current benefit formula and might not be everyone's preferred solution. Some others might argue to raise taxes even under a solution enacted today, so as to fund the full rate of benefit growth projected under the current formula, or something closer to it. The point remains, however, that if we act today we needn't necessarily raise taxes on workers, nor must we compel future retirees to accept a standard of living in retirement that is lower than for today's retirees.

Now let us examine the opposite extreme; the worst-case scenario. Suppose that we do nothing at all. Each year from now until the 2030s, burdens on taxpayers would grow. By the mid-2020s, in addition to the 12.4% Social Security payroll tax, taxpaying workers would need to finance another \$200 billion a year (in \$2010) in Trust Fund bond redemptions just to keep full benefits flowing. By the 2030s, these additional annual obligations would be over \$300 billion. As previously mentioned, the total cost of paying benefits would amount to fully one out of every six taxable dollars earned by workers by the 2030s. And even after that, the Trust Fund would still be exhausted in 2037, causing a sudden 22% reduction in benefit payments.

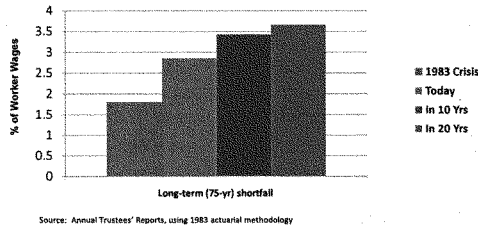
Dire though this scenario is, it actually understates the costs of inaction as they are felt in a practical sense. Further costs of delay arise because we have a fairly firm bipartisan consensus that we should not cut benefits for people who are already receiving them. The 22% benefit reduction just referred to assumes we would be willing to allow benefits for a 95-year-old widow in 2037 – someone who is already collecting benefits today in 2011 – to be suddenly and dramatically cut. This is very unlikely. In practice, any changes we make to our cost obligations will likely only prospectively affect future retirees, not those already retired.

And so we need to run this thought experiment again, and to ask how deep the cuts would have to be in 2037 if limited to new retirees. When we do so, it turns out that in 2037 the program still wouldn't be in balance even if 100% of benefit payments to that year's new retiree class were eliminated. This outcome also appears implausible. And so one must start working through the problem backwards from 2037 and ask, "How soon would any changes have to begin so that they don't result in disruptive cuts for those already retired, and do not produce unprecedented Social Security tax burdens?" The answer is: quite soon. If we don't want to raise worker taxes or to change benefits for those within five years of retirement, we probably need to legislate in the next couple of years. Beyond that, we likely must raise taxes substantially or affect those closer to retirement.

There is another very important practical reason why delay is potentially threatening to Social Security's long-term viability as a self-financing program. It is simply very challenging to bring opposing perspectives together around a common plan of action that involves either tax increases or reductions in the growth of scheduled benefits. It only gets harder to do so with delay, as the required adjustments for affected generations grow larger.

In 1983, the program came within mere months of insolvency and an interruption of vital checks to beneficiaries. That was with both parties agreeing on the immediacy of the problem, and on the dire consequences of failure. Many people do not realize, due to a subsequent change in the Trustees' accounting methods adopted in 1988, that the long-term Social Security shortfall we now face is much larger than the one corrected in 1983 – more than 50% larger if measured by the same methods in use then. By 2021, it will be more than 90% larger, and by 2031 more than twice as large. See Figure 4.

Figure 4: The Growing Social Security Shortfall



Even this illustration, however, may understate the adverse consequences of delay if our goal is a bipartisan solution that preserves Social Security's continued operation as a self-financing system enjoying special budgetary protections. If we delay long enough, our long-term problem will become a short-term crisis. Moreover, it will be a short-term crisis that utterly dwarfs the one that was solved with considerable difficulty in 1983.

The 1983 reforms involved intensely controversial immediate measures, including a delay of COLAs, a new imposition of income taxation upon Social Security benefits, an acceleration of a payroll tax increase, and bringing federal employees (and their payroll tax contributions) into Social Security. These difficult changes together altered system finances by roughly 0.84% of worker wages annually over the following ten years, on average. If going forward we were to wait as much as twenty years before acting, legislation would need to impose immediate sacrifices upon workers and beneficiaries more than *three times* as great as in the 1980s -- even in a relative sense -- simply to preserve system financing in the short-term. Given the difficulties of enacting even the 1983 reforms, it is highly doubtful that this could be achieved.

Some Common Objections to Social Security Reform

Before I close, Mr. Chairman, I would like to address some of the objections often raised against taking action to repair Social Security finances.

One objection that received attention for some time was the argument that the Trustees' Social Security projections were overly conservative; that we shouldn't implement unnecessarily severe measures when much of the problem was likely to fade by itself under more optimistic projections. With Social Security finances in much worse shape today than any of the Trustees, CBO, OMB or GAO had previously projected, this is now asserted much less frequently than was recently the case. But it was actually never true. The Trustees' projection history since 1983 is actually one of generally consistent accuracy, and their errors have tended to be slightly more on the financially optimistic side of the line than on the pessimistic side of the line. Moreover, there was not a single projection scenario within the entire 95% confidence band of the Trustees' 2010 analysis in which the program would not become insolvent.

Today, it is also sometimes said that Social Security is not a significant contributor to the larger federal deficit. First, an important factual point: the Social Security imbalance is the largest contributor to long-term deficits within any federal spending program other than Medicare or Medicaid. Over the next ten years, according to CBO's latest projections, not only will Social Security be running substantial cash deficits, and will involve more expenditures than any other

single federal program, but its aggregate cost growth will exceed that of either Medicare or Medicaid.¹⁰ But even if Social Security weren't a significant contributor to long-term deficits, this would not render corrective action unimportant: whether the rest of the budget is in surplus or in deficit, Social Security -- if it is to remain self-financing -- must be brought into balance. And the earlier that we repair Social Security's imbalance, the better off Social Security participants will be, and the stronger the program will be.

Finally, it is sometimes said that we should not take action to resolve the Social Security imbalance because doing so would cause harm to people on Social Security. I would respectfully submit that this is not true. Right now, there is a substantial imbalance between what the program is promising beneficiaries and the resources it will have available to pay benefits. One way or the other, that imbalance has to be resolved; the government cannot send out the checks without in some way producing the revenue to do so. Thus, a failure to act is simply a failure to disclose to the affected parties how this imbalance will ultimately be resolved.

Conclusion

My conclusion is best summarized by some sentences from an article I was recently privileged to co-author with Robert Greenstein of the Center on Budget and Policy Priorities. "Social Security faces a significant shortfall, which policy makers would be better off addressing sooner rather than later. Reasonable and well-intentioned people will have differences over the best way to resolve the Social Security shortfall. We share a common interest, however, in taking action to do so at the earliest possible time."

¹⁰ See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, p. 58.

Questions for Dr. Charles Blahous
Finance Committee Hearing
“Perspectives on Deficit Reduction: Social Security”
May 10, 2011

Questions for the Record from Senator Baucus

1. In your testimony, you argue that it would be better if the initial benefits of Social Security’s beneficiaries were not indexed to the average growth in wages. You suggest that initial benefits could be indexed to price growth, rather than wage growth, or somewhere between the two. But the standard of living in a society is generally tied to the growth in average wages. Wouldn’t your suggestion lead to each new cohort of Social Security recipients falling farther and farther behind the standard of living of the economy in general, and farther and farther behind the standard of living they enjoyed while working?

Answer:

Thank you for the opportunity to clarify that I did not intend in my testimony to recommend a specific rate of benefit growth. My statements were instead intended to explain the range of choices facing policy makers as well as how these choices become more difficult as long as financial corrections to Social Security are delayed. As my testimony indicates, the current method of wage-indexation of initial benefits (in combination with demographic trends) causes system costs to rise over time relative to the program’s tax base. A rate of initial benefit growth somewhere between price inflation and wage indexation is still affordable within a stable tax rate, but this will cease to be true if legislative corrections are delayed for several more years. At the same time, as my testimony also notes, “Some others might argue to raise tax rates even under a solution enacted today, so as to fund the full rate of benefit growth projected under the current formula, or something closer to it.”

The current Social Security benefit formula in effect aims to maintain constant replacement rates (ratios of post-retirement benefits to pre-retirement earnings) for “similarly situated workers.” The phrase “similarly situated workers” describes workers occupying the same relative position along the spectrum of high- to low-wage workers at different points in time. That is to say, the current benefit formula aims to provide the same replacement rate to the retired worker of 2050 who is then at the 50th percentile of wage earnings, as it pays to the retired worker who is at the 50th percentile today in 2011. As your question correctly notes, slowing the rate of growth of scheduled benefits would cause such replacement rates for similarly situated workers to decline over time. Important caveats, however, should be associated with this statement.

One is that the current formula maintaining constant replacement rates for similarly situated workers does not produce constant net treatment across generations. Because of the nature of Social Security financing and because of the decline in the ratio of

taxpaying workers to beneficiaries as the population ages, maintaining constant replacement rates subjects later generations to higher cost rates. As a result, later generations would under current law receive a declining percentage of their previous contributions back as retirement income.

Second, because Social Security is financed as an income transfer program rather than by building savings, each generation's benefits are paid from the contributions of younger generations, without creating a net addition to the pool of saving available to finance total retirement income. Accordingly, the persistently higher cost rates that result from wage-indexation would result in less income being available to later generations to build retirement saving outside of Social Security. To maintain constant replacement rates for *total* retirement income, and to enable retirees to maintain standards of living relative to national wage growth, requires attention instead to the amount of national savings dedicated to financing retirement benefits, which the current design of Social Security does not address.

Finally, the current benefit formula attempts to maintain constant Social Security replacement rates for similarly situated workers rather than for a given level of wages. In other words, the current formula would pay the worker of 2050 with wages of \$50,000 (in today's dollars) a significantly higher replacement rate than today's \$50,000 worker receives. This reflects a rationale in which the \$50,000 worker of 2050, while not poorer than today's worker in absolute terms, is nevertheless poorer relative to those around him and is therefore provided with a higher replacement rate. A benefit formula that simply preserved constant replacement rates for constant real wage levels would result in substantially lower cost growth over the long term than the current formula.

2. The thrust of your testimony is that Social Security is self-financed through payroll taxes and income taxes of Social Security benefits. Doesn't that confirm that Social Security does not contribute to Federal budget deficits? Isn't Social Security off-budget under current law?

Answer:

Social Security is designed to be self-financing in that its total revenues must be adequate to finance benefit payments in the long run. This self-financing requirement, however, permits program expenditures to exceed tax income in individual years, provided that such income exceeds expenditures in other years. Accordingly, Social Security is allowed to add to unified Federal budget deficits in some individual years, as it did in 2010 and will again this year.

Social Security is off-budget in some respects of the law, but in others its finances are intermingled with the unified federal budget. Social Security Trust Funds, for example, are invested in special-issue Treasury bonds. Academic analyses have concluded that this investment in Treasury bonds has stimulated additional federal consumption beyond what would have been the case if the federal government lacked access to the financing provided by Social Security surpluses. There are also instances of Social Security's and

unified budget finances being intermingled as a matter of deliberate policy. In 2011, for example, general revenues are being provided to the Social Security Trust Funds to offset revenue foregone as a result of a temporary 2 point reduction in the payroll tax. These transfers will provide the authority for additional future benefit payments from the Trust Funds, financed from the general budget, above and beyond any revenue generated by the Social Security system itself.

Questions for the Record from Senator Hatch

1. This is a question for each member of the panel. Since the 1983 Social Security reforms, and until 2010, payroll taxes have exceeded benefit payments from the Social Security Trust Funds. By law, the surplus receipts have been invested in interest bearing, non-marketable, special-issue government securities, which represent loans to the U.S. Treasury. At the end of 2010, the Trust Funds had assets of \$2.6 in US government debt instruments. When the Social Security Trust Funds invested the excess payroll taxes in U.S. Government debt, the Treasury placed the money in the general fund.
 - (a) What did the Treasury do with the money received in exchange for the government securities?
 - (b) Where will Treasury get the money to repay the Social Security Trust Funds back when the Trust Funds need to redeem the securities to raise money to pay benefits?

Answers:

- (a) Academic analyses have concluded that surplus Social Security revenue was used to increase general federal consumption. Examples include Smetters (“Is the Social Security Trust Fund a Store of Value?” American Economic Review, 2004) and Shoven/Nataraj (“Are Trust Fund Surpluses Spent or Saved?” NBER Working Paper 10953, 2004).
 - (b) Redemptions of Trust Fund bonds require financing from the general funds of the federal government. This can be accomplished by increasing taxes, by reducing other federal spending or by additional borrowing from the public.
2. This is a question for each member of the panel. According to the Trustee Report issued in August 2010, Social Security program costs exceeded tax revenue in both 2010 and 2011 creating a deficit, and are expected to follow that trend again from 2015 onward until 2084, the end of the actuarial 75-year projection. Each year there is a deficit, the program covers the deficit with interest earned from the Treasury securities held by the Trust. That won’t last forever, and I’d like the panel to address the question of when the Trust principal invested in U.S. Government debt securities will need to be tapped to cover the shortfall, assuming no changes in payroll taxes or benefits. Please update your answer, as appropriate, to reflect the information in the Trustees Report scheduled for publication on May 13, 2011.

Answer:

The latest Trustees' report finds that net redemptions of Trust Fund assets will begin in 2023. Through 2022 inclusive, the interest payments described in your question would cover annual shortfalls of non-interest income relative to benefit expenditures.

Two additional details may be of interest. One is that some redemptions of Trust Fund assets are occurring now and will continue to occur through and beyond 2023. Until 2023, however, annual interest payments will result in the issuance of new bonds to the Trust Funds, in an amount greater than those being redeemed.

The other important point is that while the nominal balance of the Trust Funds will continue to rise until 2023, the purchasing power of the combined Trust Funds has already begun to decline. The combined Trust Fund Ratio, which measures the duration of time that the Trust Fund could finance benefits in the absence of incoming tax revenue, peaked at 358 in 2008. The decline has begun because the annual cost of paying benefits is rising at a faster rate than the Trust Fund balance.

3. Dr. Blahous, the 2010 Trustees' Report says that the Disability Trust Fund fails the 10-year "short-range" test of financial adequacy. In fact, the Disability Fund will be exhausted by 2018, a date that is fast approaching. We don't have until 2037 to repair the problems in the Disability Fund, as some have suggested. The 2010 Trustees' Report says that Congress might want to reallocate payroll taxes between the retirement program and the disability program to shore up the disability program. What steps do you think Congress should take before the Disability Fund is exhausted in 2018?

Answer:

Taking care not to speak for the Trustees as a whole, I would approach the problem generally as follows.

First, the relative tax allocation between the OASI and DI trust funds should be examined. Current projections are that the DI Fund would be exhausted in 2018, but the OASI fund not until 2038. This discrepancy suggests that the current tax allocation between the two funds is not optimal. While changing the allocation simply strengthens one fund at the expense of the other, I believe that Congress should consider re-setting the allocation so that the two sides of Social Security are in similar financial condition.

Second, the rate of growth in the benefit formula should be examined, especially on the higher-wage end. Within the retirement portion of Social Security, savings can be achieved by, among other measures, better aligning eligibility ages with demographic realities. This option, however, does not improve the finances of the DI Fund, meaning that options for containing cost growth within that side of the program are fewer. Accordingly, progressive changes to the rate of growth of the benefit formula would benefit both the OASI Fund and the DI Fund but are especially important for DI. Different approaches to this end include "progressive indexing" as well as targeted

changes to the benefit formula factors, as developed by the President's Fiscal Commission.

Third, I believe that the construction of the benefit formula should be re-evaluated with an eye toward repairing flawed labor force participation incentives. The current system applies a progressive benefit formula to one's lifetime average earnings, considerably reducing the return on payroll tax contributions as one approaches the point of benefit eligibility (whether for disability or retirement benefits). A formula that instead delivered additional benefits based on each further individual year of earnings would strengthen work incentives, carrying financial benefits for Social Security and for the economy as a whole.

4. Dr. Blahous, some individuals who support raising the cap on income subject to the Social Security payroll tax imply that increasing taxes to cover 90% of national wages would simply make corrections by bringing current figures in line with historic averages.
 - (a) Isn't the actual historic average of revenue subject to the Social Security closer to 84%, which is approximately equal to current levels of taxation?
 - (b) Wouldn't the idea of legislatively mandating a 90% revenue target essentially institutionalize a tax increase supported by neither historic figures nor Congressional intent?
- (a) Yes. 90% was a relative high point in Social Security history.
- (b) A 90% revenue target would substantially increase the current cap and would well exceed historic averages. The 90% level was reached in 1982-83, but the 1983 reforms did not themselves enact changes in the tax cap. The 90% level was reached as a result of series of ad hoc stepped increases in the tax cap enacted in prior legislation.

Questions for the Record from Senator Coburn, M.D.

1. Some argued during the hearing that Social Security should not be a part of the discussion on reducing federal debt. In fact, the Chairman of the Committee himself stated, "I don't think Congress is going to address Social Security this year, basically because I think most members of Congress agree that it's probably not appropriate to deal with Social Security at the same time as Congress is dealing with debt and deficit reduction." Do you think it is prudent to delay reform on Social Security?

Answer:

I strongly believe that Social Security finances should be repaired at the earliest practicable time. I further believe that substantial further delays are imprudent.

2. In her written testimony, Ms. Nancy Altman asserts that the Social Security deficit is small because it's only 0.7% of GDP. Is a deficit of this size actually "small," however? How does a deficit of 0.7% of GDP affect beneficiaries?

Answer:

Though 0.7% of GDP may sound small as a comparison to the larger economy, the size of the Social Security shortfall is not small relative to the circumstances of individual participating workers. If action in repairing Social Security finances were to be delayed until the point of trust fund depletion, the consequence would be a choice between a 23% benefit reduction, affecting even the poorest of those already dependent on benefits, and a 30% tax increase on workers. It appears unlikely that participants would regard benefit or tax changes of this magnitude as small. They far exceed any sudden past changes in Social Security.

3. Is Social Security currently adding to this year's deficit? Is Social Security projected to add to next year's deficit? When is the next projected year that Social Security would not add to the deficit absent reform?

Answer:

Social Security operations are adding to the unified federal deficit this year and are projected to do so next year. According to projections from this year's report, Social Security operations will add permanently to annual unified federal deficits from this point forward.

4. According to the independent Congressional Research Service, "Cash flow deficits do not affect Social Security directly, but the redemption of trust fund bonds *puts pressure on the overall federal budget, which is in deficit*" (emphasis added). How truly separate is Social Security from the rest of the budget? Has Congress ever breached the purity of that separation?

Answer:

Social Security is off-budget in some respects of the law, but in others its finances are intermingled with the unified federal budget. Social Security Trust Funds, for example, are invested entirely in special-issue Treasury bonds. Academic analyses have concluded that this investment in Treasury bonds has stimulated additional federal consumption beyond what would have been the case if the federal government lacked access to the financing provided by Social Security surpluses. There are also instances of Social Security's and unified budget finances being intermingled as a matter of deliberate policy. In 2011, for example, general revenues are being provided to the Social Security Trust Fund to offset revenue foregone as a result of a temporary 2 point reduction in the payroll tax. These transfers will provide the authority for additional benefit payments from the Trust Funds, financed from the general budget, above and beyond any revenue generated by the Social Security system itself.

5. Do you agree that the Social Security program lacks borrowing authority? Does the lack of borrowing authority argue for or against prompt reform action?

Answer:

I agree that the Social Security Trust Funds lack borrowing authority. This is a powerful further reason as to why reforms should be enacted at the earliest possible time. It means that in the absence of legislated corrections, the imbalance between scheduled benefits and incoming tax revenues will be resolved in the most disruptive possible way – by a sudden 23% reduction in benefits affecting everyone who is collecting them in 2036 and beyond. The fact that Social Security’s finances must be balanced in any event means that reform is an imperative rather than a discretionary option. Such balancing will be least disruptive if enacted sooner and is more gradually implemented.

6. During the hearing, it was argued that a plan put forward by the President’s National Commission on Fiscal Responsibility and Reform would “cut benefits” by 33 percent, a much steeper “cut” than the 22 percent cut in benefits projected under current law. However, is it not true that the Commission’s plan actually restrains the benefit growth of high income earners to the benefit of those farther down the income scale? Please explain.

Answer:

Those figures describe reductions in benefit growth (as distinct from cuts from today’s levels) for higher-income beneficiaries under the plan developed by the President’s Commission. Significantly higher rates of benefit growth would be provided to medium and low-wage earners under the plan. The essence of the Commission proposal is to constrain the growth of benefits for higher-income beneficiaries so that lower-income beneficiaries will be spared the substantial benefit reductions that would occur under current law.

7. In your testimony, you explain that wage indexing produces benefits to younger generations that rise higher than inflation. With this in mind, would the contention that certain program reforms slash benefits – such as implementing a chained-CPI-U inflationary formula for cost-of-living-adjustments or increasing the retirement age – be accurate?

Answer:

Though others may disagree, my personal view is that it is misleading to contend that reform proposals “slash” benefits whenever they allow for the payment of higher future benefit levels, relative to inflation, than are paid today. Many Americans are very concerned that reform will instead mean reductions from current benefit levels. This is not the case under the range of existing Congressional and Commission proposals if

enacted in the near future. The longer that legislative reforms are delayed, the more the risk of such genuine declines in real benefit levels increases.

8. How much has longevity increased since Social Security first began paying benefits?

Answer:

Period life expectancy at birth has risen by more than fourteen years, while period life expectancy at age 65 has risen by about six years. Cohort life expectancy at birth has risen by more than ten years, while cohort life expectancy at 65 has risen by about six years.

9. How much would increasing the cap on taxable wages fill the program's projected shortfall? How would increasing taxes by increasing the cap on covered earnings likely affect behavior? How would incentives to work, save and retire be affected?

Answer:

The answer depends on how much the cap is increased. An oft-cited proposal to gradually increase the cap on taxable wages to cover 90% of all wages would appear to eliminate the shortfall much more by some measures than by others. While it could eliminate nearly 40% of the 75-year actuarial imbalance, it would only reduce annual shortfalls over the long term by about 15%. This is because the additional revenues collected in the near term would obligate additional benefit payments over the long term. Moreover, unless all of such near-term revenue is saved by the federal government, the action would not improve the government's ultimate ability to finance benefits to the degree suggested by the 40% figure. Increasing the cap would be a substantial disincentive to labor force participation (and correspondingly an incentive to retire) for affected individuals. Even if such individuals took into account the additional benefits that would accrue under a raised cap when making their decisions, the raising of the cap would impose on them a further incremental net income loss in each working year that it affects. Raising the cap is also likely to reduce national saving. This is because historically the federal government has not tended to save surplus Social Security tax revenue, whereas higher-income individuals would save at least some portion of the funds in question.

10. Is Social Security's limit on covered earnings unusually low relative to other developed countries?

Answer:

A recent paper by AEI scholar Andrew Biggs indicates not: "Across twenty-two Organization for Economic Cooperation and Development (OECD) countries, pension taxes were applied, on average, up to 2.1 times the average wage. In the United States, the Social Security payroll tax is applied up to around 2.9 times the average wage, a

significantly higher tax cap than in the United Kingdom, Japan, Germany, Canada, and other competing countries.”

Is the current limit on covered earnings unusually low by historical standards when looking at the entire history of the program?

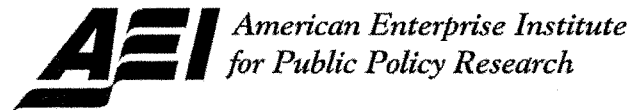
Answer:

No. The historical average is roughly 84% of total national earnings, about the level experienced in recent years.

11. A common reform proposal is to raise the Social Security taxable maximum to cover 90 percent of taxable earnings. Have those individuals who would be affected by such a reform experienced dramatic increases in their earnings?

Answer:

According to a recent paper by Mark Warshawsky, the answer is no. While the percentage of national earnings above the cap has declined over the past quarter-century, the percentage of workers above the cap has not appreciably changed. This reflects the fact that most of the growth in earnings above the cap has been among the very highest earners. By contrast, raising the cap would have the largest relative impact on those workers with total earnings just above the current-law cap.



Statement before the Senate Finance Committee
On "Perspectives on Deficit Reduction: Social Security"

An Incremental Approach to Social Security Reform

Alex M. Brill
Research Fellow
American Enterprise Institute

May 10, 2011

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Chairman Baucus, Ranking Member Hatch, and Members of the Committee, my name is Alex Brill, and I am a research fellow at the American Enterprise Institute. Thank you for the opportunity to appear before the Committee this morning to testify on Social Security and our country's deficit and debt challenges.

Chairman Baucus remarked at the opening of the first hearing in this series that “[a]ddressing our deficits and debts is an economic issue, a national security issue and a moral issue.” He went on to say that “we have a moral obligation to leave this place better than we found it, but today, our fiscal challenges prevent us from meeting that responsibility.”¹ I wholeheartedly agree and am greatly concerned by the willingness demonstrated by Congress to consistently deficit-finance federal government spending in excess of our economy's rate of growth. A broad spectrum of projections indicates that without substantive legislative action large deficits will continue for years to come, which means that we will become increasingly dependent on foreign lenders' willingness to lend and are imposing an ever-increasing burden on future generations who must service that debt.

Some policymakers and lawmakers will argue that Social Security is separate and distinct from our broader fiscal challenges. I disagree. I believe that immediately addressing the challenges facing the Social Security program offers an opportunity to improve our country's fiscal soundness, lift an undue burden from future generations, and strengthen our economy's long-run growth prospects—all objectives consistent with and complementary to the purpose of tackling our deficit and debt challenges. Congress, in addressing Social Security now, could take an important step toward achieving public policies that reflect the need of our country to live within its means.

A Manageable Approach to Reform

My testimony will focus on the long-range fiscal challenges our country faces. In this context, the Social Security program is a significant concern, and delaying action simply worsens the problem. In any near-term legislative agenda to address the deficit and debt, there is an opportunity to approach Social Security in the same manner in which deficit and debt reductions are likely to be achieved—incrementally.

¹ Max Baucus, “Hearing Statement of Senator Max Baucus Regarding Perspectives on Deficit Reduction: As Prepared for Delivery,” April 13, 2011, <http://finance.senate.gov/imo/media/doc/041311mb.pdf>.

I am not advocating for fundamental reform or an overhaul of the Social Security program. Rather, I urge the Committee simply to take a first step. One sizeable step forward could do much toward delaying the trust fund depletion Social Security faces in the next quarter century. And it will open the way for further reasonable action on Social Security reform in the coming years. Much as our fiscal challenges generally cannot be ameliorated in a single vote and the budget cannot be balanced tomorrow, so too is Social Security not going to be fixed overnight. But Congress could this year pursue meaningful, incremental change to strengthen Social Security.

Social Security and the Economy

The social security program is the largest single program in the federal government. Including the retired, the disabled, and surviving spouses of deceased workers, over 54 million people, which equates to roughly one in every six U.S. residents, receive Social Security benefits.² About 90 percent of the elderly in the U.S. are receiving benefits.

Social Security outlays in FY2010 accounted for one-fifth of the federal budget, approximately \$706 billion dollars or 4.8 percent of GDP.³ Total income earned for the trust fund, payroll taxes, interest, and taxes on certain benefits was about \$788 billion in FY2010, and about 158 million people will work in OASDI covered employment this year. Given the magnitude of the program, it should be no surprise that it has measurable consequences on our economy and our society.

Poverty. The program provides critical assistance to tens of millions of low-income retirees who depend on Social Security benefits. These benefits comprise the majority of income for 55 percent of beneficiaries age 65 or over; for 26 percent of elderly beneficiaries, Social Security benefits represent 90 percent or more of their income, while a full 15 percent of

² Social Security Administration (SSA), "Benefits Paid by Type of Beneficiary," www.ssa.gov/OACT/ProgData/icp.html.

³ Congressional Budget Office (CBO), "CBO's 2010 Long-Term Projections for Social Security: Additional Information," www.cbo.gov/ftpdocs/119xx/doc11943/10-22-SocialSecurity_chartbook.pdf.

beneficiaries age 65 or over have no income outside of Social Security.⁴ Social Security benefits keep more than 13 million elderly Americans out of poverty.⁵

Private Savings. Earning future Social Security benefits while working has been shown to depress an individual's decision to accumulate private savings. A wide range of estimates exist in the academic literature, but the Congressional Budget Office (CBO), in a study dedicated to this topic in 1998, concluded, "The best empirical estimates . . . indicate that each dollar of Social Security wealth reduces other assets between zero and 50 cents."⁶ More recent research by Sudipto Banerjee at Ohio State University finds that Social Security crowds out 20–27 cents of private savings per dollar increase in Social Security wealth. Of particular importance is the finding that the crowd-out effect is near zero for median- and low-income workers but rises to 44 cents per dollar of Social Security wealth for households in the 90th percentile and near dollar-for-dollar for higher wealth households.⁷

Labor Market Participation. Academics have debated the magnitude of the labor market participation response to changes in Social Security benefits, but recent research has indicated that it may be significant. James Vere, in a recent article in *Labour Economics*, writes, "From a policy standpoint, the results [of my research] indicate that if concerns about fiscal solvency lead Congress to reduce Social Security benefits, older workers . . . are likely to compensate by increasing their participation in the labor force and working more hours."⁸ Similarly, Giovanni Mastrobuoni, in an article in the *Journal of Public Economics*, finds a strong labor market participation response to the phased increase in the retirement age enacted in 1983.⁹

Uncertainty. An additional way that Social Security affects the economy is the economic burden posed by uncertainty over the program's future viability and potential policy changes. As

⁴ SSA, "Income of the Population 55 or Older, 2008," Table 9.B1, www.ssa.gov/policy/docs/statcomps/income_pop55/2008/sect09.html#table9.b1.ibid.

⁵ Paul N. Van de Water and Arloc Sherman, "Social Security Keeps 20 Million Americans Out of Poverty: A State-by-State Analysis," Center on Budget and Policy Priorities, August 11, 2010, www.cbpp.org/files/8-11-10socsec.pdf.

⁶ CBO, "Social Security and Private Savings: A Review of the Empirical Evidence," July 1998.

⁷ Sudipto Banerjee, "Does Social Security Affect Household Saving?" October 28, 2010, http://web.econ.ohio-state.edu/~sudipto/Research_files/Does%20Social%20Security%20Affect%20Household%20Saving_%20JMP_Banerjee.pdf. A similar finding for private pensions crowding out savings is reported by Gary Englehardt and Anil Kumar, "Pensions and Household Wealth Accumulation," *Journal of Human Resources* 46 (2011).

⁸ James P. Vere, "Social Security and Elderly Labor Supply: Evidence from the Health Retirement Study," *Labour Economics*, 2011 (in press).

⁹ Giovanni Mastrobuoni, "Labor Supply Effects of the Recent Social Security Benefit Cuts: Empirical Estimates Using Cohort Discontinuities," *Journal of Public Economics* 93 (December 2009).

then—CBO director Douglas Holtz-Eakin noted in testimony in 2005, “[T]here is uncertainty about the future of Social Security: what the program will look like and who will be affected by changes to it. The sooner that uncertainty is resolved or reduced, the better served will be current and future beneficiaries, who must make various decisions about their retirement. Phasing in changes to Social Security allows for gradual accommodation, giving people time to modify their expectations and to adjust their work and saving behavior.”¹⁰

The Social Security Outlook

As many analysts and researchers have warned, lawmakers will be forced to change the Social Security program in coming years because it is on an unsustainable path. Future projected payroll taxes are insufficient to provide expected benefits. The Social Security Administration estimates that on the program’s current course, trust fund assets will be exhausted in 2037, and benefits will have to be reduced by 22 percent.¹¹ CBO meanwhile predicts trust fund exhaustion in 2039 and a 21 percent reduction in scheduled benefits.¹² The Social Security Administration is expected to update their forecast in the 2011 OASDI Trustees Report later this month. While there is a degree of uncertainty with regard to the year in which the trust funds are exhausted, there is no plausible scenario in which the trust funds are not depleted in the coming decades.¹³

According to the CBO analysis, there is a 99 percent likelihood that scheduled outlays will exceed revenues in 2030 and a greater than 90 percent probability that scheduled benefits will exceed outlays in every decade through 2080.¹⁴ The demographic changes underlying the financial outlook for Social Security have been well documented. Currently, there are approximately three workers per beneficiary, but that ratio will drop to two to one over time, as illustrated in Figure 1. As a result of this shift, the system is unsustainable in its current structure.

¹⁰ Douglas Holtz-Eakin, “The Role of the Economy in the Outlook for Social Security,” testimony before the House Committee on Ways and Means, Subcommittee on Social Security, June 21, 2005, www.cbo.gov/ftpdocs/64xx/doc6492/06-21-Prefunding.pdf.

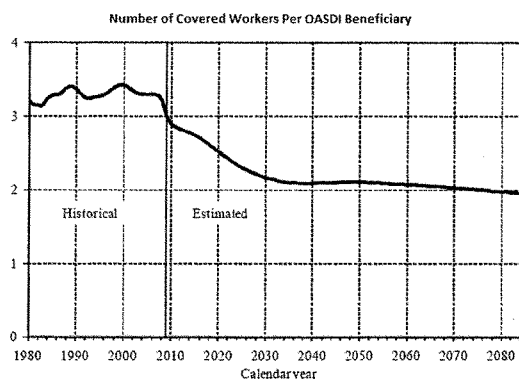
¹¹ *2010 Annual Report of the Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, August 9, 2010, www.ssa.gov/oact/tr/2010/tr2010.pdf.

¹² CBO, “CBO’s 2010 Long-Term Projections for Social Security: Additional Information.”

¹³ CBO simulates five hundred scenarios, and trust fund exhaustion dates range from 2031 to 2057 for 80 percent of the cases. (Ibid.)

¹⁴ Ibid.

Figure 1



Source: 2010 Annual Report of the Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds

Incremental Change for Social Security

The current academic and think tank community debate over Social Security reform frequently reflects an unwavering commitment to a single-step, absolute fix to Social Security's future imbalance. Whether through proposals to increase taxes, adjust future benefits, or a combination of both, no major reform proposal attempts to solve less than the entire shortfall. While I admire those researchers who choose to "think big," as a practical matter I disagree with this approach. Free from the limitations imposed by trying to solve the whole problem, Congress has a number of incremental policy options available for consideration. There are several reasons to consider an incremental approach to Social Security.

First, such an approach is consistent with the broader deficit and debt debate currently going on in Washington. It is widely accepted that the federal budget, in its current form, is unsustainable. CBO called the long-term budget outlook "daunting," pointing out that we have "been recording the largest budget deficits, as a share of the economy, since the end of World War II."¹⁵ However, while policymakers recognize the current fiscal imbalance, there is zero probability that legislation this year will balance the near-term and long-run budget. Our best hope is continued legislative vigilance aimed at fiscal stability. For example, President Obama's

¹⁵ CBO, *The Long-Term Budget Outlook*, June 2010 (revised August 2010), www.cbo.gov/ftpdocs/115xx/doc11579/06-30-LTBO.pdf

recently announced “Framework for Shared Prosperity and Shared Fiscal Responsibility” sets “a goal of reducing our deficit by \$4 trillion in 12 years or less.” While such an objective is sizable, it likely fails to even stabilize the debt-to-GDP ratio, according to the Committee for a Responsible Federal Budget.¹⁶ The President’s proposal does not include any explicit Social Security reform proposals.

Second, while the probability that the Social Security trust fund will be unable to provide scheduled benefits in the coming decades, the precise exhaustion date is uncertain. Given the myriad of uncertainties involving life expectancy, labor force participation, wage growth, immigration, and other factors, it is possible, even likely, that any policy intended to “solve” the Social Security problem may, eventually, miss the mark. For example, the 1983 Amendments to Social Security were estimated at the time to create actuarial balance for the combined OASDI trust funds.¹⁷ However, unanticipated economic and demographic changes have led to another forecast of trust fund insolvency.

And finally, an incremental approach is consistent with the political necessities of legislative compromise. While the political difficulty of addressing Social Security can be acute, policymakers from both parties have urged bipartisan cooperation and action. This kind of cooperation will be more feasible if smaller goals are set.

With this in mind, I would encourage the Committee to consider three incremental policies that would reduce the projected trust fund funding gap.

Three Options for Incremental Reform

1. Raise both the normal retirement age and the early retirement age. If implemented slowly over time, a policy that raises both the normal retirement age and the early eligibility age could both narrow the long-run financing gap and foster economic growth. As the President’s National Commission on Fiscal Responsibility and Reform points out in its December 2010 report, life expectancy has increased significantly since the Social Security program was established in 1935, making an upward adjustment of the retirement age an appropriate measure to address funding concerns, particularly since it is not outside the intent of the program as it was

¹⁶ Committee for a Responsible Federal Budget, “Analyzing the President’s New Budget Framework,” April 21, 2011, http://crfb.org/sites/default/files/Analyzing_the_Presidents_New_Budget_Framework.pdf.

¹⁷ John Svahn and Mary Ross, “Social Security Amendments of 1983: Legislative History and Summary of Provisions,” *Social Security Bulletin* 46, no. 7 (July 1983), www.ssa.gov/policy/docs/ssb/v46n7/v46n7p3.pdf.

originally established. The Fiscal Commission's recommendation to index the retirement age to gains in longevity could be one important incremental step to getting Social Security on the right track. This policy, which includes a hardship exemption for workers physically unable to work beyond the early eligibility age, eliminates almost one-third of the 75th-year financing gap.¹⁸

Raising the early eligibility age from 62 to 65, while only having a modest impact on the trust fund insolvency date by pushing it back about five years, would promote labor market participation and, as estimated by my colleague Andrew Biggs, would increase GDP by about 5 percent.¹⁹ Such a change would, as a result of the overall economic growth effects, have a positive effect on the deficit.²⁰

2. *Modify the benefit formula to slow future benefit growth.* The formula for determining a retiree's benefits is progressive. Social Security replaces 90 percent of the first \$9,000 in average annual wages but replaces just 32 percent of the next \$55,000 in average annual wages and only 15 percent of average annual wages from \$64,000 to \$107,000. The "bend points" at which this rate applies increase annually not with inflation but with average wage growth. Modifying the benefit formula to improve solvency has been advocated by the President's Fiscal Commission, the Bipartisan Policy Center's Debt Reduction Task Force, and a number of other groups. Modification could be achieved through a variety of reforms, including reducing the benefit formula's second and third rate, indexing the second and third bend points to inflation instead of wage growth (commonly known as progressive price indexing), or establishing a fourth bend point that reduces benefits for workers with high lifetime average incomes.

3. *Adopt a chain-weighted consumer price index for the annual Social Security cost of living adjustment (COLA).* Social Security benefits are adjusted annually to reflect changes in the cost of living or inflation. Under current law, inflation is measured by the consumer price index for urban wage workers (CPI-W). The President's Fiscal Commission as well as the Debt Reduction Task Force both recommended adopting an alternative measure of inflation, chain-weighted CPI-W, for adjusting Social Security payments that would reflect not only the change

¹⁸ National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," December 2010, www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

¹⁹ Andrew Biggs, "The Case for Raising Social Security's Early Retirement Age," AEI *Retirement Policy Outlook*, October 2010.

²⁰ Biggs estimates that over the first ten years of raising the early eligibility age to 65 the federal budget deficit would decrease by 0.45 percent. (Ibid.)

in prices over time but also the shift in consumption as various products' relative prices change. Social Security Administration actuaries estimate that this change would, on average, reduce the COLA in most years, which would eliminate about one-sixth of the financing gap in the 75th year.

An Essential Stipulation: Protect the Poor

With any reform we consider, we must not forget the most vulnerable among us. Thus, Congress should also consider some of the options for strengthening benefits for low-income individuals. Such proposals were endorsed by President Bush's Commission to Strengthen Social Security as well as by President Obama's recent Fiscal Commission. For example, the Fiscal Commission proposed a minimum benefit of 125% of poverty for an individual with twenty-five years of work. While such a policy by itself would exacerbate the imbalance in Social Security trust fund financing modestly, if combined with any of the options outlined above, the program's financing could be enhanced while the benefits for low-income retirees could be increased.

A Final Thought: Social Security and Thrift

This Committee has enacted a variety of policies in the last decade to expand retirement savings through various defined contribution options. Such steps have strengthened our country's "retirement security" in many regards. While I believe that still more can be done to promote retirement savings, it should be recognized that expanding and improving IRAs, 401(k)s, and the like are a complement to, not a substitute for, addressing the need for Social Security reform itself.

But I would like to highlight a final matter that must also be addressed in order to ensure that future retirees have adequate incomes and that our country has sufficient savings to facilitate growth. That matter is the virtue of thrift. Beyond tax policy changes, cutbacks in various government programs, and overall strategies for deficit reduction, our country—citizens and policymakers alike—have drifted away from thrift as a virtue, and it is evident in both consumer finance (high personal debt burdens and low savings rates) and federal finance. Inaction with regard to Social Security's finances is, in one sense, a symptom of this trend. However, Congress in its efforts to reduce the deficit and the federal debt may have the opportunity to help reestablish thrift as a virtue, one that can result in a stronger, safer, and more prosperous country for future generations.

A broad range of policy change is required to achieve the goals of debt reduction, but with regard to Social Security, I believe that incremental reforms—if implemented soon—can begin to steer the trust funds toward sustainability and steer our country back toward thrift. As we do this, workers can begin to save more, our country can grow more, and we can begin to meet the challenge of ensuring that future generations are increasingly better off.

Questions for Mr. Alex Brill
Finance Committee Hearing
“Perspectives on Deficit Reduction: Social Security”
May 10, 2011

Question for the Record from Senator Baucus

1. *You have indicated in your testimony that you recommend that we proceed incrementally with Social Security reform, rather than try to fix Social Security’s actuarial imbalance all at once. Can you give us the pros and cons of your position?*

Pros:

- The Social Security trust fund depletion date is fast approaching—in fact, the latest Trustees Report moved the projected date up one year to 2036. But reforms necessary to achieve long-run sustainability in the program have proven difficult for lawmakers to agree on. Rather than doing nothing and either risking depletion or necessitating drastic last-minute measures, Congress should begin immediately by implementing smaller reforms that mitigate the future shortfall.
- Acting sooner will allow for workers to better plan for the impact of any change in future benefits. And if both parties agree to and enact a few Social Security reforms, this could set a precedent for future cooperation on additional entitlement reform challenges. To this end, bipartisan cooperation will be more feasible if smaller goals are set initially.

Cons:

- An incremental approach obviously does not solve the entire shortfall right away, making further reform necessary down the road. To the extent that those future changes are delayed considerably, they may need to be more dramatic. However, proceeding in increments is not entirely negative, as it will allow for future reforms to more accurately reflect future conditions.

Questions for the Record from Senator Hatch

1. *This is a question for each member of the panel. Since the 1983 Social Security reforms, and until 2010, payroll taxes have exceeded benefit payments from the Social Security Trust Funds. By law, the surplus receipts have been invested in interest bearing, non-marketable, special-issue government securities, which represent loans to the U.S. Treasury. At the end of 2010, the Trust Funds had assets of \$2.6 in US government debt instruments. When the Social Security Trust Funds invested the excess payroll taxes in U.S. Government debt, the Treasury placed the money in the general fund.*

- (a) *What did the Treasury do with the money received in exchange for the government securities?*

(b) Where will Treasury get the money to repay the Social Security Trust Funds back when the Trust Funds need to redeem the securities to raise money to pay benefits?

- (a) Once cash goes into the general fund from the Social Security trust fund, it is indistinguishable from other cash in the fund and is used for expenses in excess of receipts by general revenues.
 - (b) Treasury will finance these costs through tax increases, additional debt financing, or reducing other types of spending.
2. *This is a question for each member of the panel. According to the Trustee Report issued in August 2010, Social Security program costs exceeded tax revenue in both 2010 and 2011 creating a deficit, and are expected to follow that trend again from 2015 onward until 2084, the end of the actuarial 75-year projection. Each year there is a deficit, the program covers the deficit with interest earned from the Treasury securities held by the Trust. That won't last forever, and I'd like the panel to address the question of when the Trust principal invested in U.S. Government debt securities will need to be tapped to cover the shortfall, assuming no changes in payroll taxes or benefits. Please update your answer, as appropriate, to reflect the information in the Trustees Report scheduled for publication on May 13, 2011.*
- According to the May 13, 2011, Trustees Report, the trust fund principal will begin to be drawn down in 2023, when total income, including interest, will no longer be sufficient to cover annual costs.

**STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF MAY 10, 2011
PERSPECTIVES ON DEFICIT REDUCTION: SOCIAL SECURITY**

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining the impact of Social Security on the federal budget:

Mr. Chairman, thank you for calling this morning's hearing. It is the third in a series of Finance Committee hearings designed to address deficit reduction efforts as they relate to the committee's broad jurisdiction.

Today's topic is Social Security. What role does it play in our current fiscal calamity? What role, if any, should it play in moving the federal government out of the deficit and debt ditch it is in.

A few weeks ago, that sometime political philosopher and full time comedian, Jay Leno, discussed Social Security.

Mr. Leno said: *It's the 75th anniversary of the introduction of Social Security checks. For the younger viewers who don't know what a Social Security check is, you'll never see one in your lifetime, so don't worry about it.*

The latest Social Security Trustees' Report tells us that the program will be insolvent by the year 2037. That's about 25 years from now. If you assume the current retirement age of 67 sticks, it would mean that the *younger viewers* Mr. Leno is talking to are 42 years and younger. For all of you Americans, 42 years of age or younger, if the Social Security remains as is, FAW GED UH BOWED IT, as New Yorkers say. Twenty five years from now may seem like a long way away. As the old saying goes, in politics, a year can seem like eternity.

By the way, I don't know how folks look their constituents aged 42 or under in the eye and say there's no problem. Or, for that matter, how do folks look their constituents even over 42, who hope to still be alive in 2037, and say there's no problem?

So, let's be clear about this – there is a scheduled benefit reduction come 2037. This isn't just a problem of how to finance the benefits that are scheduled for 2037 and beyond. Rather, under current law, Social Security benefits are scheduled to have an approximate reduction of 24 percent in 2037. That's right – there will be a 24 percent reduction in Social Security benefits under current law.

Some might ask what's that got to do with the current fiscal picture? Take a closer look at the facts and figures from the last trustees' report. You'll find that a good chunk of the 25 years of delay of reckoning depends on a fundamental assumption.

For many years, the Social Security Trust Fund ran surpluses. Under the unified budget, those surpluses masked the size of the deficits the federal government was running. By law, the trust fund is made whole by the issuance of Treasury IOUs to the trust fund to reflect the surpluses and interest. In the late 1990s, under a Republican Congress and Democratic President, that trend reversed briefly, but returned back to normal under Congresses and Presidents of both parties.

Those notes can be serviced in only three ways. Those three ways are higher taxes, spending reductions, or more debt.

You can see that recent fiscal history shows a direct relationship between federal deficits, debt, and the trust fund. The Social Security Trust Fund surpluses reduced the apparent size of the deficit, but pressed up on the debt limit.

That all changed last year.

Last year, payroll taxes and other revenues were less than payments out of the Social Security Trust Fund. The trust fund ran a cash flow deficit for the first time since the major Social Security reform of 1983. We can sit here like the proverbial three monkeys.

One of us can place his hands over his eyes and say he sees no fiscal evil. Another of us can place her hands over her ears and say she hears no fiscal evil. Still another of us can place his hands over his mouth and mumble he says no fiscal evil.

To be sure, those IOUs sitting in the Parkersburg, West Virginia offices of the Treasury's Bureau of Public Debt are claims against the federal government. They've got to be paid. How will they be paid if the trust fund comes to rely on them?

If someone wants to tell me that question has nothing to do with the current deficits and debt, I think I've got a fine old bridge linking the boroughs of Manhattan and Brooklyn for you to purchase.

The trustees report is plain as day on the long-term fiscal problems with Social Security.

Social Security Trust Fund surpluses hid the magnitude of the damage of recent fiscal practices. With the trust fund reversing itself, the day of reckoning is drawing near.

That, Mr. Chairman, is why we are here.

We need to look at the role of Social Security with respect to the origins and continuous causes of the unsustainable deficits and debt.

It is only proper that this committee air these issues out.

It is only proper that this committee explore the options for Social Security solvency.

The President, so far, has missed the opportunity and does not make a bold commitment to entitlement reform and deficit reduction.

Social Security has been, once again, treated as the third rail of politics.

Unfortunately, eventually the financial electricity of that rail will run out if it is not reformed.

I look forward to the witnesses' testimony.

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Testimony of

**James Roosevelt, Jr.
President and Chief Executive Officer
Tufts Associated Health Plans, Inc.**

Before the

United States Senate Committee on Finance

“Perspectives on Deficit Reduction: Social Security”

May 10, 2011

“The Mythology of Fear”

Over 75 years ago, President Franklin Delano Roosevelt spoke these words:

We can never insure one-hundred percent of the population against one-hundred percent of the hazards and vicissitudes of life. But we 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. This law, too, represents a cornerstone in a structure which is being built, but is by no means complete. . . . It is . . . a law that will take care of human needs and at the same time provide for the United States an economic structure of vastly greater soundness.

My grandfather uttered these words on August 14, 1935, on the proud occasion of his signing the Social Security Act into law.

They expressed a fundamental belief shared by him and my grandmother that all people should be free from fear of want and destitution. My grandparents possessed an almost boundless sense of optimism in the American people; freed from our fears, they had faith that we could move mountains. Thus, in 1933 President Roosevelt summoned the courage of the American people with the immortal words: “the only thing we have to fear is fear itself.”

Like my grandfather, I strongly believe we cannot address the problems confronting our nation through the politics of fear. Too often, we have seen the politics of fear move us to adopt shortsighted and sometimes irrational solutions.

Our federal deficit is growing and as a nation we need to address this issue. But we need to do so in a clear-sighted and thoughtful manner. Demonizing social security and Medicare is the wrong path.

The critics of our Social Security program tell us to fear that Social Security is not working, to fear that it is bankrupting the country and to fear that it cannot be counted on in the future.

Critics of Social Security call it “insolvent,” and say “it’s paying out more than it’s taking in” or “there is no surplus in there.”

Fear, my grandfather said, is “nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance.”

The truth about Social Security is that it has contributed to the financial wellbeing of almost every American family. The truth about Social Security is that it is solvent today because it has a dedicated income stream that covers its costs and is actuarially sound; **and more importantly, with minor adjustment it will remain solvent for decades to come.**

Social Security has transformed American society

Social Security has been the most successful government program of the past 75 years. No program has touched more American lives and benefited more American families. Today, approximately 52 million Americans receive Social Security benefits each month. Even those who have not drawn a single Social Security check have benefited. While it was forged in the heat of the Depression, Social Security remains every bit as relevant and important to Americans today. With only minor adjustments, this program will be there for Americans who have not yet been born.

The success of the program is rooted in the two words that comprise its name: “social” and “security.” Social Security is a *social* insurance program for American families. It is rooted in our belief that as members of society we have obligations to each other. We are committed to protecting our fellow Americans from the economic ravages of old age, disability and death. We see a benefit in spreading risks across society rather than placing the full burden of what my grandfather called the “hazards and vicissitudes of life” on individuals and individual families. These obligations extend across time. One generation supports the next generation, which supports the next generation, and so on.

As Barack Obama stated in his very first speech before the National Press Club, which he delivered in 2005 on the topic of Social Security, “we are all connected as one people—ready to share life’s risks and rewards for the benefit of each and good of all.”

The *security* in Social Security is vitally important to Americans. My grandfather thought of Social Security as part of a three-legged stool of financial security. Social Security would provide an income floor below which no American family would fall as a result of old age, disability or death. Social Security was not intended to stand-alone; it was to be supplemented by savings and private pension systems. Today, it may be more accurate to think of Social Security as the bedrock of a secure retirement, as the two other legs in the stool have become increasingly wobbly.

Private pension plans are looking more and more like historical anomalies, as they currently cover only about 20 percent of private sector employees. And the national savings rate, despite its current positive blip, provides little comfort that contemporary Americans are any better able to provide for their later years than our forebears.

Americans understand that, “there but for the grace of God go I.” They want to protect their families from the tragedies that can befall anyone and which no one can control. The pushers of ill-conceived privatization schemes miss the point that Americans want to be able to count on something real for themselves and their families. They might be willing to assume greater risks in their 401(k) accounts to earn higher returns, but this is because they have Social Security on which to fall back.

We are just now coming out of the worst financial crisis since the Great Depression. Economists are finding that low probability events, like stock market crashes, occur much more frequently than we think. Or as economists would put it, the “thin tails” of a normal distribution curve are often fatter than we suspect. Stock markets have experienced two “once in a generation” declines in just the past ten years. Individuals who are retired or hope to retire soon have seen their retirement savings disappear. But there stands Social Security. Beneficiaries can mark their calendars by the arrival of their check each month.

Social Security has truly transformed American society. In 1959, 35 percent of Americans aged 65 and older had family incomes below the federal poverty line. Today that figure is 10 percent—marking more than a 70 percent reduction in the proportion of elderly Americans living in poverty. In my grandparent’s day, old age was something to be feared. Today, despite financial challenges such as the high costs of prescription drugs, Social Security provides retirees with much greater financial security and peace of mind. If we took away Social Security benefits, it is estimated that nearly half of the elderly in this country would have incomes below the poverty line.

It is interesting that many critics of Social Security make an “intergenerational equity” argument that the program is not fair to workers paying into the system today. This argument depends on the utterly baseless assumption that Social Security will not pay future retirement benefits to people contributing today. But let’s even assume for one minute that that were true. Think about the burdens that young families would face today if they also had to provide financial support or a home for their aging parents. Think about the extreme hardships many families would endure if not for the long-term disability and survivor benefits that Social Security provides.

We associate Social Security with retirees but nearly one in five recipients of Social Security benefits are children under the age of 18. They may be children whose father is disabled or whose mother was killed in the attacks on 9-11. Families face many financial stresses, from the costs of food to health care to college, but there are many stresses that they don’t have to bear because of Social Security. The essentials of providing clothing and shelter are stresses that are lessened for people receiving Social Security.

It is not surprising then that Social Security is so popular with the American people. Poll after poll confirms this. The poll numbers have not escaped the notice of the critics of Social Security. Today these critics no longer talk about eliminating or privatizing Social Security. Instead, they speak in Orwellian language about “saving,” “strengthening,” and “protecting” Social Security. To advance their hidden agenda, they have developed a “mythology of fear,” trotting out their themes of a program that is “in crisis,” “bankrupt,” “broke,” and, in the wake of Madoff, even a “ponzi scheme.”

Sharron Angle from Nevada, a Tea Party and the Republican Party celebrity of sorts, has repeatedly called for phasing out Social Security over time, characterizing it as “a broken system without much to recommend it.” She has voiced support for shifting younger workers to private retirement accounts, an idea similar to what former President George W. Bush proposed six years ago in his veiled effort to dismantle the program.

Most Americans can see through the deception, but I am wary that many Americans, as much as they support Social Security, are questioning whether it will be there when they retire. This is a dangerous trend. Social Security needs to do more to educate Americans of the benefits and stability of Social Security. We need to debunk those “nameless, unreasoning, unjustified terrors” that are being perpetuated by those whose philosophy of economics doesn’t take into account the unarguable success of Social Security.

Social Security is financially stable

There is a saying that if you repeat something often enough it becomes the truth. Nothing better illustrates that point than the notion that Social Security will be bankrupted by Baby Boomers.

Supposedly it is the enormous bulge of retirees from this generation that will sink Social Security once and for all. Indeed, the generation of Americans born between 1946 and 1964, who drew their first retirement checks from Social Security in 2008, will place heavy demands upon the system as they reach their retirement years. But this is also a generation that has been paying into the system since they started working in the early 1960s. The critics of Social Security often “forget”—conveniently I think—about the “pay it forward” aspect of Social Security. They “forget” that Social Security is an insurance program, where people need to contribute before they collect. The Baby Boomers have been contributing to Social Security for more than forty years. It is through their contributions that Social Security has amassed massive surpluses. Much of the money that the Baby Boomers are, and will be, drawing from Social Security is and will be their own.

We have known about the impact of the Baby Boom generation for a long time. It is not as if we woke up yesterday and discovered that there are millions of new retirees about to draw on Social Security. The last of the Baby Boomers was born in 1964.

And we have been planning for the impact of this generation on Social Security for a long time. Congress has enacted ten significant Social Security bills in the last 60 years. As Nancy Altman has pointed out, “every enactment has taken into account the Baby Boom, and each has left the program in long-run actuarial balance.”

In fact, the projected deficit of Social Security beginning in 2037 is really not a result of the Baby Boomers. Forward-thinking Social Security Administration actuaries had already accounted for them. Instead, changes in the projected deficit have more to do with factors such as economic and wage growth, productivity and disability rates.

But these important parts of the story are usually left out. Instead, the purveyors of fear want you to believe that the Baby Boomers are retiring on the backs of their children and grandchildren. If you buy this premise, then they pull out their frightening statistics showing a declining number of contributors supporting a rising number of beneficiaries of Social Security to “prove” that the program is unsustainable.

These utter distortions, however, are nothing new. My grandfather had to contend with them. In the 1936 presidential campaign, the Republican nominee, Alf Landon, labeled Social Security a “hoax.” In dismissing Social Security as “unworkable,” the GOP platform of that year stated that Social Security would be unable to pay benefits to two-thirds of retirees. My grandfather then, would not be surprised by the fear mongering of today. Indeed, Social Security’s critics have been casting the same aspersions on the program for 75 years.

The interesting thing about all of these dire warnings of Social Security’s demise is just how exaggerated they have been. Prognosticators of Social Security’s impending doom are the political equivalent of Chicken Little and the falling sky. These chicken littles have created the mythology of fear surrounding Social Security. This fear has seeped into our collective conscience. Polls suggest that a majority of Americans do not expect to receive Social Security benefits when they retire.

Now let’s take a true measure of where we are. Social Security has not only been the most effective government program, it has been the most responsible government program. Social Security costs are funded out of its own dedicated revenue stream. It does not and cannot borrow money to finance its operations. There is no deficit financing. Social Security is the epitome of Yankee frugality. It could not be better managed. Social security returns more than 99 cents to beneficiaries on every dollar collected. I dare you to find a private retirement plan that can claim that.

By the end of calendar year 2009, the Social Security Trust Fund had a *positive* balance of \$2.54 trillion. Let me repeat: a *2.54 trillion dollar surplus*. *By some estimates, in 2010 that number grew to 2.6 trillion dollars*. It is estimated that Social Security revenues (including interest on the Trust Fund) will continue to exceed expenditures through 2024. As a result of interest earned on the Trust Fund balances, the Trust Fund surplus will continue to expand to an approximate \$4.3 trillion in 2023. After that year, it is projected that the balance in the Social Security Trust Fund will begin to decline. Still, reserves

will be sufficient to pay full benefits through the year 2037. After 2037, Social Security would still be able to pay for 76 percent of benefits.

Now since when is news that a program is completely solvent for 27 years bad news? Even in year 28 and thereafter it could still fund 3/4 of anticipated benefits. This is decidedly NOT a program that is broke, going broke, or won't be there when current contributors retire. In fact, this is quite a remarkable achievement.

I think if Americans really understood its true financial picture, those poll numbers suggesting people are not counting on Social Security would be reversed. Doubt would give way to confidence, fear to security.

The point is we don't have to make radical changes to the program to keep it working for future generations of Americans. That would be like overhauling a car engine when all we need to do is change the oil. We don't need to scrap a secure program of social insurance for a risky individual self-help scheme, as the slick salesmen of privatization keep trying to convince us.

What are the policy equivalents of oil changes that will keep the program running? There are a range of options, which alone or in combination can keep Social Security completely solvent almost into the next century. For example, increasing employee and employer contribution rates by 1.1 percent—from the current 6.2 percent to 7.3 percent—would eliminate the *entire* projected shortfall (i.e., provide 100 percent of benefits after the year 2037 through 2085).

We could eliminate the cap on wages subject to Social Security contributions. In 2010, only earnings up to \$106,800 are subject to FICA. In creating the cap, Congress intended to cover 90 percent of the aggregate wages of all workers. Today, because wages have been increasing faster than the cap—especially for the top five percent of wage earners—FICA is assessed on only 83 percent of aggregate wages. If we eliminated the cap, even if we counted all the increased earnings toward benefits, we would eliminate an estimated 95 percent of the shortfall. And, this change would impact only the top six percent of wage earners in this country.

We might also consider expanding the base of workers covered by Social Security. Almost all workers pay into the system, with the exception of about one-quarter of state and municipal government employees who are covered by alternative pension systems. In my home state of Massachusetts, for instance, almost 95 percent of state and local government workers do not pay into Social Security. If we extended Social Security to all newly-hired state and local employees over the next five years, the Special Committee on Aging estimates we would eliminate almost 10 percent of the projected deficit, while also eliminating another burden on state and local governments.

Former Social Security Commissioner Robert Ball—whose reasoned voice is one I dearly miss—and Nancy Altman have developed a plan that would keep Social Security running for at least another 3/4 of a century without cutting any benefits and not increasing the

FICA rate for approximately 19 out of 20 American workers. Their plan would gradually raise the cap to cover 90 percent of aggregate wages, as Congress intended. Again, this change would affect only a small proportion of the American public, and if phased in over the next 20 to 30 years, would have no discernible financial impact on them. Second, Ball-Altman would retain a residual estate tax at 2009 levels and dedicate those revenues to the Social Security system. The estate tax would affect only individuals with estates of more than \$3.5 million. Finally, they would allow Social Security gradually to invest some of its Trust Fund assets into equities to earn somewhat higher returns, just as other public and private pension plans do. While the private equity markets pose higher risks, the risk will not be borne by individuals (as in the privatization schemes). Since Social Security will be around for some time, the risks are mitigated by being spread over many more years.

I am not here to advocate for one solution or the other. What I am here to say is that there are many smart people who have figured out how we can make modest changes to Social Security that will keep benefits flowing to millions of American families for decades to come.

There are some ideas which we should oppose. First, we should absolutely oppose any cut in payment levels. Social Security pays only modest amounts to begin with. The average benefit check is around \$1,100. Cutting benefits would expose millions of Americans to financial distress—especially the 1/3 of elderly retirees who depend on Social Security for 90 percent or more of their income.

Second, we should not contemplate raising the retirement age at which workers can collect benefits, as many are proposing, unless we revamp the disability system under Social Security. Any change must account for occupational differences and requires more nuanced, analytical judgments about which people can reasonably be expected to work to a later age before collecting.

Without revamping the disability system to improve its efficiency as well as its scope, raising the eligibility age could create unacceptable hardship for whole groups of workers. Any reform must meet the twin demands of fiscal savings and equity.

The United States does not have a Social Security crisis. It never did. What we do have is the politics of fear. If we let our fears rule our judgment we will undo the greatest government program in our history, one that has eliminated poverty for millions of Americans and supported millions of families in times of need.

It is time to stop playing politics with Social Security. It is time to stop playing politics with the retirements of American workers. It is time to stop playing politics with the disability benefits millions of children and families rely on.

My grandfather led this nation through some of its darkest moments, the Great Depression and World War II—periods in our history when the characteristic courage of

Americans was most tested. He called on us to rise above our fears. America answered his call.

His generation and the generations that followed have built the most prosperous, the most powerful and the most generous nation in human history.

Social Security embodies my grandfather's determination to free us from fear by securing the American people against some of the "hazards and vicissitudes of life."

Questions for Mr. James Roosevelt, Jr.
Finance Committee Hearing
“Perspectives on Deficit Reduction: Social Security”
May 10, 2011

Question for the Record from Senator Baucus

1. Some people have suggested that Social Security benefits for future retirees be reduced. The premise for this view is that Social Security benefits are sufficiently large so that there is room for such reductions. I think that this premise is wrong. Aren't Social Security benefits already very modest and won't they continue to be modest in the future?

James Roosevelt, Jr.'s on the Record Response

Let me say strongly that Social Security benefits should not be cut in order to resolve the budget deficit, as they do not contribute in any way to causing the deficit. Particularly in difficult economic conditions, Social Security benefits serve as a lifeline for so many Americans. Without Social Security benefits almost half of Americans 65 and older would have incomes below the poverty level as most elderly beneficiaries rely on Social Security for the majority of their income. This fact goes right to heart of the basis for the creation of this important public policy. Let me again quote my grandfather on his vision for Social Security. “But we 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.”

According to public data, in 2010, nearly 53.4 million people, or about one in every six U.S. residents, collected Social Security benefits. While three-quarters received benefits as retirees or elderly widow(er)s, another 10 million (19 percent) received disability insurance benefits, and 2.3 million (4 percent) received benefits as young survivors of deceased workers. In 2010, the average Social Security retirement benefit was only \$1,170 per month or about \$14,000 annually.

Moreover, in the future benefits will increase only slightly. It should be noted that because the recession depressed consumer prices, there has been no cost of living adjustment in Social Security benefits since 2009. The next increase in the cost of living adjustment will be determined in October, for effect in 2012. Predictions range from 0.9 percent to 1.2 percent, which translate into a typical increase of \$10 to \$13 for the average Social Security recipient. I believe you could rightfully characterize this increase, as well as the current level of benefits, as modest.

Questions for the Record from Senator Hatch

1. This is a question for each member of the panel. Since the 1983 Social Security reforms, and until 2010, payroll taxes have exceeded benefit payments from the Social Security Trust Funds. By law, the surplus receipts have been invested in interest bearing, non-

marketable, special-issue government securities, which represent loans to the U.S. Treasury. At the end of 2010, the Trust Funds had assets of \$2.6 in US government debt instruments. When the Social Security Trust Funds invested the excess payroll taxes in U.S. Government debt, the Treasury placed the money in the general fund.

- (a) What did the Treasury do with the money received in exchange for the government securities?

James Roosevelt, Jr.'s on the Record Response

When Social Security receives U.S. Treasury bonds, as evidence of money lent to the general fund, the borrower, as with any other loan, determines uses of those funds. In this case, appropriations by the U.S. Congress make these determinations.

- (b) Where will Treasury get the money to repay the Social Security Trust Funds back when the Trust Funds need to redeem the securities to raise money to pay benefits?

James Roosevelt, Jr.'s on the Record Response

As U.S. Treasury bonds held by the Social Security Trust Fund reach maturity, they are redeemed from general revenues of the U.S. government, as are all other Treasury securities.

2. This is a question for each member of the panel. According to the Trustee Report issued in August 2010, Social Security program costs exceeded tax revenue in both 2010 and 2011 creating a deficit, and are expected to follow that trend again from 2015 onward until 2084, the end of the actuarial 75-year projection. Each year there is a deficit, the program covers the deficit with interest earned from the Treasury securities held by the Trust. That won't last forever, and I'd like the panel to address the question of when the Trust principal invested in U.S. Government debt securities will need to be tapped to cover the shortfall, assuming no changes in payroll taxes or benefits. Please update your answer, as appropriate, to reflect the information in the Trustees Report scheduled for publication on May 13, 2011.

James Roosevelt, Jr.'s on the Record Response

According to the Trustees' Report issued on May 13, 2011, the interest on the Social Security Trust Fund, together with ongoing FICA contributions will be sufficient to meet program costs until 2023. Under current actuarial projections, principal and interest in the Trust Fund together with ongoing FICA contributions will be sufficient to pay planned benefits until 2036.

COMMUNICATIONS



**STATEMENT FOR THE RECORD
SUBMITTED TO THE
SENATE FINANCE COMMITTEE**

Perspectives on Deficit Reduction: Social Security

May 10, 2011

**AARP
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Government Relations & Advocacy

On behalf of our members and all Americans age 50 and over, AARP appreciates the opportunity to submit written comments on the importance of Social Security's earned benefits and financing as part of the Committee's review of deficit reduction perspectives. AARP believes that the nation's long-term debt requires attention and we are committed to lending our support to a balanced approach that addresses the nation's long-term fiscal challenges. However, older Americans recognize that Social Security is a self-financed program that has run surpluses for nearly 30 years and has not contributed to our large deficits. Accordingly, they firmly believe that using the Social Security benefits Americans have earned to remedy a problem that Social Security did not create is simply unfair.

From surveys, town hall meetings, ongoing correspondence and numerous other interactions, we know older Americans are deeply concerned about the deficit and our nation's fiscal health. However, they also want to make certain the promises made to them regarding Social Security (as well as Medicare) -- which help them plan for and gain a measure of security in their retirement -- are kept both for them and for their children and grandchildren. Americans who have contributed payroll taxes over a lifetime of hard work into Social Security have earned their benefits, and the Trust Funds, like any other creditor, should be paid back the money it lent to the federal government in order to provide the workers who contributed a greater measure of financial security in their retirement years.

Social Security

Social Security benefits are financed through payroll contributions from employees and their employers, each and every year, throughout an individual's working life. The payroll contributions and benefits paid, including any administrative costs, are accounted for separately from the rest of the federal budget. Importantly, Social Security has not contributed to our large deficits.

To the contrary, Social Security has had cash surpluses each year for most of the past 30 years, taking in more in revenue than it has needed to pay benefits. These surpluses, generated by the payroll contributions made by the American people, have been used to meet other expenses of the federal government. In exchange for use of these surpluses, the federal government has issued Social Security U.S. Treasury bonds of equal value. That is, Social Security has reduced the past need for additional government borrowing from the public and resulted in a public debt that is less today than what it otherwise would have been.

Social Security reserves are invested in the safest investment in the world, U.S. Treasury bonds, which are backed by the full faith and credit of the United States government and have never been defaulted on in our history. The debt held by the Social Security Trust Funds is a real obligation of the United States to its own people, and the American people, like any other creditor, expect that the money borrowed from them by the government will

be paid back. If Congress chooses to not pay back the Trust Funds obligations and defaults on the U.S. Treasury bonds, then this will be a true "raid" on Social Security. However, honoring the full faith and credit of the United States is a core value of our country and fundamental to the economic security of all Americans, not just retirees.

According to the Social Security Trustees, the program has sufficient income from payroll contributions and assets in Treasury notes to pay 100 percent of promised benefits for over a quarter century, and even with no changes, can continue to pay approximately 75 percent of promised benefits thereafter. While Social Security faces this long-term shortfall, targeting it now for arbitrary, across-the-board cuts is unfair and unnecessary, and would most assuredly mean significant reductions in benefits for current beneficiaries, as well as for their children and grandchildren.

Older Americans truly understand that budgets matter and that we all need to live within our means. But they also understand that budgets impact real people – federal programs can make meaningful differences in peoples' lives and help ensure that older and disabled Americans can live independently and with dignity as they grow older. They also understand the difference between programs that have been contributed to and earned over the course of a lifetime of work and those that are not. For example, AARP generally opposes proposals that result in arbitrary, across-the-board, spending cuts that fail to distinguish between different types of spending and would take a meat ax approach to governing.

In this regard, we are opposed to subjecting Social Security to sequestration procedures that serve to enforce spending caps. Social Security is currently exempt from sequestration in statutory PAYGO, and was exempt from sequestration or other generalized budget cuts in Gramm-Rudman-Hollings. Social Security is also not subject to reconciliation instructions, which would otherwise permit changes to the Social Security program on a fast track and for the purpose of reducing deficits. These exemptions are consistent with the recommendations of the National Commission on Fiscal Responsibility and Reform, which explicitly noted that Social Security should be reformed "for its own sake, and not for deficit reduction." The Commission's view echoes that of the National Commission on Social Security Reform (also known as the Greenspan Commission), which stated in its report in 1983: "The National Commission believes that changes in the Social Security program should be made only for programmatic reasons, and not for purposes of balancing the budget." The policy of exempting Social Security from cuts to meet deficit reduction has stood for over a quarter century and we urge that this prudent and justifiable policy continue.

Social Security is currently the principal source of income for nearly two-thirds of older American households receiving benefits, and roughly one third of those households depend on Social Security benefits for nearly all (90 percent or more) of their income. Despite its critical importance, Social Security's earned benefits are modest, averaging

only about \$1,200 per month for all retired workers in March 2011. Nonetheless, Social Security keeps countless millions of older Americans out of poverty and allows tens of millions of Americans to live their retirement years independently, without fear of outliving their retirement income. Social Security also provides critical income protection for workers and their families who become disabled or deceased. Moreover, while personal savings should always play an important role in retirement planning, with the growing prevalence of 401(k) and other individual account plans and the decline in defined benefit pension plans, the guaranteed benefit of Social Security will become increasingly important to future generations as workers live longer and bear more of the market risk associated with investing for their own retirement.

Given the already modest benefits current Social Security beneficiaries receive, the program's continued critical importance to future generations' income and retirement security, the system's dedicated financing, and the lack of a contributory impact on our current large deficits, AARP firmly believes that Social Security should not be targeted for cuts for deficit reduction or as part of a budget exercise to satisfy arbitrary spending thresholds. More importantly, in the face of declining pensions, shrinking savings, falling home values, and longer life expectancies, Social Security deserves to have its own national conversation that focuses on preserving and strengthening the retirement security of Americans and their families for generations to come. AARP welcomes that conversation, and we have already begun a renewed effort to engage our members and other Americans on ways to strengthen Social Security now and in the future.

Conclusion

Today's older Americans have contributed a great deal to our society throughout their lives. They have helped to build our nation through employment, paying their taxes, raising families, and contributing to their communities as leaders, mentors, military service men and women, and volunteers. Millions of them are still very active members of their communities today – whether they are paid or unpaid – contributing countless hours to charitable efforts or helping to care for their friends and loved ones in their own homes.

On behalf of our millions of members nationwide and all older Americans, we appreciate the opportunity to share our views on this important debate. We urge Congress to not simply look at the numbers in the budget, but the real people that would be impacted by these budget-driven changes and enforcement mechanisms. We look forward to working with Members of this Committee, as well as Members from both Houses of Congress and both sides of the aisle, to craft legislation that will address our nation's long-term debt without sacrificing the current or future health and retirement security of our nation's seniors.

Comments for the Record

Perspectives on Deficit Reduction: Social Security

United States Senate Committee on Finance
Tuesday, May 10, 2011, 10:00 AM
215 Dirksen Senate Office Building

Submitted by:

Michael Bindner
Center for Fiscal Equity
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Chairman Baucus and Ranking Member Hatch

Thank you for this opportunity to provide comments to the Committee.

My comments are within the context of comprehensive tax reform, where the first 25 percent of personal income tax rates, the corporate income tax, unemployment insurance taxes, the Hospital Insurance payroll tax, the Disability Insurance payroll tax and the portion of the Survivors Insurance payroll tax funding survivors under the age of 60 have been subsumed by a Value Added Tax (VAT) and a Net Business Receipts Tax (where the net includes all value added, including wages and salaries).

Net income would be adjusted upward by the amount of the VAT percentage and an increased child tax credit of \$500 per child per month. This credit would replace the earned income tax credit, the exemption for children, the current child tax credit, the mortgage interest deduction and the property tax deduction. This will lead employers to decrease base wages generally so that the average family with children and at an average income level would see no change in wage, while wages would go up for lower income families with more children and down for high income earners without children.

Gross income would be adjusted by the amount of tax withholding transferred from the employee to the employer, after first adjusting net income to reflect the amount of tax benefits lost due to the end of the home mortgage and property tax deductions.

This shift in tax benefits is entirely paid for and it would not decrease the support provided in the tax code to the housing sector – although it would change the mix of support provided because the need for larger housing is the largest expense faced by growing families. Indeed, this reform will likely increase support for the housing sector, as there is some doubt in the community of tax analysts as to whether the home mortgage deduction impacted the purchase of housing, including second homes, by wealthier taxpayers.

The largest problem facing Social Security and the health care entitlements, Medicare and Medicaid, is the aging of the population. In the long term, the only solution for that aging is to provide a

decent income for every family through more generous tax benefits. The free market will not provide this support without such assistance, preferring instead to hire employees as cheaply as possible. Only an explicit subsidy for family size overcomes this market failure, leading to a reverse of the aging crisis.

Within twenty years, a larger number of children born translates into more workers, who in another decade will attain levels of productivity large enough to reverse the demographic time bomb faced by Social Security in the long term.

Such an approach is superior to proposals to enact personal savings accounts as an addition to Social Security, as such accounts implicitly rely on profits from overseas labor to fund the dividends required to fill the hole caused by the aging crisis. This approach cannot succeed, however, as newly industrialized workers always develop into consumers who demand more income, leaving less for dividends to finance American retirements. The answer must come from solving the demographic problem at home, rather than relying on development abroad.

This proposal will also reduce the need for poor families to resort to abortion services in the event of an unplanned pregnancy. Indeed, if state governments were to follow suit in increasing child tax benefits as part of coordinated tax reform, most family planning activities would be to increase, rather than prevent, pregnancy. It is my hope that this fact is not lost on the Pro-Life Community, who should score support for this plan as an essential vote in maintaining a perfect pro-life voter rating.

Obviously, this proposal would remove both the mortgage interest deduction and the property tax deduction from the mix of proposals for decreasing tax rates while reducing the deficit. This effectively ends the notion that deficit finance can be attained in the short and medium term through tax reforms where the base is broadened and rates are reduced. The only alternatives left are a generalized tax increase (which is probably necessary to finance future health care needs) and allowing tax rates for high income individuals to return to the levels already programmed in the law as of January 1, 2013. In this regard, gridlock is the friend of deficit reduction. Should the President show a willingness to let all rates rise to these levels, there is literally no way to force him to accept anything other than higher rates for the wealthy.

When Social Security was saved in the early 1980s, payroll taxes were increased to build up a Trust Fund for the retirement of the Baby Boom generation. The building of this allowed the government to use these revenues to finance current operations, allowing the President and his allies in Congress to honor their commitment to preserving the last increment of his signature tax cut.

This trust fund is now coming due, so it is entirely appropriate to rely on increased income tax revenue to redeem them. It would be entirely inappropriate to renege on these promises by further extending the retirement age, cutting promised Medicare benefits or by enacting an across the board increase to the OASI payroll tax as a way to subsidize current spending or tax cuts.

This is not to say that there is no room for reform in the Social Security program. Indeed, comprehensive tax reform at the very least requires calculating a new tax rate for the Old Age and Survivors Insurance program. My projection is that a 6.5% rate on net income for employees and employers (or 13% total) will collect about the same revenue as currently collected for these purposes, excluding sums paid through the proposed enhanced child tax credit. This calculation is, of course, subject to revision.

While these taxes could be merged into the net business income/revenue tax, VAT or the Fair Tax as others suggest, doing so makes it more complicated to enact personal retirement accounts. My proposal for such accounts differs from the plan offered in by either the Cato Institute or the Bush Commission (aka the President's Commission to Save Social Security). As I wrote in the January 2003 issue of *Labor and Corporate Governance*, I would equalize the employer contribution based on average income rather than personal income. I would also increase or eliminate the cap on contributions. The higher the income cap is raised, the more likely it is that personal retirement accounts are necessary.

A major strength of Social Security is its income redistribution function. I suspect that much of the support for personal accounts is to subvert that function – so any proposal for such accounts must move redistribution to account accumulation by equalizing the employer contribution.

I propose directing personal account investments to employer voting stock, rather than an index funds or any fund managed by outside brokers. There are no Index Fund billionaires (except those who operate them). People become rich by owning and controlling their own companies. Additionally, keeping funds in-house is the cheapest option administratively. I suspect it is even cheaper than the Social Security system – which operates at a much lower administrative cost than any defined contribution plan in existence.

Safety is, of course, a concern with personal accounts. Rather than diversifying through investment, however, I propose diversifying through insurance. A portion of the employer stock purchased would be traded to an insurance fund holding shares from all such employers. Additionally, any personal retirement accounts shifted from employee payroll taxes or from payroll taxes from non-corporate employers would go to this fund.

The insurance fund will serve as a safeguard against bad management. If a third of shares were held by the insurance fund than dissident employees holding 25.1% of the employee-held shares (16.7% of the total) could combine with the insurance fund held shares to fire management if the insurance fund agreed there was cause to do so. Such a fund would make sure no one loses money should their employer fail and would serve as a sword of Damocles' to keep management in line. This is in contrast to the Cato/ PCSSS approach, which would continue the trend of management accountable to no one. The other part of my proposal that does so is representative voting by occupation on corporate boards, with either professional or union personnel providing such representation.

The suggestions made here are much less complicated than the current mix of proposals to change bend points and make OASI more of a needs based program. If the personal account provisions are adopted, there is no need to address the question of the retirement age. Workers will retire when their dividend income is adequate to meet their retirement income needs, with or even without a separate Social Security program.

No other proposal for personal retirement accounts is appropriate. Personal accounts should not be used to develop a new income stream for investment advisors and stock traders. It should certainly not result in more "trust fund socialism" with management that is accountable to no cause but short term gain. Such management often ignores the long-term interests of American workers and leaves CEOs both over-paid and unaccountable to anyone but themselves.

Progressives should not run away from proposals to enact personal accounts. If the proposals above are used as conditions for enactment, I suspect that they won't have to. The investment sector will run away from them instead and will mobilize their constituency against them. Let us hope that by then workers become invested in the possibilities of reform.

Labor & Corporate Governance

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AN OWNERSHIP PERSPECTIVE ON SOCIAL SECURITY REFORM

BY MICHAEL BINDNER

The conventional wisdom among progressives regarding Social Security is that any privatization is to be avoided at all costs. In this month's LCG—the first of a two-part series—author Michael Bindner attempts to challenge the conventional wisdom of the political left surrounding Social Security privatization by highlighting how current reform proposals could in fact be used to advance a progressive ownership agenda for working Americans. The views expressed here are that of the author and do not necessarily reflect the opinion of PVS, its clients, or the AFL-CIO.

Setting the Stage for Political Debate

On December 21st, 2001, the President's Commission to Strengthen Social Security—chaired by former New York Senator Patrick Moynihan—released its recommendations in a report entitled *Strengthening Social Security and Creating Personal Wealth for All Americans*. The President's Commission called for a yearlong debate on retirement security, with no action until after the 2002 election cycle. During that year, the matter was briefly raised as an election issue, although by and large it was overshadowed by tax policy and the pending war.

In many Congressional races during the last election cycle, Republican candidates shied away from the President's proposals. Although the Republicans now have slim majorities in both chambers of Congress, the majority in the Senate is still less than 60 votes. This means that unilateral action by the Republicans will not be possible on this issue. If the President is serious about bringing private ownership to Social Security, he will have to modify his proposals to make them politically acceptable to labor and other constituencies.

Organized labor has two choices. The first is to stand firm against privatization and assure that nothing passes. The other is to seek modifications in the President's proposal to benefit organized labor. Modifications can be of two types. The first

type could improve the workability of any privatization plan, while the second can be considered a poison pill, which would ultimately make any legislation unpalatable for its original supporters. Whether an amendment is perfecting or a poison pill rests in the minds of the privatizers. My aim is to list possible improvements to make the proposal more acceptable to labor, although many on the right may consider them killing amendments. Ultimately, the fate of the recommendations of the President's Commission come down to the President's desire, or lack thereof, to compromise enough with organized labor and to force his own supporters to compromise.

Presidential Commission Recommendation

The commission's chief recommendation in the report was that some portion of Social Security tax revenue should be directed to personal retirement accounts. Funds for these accounts would be collected from employees and employers through the current payroll tax system. A federal Governing Board modeled after the federal Thrift Savings Plan and the Federal Reserve Board would manage the program. This design is meant to duplicate the low administrative costs of the current Social Security program, which it would augment. Part of the Board's charge will be to find ways to speed the reconciliation process between fund collection and the crediting of accounts, which can last well over a year.

Personal accounts would be invested in a two-tier system. Tier I will be managed by the Governing Board, who will contract management to multiple fund managers on a competitive basis. It will include three indexed balanced funds (conservative, medium, and growth) or any combination of five index funds patterned after the federal Thrift Savings Plan, as well as an inflation-protected bond fund. There will be a default standard fund for participants who do not make a fund choice. Private sector account managers will manage Tier II. Participants will be allowed to make Tier II investments after their funds have accumulated to a set amount. The Commission recommends that the private sector fund managers vote equity shares in both tiers, as is the case with the Thrift Savings Plan and private sector mutual funds. Clearly, this could have major implications for proxy voting down the road. Exactly how is too early to say.

If Organized Labor is willing to seek a compromise, a natural proposal would be to insist that the Personal Retirement Accounts created using Social Security funds be managed within the Taft Hartley system, rather than by investment managers operating independently under contract to the Governing Board proposed above. Of course, some may consider such a proposal a poison pill, though it need not be.

Three Models Being Proposed

Model One proposes that 2% of income be diverted to personal accounts, with no other changes to Social Security. Optional within this model is to transfer these funds from the General Fund rather than redirecting the funds from Social Security, or to combine the two approaches. Model Two redirects four percent of income to personal accounts, with a limit on accounts of \$1,000 in any given year. For long-term actuarial balance, benefits would be adjusted for price inflation, rather than for wage inflation – which means that retirees and disabled workers would lose purchasing power relative to workers, but not relative to prices. Model Three requires an additional employee contribution of 1% of income, to be matched by a diversion of 2.5% of

income up to \$1,000 (which means that higher wage workers can contribute quite a sum, even though the amount diverted from current payroll taxes is capped at a lower level). Because wealthier employees can contribute so much more, the “bend point” used to calculate benefits would be adjusted so that the benefit payout is less generous than it is currently. Additionally, inflation would be indexed to gains in life expectancy, which will result in annual growth of 0.5% over price inflation. Both Models Two and Three also include a guaranteed minimum benefit, which is linked to the poverty level.

The President’s Commission went to great pains to assure that distributional equity is maintained in Models Two and Three. While the sentiment is admirable, organized labor should insist that the outcome be even more progressive than the current program. A starting point in doing so is to recalculate how contributions are credited to American workers. Currently, the employer contribution is credited as a match to the employee contribution. Meanwhile, benefits are linked to average income. This perceived imbalance is a driving force behind the move to create private accounts, because wealthier taxpayers believe they do not receive nearly what they contribute.

Changing the way that accounts are credited will change this perception. The key lies in the way the employer match is calculated. Instead of basing the employer contribution on the employee contribution, credit each full-time worker at the firm at the average contribution for such workers in the nation as a whole. Part-time workers would be credited at a separate rate, at some percentage of the full-time rate based on the number of hours worked in the quarter. This result will bring contributions more in line with expected benefits. Even if organized labor opposes all of the President’s proposals, advocating this accounting change will be of great benefit to workers, as it will take much of the wind out of the sails of privatization advocates. Of course, my experience debating conservatives on this issue is that their major complaint with Social Security is not the involvement of the government, but the redistributional nature of the program itself.

especially as it impacts the upper middle class. Given this, such a proposal might also be a poison pill.

Alternative Solution: Establish ESOPs!

No provision is made in the Commission's recommendations for Employee Stock Ownership Plans, even voluntarily. Unlike the kind of "trust fund socialism" proposed by the President's Commission, the inclusion of an ESOP component would encourage employee productivity and may well provide that extra edge needed to overcome a part of the long-long term actuarial deficit in the nation's retirement system.

The Iowa Center for Fiscal Equity proposes that Personal Retirement Accounts include an ESOP option. To incorporate ESOPs, employer and employee contributions should be considered separately in funding personal accounts; with the employee contribution funding diversified personal accounts as proposed by the Commission. Under Model One, 1% of individual income would be transferred to personal accounts - or funded from the General Fund. Under Model

Two, 2% of income up to \$500 could be transferred to personal accounts. Under Model Three, after an additional 0.5% individual contribution, 1.25% of income up to \$500 could be transferred to personal accounts

The employer contribution could be paid to an ESOP, at the option of the employee, rather than to the government. Separate ESOPs should be established for each type of worker (union, professional, management) or each type of worker should be represented on the ESOP board (with union employees represented through the union). The amount contributed to the ESOP reflects the rebasing of the employer contribution on the average wage. Under Model One, the employer would contribute 1% of average income to the ESOP for each employee, regardless of wage, rather than contributing it to FICA. Under Model Two the employer contribution would be 2% of average income. Under Model Three, the employer would contribute an additional 0.5% of average income to the ESOP for each employee, as well as redirecting 1.25% from FICA. The following chart illustrates this breakdown.

Recommended	Model 1	Model 2	Model 3
Presidential Commission	2%*	4 % up to \$1000	1% additional contribution, 2.5 % up to \$1000
Employee Contribution	1% of personal income	2% of personal income up to \$500	0.5% additional contribution, 1.25% of personal income up to \$500
Employer Contribution	1% of average income	2% of average income	0.5% additional contribution of average income, 1.25 % of average income

**Percentages reflect amount of taxable income contributed to personal retirement accounts*

If increasing diversification is a goal (although there is nothing more diversified than an economy wide social insurance system), some portion of the employer contribution might be invested with the employee contribution, with the remainder going to the ESOP.

To prevent workers from losing their ESOP savings, some form of insurance for ESOP contributions in the manner that the FDIC insures

deposits should be created. Such an insurance plan would provide the safety net required to protect workers against bad actors and might include a regulatory component for added security. Eventually, contributions (not share value) to 401(k) accounts might also be insured.

Average income can be calculated in different ways for the purposes of the employer contribution. Different averages can be credited

for full-time and part-time workers. The average can be for the firm or for the economy at-large. If a firm average is used, contract and temporary workers should be included in the average for the client firm. If the national average is used, the amount paid into FICA by the firm should be adjusted so that the total cost to the firm of the employer contribution is the same percentage of payroll as the current obligation.

Employer contributions based on average income would be a change in the way most ESOPs distribute shares to their employees, as the common method is as a percentage of income. In my experience as an ESOP employee-owner, the current practice is demoralizing to lower salaried junior employees, causing retention problems. The effect of longevity should be enough to reward higher salaried employees and to provide them with enough control over the operation of the firm. Adding a differential based on wage is a perceived double hit on equity as seen by these employees. Additionally, the awarding of an equal number of shares each pay period to each employee prevents the kind of incentives found at Enron, especially if the award of additional shares are limited to rewarding results rather than salary level and are distributed to an entire work team. This development will also benefit workers, especially the rank and file.

Investing private account funds in ESOPs provides for a more direct avenue of investment in plant and equipment, rather than encouraging stock speculation and subsidizing mutual fund managers. It gives the employees of the firm an ownership incentive and long-term protection against layoffs, provided that employees also have the appropriate voice in the leadership of the firm, through their elected union representatives where applicable.

Forging Ahead

Labor organizations should seriously consider the President's proposals if doing so means a debate on union representation on corporate and ESOP boards, a long held demand of organized labor. The enactment of such structure might also encourage Union pension funds to convert a

portion of their assets from diversified ownership to ESOP participation in the firms at which their members are employed (which I will address in my next article).

The final question addressed here is the shortfall in the Social Security system and how it might be funded. The existence of both private accounts and the ESOP option makes a discussion of raising or abolishing the income cap on contributions more palatable, as such an increase will raise the average income which can be invested in the ESOP trust fund. Higher percentage contributions would also be more acceptable to both employees and employers, provided that a portion of these increases goes to the personal and ESOP retirement accounts.

For progressives, increasing the income cap is more palatable than subsidizing Social Security privatization using the general fund. The President's Commission has recommended in two of its plans that this shortfall be paid out from the General Fund and that benefits be cut by changing the way inflation is calculated (making retirees foot the bill). When the General Fund is tapped for this purpose, either income tax rates must be raised or debt increased. Increases in the debt draw money from the same demographic as income taxes or increased payroll taxes, though the wealthy would much rather lend their money and receive interest than to have it confiscated. If the wealthy must be taxed, most seem to prefer income taxes so that they can attempt to shelter some or all of the money.

No matter how you slice it, however, upper income individuals will fund the difference. Assuring that they do so in a way which does not mortgage our children's future is one area where organized labor can be effective in exacting concessions, although more than any other provision, insisting on higher payroll taxes may be considered a poison pill. How the White House and the Republican leadership in Congress respond to such proposals will be key to judging how seriously they are pursuing the creation of Personal Retirement Accounts.



**Statement for the Record by Max Richtman, Executive Vice-President and Acting
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United States Senate Committee on Finance

Hearing on Perspectives of Deficit Reduction: Social Security

May 10, 2011

On behalf of the millions of members and supporters of the National Committee to Preserve Social Security and Medicare, I am writing to provide the Senate Finance Committee with our views on the relationship between debt reduction and Social Security.

As Executive Vice-President and Acting CEO of the National Committee, I represent over 3 million members and supporters from all over the United States, all walks of life and all political persuasions. Within that diversity, our membership finds unity in a shared passion for Social Security and Medicare, the twin pillars of our nation's retirement security.

Before turning to a discussion of the relationship between the nation's debt and Social Security, I would like to briefly describe the Social Security program. Today, Social Security is a vital source of income to 54 million Americans, including 90 percent of America's seniors. Throughout its 75 year history, Social Security has proven time and again that it is a program upon which the American people can rely.

Although it was never intended to be a retiree's sole source of income, today one in three seniors relies on Social Security for more than 90 percent of his or her income, and 6 in 10 rely on Social Security for more than half of their income. The benefits they receive are hardly generous. The average Social Security benefit for a retiree is about \$14,000 a year, while for women it is about \$12,000. If not for Social Security, about half of today's seniors would be living in poverty—approximately the same percentage of the population that lived in poverty before Social Security was created during the Great Depression.

But Social Security provides far more than retirement benefits. It is a social insurance program that provides essential protection whenever an individual is no longer able to work, whether as a result of retirement, disability or death. In discussing Social

Security, its role of helping children sometime goes unmentioned. In fact, about 6 million children receive part of their family income from Social Security.

I have taken time to describe the current Social Security program so that we all see clearly the vital role it plays in the lives of virtually all Americans. With that in mind, I would like to turn now to the relationship between Social Security and the federal debt.

Of course, the members of the National Committee are concerned about the national debt. We all agree that steps need to be taken to bring spending and revenue more closely into balance. In considering how this might be achieved, we believe it is important to recognize that the Social Security program has not been the cause of that debt. By law, Social Security lacks the authority to add to the federal deficit. Because it has no independent borrowing authority, Social Security can pay benefits only if its payroll tax revenue and trust funds have the financial resources required to pay them.

So, what does Social Security's financing look like today, and how is the picture projected to change in the future? Let's start by looking at the program's balance sheet for 2011. The Social Security Board of Trustees issue a report each year on the status of the program, and the following numbers are from its 2011 report.

First, there is a revenue stream that comes from the contributions paid into the program by some 157 million workers and their employers. Usually, employees contribute 6.2 percent of their wages, up to a taxable maximum of \$106, 800, with employers matching their employees' contributions.¹ The total of their contributions, including those of the self-employed, are projected to be about \$670 billion in 2011².

The second source of income to the program comes in the form of income taxes paid by Social Security beneficiaries on the portion of their benefits that are subject to income taxation. The Social Security trustees estimate that these revenues will produce income to the trust funds in 2011 of about \$23 billion.

The remaining source of income is interest payments on the assets held in the trust funds. Currently, the trust funds hold treasury obligations, or bonds, valued at about \$2.6 trillion. These bonds earn interest, which is deposited periodically into the trust funds. The total amount of interest that will be earned by the trust funds in 2011 is estimated to be about \$115 billion.

Added together, these three sources of income are estimated to equal about \$808 billion. How does that match up against the trust funds' total obligations for 2011? These obligations, including benefits and administrative costs, are projected to be approximately \$738 billion, about \$69 billion less than the trust funds' total income for the year. That surplus will be deposited into the trust funds, which are projected to

¹ Due to this year's "payroll tax holiday," employees will contribute 4.2 percent of their wages to Social Security in 2011.

² This total is projected payroll and self-employment tax receipts augmented by the projected amount required to make the trust funds whole because of the "payroll tax holiday."

continue to grow until they peak in 2022 at a projected \$3.7 trillion with no changes in the law. In subsequent years, these assets will be “drawn down” to pay benefits; by 2036, the trust funds are projected to be exhausted. However, the program will still have revenue in 2036 that will equal about 77 percent of the benefits owed in that year.

As the foregoing demonstrates, the Social Security program is adequately funded today and will continue to be adequately funded for many years into the future. It’s not “going broke”; to the contrary, it has surplus revenues that will continue for many years to be invested in treasury securities that, by law, are backed by the full faith and credit of the United States.

To conclude, the National Committee to Preserve Social Security and Medicare agrees that the financial soundness of the Social Security program needs to be strengthened so that Americans can continue to rely on its protections and benefits now and in the future. There are many different options for strengthening this vital program, and developing a consensus remains a challenge that must be met by the nation’s leaders. But as the foregoing review of Social Security’s current finances reveals, we have time to develop that consensus. We do not need to try to do so during these challenging economic times when the more appropriate focus for elected officials should be job creation and the deficit.

