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Committee on Ways and Means
U.S. House of Representatives
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Questions for the Record
June 3, 2011 Hearing
Answers of Charles Blahous

1. The Trustees' make projections for the next 75 years and even beyond. How confident are you that these projections will hold given our uncertain economic future?

The further out in time one projects, the greater the range of quantitative uncertainty surrounding the projections. That said, while the precise size of Social Security's financing shortfall is uncertain, the existence and basic contours of that shortfall are relatively certain, as is the desirability of acting sooner rather than later to address it. These basic contours are defined primarily by substantial program cost growth (relative to the tax base) that is projected to continue from now through the mid-2030s.

The qualitative certainty of the shortfall derives from the fact that most of the factors producing it are already in evidence. Cost growth through 2035 is primarily a consequence of a rapid decline in the ratio of workers to beneficiaries as the Baby Boomers enter their retirement years. These projections are not likely to change in a qualitative way, as the Boomers have already begun to claim retirement benefits, the number of taxpaying workers to which they gave birth is now reasonably well established, and most of these Boomers' own Social Security benefits have already accrued. Indeed, a fuller analysis of the components of Social Security's total structural shortfall, published in the Trustees' report, demonstrates that the entirety of it is attributable to an imbalance of benefits and contributions with respect to individuals who have already entered the Social Security system (see Table IV.B7).

A stochastic analysis published with the Trustees' annual report reveals that in 95% of projection scenarios in which economic and demographic assumptions are permitted to fluctuate, the combined Trust Funds would be depleted at some point between 2030 and 2049. If any of these possible scenarios prove accurate, we would be well advised to enact financial corrections today.

Over the years, various suggestions have been developed to ward against inevitable projection uncertainty. Some have suggested that benefit and tax schedules be crafted with automatic adjustments to restore financial balance if projections turn out to be wrong. Others have suggested that Congress implement a periodic review procedure facilitating expedited legislative action if imbalance has resurfaced. It is also worth noting that in 1983 negotiators agreed upon ground rules requiring that their solution preserve near-term solvency under both the Trustees' intermediate and alternative "high-cost" projection scenarios.

> 2. As a percentage of the Gross Domestic Product, Social Security's shortfall is 0.7%. Does this mean that the problem is small and something that we can wait to address, since it is not a large number in the context of the United States' economy?

No. Though when viewed from some perspectives the problem may appear small, it is not small from the perspective of individual participants, particularly if action is further delayed. Were resolution of the shortfall postponed until 2036, then under current projections either benefits must be reduced by 23%, or taxes on workers increased by 30%. Neither beneficiaries nor workers would be likely to regard these as small changes to their quality of life. Indeed, there is no precedent in Social Security history for enacting sudden austerity measures of this magnitude. Understood in its proper context, the Social Security shortfall is already so large that further delays in its resolution will threaten the program's continued efficacy and political support.

> 3. Some argue that Social Security has remained largely self-financed through workers' hard-earned payroll taxes. However over this year and next year, $114 billion in general revenue transfers will compensate Social Security for the temporary payroll tax reduction signed into law last year. What is the history of general revenue transfers to Social Security? What are the implications of growing general revenue transfers in terms of Social Security's status as a self-financed program?

For most of Social Security's history general revenue financing has remained controversial and has generally been avoided, notwithstanding this year's general revenue transfers as well as some temporary general revenue financing during the program's funding crisis in the early 1980s.

Historical opposition to general revenue financing is based on Social Security's depiction before the public as a contributory insurance program, in which benefits are earned directly through a dedicated, separate stream of worker contributions. To the extent that Social Security is subsidized by general revenues, we undermine this historical foundation for program financing and render accounting conventions such as separate Social Security Trust Funds less meaningful.

This is one reason why President Clinton's otherwise-divided 1994-96 Advisory Council unanimously agreed that "Social Security should be financed by taxes on workers' earnings, along with taxes paid by employers, earmarked taxes on benefits, and interest earnings on accumulated reserves, without other payments from the general revenue of the Treasury." As the Council further noted, "The method of financing Social Security entirely by dedicated taxes has given the system considerable protection from having to compete against other programs in the general budget." General revenue financing is incompatible with such protections.

> 4. Is it true that initial benefits are rising over time so that today's retirees are receiving larger benefits than their parents in real terms? How has benefit growth changed over time? What are the options for slowing the growth of benefits while protecting lower earners?

Yes. A typical medium-wage retiree retiring at the normal retirement age today expects an annual benefit of roughly $18,000. Thirty years ago, such a medium-wage retiree would expect a benefit of about $15,000 in today's dollars. Thirty years before that, a medium-wage retiree expected a benefit of about $5,000 in today's dollars, though much of the increase since then is attributable to a series of legislated *ad hoc* benefit increases.

Social Security's initial benefit formula is automatically adjusted each year for growth in the national Average Wage Index (AWI). This formula would provide a medium-wage retiree retiring at NRA in 2050 an annual benefit of roughly $29,000 in today's dollars. This rise in per-capita benefits is one reason (in combination with demographics and the program's financing structure) why Social Security costs are projected to rise so rapidly as a percentage of the tax base.

Early in its history, Social Security benefits were not automatically increased by statutory indexation. This meant that the program became more affordable as economic growth increased the program's tax base. This phenomenon in turn afforded the opportunity for legislators to repeatedly increase benefits and to reap political gains for doing so. In 1972, however, an ambitious benefit expansion took place that brought this era to an end: benefits were increased 20%, automatic COLAs were added for those already in retirement, and benefits for new retirees were inadvertently indexed to grow so quickly that they would ultimately have exceeded workers' pre-retirement wage income. This flawed 1972 formula was later phased out in the 1977 amendments, leaving us with the basic form of wage-indexing of initial benefits that we have today.

There are a number of options for slowing the growth of benefits while protecting lower earners. Provisions to do so can be thought of being in one of two "families." In one family of plans, initial benefits for low earners would continue to grow with wage inflation while initial benefits for higher earners grow more slowly, for example with price inflation. Benefits for those with wage incomes in between would grow according to a sliding scale based on a blend of wage and price inflation. An advantage of this approach is that it ensures that all workers receive benefits that grow as rapidly as price inflation, with the poorest workers benefiting from the most rapid growth. A disadvantage is that at first the savings accrue very slowly, perhaps too slowly to achieve desired cost-savings before all the Baby Boomers have retired.

Under the second family of plans, the numbers in the benefit formula are simply changed to achieve a desired distribution of benefits. This can be done to preserve (or even increase) benefits on the lower-income end, while targeting the effects of cost restraints on higher wage levels and on such birth cohorts as policy makers desire. One advantage of this approach is that it allows for greater precision in the targeting of benefits and the timing of savings. A possible disadvantage is that it would be clear that the formula reflected discretionary choices by lawmakers rather than a "neutral" method of re-indexing.

Under both approaches, it is likely that further measures would be needed to attain sustainable solvency, such as changing eligibility ages or increasing revenue collections.

> 5. For the period 1983 through 2009, revenues outpaced outlays resulting in annual surpluses, but these surpluses were spent by Washington and replaced with Treasury bonds or IOUs. In your research, what did you find regarding whether the Congress intended to create these surpluses in the 1983 reform?

There is substantial evidence that Congress did not deliberately intend to create these surpluses in the 1983 reforms.

First, there is the contemporary testimony of individuals associated with the effort. Legislators such as Congressman Jake Pickle and Senator Daniel P. Moynihan, as well as Greenspan Commission Executive Director Robert Myers, stated that the intention was to continue with an essentially pay-as-you-go system. When later the surpluses began to appear, some of these individuals (notably Moynihan and Myers) supported legislative action to eliminate them.

Second, the process did not facilitate either the Greenspan Commission or Congress performing an analysis showing that solvency would be predicated on such a substantial Trust Fund buildup. The Greenspan Commission did not unite around a complete solvency plan, and thus could not analyze such a plan's effects on annual Trust Fund balances. Instead, the Commission reported a partial solvency solution and presented *options* to Congress for getting the rest of the way to long-term solvency. Greenspan Commission memoranda showed the effects of individual provisions upon annual program operations over the short term, but only upon an "average" actuarial balance over the long term.

Third, much of the surplus was created not by the 1983 reforms themselves but by the provisions of previous legislation. This can be substantiated by examining annual projections for the 1990s and 2000s as estimated in earlier Trustees' reports.

Finally – and I believe, most compellingly – the Greenspan Commission and Congress relied upon a measure of long-term actuarial balance that is inconsistent with the concept of a large Trust Fund buildup. That actuarial method implicitly assumed that future benefits would be paid by taxing future wages, and did not include the carryover balance of assets in the Trust Fund. This is clearly not the method policy makers would have used if they intended to rely upon the buildup and drawdown of a large Trust Fund to finance future benefits. The current method, which does count the assets of the Trust Fund in the actuarial balance calculations, was not adopted until the 1988 Trustees' Report.

> 6. In 2036, Social Security's revenues will cover only 77% of promised benefits. Since beneficiaries are entitled to 100% of their benefits, what would happen in 2037 if nothing was done? Would Social Security's ability to pay individual beneficiaries each year diminish over time?

There is some legal uncertainty about what specifically would happen if the Trust Funds are depleted. The Social Security Act stipulates that benefits are paid from the Social Security Trust Funds. Accordingly, many have concluded that if a Trust Fund is depleted, benefit payments would have to be delayed until incoming tax revenues again produced a positive Trust Fund balance.

This would in effect cause a reduction in Social Security benefits through the mechanism of delay; in 2036, only 77% of total payments could be made based on the level of incoming tax revenues, with the Social Security Administration having to repeatedly wait until sufficient tax revenues had arrived in order to resume payments. Others have theorized that the Social Security Commissioner may have more flexibility to allocate reductions among beneficiaries, but the theory that SSA would simply have to wait to send out the payments is a fairly common interpretation.

Yes, Social Security's ability to pay benefits would diminish over time. Under current projections, 77% of benefits could be paid in 2036, declining to 74% later in the long-range valuation period.

> 7. In your testimony, you supported action sooner rather than later to address Social Security's financing shortfalls. Please describe the combination of options which will best address the shortfall.

The following are my own subjective opinions, and do not represent the views of the Social Security Trustees.

I would support progressive cost-saving changes to the bend point factors in the benefit formula. A new bend point could be established within the 32% bend point factor region, with the 32% and 15% factors phased downward above that new bend point. I would advocate fully phasing in such changes over 30 or 40 years, to be effective to the extent practicable within the period of most rapid projected cost growth.

I would support gradually raising the early eligibility and normal retirement ages in tandem so that the age of earliest claim is returned to 65 as it was at Social Security's inception. I would support continuing to index these eligibility ages afterward for changes in life expectancy.

I would support steepening the actuarial penalty for early retirement claims and increasing the reward for delayed retirement claims, to adjust for the expected value of payroll tax contributions workers typically make when they postpone their claims to benefits. This would both improve Social Security finances and reward continued work by seniors. I would also support offering the delayed retirement credit with a lump sum option, to make it more attractive to workers.

I would support replacing the current "PIA" formula, which is based on average lifetime earnings, with a "mini-PIA" formula that applies to each year of covered earnings. This would ensure that seniors continue to receive proportional value for their Social Security contributions if they extend their working careers, unlike the current formula in which returns generally diminish the longer one works. This would also improve Social Security finances while redistributing some system resources from intermittent high-earners to steady low-wage workers.

I would support eliminating the earnings limit above Early Eligibility Age, to remove a work disincentive.

I would support capping the growth of the non-working spouse benefit, so that it does not exceed the inflation-adjusted value of the benefit that a minimum wage worker can currently earn over a full working lifetime of contributions. This would improve system finances, distributional equities and work incentives.

I would also support, in the right context, a strengthened special minimum benefit that protects lower earners from poverty in old age. I believe that such a benefit is best designed so that it phases upward with the number of years worked, for example from 28 to 38 years. This formulation could help to target the benefits on those of greatest need while also preserving work incentives. I would not however support such a benefit expansion in the absence of action to render Social Security's finances genuinely sustainable.