February 25, 2015 Hearing Record

Questions for the Record

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<u>Questions from Chairman Sam Johnson:</u>

Q1: *Some have argued that since the 1995 Trustees Report estimated the Disability Insurance (DI) Trust Fund would deplete its reserves in 2016, the situation we are facing today should come as no surprise. Have the Trustees consistently projected that the DI Trust Fund would face exhaustion in 2016?*

A1: The projected date of the DI Trust Fund reserves' depletion has varied with the year the estimates were made. The currently projected year of depletion (2016) matches the projection from the preceding two trustees' reports as well as, as the question notes, the 1995 report. However, there have been other intervening trustees' reports projecting longer durations for positive balances in the DI Trust Fund. For example, the fund's projected reserve depletion date ranged from 2025 to 2029 in the 2001-08 annual trustees' reports. The projected DI depletion date moved much closer after the Great Recession simultaneously produced an increase in benefit claims and a decrease in program revenues.

It is fair to say it is not a surprise that the DI Trust Fund is facing depletion sooner than the OASI Trust Fund or the theoretical combined OASDI trust funds, though the DI financing crisis is now more immediate than was anticipated prior to the Great Recession. As noted during the February 25 hearing, it has long been expected that under current law DI would face depletion sooner than OASI because the large baby boom generation would pass through its years of peak disability incidence before reaching retirement age. Also as noted during the hearing, the current allocation of taxes between OASI and DI was set to provide "time and opportunity to design and implement substantive reforms that can lead to long-term financial sustainability." In 1993 testimony about the proposed reallocation later enacted in 1994, the public trustees noted that reallocation would enable the DI Trust Fund to meet their 10-year test of "short-run financial adequacy," permitting more than enough time to enact needed financing reforms before depletion. As witness Ed Lorenzen noted at this year's February 25 hearing, the trustees' initial recommendation for reallocation was also accompanied by a warning against further reallocations that "could raise concerns about the financial viability of the OASI program." Summarizing, further reallocation of taxes between OASI and DI in the absence of long-needed financing reforms would be counter to the trustees' expressed intent in recommending the current allocation enacted in 1994.

Q2: *In your testimony you noted that the 1994 payroll tax reallocation between the DI and Old-Age and Survivors (OASI) Trust Funds was an outlier, and that lawmakers have usually paired reallocation with other reforms to Social Security. As we consider how to ensure DI benefits continue to be paid in 2016 and beyond, what lessons should Congress take away from the experience of the 1994 reallocation?*

A2: The 1994 reallocation exemplifies the problems that can arise from using tax reallocations to postpone needed financing reforms. Historically lawmakers had stepped forward to make tough decisions to slow program cost growth and shore up system finances whenever projected trust fund reserve depletion had become imminent. Because in 1994 it was felt there was insufficient analysis to inform structural reforms to DI, lawmakers reallocated taxes between the Social Security trust funds to buy additional time. The result was that the needed reforms were never enacted, and now Social Security as a whole is in much weaker financial condition than it would have been had reforms not been postponed via tax reallocation. As explained during the hearing, this is not a mistake lawmakers can afford to make again if Social Security's historical financing structure is to be maintained.

Questions from Representative Tom Reed:

Q3: *The DI Trust Fund will be depleted in late 2016. I cosponsored Chairman Johnson's rule as part of the House Rules package to bring attention to and address this important issue before us. If the House were to waive the rule, what would be the repercussions?*

A3: Waiving the House rule would remove a procedural barrier to reallocating funds between the OASI and DI trust funds in the absence of action to strengthen the finances of Social Security as a whole. Such action would increase the risk that necessary financing reforms would be further postponed to the point that Social Security's historical financing structure is severely jeopardized. On the other hand, upholding the rule would mean that any such reallocation of funds must occur in the context of legislation strengthening Social Security's overall finances, in keeping with most historical precedent and rendering benefits more secure.

Answers to Questions for the Record
United States House of Representative Committee on Ways and Means
Subcommittee on Social Security
Hearing on "Maintaining the Disability Insurance Trust Fund's Solvency"
February 25, 2015

Questions from The Honorable Sam Johnson

1. In your testimony you noted that 1994 payroll tax reallocation between the Disability Insurance (DI) and Old-Age and Survivors Insurance (OASI) Trust Funds was an outlier, and that lawmakers have usually paired reallocation with other reforms to Social Security. As we consider how to ensure DI benefits continue to be paid in 2016 and beyond, what lessons should Congress take away from the experience of the 1994 reallocation?

The 1994 reallocation was an outlier in that it provided for a permanent shift in revenues to DI that was not accompanied by other reforms to the program. The only other "clean" reallocation was a temporary reallocation enacted in 1980, which was limited to one year with the stated purpose of keeping pressure on Congress to address the underlying shortfall facing the trust fund.

The 1994 reallocation was designed by the Social Security Trustees as a short-term fix to give policymakers time to address the underlying financial imbalance in OASDI. The letters recommending the reallocation and other statements by the Trustees emphasized the need for subsequent action to address the imbalance between revenues and spending. The Trustees reiterated this point in their 1995 report after the reallocation:

> *"The condition of the Disability Insurance Trust Fund is more troublesome. While the Congress acted this past year to restore its short-term financial balance, this necessary action should be viewed as only providing time and opportunity to design and implement substantive reforms that can lead to long-term financial stability."* [i]

However, because the 1994 reallocation enacted was sufficient to delay depletion of the DI trust fund for over twenty years, there was no urgency for Congress to heed the advice of the Trustees to restore long-term financial stability of the trust fund. In contrast to the temporary reallocation in 1980 and the subsequent limited inter-fund borrowing authority preceding the 1983 reforms, extending solvency of the combined trust fund when borrowing authority was about to expire, the 1994 reallocation was followed by twenty years of inaction.

The main lesson from the 1994 reallocation is when the pressure for action is lifted reallocation delaying trust fund depletion without addressing the underlying imbalances, policymakers avoid action until confronted by the next crisis. The experience following the 1994 reallocation suggests that if Congress enacts a reallocation of payroll taxes sufficient to prevent depletion of the DI trust fund to 2033, as the President has proposed, there will be no action taken to address the shortfalls facing the Social Security program. As a result, in twenty years we could find ourselves facing the imminent insolvency of the combined OASDI fund.

The cost of waiting for comprehensive Social Security reform is high. With every year that passes, the policy choices that will be necessary to fully address the long-term shortfall become more painful and disruptive. In twenty years, the only options left to restore solvency will be extremely high tax increases, deep and immediate reductions in benefits for current as well as new beneficiaries, or general revenue bailouts of the OASDI trust fund, which would fundamentally change the nature of Social Security's financing and place tremendous pressure on the rest of the federal budget.

There are several key differences between 1994 and today which weaken the case for a clean reallocation shifting revenues from OASI to DI and magnify the risks of repeating the experience with the 1994 reallocation. The early 90's shortfall in the DI trust fund was unexpected and due to factors that were not understood, which led the Trustees to recommend reallocation in order to provide time for policymakers to gain a better understanding of the growth of the program and determine what changes to make. In contrast, the current projected depletion of the DI trust fund has been anticipated for over twenty years. Second, DI faced an actuarial shortfall in 1994 that was four times larger than the OASI shortfall in relative terms. Today OASI faces a slightly larger shortfall in relative terms, so reallocating revenues away from OASI would make the larger shortfall worse. Most significantly, in 1994 OASI depletion was projected to be forty years away, whereas OASI is currently projected to be depleted in twenty years. We cannot afford to delay reforms for another twenty years.

Given the growing strains on the OASI program and the consequences of delaying action to address them, Congress should view the imminent depletion of the DI trust fund as a warning about the need to enact comprehensive Social Security reform to put the entire system on a financially stable course. Absent comprehensive reform, reallocation should only cover the shortfalls in the SSDI trust fund for a limited period of time to keep pressure to address the underlying shortfalls with a process that will facilitate action on comprehensive reform. It should also be accompanied by reforms improving overall trust fund solvency, making improvements to the DI program, and testing options for further reform.

2. *Some have argued that reallocation is a routine procedure, and that the need to reallocate revenues to the DI Trust Fund around this time was expected the last time Congress*

reallocated payroll taxes between the trust funds in 1994. Do you agree with that assessment?

When the Trustees initially recommended the 1994 reallocation they were uncertain whether the growth in the DI program would continue. They suggested that and the reallocation could be reversed if the growth in program enrollment subsided and the finances of the DI trust fund might be stronger than they projected. In any event, the Trustees clearly viewed the reallocation as a short-term solution to address the immediate crisis that would need to be followed up with further action by Congress to address the structural imbalance between spending and revenues if costs continued to grow as projected.

The Trustees recommendations, which Congress adopted without change, were specifically designed to ensure short-term fiscal adequacy (a trust fund ratio of 100 percent for the next ten years). The Trustees explained this would provide time to study the causes for the growth in DI enrollment and to design reforms to address the structural imbalance between spending and revenues. It is not surprising that a reallocation designed to maintain a trust fund ratio of 100 percent for ten years left the trust fund on course to be depleted in slightly over twenty years.

The fact that DI depletion was expected to occur absent further action, however, does not mean that the Trustees intended a further reallocation in 2016 unaccompanied by reforms. Indeed, when the Trustees recommended the 1994 reallocation they warned that further reallocations could endanger the financial health of OASI. In a 1992 letter to Congress the Trustees wrote:

> *"In recommending a reallocation of the tax rate to meet the DI Trust Fund's near-term shortfall, we recognize that future legislation may be necessary to further raise the DI tax rate or lower program expenditures. A further reallocation from OASI would raise ultimately raise concern about the financial viability of the retirement and survivors program."*[ii]

The imminent depletion of the trust fund reserves and the subsequent 19 percent reduction in benefits is a crisis. But that crisis has been looming for twenty years because of the lack of action to restore long-term sustainability to DI. Enacting a further reallocation of payroll taxes without taking action to address the program's structural shortfalls would completely ignore the intentions and warnings of the Social Security Trustees who recommended the 1994 reallocation.

3. *In your testimony you discussed the need to bring DI Trust Fund revenues in line with its costs. The President's Fiscal Year 2016 budget includes a proposal to increase the DI payroll tax rate to 2.7 percent and reduce the OASI payroll tax rate to 9.7 percent for five years. Does the President's proposal bring revenues in line with costs?*

The proposed reallocation of payroll taxes in the President's budget would extend the solvency of the combined DI Fund to 2033 but would not change overall revenues or spending, leaving the projected shortfall facing the combined OASDI trust fund unchanged.

Under the President's proposed reallocation, DI revenues would be almost 22 percent of OASDI payroll tax revenues for the next five years, much higher than the program's share of outlays. Currently, the DI program's share of revenues is roughly the same as its share of costs. The DI tax rate of 1.8 percent collects about 15 percent of OASDI payroll tax revenues, while DI will also comprise 15 percent of OASDI outlays over the next five years.

The President's budget would do little to improve Social Security's finances or address the underlying imbalance facing the Trust Fund. The major exception is the President's support for immigration reform, which, depending on the details, could reduce the 75-year shortfall by 5 to 10 percent. Still, by bringing in new workers who will eventually be paid Social Security benefits, immigration reform would primarily delay the day of reckoning and buy time for other reforms to be phased in – not replace the need to enact such reforms.

The budget does include several proposals which would make modest changes in the DI program, including mandatory funding for Continuing Disability Reviews, which the Office of Management and Budget (OMB) estimates would achieve savings in Social Security of $9 billion over the next decade and greater amounts beyond that period. It also proposes limiting the concurrent receipt of DI and unemployment insurance benefits, a few program integrity measures that achieve savings in the Social Security system as a whole, and provisions that would increase revenues into the Social Security trust fund.

The proposals in the President's budget would reduce Social Security spending by $14 billion and increase revenues by $46 billion over ten years. These savings would improve OASDI solvency, but by a very small amount. It is also worth noting that the budget does not suggest these savings should accompany reallocation legislation. In fact, it calls on Congress to enact a clean reallocation of payroll taxes without other changes to the program that improve its finances.

In his fiscal year 2014 budget, the President proposed a shift to chained-CPI for calculating Social Security COLAs along with provisions to protect low income and vulnerable populations. The 2014 proposal would have closed roughly one-fifth of the long-term shortfall facing Social Security. However, that proposal was dropped from his fiscal year 2015 budget and was not included in the fiscal year 2016 budget either.

4. *Is the President's reallocation proposal the largest shift in payroll taxes between the DI and the OASI funds ever? Has the DI payroll tax ever been as high as the President has proposed?*

The President's proposal would increase the share of the payroll tax going to DI by 50 percent, from 1.8 percent of payroll to 2.7 percent of payroll for the next five years. That would be the largest shift in payroll taxes in absolute terms – and it matches the highest percentage increase – since the two trust funds were created. In comparison, the reallocation in the 1983 Social Security reform act increased the share of payroll taxes going to OASI by roughly 10 percent, from 10.2 percent of payroll to 11.2 percent, from 1990 to 1999; and the 1994 reallocation increased the payroll taxes going to DI by 50 percent, from 1.2 percent of payroll to 1.8 percent.

However, because the proposed reallocation in payroll taxes in the President's budget would only be in place for five years, the total shift in payroll taxes over the ten and seventy five year estimating windows would not be as large as the amount of revenues shifted as a result of the 1994 reallocation of payroll tax rates which permanently reallocated DI and OASI tax rates. The total amount of the proposed transfer in the President's budget would equal roughly 0.08 percent of payroll over seventy five years, compared to a reallocation of 0.40 percent of payroll over seventy five years as a result of the 1994 reallocation.

The reallocation proposed by the President would increase the DI payroll tax rate to 2.7 percent, the highest DI payroll tax rate since the enactment of the program. The highest the DI payroll tax rate has ever been is 1.88 percent, the level it was at from 1994 to 1996 before dropping to the current 1.8 percent rate. In addition, the President's proposal would result in DI taking a much greater share of the total OASDI tax rate than it ever has before. Under the President's proposal, the DI tax rate would represent nearly 22 percent of the total OASDI tax rate, up from 14.5 percent of the total tax rate today and well above the previous high of 15.3 percent of total OASDI tax rate.

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[i] Social Security Board of Trustees, Summary of the *1995 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, April 3, 1995, http://www.ssa.gov/history/pdf/1995.pdf.

[ii] Social Security Board of Trustees, Letter to Congress accompanying Department of Health and Human Services, *The Social Security Disability Insurance Program: An Analysis,* December 16, 1992.