

1. The suggestion was made during the hearing that the Chief Actuary of the Social Security Administration was the author of the Trustees Report. Please clarify for us – who authors the report? What is the role of the Chief Actuary?

The authors of the Trustees Report, pursuant to the Social Security Act, are the six members of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds. The individual Trustees include the Secretary of the Treasury, the Secretary of Health and Human Services, the Secretary of Labor, the Commissioner of the Social Security Administration (or those acting in these capacities), and two members of the public who may not be from the same political party. The Chief Actuary authors an actuarial opinion provided with the report, “certifying that the techniques and methodologies used are generally accepted within the actuarial profession and that the assumptions and cost estimates used are reasonable.”

In practice the Trustees rely heavily upon the expertise of the Social Security Administration Chief Actuary in developing the assumptions and methods underlying the actuarial estimates, though the final decisions regarding financial projections, as well as other contents of the report, are made by the Board of Trustees.

2. According to the 2014 Social Security Trustees Report, the Disability Insurance (DI) program will be unable to pay full benefits in 2016. At a recent Senate Finance Committee hearing on the DI program there was discussion regarding reallocating payroll tax revenues from the Old-Age and Survivors (OASI) Trust Fund to the DI Trust Fund. In your view, is such a reallocation – unaccompanied by other reforms – the right course of action? How does the current situation differ from the last time Congress reallocated payroll taxes between the two funds?

A reallocation of payroll tax revenues between the Social Security trust funds, if unaccompanied by other reforms, would not be an optimal course of action for the simple reason that substantial further delays in enacting comprehensive reforms to strengthen Social Security finances are not in the best interests of the program or its participants. A reallocation of payroll tax revenues would be problematic if its purpose and effect were to facilitate such continued delays. That said a temporary reallocation of payroll tax revenues warrants consideration in the context of comprehensive reforms, especially given the short time available for reforms to produce significant cost savings before DI trust fund depletion is projected to occur in 2016.

The current situation is different from the last time lawmakers reallocated payroll taxes in that the DI trust fund is not currently in weaker long-term condition than the OASI trust fund. OASI currently faces the larger long-term deficit in both absolute and relative terms (2.55% of taxable payroll, compared with 0.33% for DI); DI faces the earlier trust fund depletion date largely because the baby boomers are moving through their years of peak disability incidence before reaching retirement age. Thus, the DI fund's projected depletion date of 2016 is a manifestation of financing strains affecting both sides of Social Security, warranting comprehensive reforms to the program as a whole rather than reflecting a need for DI to receive a larger share of the payroll tax relative to OASI.

In 1994, the last time payroll taxes were reallocated, lawmakers faced a different situation. At that time the projected 75-year income rate for OASI was fully 8.25 times higher than for DI, even though the ratio of the two funds' projected costs over 75 years was only 6.35. Given their respective cost rates, a tax reallocation was then necessary to place OASI and DI in a comparable long-term financial condition.

3. Congress has also previously authorized borrowing between the OASI and DI Trust Funds, known as interfund borrowing. What are the differences between reallocation and interfund borrowing and is there a preferred approach in your view?

There are advantages and disadvantages to each approach. Interfund borrowing might be relatively more applicable to the current situation, in that it reflects the underlying reality that the more immediate strain on DI is temporary and is in the process of shifting to the OASI fund, whereas a tax reallocation might be more appropriate if DI faced a lasting need for greater revenues relative to OASI. On the other hand, one could argue that interfund borrowing is less transparent to program participants than a tax reallocation. More important than the distinctions between these two options is that neither should be pursued as a means of delaying needed legislation to shore up the finances of Social Security as a whole.

4. Previous editions of the Trustees Report included a presentation of replacement rates; however, this presentation was changed in the 2014 report. How was the presentation changed and why did the trustees make this change?

The presentation of illustrative benefit levels was changed to provide more data with greater transparency to readers, to enable readers to make desired comparisons more easily, and to prevent misunderstandings that had arisen as a result of presentations in recent reports. The 1989-2000 trustees' reports had contained comparisons of hypothetical workers' benefits with their final annual

pre-retirement earnings levels. These calculations were removed in the 2001 report in part because those hypothetical workers' patterns of annual earnings growth were not reflective of real-world experience. In 2002 a more refined calculation was adopted in which the hypothetical workers' annual earnings evolved according to national trends with respect to both employment earnings as well as the probability of employment at different ages. At the same time, however, the method of comparing benefits to earnings was changed; the calculation no longer compared the illustrative benefit level to that specific worker's pre-retirement earnings, but in effect to the earnings of a younger worker still in the workforce (deemed comparable by virtue of being at the same relative place on the wage spectrum as the original worker) at the time the benefit was paid. However, because the column was still labeled "percent of earnings," many readers misconstrued the calculations in the 2002-13 reports as reflecting a pre-retirement earnings replacement rate in the same manner as the 1989-2000 reports.

In this year's report the trustees expanded the information in this table to provide more explicit information to readers and to prevent misreading of the data. One important addition was a column providing the national average wage index (AWI) in 2014 dollars, which can now be cross-referenced with information in the footnotes to enable readers to calculate career-average earnings for the various hypothetical workers retiring in any of the years shown. Because there is no universally agreed-upon method for calculating replacement rates, the trustees have not suggested that any particular comparison between the data in the table provides the best means of doing so. However, the updated table's additional information enables readers to make the comparisons that they wish. For example, if readers wish to compare the benefits of a retiree with the earnings of workers in the surrounding workforce, as was done in the trustees' reports from 2002-13, this comparison can be made. If on the other hand readers wish to determine how much income a retiree's benefit replaces relative to wages when that individual was still working -- whether at mid-career, at peak earnings ages, or other comparison points -- this can be done as well. By presenting all of the pertinent information more transparently, we have sought to enable readers to make the comparisons that they wish to, without mistaking one calculation for another as had often occurred with previous versions of the table.

5. Please describe the differences between measuring Social Security's unfunded obligations over 75 years and over the infinite horizon, both of which are included in the Trustees Report. What are the advantages and disadvantages of using each measure?

Each of the two measures referenced in this question compares the projected magnitudes of program costs to program income, one measure summarizing over the next 75 years, the other over all time going forward. A critical disadvantage of the measure truncated after 75 years (or after any limited time frame) is that it understates financial imbalances for a program financed in the manner of Social Security. The reason for this is that each cohort's payroll tax contributions are mostly spent immediately on current benefit obligations to older participants, while at the same time creating new entitlements to

benefits that will not be paid out until a future date. Thus any limited time window will count many years of payroll taxes contributed by several birth cohorts, but not the benefits earned by those same payroll tax contributions, thereby understating total costs relative to income. This is one reason why Social Security's 75-year unfunded obligation of \$10.6 trillion (in present value or PV) falls considerably short of its infinite horizon unfunded obligation of \$24.9 trillion (PV), which does not suffer from this problem. On the other hand the infinite horizon measure has the disadvantage that "the degree of uncertainty" in the calculations "increases substantially for years further in the future," as noted in our report.

A third measure that does not suffer from either disadvantage described above is to calculate all benefits obligated and revenues contributed for a defined set of birth cohorts. For example, Table VI.F2 in our report shows that the unfunded obligations for all current and past participants in Social Security equal \$25.5 trillion (PV), a figure that does not require calculations over the infinite horizon. However, this figure also has shortcomings, in that this \$25.5 trillion shortfall will not be manifested immediately or even over the next 75 years, because the incoming payroll taxes of younger generations will arrive to offset near-term imbalances before those younger generations' benefits must be paid.

In sum, there is no flawless measure of the Social Security financing shortfall, and each measure presented in our report suffers from its own unique limitations. Examining multiple measures of the shortfall provides a fuller picture of program finances than any single one provides by itself.

6. In her testimony, Ms. Entmacher suggested that income inequality has been a primary driver of Social Security's financing shortfall. Do you agree with this conclusion?

Social Security's long-term (75-year) financing shortfall was last closed in the 1983 program amendments. The financing shortfall that has emerged since has done so for reasons mostly unrelated to income inequality. According to an analysis provided by the Office of the Actuary of the Social Security Administration, <http://www.socialsecurity.gov/OACT/NOTES/ran8/index.html>, 63% of the current shortfall is attributable simply to the passage of time since the 1983 amendments were passed. In essence, the 1983 reforms did not place the program on a sustainable long-term trajectory, achieving balance on average by offsetting near-term surpluses against long-term deficits. As time has passed, the trustees' 75-year valuation window has shifted and more of those predictable long-term deficits have appeared within it. Thus the largest component of the current shortfall derives from the fact that in 1983 benefits and tax obligations were left on a course that would have been unsustainable over the long term even with no subsequent changes in income inequality.

Another 24% of the worsening that created the current shortfall is attributable to changes in disability data and assumptions since 1983, the vast majority of that deterioration occurring in the first decade after the 1983 amendments, during which time disability award policies were changed. Another 31% of the decline is attributable to changes in economic data and assumptions (together, these three categories account for more than 100% of the deterioration because changes in demographic assumptions and other methods cut slightly in the other direction).

Most of the decline arising from updated economic data and assumptions is a result of changes made in the 1988-94 reports, including correcting overly-optimistic assumptions that had been made for average real wage growth in the 1983 projections. Adjustments were also made during 1988-94 to lower previous estimates for labor force participation as well as the ratio of taxable to total earnings, these adjustments reflecting updated profiles for the disabled and immigrant populations respectively. A piece of these adjustments was related to unequal income growth around the cap on taxable wages but this has reflected a lesser portion of the overall economic data adjustments, and is much smaller than the structural imbalance between scheduled benefits and revenues that would have caused most of the current shortfall even if there had been no such income growth differential.

7. The Treasury securities in the trust funds accrue interest. Interest used to pay benefits is paid from general revenues, yet many say that Social Security has no impact on the federal budget. How does Social Security affect the federal budget and the deficit?

Social Security places pressure on the federal budget and adds to the unified federal deficit in years when program expenditures exceed dedicated Social Security revenues generated from sources external to the federal government, as has been the case since 2010. As noted in this year's report, Social Security's deficit of tax income relative to cost was \$76 billion in 2013, and in 2014 this deficit is projected to be approximately \$80 billion. The Social Security trust funds also receive payments of interest from the general government fund. Interest payments add to the balance of the trust funds though they do not reduce the unified budget deficit. Thus, interest payments to the trust funds are appropriately included when assessing the Social Security trust funds' balance and their ability to finance benefit payments, but not when assessing Social Security's impact on the federal deficit.

8. As you noted in your testimony, the combined Social Security trust funds will be depleted in 2033, yet that doesn't mean we have 19 years to fix the problem. What is the cost of each year of delay?

Certain costs can be quantified by illustrating how the magnitudes of required changes increase with each year of inaction. For example, a solution enacted today consisting of benefit changes only affecting new beneficiaries would require a nearly 21% reduction in their scheduled benefits, whereas by 2033 even a 100% elimination of scheduled benefits for new claimants would be insufficient to restore program finances. This is suggestive that each year of delay would on average add at least a 4 percentage point benefit reduction to a solution consisting solely of benefit changes for those newly coming onto the rolls. These percentage reductions would be less if applied to those already receiving benefits, but historically lawmakers have been disinclined to do so.

As a practical matter, the cost of delay are greater than this because further delay increases the risks that our political system will be unable to broker a solution preserving Social Security's historical financing structure. It is already the case that a long-term solution today would require a compromise in which the political left and right must accept an outcome that imposes roughly twice as much in both benefit restraints and tax increases as were enacted with great controversy in 1983. There is no assurance that such a plan can be agreed to, which further delay makes even more severe. If such legislation cannot be enacted, then Social Security's historical financing structure must likely give way to a new one in which the program is permanently financed from the general fund. Historically programs financed from general funds have tended to experience greater changeability in benefits, including more sudden changes in eligibility rules and the application of means-tests. The cost of such a decline in the security of Social Security benefits is unquantifiable.

9. Some have criticized the idea of using the chained Consumer Price Index (CPI) to determine Social Security's cost of living adjustments. What are your views on the chained CPI?

Whether chained CPI is used as the basis for cost of living adjustments should be a function of whether lawmakers conclude that it provides the best available estimate of general price inflation. Cost of living adjustments should not be crafted with an eye toward fulfilling a particular distributional goal, or with the intent of capturing the unique purchasing patterns of particular subgroups of the population. Social Security recipients come in all ages, are of both sexes, and live in all regions of the nation; the historical purpose of the cost of living adjustment is solely to capture general economy-wide price inflation rather than to provide some recipients with larger cost of living adjustments than others. Distributional goals are best pursued through Social Security's benefit formula, and should be consistent with the tax levels that lawmakers are willing to assess on participants.