STATEMENT OF THE HONORABLE MARK J. WARSHAWSKY TO THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON SOCIAL SECURITY, HEARING ON SOCIAL SECURITY'S FINANCES, JUNE 23, 2011

Chairman Johnson and Ranking Member Becerra and Members of the Subcommittee on Social Security, my name is Mark Warshawsky. I am a Member of the Social Security Advisory Board and formerly was Assistant Secretary for Economic Policy at the Treasury Department where I had oversight responsibility for the preparation of the Trustees Reports and analysis of Social Security reform proposals. Today I am not speaking on behalf of the Advisory Board or any other organization. Rather, my statement today is based on my research and insights gained from years of analysis of Social Security and public finance.

I would like to congratulate you for holding this hearing discussing the revenue options for Social Security reform. As the recent Trustee Report shows, the program's financial status has worsened, both in the short- and long-term. Social Security is now running large and soon-to-be rapidly growing cash flow deficits, adding to the federal debt outstanding held by the public and to the budget deficit of the federal government. The day is steadily drawing closer when benefits, by law, will have to be cut – indeed for disabled beneficiaries and their families, this is projected to occur in seven years. I believe that doing nothing to solve the program's financial problems also has negative consequences for the economy right now. When consumers, investors, and other economic decision-makers see that we as a body politic cannot make progress on well-known, long-standing and large fiscal problems, it creates uncertainty and saps the confidence needed for both small and large businesses to create jobs and make productivity-enhancing investments.

It is good that we are now discussing more actively options to strengthen Social Security and it is promising that many groups and individuals and legislators have put forward specific proposals. At the same time, not all provisions in all reform proposals are good policy. For example, there are proposals coming from the deficit reduction commissions and elsewhere to increase Social Security payroll taxes substantially by increasing the contribution and benefit base. In particular, the commissions propose to increase the Social Security contribution and benefit base (taxable maximum) by an additional 2 percent each year, starting in 2012, until 90 percent of total earnings of the labor force are taxable. The actuary has indicated that these increases are expected for 38 years, that is, through 2049. If the increase to reach 90 percent of total earnings taxed were done in one step in 2012, the taxable maximum would be about $215,000, up from $106,800 today. This is a very large tax increase on about 10 million of our most productive workers. Almost 99 percent of workers would then be subject to Social Security taxation on all of their earnings, up from about 94.5 percent today.

This proposed provision is a bad idea for at least four reasons in addition to the general ill effects of tax increases: it unfairly targets a specific segment of the population that has not seen particularly large gains in earnings, it is an extra burden in addition to the new taxes imposed on this and other groups to finance Medicare and in the recent health care legislation to finance health insurance coverage for poor and middle-income households, it will cut private retirement savings, and it represents an unnecessary expansion of the Social Security program. Let me explain each reason, in turn, in more detail.

Those who advocate an increase in the taxable maximum have stated that their goal is to have 90 percent of total earnings of the labor force subject to Social Security taxation. This "taxable coverage" ratio has fluctuated over the history of the program, from a low of 71.3 percent in 1965 to a high of 90.0 percent in 1983; most recently, in 2009, it was 85.7 percent. The use of this ratio for policy design seems arbitrary. It may actually be, however, a manifestation of a deeper concern by advocates arising from the widely discussed research claim that a shift has occurred over the last four or more decades in the distribution of income and earnings toward higher-paid workers and tax units and households, that is, that the share of earnings going to the top percentiles of workers and household units has increased.[1] Therefore advocates want to use tax and other government policies to change the impact of what they view as less social equity. Some analysts have questioned the relevance of the statistics of this research claim has been made, because it ignores the shift in resources toward the poor and middle-class that has come in the form of increased spending on employer- and government-provided health insurance coverage, and for many other methodological issues.[2] Nonetheless let's take the claim as true and relevant for the sake of argument.

But then consider another study that focuses on the wages of most private sector workers ages 25 to 60 over time – it finds that the increase in inequality has slowed since the late 1980s and that the vast majority of the increase for the top 20 percent of workers since 1980 is due to the surge in earnings within the top percentile, that is, the 1 percent of workers now earning more than $215,000.[3] Indeed, looking at wage statistics from the Social Security Administration, I estimate that the group of workers in about the same segment of the earnings distribution equivalent to those earning from $106,800 to $215,000 in 2009 has experienced a smaller gain in their relative share of total earnings since 1990 than those earning above $215,000. And, of course, the first, more modestly paid, group is much larger in number than the second, very high-paid, group, so the rate of wage increases for the first group is lower than for the second group. Using SSA statistics, for example, I estimate that workers and self-employed individuals earning at the 95th percentile saw their earnings increase about 30 percent from 1999 to 2006, but those earning at the 99.95th percentile saw their earnings increase over 35 percent. Punishing the first group with a much bigger tax increase than the second group would be quite unfair.[4]

Many of the workers earning above $106,800 are in their early 50s at the peak of their earnings profiles, after years of hard work at lower wages, supporting growing children and perhaps a low-earning or non-working spouse. These workers have also been hit hard in recent years by rapidly rising health care and

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[1] See Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913-1998," *Quarterly Journal of Economics*, February 2003, pp. 1 – 39, with updates through 2007 on Professor Saez' website.
[2] See Richard V. Burkhauser and Kosali I. Simon, "Measuring the Impact of Health Insurance on Levels and Trends in Inequality," NBER Working Paper No. 15811, March 2010.
[3] See Wojciech Kopczuk, Emmanuel Saez, and Jae Song, "Earnings Inequality and Mobility in the United States: Evidence from Social Security Data Since 1937," *Quarterly Journal of Economics*, February 2010, pp. 91 – 128.
[4] Even under current law, the asymmetric pattern of earnings growth leads to an unfairness -- the increase in earnings at the very top of the distribution is included in the average wage index which increases the taxable maximum automatically, but workers with earnings just around and above the maximum have gotten lower wage increases than those at the very top. This unfairness could be fixed by relating the average wage index just to the earnings of those in the lower percentiles below the 94.5th of the earnings distribution.

education costs, without the assistance and relief given to lower-paid workers and retirees in the recent health law and other legislation.

The second reason why an increase in the taxable maximum is bad policy is that workers in this segment and above of the earnings distribution are already bearing significant increases in payroll taxes and are scheduled for further increases soon. In 1991, the earnings cap for Medicare Health Insurance (HI) payroll taxes was increased, and in 1994, it was lifted entirely. So these workers already have seen a significant payroll tax increase of 2.9 percent of earnings. Moreover, under the new health care law, an additional HI payroll tax of 0.9 percent will be collected from workers with earnings over $200,000 for single filers and $250,000 for joint filers, effective for taxable years after December 31, 2012. These earnings thresholds are not indexed and hence many of the workers to be hit by this HI tax rate increase will be the same individuals to be hit by the proposed increase in the Social Security taxable maximum. In addition, there is a new tax of 3.8 percent on unearned income of individuals with modified adjusted gross income above $250,000 (in the case of a joint return) or $200,000 (in the case of a single filer return). On top, of course, a progressive income tax structure exists at the federal level and in most states and localities.

The third reason for opposition to the proposal to increase in the taxable maximum is that will reduce private retirement savings. Using a comprehensive retirement planning model for some illustrative household situations, a colleague and I have found that an individual now earning just above $106,800 would reduce her optimal retirement savings by about 4 percent.[5] Of course, upper-income households contribute more than proportionately to aggregate household savings for the nation and therefore this decline in savings, when added up across 10 million workers, will mean much less in domestic sources of investment capital. The reason for the decline is quite simple – the higher payroll tax provision takes an increasingly large share of earnings for these workers over time and their standard of living declines. As a result, they have fewer resources with which to save for their retirement.

Finally, an increase in the Social Security contribution and benefit base represents an unnecessary expansion of the Social Security program, in at least three senses. First, it is unnecessary because upper-income workers have many other methods of saving for their retirement, whether through employer plans or individual savings vehicles, and do not need or want Social Security beyond a base retirement benefit related to their earnings. Second, Social Security is already a progressively designed program, and making it more of a welfare program will reduce its political support. In the third sense, an increase in the taxable maximum is unnecessary because there are fairer and better ways of bringing Social Security to permanent solvency, with no payroll tax increase, which involve changes in several aspects of the program affecting different groups that together add up to sustainability.[6]

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[5] See Gaobo Pang and Mark Warshawsky, "Implications of Some Deficit Reduction Proposals for Retirement Savings," *Benefits Quarterly*, forthcoming.

[6] In 2008, I put forward such a proposal, scored by the Social Security actuary as sustainably solvent; see http://www.ssa.gov/OACT/solvency/Warshawsky_20080917.pdf. Since then, I have worked with Congressional staff to update and refine a proposal based on these ideas and would be glad to continue to do so.

In summary, strengthening Social Security is necessary now, not in future years. Increasing the taxable maximum as part of an overall reform package, however, would be unfair, burdensome, inefficient and unnecessary.