

THE 2011 ANNUAL REPORT OF THE SOCIAL SECURITY BOARD OF TRUSTEES

HEARING BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY OF THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED TWELFTH CONGRESS FIRST SESSION

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FRIDAY, JUNE 3, 2011

U. S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:07 a.m., in Room B-318, Rayburn House Office Building, the Honorable Sam Johnson [chairman of the subcommittee] presiding.
[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Chairman Johnson Announces Hearing on the 2011 Annual Report of the Social Security Board of Trustees

Friday, May 27, 2011

U.S. Congressman Sam Johnson (R-TX), Chairman of the House Committee on Ways and Means Subcommittee on Social Security announced today that the Subcommittee will hold an oversight hearing on the findings in the 2011 Annual Report of the Social Security Board of Trustees. **The hearing will take place on Friday, June 3, 2011 in B-318 Rayburn House Office Building, beginning at 9:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

The Board of Trustees of the Federal Old-Age and Survivors Insurance (OASI) and the Federal Disability Insurance (DI) Trust Funds was established under the Social Security Act to oversee the financial operations of the OASDI Trust Funds.

The Board is comprised of six members, four of whom serve by virtue of their positions in the Federal Government (the Secretary of the Treasury (who also serves as Managing Trustee), the Secretary of Labor, the Secretary of Health and Human Services, and the Commissioner of Social Security) and two members of the public who are appointed by the President and confirmed by the Senate.

The Social Security Act requires that the Board, among other duties, report annually to the Congress on the financial status of the OASI and DI Trust Funds. The overview section of the 2011 report concluded, "Under the long-range intermediate assumptions, annual cost for the OASDI program is projected to exceed non-interest income in 2011 and remain higher through the remainder of the long-range period. The combined OASI and DI Trust Funds are expected to increase through 2022, and then to decline and become exhausted and unable to pay scheduled benefits in full on a timely basis in 2036. However, the DI Trust Fund is projected to become exhausted in 2018, so legislative action will be needed as soon as possible."

The report also projected that the reserves held in the trust funds would reach nearly \$2.7 trillion by the end of 2011. The U.S. Treasury bonds held by the trust funds, which are backed by the full faith and credit of the U.S. government, will be used to supplement current income through 2036. However, since no funds have been set aside to redeem these bonds, doing so will require the Federal Government to raise taxes, cut spending, or borrow more. Thereafter, in the absence of intervening Congressional action or changes in projections, the Trustees project that incoming revenues would be sufficient to pay only three-quarters of scheduled benefits.

The Trustees concluded, "Social Security will play a critical role in the lives of 56 million beneficiaries and 158 million covered workers and their families in 2011. With informed discussion, creative thinking, and timely legislative action, Social Security can continue to protect future generations."

In announcing the hearing, Chairman Sam Johnson (R-TX) stated, **“This year’s annual report again sounds the alarm that Social Security will be unable to keep its promises to the hard-working Americans who pay into the system. Americans want, need and deserve a Social Security program they can count on and a fact-based conversation about how to get there. This hearing will begin that conversation.**

FOCUS OF THE HEARING:

The hearing will focus on the findings in the recently released 2011 Annual Report of the Board of Trustees of the OASDI Trust Funds, the effect of the trust fund’s current cash flow deficit status and future exhaustion, and the cost of delaying actions to address Social Security’s fiscal challenges for workers and beneficiaries.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select “Hearings.” Select the hearing for which you would like to submit, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, **by the close of business on Friday, June 23, 2011.** Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721 or (202) 225–3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://www.waysandmeans.house.gov/>.

Chairman JOHNSON. The committee will come to order.

I want to thank our witnesses for being here today. And just know that we appreciate what you all do.

You know, for over 75 years, Social Security has relied on the strong work ethic of American workers paying part of their hard-earned wages for promise of future benefits should they retire, become disabled, or die. You are going to get money when you die.

Seniors, those with disabilities, widows, and their families count on these benefits to be there for them. Yet, according to the recently released annual report of the Social Security Board of Trustees—and, Doctor, I think you have spoken on this already—unless we act, Social Security won't be able to keep its promises.

For example, Social Security's disability insurance program will be unable to pay full benefits in 2018. Let's face it, the program is almost broke right now. In addition, by 2036, tax income will cover only 77 percent of benefits. The average monthly benefit for a retired worker today is only about \$1,175, a potential cut of about \$270. And that is real money, especially for those that are on a fixed income.

According to the trustees, Social Security is already running permanent cash flow deficits. As a result, Social Security must rely on general revenue to pay back, with interest, Social Security surpluses—with interest—do you hear that? We have been lying to ourselves for a long time.

Over the next 10 years, Social Security's cash shortfall will reach \$416 billion. And to pay its debt to Social Security in these times of record deficits and debt, the Treasury is going to need to borrow more. And we are at our debt limit, aren't we? We do so at our own economic peril.

Today, the U.S. borrows 40 cents for every dollar it spends, a good amount of which comes from the Chinese, and sends the bill to our children and grandchildren. The bottom line is that China and other foreign governments are also financing our Social Security program.

Families are right to be worried about the country's economic future. We face great challenges. But I believe in the greatness of this country we call America. We need to make sure this program is safe, secure, and sustainable. And let's be clear: Current and near retirees deserve the peace of mind of knowing they will get their promised retirement benefits. We are paying into it; we need to give them back what they have done.

At the same time, though, we have a responsibility to ensure that Social Security will be there for younger workers. At the end of the day, Americans want, need, and deserve a Social Security program they can count on and a fact-based conversation about how to get there.

I look forward to beginning that conversation today, and thank our two witnesses for the testimony we are about to hear.

With that, I will recognize my famous "companionero," Mr. Becerra, the ranking Democrat.

Mr. BECERRA. Mr. Chairman, thank you very much for holding this hearing.

Let me begin first, Mr. Chairman, by disagreeing with you. Social Security is not broke. The trustees report for 2011 shows that

Social Security is once again the reliable workhorse in our economy. Social Security has weathered 13 recessions in the last 75 years, and never once—let me repeat—never once failed to pay, on time and in full, every retiree, widow, child, or disabled worker the benefits they have earned.

Even through the Bush recession, the worst economic upheaval since the Great Depression where 8 million Americans lost their jobs and 6.7 million Americans lost their homes, the Social Security surplus continued to grow.

The Bush recession has hit American families hard. From June 2007 to the beginning of 2009, it stripped Americans of a total of \$19.4 trillion in household wealth. To put that in perspective, the Bush recession, by itself, took from Americans enough wealth to wash away the Nation's entire debt and still leave America with a \$5 trillion-plus surplus. The average family saw its wealth—the value of its home, retirement, and other savings and investments—drop by \$40,000, more than 25 percent of their total net worth. In contrast—oh, by the way, families who own stock, they saw their portfolio of stock drop by more than a third.

In contrast, Social Security remains strong, and the surplus is real. Social Security and seniors didn't cause the current deficit. Indeed, Social Security has never—I repeat, never—added a single cent to the Nation's debt.

The trust fund's income from tax revenues and interest on the U.S. Treasury bonds that it owns is more than what is being paid today in benefits. So Social Security will run a surplus of \$69 billion in 2011. At the end of 2011, the Social Security Trust Fund will hold \$2.7 trillion in U.S. Treasury bonds. And the trustees project that the balance will continue to grow until 2022, when it reaches \$3.7 trillion.

In addition to payroll contributions, the trust fund earns interest on the Treasury bonds—the interest is real—on Treasury bonds purchased with workers' contributions. Over its lifetime, Social Security has so far collected \$15.5 trillion and paid out a total of \$12.8 trillion in benefits and administrative costs. Do the math. Americans have built up a \$2.5 trillion surplus in their trust fund.

The Treasury bonds held by the trust fund are real, and, just like all other bonds held by Treasury that have been issued over the last several years, they have real value. American workers know that their Social Security contributions are real. They see the amount deducted from their paychecks every week.

In the long term, in about a quarter century, Social Security does face a shortfall. But this is a manageable challenge. The trustees report looks at Social Security solvency 75 years into the future. This gives Congress the ability to carefully consider how best to improve and strengthen Social Security for future generations.

The cost of Social Security's shortfall, which begins around 2036, would be reduced, for example, by allowing the Bush tax cuts for the wealthiest 2 percent of Americans to expire. And we know how important Social Security has been to so many of our seniors who, today, do not live in poverty.

Mr. Chairman, I appreciate that we are holding this hearing on Social Security's long-term outlook. However, as you know, the Social Security Administration has a more immediate need, which is

to ensure that it can get beneficiaries their Social Security benefits today.

I know that you and I both believe that it is essential that the Social Security Administration provide today's seniors with the benefits they have earned. Therefore, I would request that we also hold a hearing on the Social Security Administration's operating budget so that we can ensure that it can continue to provide essential services to today's beneficiaries, such as processing benefit claims on time and accurately, processing disability applications and appeals without lengthy waiting times, and answering calls and addressing problems for current and future beneficiaries.

We have worked in a bipartisan way in the past to make Social Security and the Social Security Administration do its job and do it right. Most recently, we did that when we provided \$500 million in the American Recovery and Reinvestment Act to reduce the disability backlog. Let's not undo that type of success. Let's continue to work together in a bipartisan fashion to strengthen Social Security in the long run.

I yield back.

Chairman JOHNSON. When we get the premise straight, we can work together. The system is broke, and you know it. They are borrowing money. Sure, we got pieces of paper over there, but that is not real money.

Mr. BECERRA. Mr. Chairman, you tell that to any American who deposits money in a bank, and if the bank tells them, "That is not real money"——

Chairman JOHNSON. I think our witnesses will confirm that.

Mr. BECERRA [continuing]. They will tell you what they think about the banking system.

Chairman JOHNSON. We have two witnesses today, both of them well-versed in the Social Security program.

And I welcome you both here.

Mr. Blahous, would you like to begin your testimony at this time, please?

**STATEMENT OF CHARLES P. BLAHOUS III, PH.D., TRUSTEE,
SOCIAL SECURITY AND MEDICARE BOARD OF TRUSTEES**

Mr. BLAHOUS. Thank you, Mr. Chairman, Mr. Ranking Member, all of the members of this subcommittee. It is a great honor to appear before you today to discuss the findings of the latest Social Security trustees report.

My written testimony contains some basic background information about program benefits, taxes, trust fund operations. Because our speaking time is limited, what I would like to do is skip over most of that and just make three main points in my oral remarks.

The first point is simply this, that Social Security expenditures are rising and that this carries important implications both for the program's own financing outlook as well as for the general Federal budget.

Last year, in 2010, we reached the point, for the first time since the 1983 reforms, that program expenditures exceeded incoming program tax revenue. That deficit last year was \$49 billion. This year, we are expecting a similar cash deficit of about \$46 billion in 2011.

Now, what is significant about this, or what is new about this, is that this is actually the first trustees report, since there have been public trustees, to have concluded that an era of permanent annual cash deficits has been reached.

Now, as noted in the opening remarks, the trust fund balance is going to continue to grow in the near term because of interest payments from the general fund to the trust fund. So we are in something of an unusual period right now where we are running a deficit of tax income relative to outgoing benefit obligations but the trust fund balance is still rising.

A couple of important caveats to bear in mind about the rising nominal balance of the trust funds: One is that, in terms of their ability to finance benefits, the purchasing power of the trust funds has actually already begun to decline relative to benefit payments. The so-called "trust fund ratio" peaked in 2008. That basically measures the duration of time that the trust funds could finance benefits in the absence of payroll tax revenue. And the reason it has begun to decline is that the cost of paying benefits is rising faster than the nominal balance of the trust funds.

Second, while the interest payments to the trust funds increase the balance of the funds, they don't have a unified budget impact. So what is determinative from a unified budget standpoint is the balance between the program's tax income and its outgoing benefit obligation.

And, third, as you alluded to, Mr. Chairman, the data that I have just described pertains to the combined trust funds, but the disability insurance trust fund, individually, is in worse shape. We project trust fund exhaustion in 2018.

The second major point I would like to make is simply that costs are growing for a very specific reason, and that is population aging. Before the baby boomers started entering the retirement rolls and before the recession hit in 2007, the cost of paying Social Security benefits amounted to about 11½ percent of the program's payroll tax base, basically 11½ percent of the taxable wages earned by workers.

Now, it has risen since then, and it is going to continue to rise in the future. We are projecting that that will hit 17 cents on the dollar by the mid-2030s. And this predominantly reflects a decline in the ratio of workers to collectors, as the baby boomers move out of the workforce and into the retiree population.

The third and final point that I would make, Mr. Chairman, is simply that these financial challenges, as the trustees report states in multiple places, should be addressed soon if we want to minimize adverse impacts on vulnerable populations, including people already getting benefits, low-income workers, et cetera.

One of the things the trustee reports do is they provide for these illustrative examples of how much benefits or taxes would have to be raised in order to keep the program sound from a financial standpoint. And these illustrations are useful insofar as they go, but obviously you, as legislators, have to consider a number of policy considerations and constraints as you make policy for the program.

So we can show you, for example, that in 2036 benefits would have to be reduced by 23 percent to fit within projected tax reve-

nues. But you might look at that and say, "Well, I don't want to reduce benefits for people already receiving them." Historically, Congress has wanted any benefit changes to be prospective, to affect new retirees, rather than people already on the rolls.

And so, if you asked the question again and said, how much would benefits have to be reduced in 2036 if we confine the changes to new retiree claimants, the answer is, the system wouldn't be in balance even if 100 percent of those benefits were cut off.

So you start working through the problem backwards and ask yourself, well, if I want to take into account bipartisan policy reality that we don't want to change benefits for people now in retirement or on the verge of retirement, our window for acceptable action closes much sooner.

So I would simply summarize by saying that the essential message conveyed by the reports is that Social Security faces real and substantial challenges, and we will best serve the interests of the public if financial corrections are enacted at the earliest practicable time.

Thank you.

[The prepared statement of Mr. Blahous follows:]

Statement of Charles P. Blahous
Research Fellow, Hoover Institution and Public Trustee for Social Security
Before the Subcommittee on Social Security
of the U.S. House of Representatives Committee on Ways and Means
June 3, 2011

Thank you, Mr. Chairman, Mr. Ranking Member, and all of the members of the subcommittee. It is an honor to appear before you today to discuss the findings of the latest Trustees' report with respect to projected Social Security finances. 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 and Benefits

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, as are the interest payments that they receive. 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. 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.

Social Security's Financing Challenges

Social Security expenditures exceeded the program's non-interest income in 2010 for the first time since 1983. This deficit stood at \$49 billion last year and is projected to be \$46 billion in 2011.³ This deficit is expected to shrink to about \$20 billion for years 2012-2014 as the economy strengthens. After 2014, cash deficits are expected to grow rapidly as the number of beneficiaries continues to grow at a substantially faster rate than the number of covered workers. The 2011 Trustees' report is the first in which Public Trustees have ever participated to have concluded that an era of permanent annual deficits has been reached (assuming no future change in law).⁴

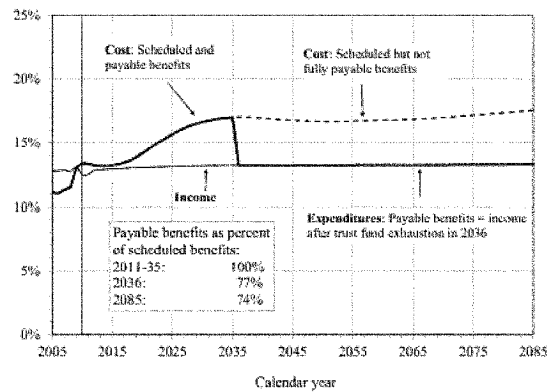
³ Due to a recently-enacted temporary payroll tax reduction, incoming program tax revenues will fall short of expenditures by \$151 billion in 2011. The total non-interest deficit is smaller (at \$46 billion) due to the provision of \$105 billion in general fund reimbursements, offsetting the revenue effects of the payroll tax reduction.

⁴ Technically, Social Security would not be permitted to run annual deficits after Trust Fund exhaustion due to its lack of borrowing authority. The deficits are permanent in the sense that annual benefit obligations are projected to exceed annual non-interest revenues.

Through 2022, these annual cash deficits will be made up by redeeming Trust Fund assets from the General Fund of the Treasury. Because these redemptions will be less than interest earnings, combined Trust Fund balances will continue to grow. After 2022, Trust Fund assets will be redeemed in amounts that exceed interest earnings until combined Trust Fund reserves are exhausted in 2036, one year earlier than was projected last year. Thereafter, tax income would be sufficient to pay only about three-quarters of scheduled benefits through 2085.

Though the nominal balance of the Trust Funds is still rising, there are important caveats to bear in mind about this. 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.

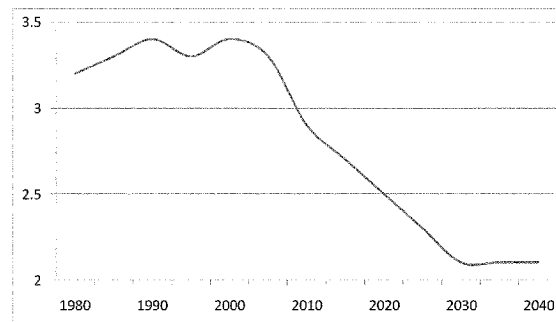
Under current projections, the annual cost of Social Security benefits expressed as a share of workers' taxable wages will grow rapidly from 11-1/2 percent in 2007, the last pre-recession year, to roughly 17 percent in 2035, and will then dip slightly before commencing a slow upward march after 2050.



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.

This cost increase primarily reflects population aging, in particular the diminishing ratio of workers to beneficiaries as the large Baby Boom generation moves from the ranks of the workforce to the ranks of the beneficiary population.

Ratio of Workers to Beneficiaries
(Past and Projected)



These results just described pertain to the combined OASDI Trust Funds. Considered separately, the Disability Insurance (DI) Trust Fund is in more serious condition. DI costs have exceeded non-interest income since 2005 and Trust Fund exhaustion is projected for 2018; thus changes to improve the financial status of the DI program are needed soon.

Actuarial balance measurements over long spans of time are inherently imprecise and can obscure the more salient issue of trends in annual program cost growth. Because our projections show increasing annual deficits over the long term, a hypothetical immediate tax rate increase sufficient to achieve long-term actuarial balance would result in large annual surpluses early in the period but would still be followed by increasing and unsustainable deficits in later years. This is because the annual deficits projected at the end of the 75-year projection period -- equal to 4.24 percent of taxable payroll in 2085 -- are much larger than the average long-range actuarial deficit of 2.22 percent of taxable payroll.

The Costs of Delay for Program Participants

The financial challenges facing Social Security should be addressed soon. If action is taken sooner rather than later, more options and more time will be available to phase in changes so that those affected have adequate time to prepare. Earlier action will also afford elected officials with

a greater opportunity to minimize adverse impacts on vulnerable populations, including lower-income workers and those who are already substantially dependent on program benefits.

Reluctance to resolve the Social Security shortfall is understandable, as doing so involves slowing the growth of program benefits, increasing the age at which individuals become eligible for benefits, or increasing program taxes. Failure to enact such measures, however, will not shield participants collectively from adverse effects. One way or the other the imbalance between scheduled benefits and future revenues must be resolved. Further delay in enacting corrective legislation to do so as equitably as possible would simply mean that continued uncertainty will surround how the imbalances will be resolved and that the unavoidable adjustments will be compressed into a shorter time period, be concentrated upon fewer affected individuals, and be more disruptive as a result.

For many years, the Trustees Reports have contained illustrations of the magnitudes of changes to benefits or taxes required to place Social Security on a financially sustainable path. Useful though these illustrations are, they understate the likely effects of legislative actions over time. First, such illustrations often assume that the full effect of legislation takes place immediately, with no phase-in or lead time. Perhaps even more importantly, the benefit examples assume that legislators would be equally willing to reduce support for current beneficiaries as to restrict the growth of benefits to future participants. In the past, policy makers have been reluctant to significantly reduce the benefits of those who have already begun to collect them. In a practical sense, therefore, changes adversely affecting younger generations are likely to be much more severe than indicated in these simple illustrations. The costs that will be borne by younger generations will grow significantly each year that a new cohort of baby boomers joins the benefit rolls.

For example, imagine that no legislative action is taken until the Trust Funds' exhaustion date of 2036 is approached, despite the substantial growth in financial pressure exerted by the program on the general budget in the decades prior to that time. In 2036, incoming tax revenues would be sufficient only to fund 77% of promised benefits. This constraint, however, would apply to pre-existing as well as new benefit payments. Even the complete elimination of benefit payments to new claimants would not then by itself balance system finances. Accordingly, unless there was then an unprecedented increase in payroll tax assessments, the opportunity to confine any benefit changes only to prospective ones would have been long lost. Legislators can minimize these adverse impacts by acting promptly to repair Social Security's financial outlook.

Conclusion

The essential message conveyed by the Trustees' report is clear and will not change, absent legislation: that Social Security faces real and substantial challenges, and that elected officials will best serve the interests of the public if financial corrections are enacted at the earliest practicable time.

Chairman JOHNSON. Thank you, sir. Thank you for your testimony.

Dr. Reischauer, you are recognized.

STATEMENT OF ROBERT D. REISCHAUER, PH.D., TRUSTEE, SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES

Mr. REISCHAUER. Chairman Johnson and Ranking Member Becerra and Members of the Subcommittee, I appreciate the opportunity to discuss the 2011 trustees report with you and with my fellow public trustee, Dr. Blahous.

We divided up the topic, so you wouldn't hear a repetition. What I thought I would do would be to cover the financial outlook changes from last year's report to this year's report.

Every year, of course, the financial situation changes, sometimes by a little bit, sometimes by a moderate amount, sometimes by large and very significant amounts. As an indicator of how significant the changes are from year to year, the public and the press tend to focus on the dates at which the various trust funds are projected to be exhausted.

By that metric, the changes between the 2010 and 2011 report are pretty small. The exhaustion date for the OASI trust fund is now projected to be 2038, which is 2 years earlier than last year's report suggested.

The projected exhaustion date for the DI trust fund remains unchanged, at 2018. The fact that it is unchanged shouldn't allow us to sleep any easier because, of course, 2018 isn't too far away. That suggests that you will be faced with making some adjustments sometime in the next 3 or 4 years to ensure that that trust fund pays on a timely basis full amounts.

A more comprehensive measure of the trust fund's financial condition is its actuarial balance over the 75-year valuation period. This balance is essentially the difference between annual income and costs summarized over 75 years and then expressed as a percentage of taxable payroll. An actuarial deficit can be interpreted as the percentage points that would have to be either added to the current law income rate or subtracted from the cost rate for each of the next 75 years to bring the system into actuarial balance.

While the actuarial balance of the DI trust fund has not changed from last year, it is still minus 0.3 percent; the actuarial balance for the combined OASDI trust fund has deteriorated by 0.3 percentage points. So how does this look in historical perspective? Is that big, or is it small? With the exception of the change that took place between the 2008 and 2009 trustees reports, you have to go all the way back to the 1994 trustees report to find a bigger change from one year to the next.

Now, the year-to-year changes in Social Security's financial situation can occur for a whole lot of reasons. They occur almost inevitably because the valuation period changes when we move the whole estimation process forward 1 year. They also might occur because legislation is enacted, because the underlying economic and demographic assumptions are modified, because there are new administrative practices, or because projection methodologies and data are improved.

If we look at what happened over the course of the 1-year period that I am contrasting, you find that the 75-year valuation period, which involved dropping from the year 2010 and adding the year 2085, accounted for a sixth of the increase, 0.05 percent of the 0.30 percent that I was talking about.

Clearly, there was no legislation enacted during the past year that had a significant impact on Social Security's long-run financial position. However, there were important changes in the demographic and economic assumptions that were used in this year's report, and they did have a significant impact, as I said.

Lower recent and projected mortality for those age 65 and older account for a third of the increase. Now, in one sense, that is good news: People are living longer, especially good news for people like me who are old. And this is the projection from new data for people 65 and over. That accounts for one-third of the deterioration in the long-run actuarial balance.

There have also been changes in net immigration that have to do with falloff in net immigration that occurred as a result of the weakness in the economy.

The 2011 report also assumes that the economic recovery is a bit lower, that real earnings in the base year off of which these projections are made are lower, and it takes longer for earnings to get back to what would be regarded as a normal level, and that we have slightly lower real interest rates on trust fund assets.

Those things, all together, combine to account for about a sixth of the year-to-year deterioration.

Chairman JOHNSON. Doctor, can you wind it down? Your 5 minutes are up.

Mr. REISCHAUER. Okay. Well, let me just close with one additional comment—

Chairman JOHNSON. Sure.

Mr. REISCHAUER [continuing]. Because that was all I was really going to say about the changes.

And that additional comment is, over the last 8 months, Dr. Blahous and I have had the opportunity to work closely with the chief actuaries and their staffs, as well as the professional staffs of the ex-officio members of the Board of Trustees—that is, Treasury, HHS, DOL, and SSA. One cannot but be impressed by the depth of their expertise, their objectivity, their willingness to engage in a free and open debate at all hours of the day and night, and their dedication and hard work.

And this experience has convinced me, and I believe Chuck as well, that both the Congress and the public are being very well-served by the current support for these reports in providing good information to the Congress for its deliberations.

Thank you.

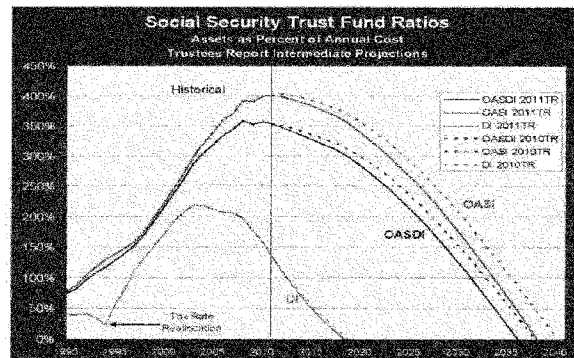
[The prepared statement of Mr. Reischauer follows:]

Statement of Robert D. Reischauer
President, Urban Institute¹ and Public Trustee for Social Security
Subcommittee on Social Security, Committee on Ways and Means
U.S. House of Representatives

June 3, 2011

Chairman Johnson, Ranking Member Becerra, and members of the subcommittee, I appreciate this opportunity to discuss the 2011 Social Security Trustees Report with you. So as not to repeat the points made by my fellow Public Trustee, Dr. Charles P. Blahous, who covered the basic operations and projected financing shortfall of the program, my statement focuses on the changes in the financial outlook from last year's report and the impact that a weak economy can have on this vital program. To illustrate my points, I have included in my statement several charts that were prepared by the Office of the Chief Actuary of the Social Security Administration.

The projections in the Trustees Reports of the financial health of the Social Security program change each year, sometimes by small amounts, sometimes by moderate amounts, and sometimes by large amounts. As an indicator of how significant the year-to-year changes are, the media and the public tend to focus on the changes in the dates at which the various trust funds are projected to be exhausted. By this measure, the changes between the 2010 and 2011 Reports of the Trustees are small, albeit in a negative direction. (See Chart) The exhaustion date of the OASI Trust Fund is now projected to be 2038, two years sooner than was projected in last year's report. The projected exhaustion date of the DI Trust Fund remains unchanged at 2018 and the combined OASDI Trust Fund exhaustion date, at 2036, is projected to come one year sooner than was projected last year.



¹ The views expressed in this statement should not be attributed to the Urban Institute, its sponsors, staff, or trustees.

A more comprehensive measure of a trust fund's financial condition is its actuarial balance over the 75-year valuation period. This balance is essentially the difference between annual income and costs, summarized over the 75-year projection period, and expressed as a percentage of taxable payroll.

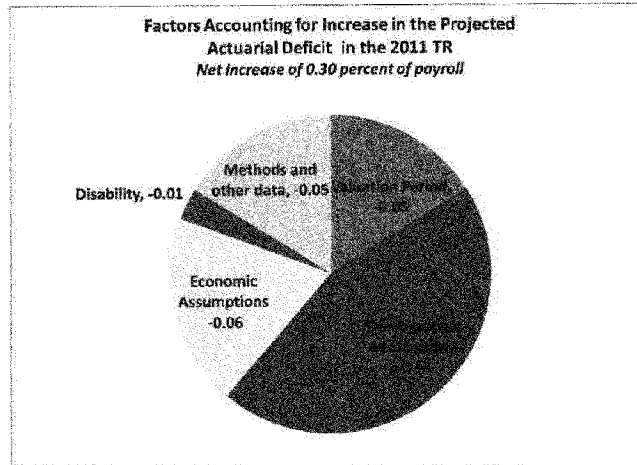
An actuarial deficit can be interpreted as the percentage points that would have to be either added to the current-law income rate or subtracted from the cost rate for each of the next 75 years to bring the fund into actuarial balance. By definition, balance requires that the assets in the trust fund at the end of the 75th year equal the 76th year's cost.² While the actuarial balance of the DI Trust Fund, at -0.30 percent of taxable payroll, has not changed since last year's report, that for the OASI Trust Fund has deteriorated from -1.62 percent of taxable payroll to -1.92 percent of taxable payroll and that for the combined OASDI Trust Fund from -1.92 percent of taxable payroll to -2.22 percent of taxable payroll. (See Table) Along with an equal sized deterioration that occurred between the 2008 and 2009 Trustees Reports, this -0.30 percentage point change is the largest single-year deterioration in Social Security's actuarial balance since the 1994 Trustees Report.

	Long-Range Actuarial Deficit of the OASI, DI, and OASDI Trust Funds (percent of taxable payroll)		
	OASI	DI	OASDI
2010 Trustees Report	-1.62	-0.30	-1.92
2011 Trustees Report	<u>-1.92</u>	<u>-0.30</u>	<u>-2.22</u>
Difference	-0.30	0.0	-0.30

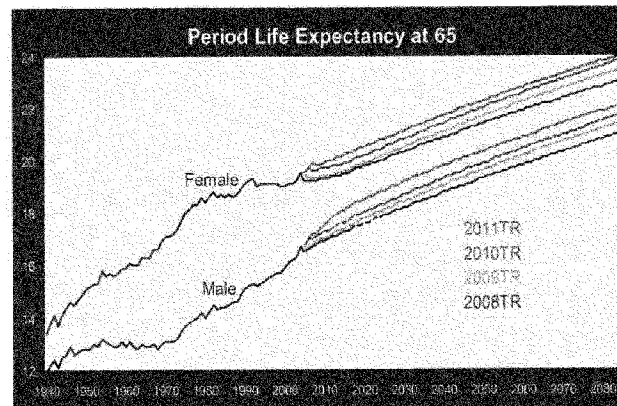
Year-to-year changes in Social Security's projected financial situation always occur because the valuation period is moved one year forward. Changes can also occur because new legislation is enacted, underlying economic and demographic assumptions are modified, administrative practices are revised, projection methodologies are refined, and new data becomes available.

The 75-year valuation period used in the 2011 Trustees Report (2011-2085) adds the year 2085 and drops 2010. This change from the previous report alone accounts for one sixth of the increase in the actuarial deficit. (See Chart)

² Because Social Security's annual deficits, expressed as the difference between the cost rate and income rate, are projected to increase gradually from 2015 to 2038, to decline slightly during the 2039-52 period and then to increase through 2085, the single tax rate increase for all years starting in 2011 sufficient to achieve actuarial balance would result in large annual surpluses early in the period followed by increasing deficits in later years. The relatively large deficits at the end of the 75-year projection period—equal to 4.24 percent of taxable payroll in 2085—indicate that sustained solvency would require payroll tax rate increases or benefit reductions (or both) by the end of the period that are substantially larger than those needed on average for the valuation period (2011-85).

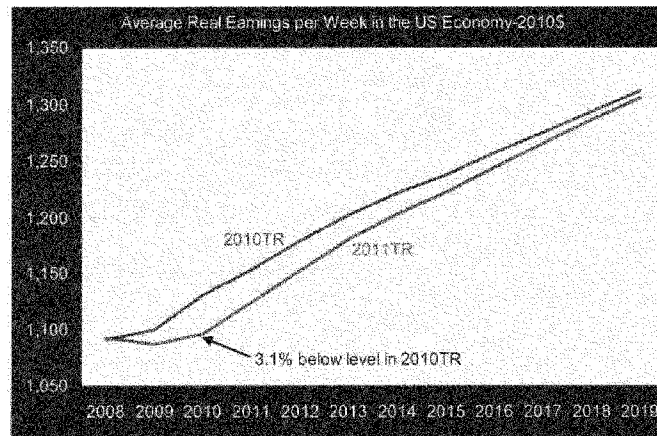


No legislation enacted during the past year significantly affected Social Security's long-range financial position. However, changes in the demographic and economic assumptions used for the 2011 Report did have significant impacts. Lower recent and projected mortality for those age 65 and older account for one third of the increase in the long-range actuarial deficit projected in the 2011 report. As the next chart shows, this bit of unabashed good news is not a new story since mortality improvements have been reflected in all of the recent Trustees Reports.



The recent and projected decline in net immigration of those other than legal immigrants, attributable largely to the recession and weak recovery, account for another one sixth of the deterioration in the long-run actuarial balance between the 2010 and 2011 reports.

When compared to the 2010 report, the 2011 report assumes a slower economic recovery, lower base-year real earnings and a slower return to the long-run average (See Chart), and lower real interest rates on trust fund assets that, together with other small changes in economic assumptions, account for a bit more than one sixth of the year-to-year deterioration in the projected actuarial balance.

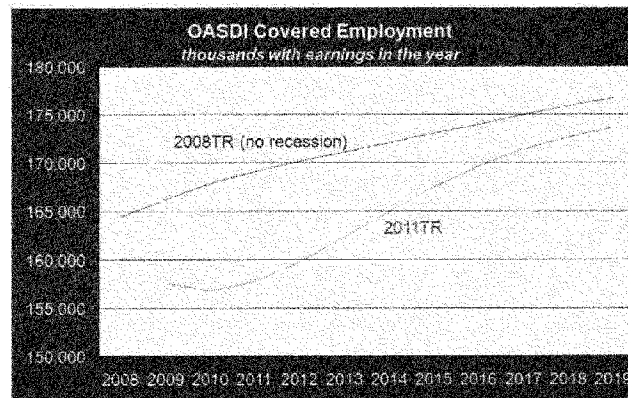


Numerous improvements in methods and data were introduced in the 2011 report and, on balance, they accounted for about one sixth of the increase in the projected long-run actuarial deficit.

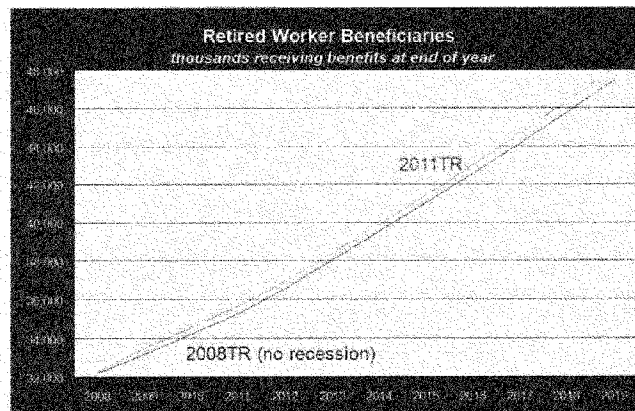
The previous discussion underscores how important a strong economy and healthy long-run growth rate are to the Social Security program. While much of the impact of temporary weakness in the economy is assumed to be offset over the long run, prolonged periods of weakness can affect the economy's potential, the productivity of the work force, and patterns of labor force participation even over decades.

Some insight into the magnitude of these effects can be gleaned by contrasting the projections contained in the last Trustees Report before the Great Recession with those of the 2011 Trustees Report which reflects the full depth of the December 2007-June 2009 downturn and subsequent weak recovery.

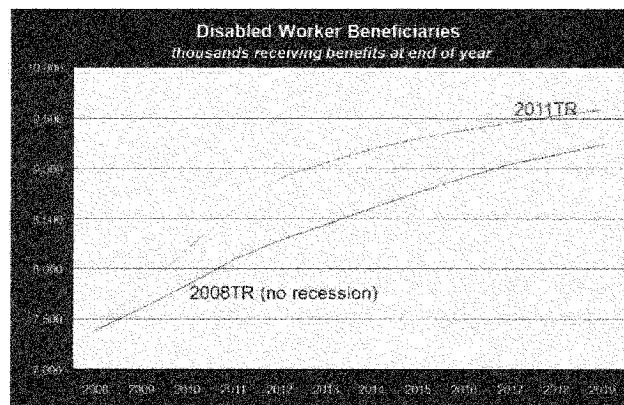
Today, there are well over 10 million fewer workers in covered employment contributing payroll taxes to the trust funds than was anticipated to be the case in the 2008 Trustees Report. Even by the end of the decade the shortfall will be several million under current projections.



While a number of factors have contributed to the increase in the number of retired worker beneficiaries projected in the 2008 versus the 2011 Trustees Report, the weak economy has been an important one. Faced with a weak labor market, some workers who have reached the age at which they are eligible for benefits and are laid off will decide to retire and draw benefits; others may supplement their diminished paychecks from part-time work or a lower-paying job with Social Security benefits.



The story is much the same for the workers with some level of disability. While they may be able to carry on in a job they have performed for a number of years, once laid off they face significant barriers to reemployment. Competing against many healthy and younger job seekers for the few available positions, more are likely to apply for DI benefits than would be the case in a stronger economy. While the disability rolls reflect a complex interplay of factors, the projected increase of half a million in the number of disabled worker beneficiaries in 2011 reflects, to a significant degree, the economic weakness that unfolded between the 2008 and 2011 Trustees Reports.



The fact that Social Security's financial viability is significantly affected by the strength of the overall economy in no way diminishes the undeniable fact that changes will have to be made in currently scheduled benefits and payroll taxes if the program is to provide our children and grandchildren an adequate level of retirement security. The sooner we address this challenge, the less disruptive the changes will be. Those most adversely affected can be given the time they need to prepare, the burden can be more equitably shared across the generations, and the political animosity and public anxiety associated with the unavoidable changes can be moderated.

Chairman JOHNSON. Thank you, sir.

You know, you mentioned that there are actually two funds, the old age and the disability. And it appears to me that the disability fund is in worse shape than anything else. Part of that is our problem, because we haven't had enough judges working and we haven't handled the situation properly. Mr. Becerra and I have talked about that, and I think that we need to try to fix that.

Under current law, the trustees are required to warn Congress in writing when the program is in real trouble, meaning when the trust fund IOU assets can only cover 20 percent of benefits for a given year. The chief actuary provided the unsigned copy of that letter at a recent staff briefing, and I will insert that into the record, without objection.

Chairman JOHNSON. Hearing none, okay.

Dr. Blahous, what does this year's report say about the status of the disability trust fund?

Mr. BLAHOUS. Well, as you know, Mr. Chairman, from a trust fund financing standpoint, the disability insurance program faces a more severe challenge than the old-age and survivors portion of the program, what people think of as the retirement program.

The disability insurance program began to show an excess of expenditures over tax income in 2005. It began to have a net draw on its trust fund assets by 2009. Its trust fund balance is already in decline; its trust fund ratio is in decline. The 20 percent trust fund ratio warning that you referred to is something we would hit, I believe, in 2017. And we are projecting trust fund exhaustion in 2018.

So it is in much more serious condition than the program as a whole.

Chairman JOHNSON. Well, how many times has the disability trust fund faced exhaustion in the past, and what have we done about it?

Mr. BLAHOUS. I don't know the exact number of times, but, certainly, there have been instances where, in the past, the disability insurance fund has come close to that 20 percent ratio. It neared there in the late 1970s. It neared there in the early 1980s. It neared there in the early 1990s. In the early 1990s, there was a reallocation of the tax rates between the retirement portion of the program and the disability portion of the program.

Chairman JOHNSON. Yeah, but we are stealing from the Social Security retirement and survivors fund to do that, which will be broke.

Do you support reallocating the payroll tax to improve the financing of the disability program at the expense of the retirement program? That is what we have done in the past.

Mr. BLAHOUS. Well, I want to be very careful, obviously, sitting here as a trustee, not speaking for Dr. Reischauer, not speaking for the trustees as a group. But I would—

Chairman JOHNSON. Your personal opinion.

Mr. BLAHOUS. My personal opinion is that the tax rates certainly warrant review. I mean, we have a 2038 insolvency date projection for the retirement portion of the program, 2018 for disability, which, in my view, powerfully suggests that we don't have the tax allocation right. I mean, if you had an appropriately proportional allocation between the funds, the two funds should be in a comparable state of financial health.

So I do think it makes sense to review that allocation, though, as you say, it doesn't increase or improve the net financing position of the program as a whole. It would just move resources from one side of the program to the other.

Chairman JOHNSON. You mean that is delaying disaster, is what you are saying?

Mr. BLAHOUS. Well, you could say that it is putting the two programs on a comparable course of concern, rather than one being far worse than the other.

Chairman JOHNSON. Okay.

Dr. Reischauer, would you like to comment on those issues?

Mr. REISCHAUER. I would agree with what Chuck said. Both programs need to be strengthened. It would be best, in my opinion, to address these problems together. And if they were on a comparable time pattern, that would probably facilitate—

Chairman JOHNSON. I think that is one thing that Mr. Becerra and I do agree on, that we do need to have some reform.

And do either of you have specific suggestions as to what actions we ought to be considering to solve these issues? And would you submit your recommendations for the record?

Mr. BLAHOUS. I am happy to follow up with specific suggestions for the record.

I would just say that the way I tend to conceptually think about the disability program, sort of in five pieces. One is, do we have the tax allocation right? And I think we probably don't.

Second, remember, on the retirement side of the program, there are more levers you can pull. You can pull the retirement-age lever, you can pull the benefit-formula lever, you can pull the tax lever. You don't have quite as many levers on the disability side because the retirement-age lever doesn't do anything for you. And so, that suggests you almost have to look at things associated with the tax allocation and with the benefit formula. And I tend to believe that we do need to consider the rate of benefit growth above inflation, especially on the high-income end, in both programs.

I also have a longstanding concern that the way that the benefit formula works, where it sort of mixes together its aims of keeping track of each individual's wage history and also being a progressive redistribution, both of which are worthy goals, but, combined in one formula, have the effect of really dampening work incentives on both sides. And that is a particular problem on the disability side, and I am happy to follow up with more details.

Chairman JOHNSON. Thank you, sir.

Mr. Becerra, you are recognized.

Mr. BECERRA. Thank you, Mr. Chairman. Let me see if I can dissuade you that the Social Security program is broke. At least, I probably can find you a couple hundred million Americans who would challenge that statement, because sometime this week, when they receive their paycheck and their paycheck stub and they look at that paycheck stub, they are going to see a deduction from their pay for a tax contribution, a FICA tax contribution, that goes to Social Security and to Medicare.

And, gentlemen, see if you can help me with something. The number I have from the inception of Social Security is that American workers, through their tax contributions, through their paychecks, have contributed \$13.9 trillion straight out of their pocket into the system, into Social Security. And please correct me, shout out or raise your hand, if it is a wrong number—\$13.9 trillion.

Looking at SSA's records, I see that, since the trust fund was established in the 1930s to collect the tax contributions that Americans pay in and because we were collecting more than what was needed to pay the benefits for those who retired, we had excess contributions by American workers. Those were put into this fund, this trust fund. And the money was replaced with Treasury bonds, the most secure investment in the world, as far as I know. At least, that is why China continues to lend us money.

And, to date, since the inception of the trust fund, those Treasury bonds that are exchanged for the contributions that taxpayers have paid into the system, those bonds have earned \$1.6 trillion in interest in the trust fund. That quick math, if I can still remember how to do that, is \$15.5 trillion.

SSA says to us that, since the beginning of Social Security in the 1930s, we have had to pay out to Americans who have retired, who are disabled workers, or who are the survivors of an American worker who has perished and therefore can collect Social Security, that those Americans have been given, have been paid—Social Security has paid out to them a total of \$12.7 trillion. And in terms of the cost of administering the program—and, by the way, the Social Security Administration runs a very tight ship here—the total cost for those 70-plus years is \$0.1 trillion, or \$100 billion, for a total cost to the system, to Americans, of \$12.8 trillion.

Again, with my quick math, if I subtract the \$12.8 trillion that we have had to put out in benefits or to pay for costs and subtract that from all that has been collected from American taxpayers' contributions, I net \$2.7 trillion as a balance that has not been used.

Now, Mr. Chairman, you said that the system is broke. I defy you to find me another, whether government program or private enterprise, that can say it has \$2.7 trillion in reserve, ready to use for the purpose it was contributed.

Chairman JOHNSON. The money isn't there.

Mr. BECERRA. Well, then, if that is a statement, that the money isn't there, it is not that American workers didn't contribute it with their taxes; it means that politicians have been stealing the money and lying—

Chairman JOHNSON. You are exactly right.

Mr. BECERRA. Okay.

Chairman JOHNSON. That is what has happened.

Mr. BECERRA. Well, then we make the distinction and there I think we can clearly define the lines here.

There are some politicians who say, "Continue, American worker, to pay those contributions in your taxes, have that deduction made, but while we tell you it is going to be put into a trust fund, we are lying to you, because we are going to use it to pay for other things we are not willing to pay for."

And so, Mr. Chairman, the only reason Social Security and American workers would not have \$2.7 trillion that they can count on in the future to deal with the long-term challenges is because politicians are willing to steal the money that American workers have contributed for Social Security.

Dr. Blahous, you mentioned some things that I want to get into. Are you fortunate enough to own your home?

Mr. BLAHOUS. I am.

Mr. BECERRA. Outright?

Mr. BLAHOUS. I have a mortgage outstanding.

Mr. BECERRA. Okay. Own your car?

Mr. BLAHOUS. Yes.

Mr. BECERRA. Outright?

Mr. BLAHOUS. That one I own outright, yes.

Mr. BECERRA. Do me a favor, can you tell me if, in your pocket, you have enough money to pay for your house right now, the mortgage?

Mr. BLAHOUS. I am a little bit short.

Mr. BECERRA. A little bit short? You are broke. According to those who say Social Security can't pay out benefits, you are broke.

Because, see, you, yourself, used the word "cash deficits" to explain what Social Security is incurring, a "cash deficit." What you are saying there is that, today, Social Security isn't collecting from American workers contributions sufficient to pay for the benefits that are paying out. You are disregarding the more than \$2½ trillion that was built up in the surplus. Because, as the chairman has said, politicians have been using the money.

But just for the same reason, I could today say that you are broke. And I guarantee you, if I look at your balance sheet, I know you are not broke. Social Security is not broke. Social Security, if people want to be cute and talk about cash deficits, well, you could say we are broke. But just because for the same reason you don't carry hundreds of thousands of dollars in your pocket to pay off your mortgage or your car loan and you keep it in a bank where you think it will be safe, Americans trusted politicians who said that if you put the money in the trust fund, it will be there, the tax dollars you are contributing will be there, to pay benefits.

And so, therefore, I think, Mr. Chairman, we can resolve this challenge that Social Security will face a quarter century from now, but you don't have to steal the money out of the Social Security Trust Fund that Americans have contributed to take care of Social Security.

Chairman JOHNSON. Well, you need to work with us to not steal any more money.

Mr. BECERRA. Mr. Chairman—

Chairman JOHNSON. I would just about guarantee you that Dr. Blahous, if he decided to cash in all his reserves, could pay for his house.

Mr. BECERRA. Absolutely. And if the Social Security Administration were to cash in all of its reserves out of the trust fund, it could pay benefits for quite some time.

Chairman JOHNSON. Where are they going to get the money from? We are borrowing money from other countries.

Mr. BECERRA. Oh, so you are essentially saying that those Treasury bonds that the American public owns through the trust fund are not real?

Chairman JOHNSON. That is right.

Mr. BECERRA. Okay. And so, do you tell that to China?

Chairman JOHNSON. Well, is China going to fund it?

Mr. BECERRA. No, Mr. Chairman, you have said that the American people have fake Treasury bonds. So are the Treasury bonds—

Chairman JOHNSON. The Treasury bonds are there, and the full faith of the United States Government is behind them.

Mr. BECERRA. Okay. So they are real.

Chairman JOHNSON. But the United States Government doesn't have any money. We are borrowing it. You ought to go

down there and look at Treasury borrowing money like it is going out of style.

Mr. BECERRA. I understand what you are saying, Mr. Chairman. But what you are saying is that Social Security should pay the price for the terrible spending policies of others. We did a war in Iraq and Afghanistan, never paid for it. So Social Security recipients should pay for that?

Chairman JOHNSON. Well, the baby boomers have had an effect on it.

Mr. BECERRA. The Bush tax cuts, trillions of dollars of Bush tax cuts, never paid for. So Social Security recipients should pay for that?

Chairman JOHNSON. Yeah, your time has expired.

Mr. BECERRA. But fortunately not the Social Security Trust Fund.

Chairman JOHNSON. Mr. Tiberi, you are recognized.

Mr. TIBERI. I have a headache, Mr. Chairman.

Wow. You know, my mom—and Mr. Becerra has heard this—my mom and dad are pretty simple people. And they say to me, you know, “I watch a story on Fox News and then I watch MSNBC. I see the same story, and there is a different outcome to the story.” Now I know what they mean, watching this. I am thoroughly confused.

And let me kind of recap, and maybe you two can help me, without my editorial comment. But I will give some anyway.

So you say permanent cash deficit. You say \$46 million cash deficit. You guys say lower mortality rates, falloff on net immigration, population aging—all things that are part of the trustees report. I have had actuaries say to me that we have fewer workers for more retirees that plays into this. I have had actuaries say to me that we not only live longer, the system has—and I think, Dr. Reischauer, you alluded to this—you have a system that wasn’t designed for people living as long as they are living today. So they worked longer, were in retirement for a shorter period of time; so now you have people in retirement for a longer period of time.

So Mr. Becerra says, and we heard a little bit more about it a little bit ago, Social Security remains strong and the surplus is real. Which is different than what the trustees report says, which is different than what you say.

Mr. Becerra says, Mr. Chairman agreed, that the problem is because politicians have taken from the trust fund. But then you all have said, we paid back the trust fund with interest.

I get a statement from the Social Security Administration that says, a few years after my full retirement, I can expect to get 75 percent of what I paid into it. Yet Mr. Becerra says the system is strong. And that is less than 25 years from now.

Now, maybe—

Mr. BECERRA. Will the gentleman yield?

Mr. TIBERI. Oh, you had a lot of time. If I had more time—

Mr. BECERRA. But you have mischaracterized what I said, Mr. Tiberi. I didn’t say that—

Chairman JOHNSON. Regular order.

Mr. BECERRA. I just was asking—

Mr. TIBERI. Go ahead.

Mr. BECERRA. I said that the system is strong—

Mr. TIBERI. For 25 years.

Mr. BECERRA [continuing]. And, for the next 25 years, it will pay out full benefits.

Mr. TIBERI. Right. Well, in my statement from the Social Security Administration—I will bring it in and show you—is, in less than 25 years, I, if I retire at 67, will get less than 100 percent of the benefits that I paid. That is not from me; that is from them.

Mr. BECERRA. Well, I would love to see that, if it is less than 25 years.

Mr. TIBERI. Yeah, I will show you. I will show you. And Mr. Schock probably has a statement that is much scarier than that.

So we can blame the Bush-Pelosi-Reid recession for this, but the reality is, I think, what you are telling us, the reality is actuaries, numbers, right? I mean, this isn't about politics. This isn't about blaming Bush, Pelosi, politicians, quite frankly. Based upon reading the trustees report, it appears to me—and we can't even agree on this—that this is actuarial, this is numbers, this is math. This is more people retiring, living longer, which Dr. Reischauer said is a good thing, and I agree. This is a country that has fewer workers for retirees and net immigration loss.

Can you both expand upon that and help us clear this up? Is the trust fund being reimbursed by the general revenue fund with interest over the next 20 years, so that stealing of the money actually has been paid back? Can you comment on that?

Mr. BLAHOUS. Sure. And, obviously, this discussion that is playing out today is one that you hear everywhere. It is a classic example of people looking at different parts of the animal.

Mr. TIBERI. But you are the experts, so tell us.

Mr. BLAHOUS. Right. Well, basically, there is truth in what everybody is saying. From the trust fund standpoint, they are real assets—the bonds in the trust fund are real assets of the Social Security system. They do earn interest, and it is paid from the general fund.

A lot of the controversy about the trust funds has to do less with mechanically what is in there and are they assets for Social Security, but whether or not there is actually real saving there, whether there are real savings resources behind the trust fund, so that when the bonds need to be redeemed, we are in a position where we can pay those bonds back.

I think all the things that have been said about the trust funds today are basically correct. I mean, the Social Security system has a trust fund balance of about \$2.6 trillion. It is earning interest. The trust fund balance continues to rise.

But there is also a lot of things that the trust fund balance doesn't tell you. It tells you what assets does the Social Security system command that establish its authority to pay out benefits. But it doesn't tell you such things as when you should take action to fix Social Security. If you were to wait until the point of trust fund depletion, you would have the harshest, least equitable outcome, relative to acting now and creating a more equitable schedule of benefits and taxes going forward.

And it also doesn't tell you whether or not the problem is still soluble. I mean, we have a very unusual situation right now. In the

1980s, early 1980s, when they had a Social Security crisis, they were able to fix it, but one of the reasons they were able to fix it was that the trust fund balance had been pretty small, historically, up to that point. So, at the point when the trust fund was running out, incoming taxes and outgoing benefit obligations were still pretty close together. That is not the situation we are in now. If we were to try to ride the trust fund for the next quarter century and redeem all those bonds, we would be at a point, ultimately, where taxes and benefits were so far apart that there would be no historical political precedent for taking short-term action to close that shortfall.

So we are in a much more difficult situation. Yes, the trust fund is real, from the system's perspective. It is an obligation from the general government's perspective. But it also doesn't tell you how soon you have to act to fix the system——

Chairman JOHNSON. The time of the gentleman has expired.

Mr. Schock, you are recognized.

Mr. SCHOCK. Well, thank you both for your testimony.

I, too, am a bit taken back by some of our friends on the other side of the aisle who seem to believe that everything is rosy and fine.

You have mentioned that we can pay out benefits for the next 25 years. But, at the same time, after 25 years, what happens?

Either one of you.

Mr. REISCHAUER. What happens is that the Social Security system is not allowed to pay benefits in excess of the resources that are flowing in through tax revenues, plus whatever its accumulated asset position is. And so that is why your statement says that after 2036 there would be a ratable reduction in your benefit of roughly 25 percent.

The discussion that we have been having from the trustees report assumes that these assets are real, that the Social Security Administration will be able to go to the Treasury and say, "Here are these pieces of paper; we need cash," and that the Treasury will go and either borrow more money from the public or other taxes will be raised or other spending will be cut. And that is the——

Mr. SCHOCK. To make good on those Treasuries.

Mr. REISCHAUER [continuing]. Assumption. And if those aren't real, you would have a statement that would look very different. It would be flashing when you opened up your envelope.

Mr. SCHOCK. So let me make sure I understand this. If I take Mr. Becerra's rosy view that these are real bonds that the government will make good on——

Mr. BECERRA. That is a rosy view?

Mr. SCHOCK. Well, I am just saying as opposed to our chairman's less rosy view. Okay? All right?

So let's take the minority's view, all right, that we are going to get all the money on this, even in the best-case scenario, in 25 years you are going to be able to pay me or pay recipients 76 cents on the dollar?

Mr. REISCHAUER. Correct.

Mr. SCHOCK. Okay. So what this sounds like to me is what has happened in my State, which has now one of the largest unfunded

liabilities in the Nation for States, whereby when I read my statement, it says I will still be entitled to my benefit and the benefit will accrue each year, but I will only be paid what the Social Security Administration has cash in hand to cover, correct?

So, basically, the money now will no longer be borrowed from the Treasury, but Social Security, in essence, will be borrowing this money from people who are expecting to receive the benefit in present form?

Do you understand my question?

Mr. REISCHAUER. Yes, I understand your question. The point here is that the Social Security system sets up promises to individuals: If you pay in this amount, we will pay you when you retire that amount, subject to—

Mr. SCHOCK. Only if we have the money.

Mr. REISCHAUER [continuing]. The resources available at that time.

Mr. SCHOCK. Thank you. And when I am looking at my statement, it says, based on what I have paid in, I am going to get about \$3,000 a month if I keep working and wait until I am 70. What do you think I am going to make—of the \$3,000 a month I am supposed to get, 40 years from now, not 25 years, what percent of that \$3,000 a month should I expect if we don't make any changes?

Mr. BLAHOUS. I mean, if you didn't make any changes, then, by definition, it would be 77 percent declining to 74 percent. If we made changes, it would be somewhere between 77 percent and—

Mr. SCHOCK. That is if I retired in 25 years.

Mr. BLAHOUS. Right. But—

Mr. SCHOCK. And the accrued liability only increases each year, because if you can only pay 76 percent of your obligations in year 1, even if you can pay 76 percent in year 2, you are not going to pay 76 percent because you owe 25 percent last year. Right? It becomes a snowball effect.

Mr. BLAHOUS. Right. The percentage starts at about 77 cents on the dollar, and it goes down to about 74 by the end of the 75-year valuation period. And what legally is expected to happen is that this would not be manifested by the Social Security Administration's arbitrarily doing a 23 percent cut across the board. Basically, they would have to delay the issuance of the benefit checks until the financing came in. So, in effect, your benefits would be cut 23 percent, gradually increasing to an annual benefit cut of about 26 percent. But it would happen simply through your getting fewer benefit checks.

But roughly a quarter of your benefit.

Mr. SCHOCK. Well, I would like to see at some point what happens each year, because I think that what is going to happen is something similar to what has happened in many States across this country, where the States have basically balanced their books on the back of providers who provide services to the State, and basically the State has become more and more in debt to the people to whom they owe money. And I would hate to see that happen to people who are expecting their Social Security check to live on.

Chairman JOHNSON. Thank you. The gentleman's time has expired.

Ms. Berkley, you are recognized.

Ms. BERKLEY. Thank you, Mr. Chairman.

I have a terrible head cold, and I dragged myself to this hearing. I feel like being here like I feel like having a toothache. But it is very important, what we are talking about.

And I have about 408,000 Social Security recipients in the State of Nevada. My congressional district, which encompasses Las Vegas, has the fastest-growing senior population in the United States. So issues that affect seniors are very important to me. And this is about as rosy as I am going to be this morning.

I am here to find out what it is we can do, given the fact that a third of the seniors that I represent have no other income but that Social Security check. They depend on it. They count on it. They don't have supplemental income. They don't come from rich families that can take care of them. They don't have other assets.

What do we do to keep the program solvent beyond the 75-year window so that other seniors—I actually heard an elected official in Nevada chide a group of seniors for being in the position that they are in because they didn't make good choices when they were young. Now, when I looked out at that audience, I saw a bunch of World War II vets that enlisted in the Army, served their country, came home, married their high school sweetheart, got a job, had children, their children went on to lead good lives, and now they are retired on their Social Security. They didn't make bad choices. They depended on the promises of their government to have an income that they had been paying into for many, many years since they started working.

I don't think privatizing the system is a good way to go. If you are somebody in my income bracket and you have an extensive portfolio, you can invest in stocks and not have to worry about the bottom falling out from under you. But for most people that depend on this Social Security check, they have no alternative. And I think it is a little too risky to play, dare I say, roulette with people's only means of survival.

So what suggestions do you have? You deal with this on a daily basis. What do we do as a Congress, where we obviously come from different positions, different belief systems, but know that this system is important enough to keep solvent and keep our seniors receiving their Social Security?

I would like to hear it, because, as you can hear from here, we are nowhere near a conclusion that is going to be beneficial. And the longer we wait, the worse it is going to get.

So what do you suggest we do in a political environment? This isn't actuarial, obviously. If it was, it would be an easy decision. What do you do? How do I protect my people?

Mr. BLAHOUS. Let me answer in two parts.

First, I would just stress the importance of acting soon. It is very important, especially if you are talking from the vantage point of people now receiving benefits. And the reason for that, if you did a solution today, you could honor full benefits to people now getting them, you could honor benefits to people on the verge of retirement, and you basically would face a set of choices that would be I think at least comparatively benign.

If you wanted to, you could fix the system without raising taxes, and you could pay a rate of benefit growth for initial retirees going forward that is somewhere between the rate of inflation and wage indexation. If you want to pay something closer to the current benefit formula going forward, you would have to raise taxes somewhat.

But at least you have comparatively benign—

Ms. BERKLEY. Are you talking payroll taxes?

Mr. BLAHOUS. Well, I am just sort of outlining the choices today, that basically, within a stable tax rate right now, we can afford not only to pay today's benefits but, actually, a level of benefits in the future that is somewhat higher, even relative to the inflation. Now, if you want to pay for the current benefit formula, you have to raise either the payroll tax base or the payroll tax rate somewhat to do it.

But at least your choices today are comparatively benign. If you wait a while, because of all the baby boomers heading into the system, then you start facing much more difficult choices. Then you start facing choices of affecting people close to retirement or already in retirement or actually having real declines in benefit levels.

And, of course, the nightmare scenario is you wait until 2036, and then you have the choice between a 23 percent benefit reduction and a 16.4 percent payroll tax rate. So there is a huge advantage to today's seniors if we act earlier.

Now, stepping back from that—and this is just my personal set of policy views. I am not speaking for the trustees. But I tend to think that the basic levers in Social Security, the three that I look at are: the eligibility age—right now we are living about 6 years longer at age 65 than when Social Security was first established, but we are actually—a typical beneficiary is collecting benefits 3 years earlier, because we moved the first age of claims from 65 to 62.

Chairman JOHNSON. Could you summarize?

Mr. BLAHOUS. Well, I would look at the eligibility age; the benefit formula, especially for high-income beneficiaries; and the work incentives provided in the system.

Chairman JOHNSON. I think that Mr. Becerra and I are both energized to try to fix the system. And it can be fixed. And we agree with you that people who put their money in there expect to get a return from it.

Ms. BERKLEY. And it is the safety net that millions of older Americans depend on for their very survival.

Chairman JOHNSON. You are right. You are right. Thank you. Your time has expired.

Mr. Paulsen, you are recognized.

Mr. PAULSEN. Thank you, Mr. Chairman.

First of all, thank you for being here and for sharing your expertise, because you are the experts, you deal with this. And I find much of what is in your report actually fascinating.

Let me just follow up on some of the comments or questions that were offered a little earlier.

Last night, I was signing high school graduation letters, and I had 800. I was signing for one of the high schools. I know a lot of

the kids where my daughter is graduating. And, you know, these high school students are essentially set to retire in about year 2055. A long time away, right? And many of them will be going to college or entering the workforce. They are going to start paying Social Security payroll taxes.

Can you comment, I mean, what rate of return can these young people expect on the taxes that they are paying? And how would that be different from the return of their grandparents and parents?

Please, Mr. Blahous, first.

Mr. BLAHOUS. A typical high school graduate today, they would probably expect a personal rate of return of about 1½ to 2 percent over inflation on their Social Security contributions. That would be a bit less than their parents. Their parents are probably 2, 2½. And their grandparents are probably 3 percent or so.

It has been gradually drifting down, and that reflects a couple of things. One, it reflects population aging. So, as you have a declining ratio of workers to beneficiaries, if you want to have comparable benefit payments between generations, each succeeding generation has to face a higher tax rate to get it. And so that causes internal rates of return to be depressed over time.

The internal returns were highest for the first recipients, the people who collected benefits without themselves putting in appreciable amounts into the system. So they were much higher in the very early years of the program.

Mr. PAULSEN. Mr. Reischauer?

Mr. REISCHAUER. I just want to ask Chuck a question.

That assumes that the people retiring in 2055 don't have a ratable reduction in their benefit.

Mr. BLAHOUS. Actually, I am assuming the ratable reduction.

Mr. REISCHAUER. Oh, you are.

Mr. BLAHOUS. Yeah. There is basically—

Mr. REISCHAUER. So it would be higher if the system were fixed in some way without changing the benefit structure that exists now?

Mr. BLAHOUS. Right.

Mr. PAULSEN. Well, that goes to the question, then, of how does further delay impact these young people and future generations? I mean, a future delay in acting on fixing the program, right? Because this is the trustees report. It is offering us the challenge of 2036 and, you know, 75 years out.

Mr. BLAHOUS. I mean, I would say that delay—obviously, delay is costly from the perspective of your choices as legislators. But it is especially costly from the standpoint of younger generations, because you wind up in a situation where the effects of balancing the system are concentrated much more on younger participants.

So the longer that you leave the current imbalance between scheduled benefits and projected revenues on the table, and you have cohort after cohort after cohort of baby boomers entering the rolls who, themselves, aren't contributing to removing that imbalance, you are loading up on the younger generation the adverse consequences of that imbalance.

So delay is particularly costly from the standpoint of younger workers.

Mr. PAULSEN. You know, it seems to me—and I don't know the exact wording of the statute, but the reason we have the trustees report and the reason that you are out there to provide us the expertise and the benefit of your knowledge and share information with us, the Members of Congress, is not to give us sort of the snapshot of where we are right now, but it is to share the picture of where this program is going, right? Isn't that what the trustees are responsible for?

Mr. REISCHAUER. "Under no change in the law" is what we—We are not, with our public trustees hats on, opining on various methods to strengthen the system or alter it.

Mr. PAULSEN. Right. Right.

Well, I just think this is an important point, Mr. Chairman. I mean, I haven't been in Congress very long, just for 2 years. But I just notice that Congress always tends to deal with short-term thinking. We are always thinking 6 months, 2 years. We are never thinking for the long term. And some of the issues that are portrayed here are no different than what faced us with AMT, estate taxes, or other issues. If you don't tackle them earlier, they become much more difficult—the doc fix—to address down the road. And I think your warnings, early warnings, are really important.

I mean, there are a couple of things that just really stick out to me. Right now, cash flow deficits that started earlier, they are projected to be permanent. That is right around the corner. And that is going to continue permanently right on down the road. And the gap is real. And, again, by 2036, it is either a 32 percent increase in taxes or it is going to be a 23 percent reduction in benefits down the road. I mean, that is significant.

So I just want to thank you for being here. I know we have, bipartisanly, have a lot of opportunity and challenge in addressing this, Mr. Chairman.

Chairman JOHNSON. Thank you, sir. I appreciate your testimony.

Mr. Smith, you are recognized.

Mr. SMITH. Thank you.

I appreciate the opportunity to have a dialogue here today. I think we owe the American people a sincere discussion here. And I am kind of intrigued by the preview of some future campaign advertisements. But I hope that, as we do look at the balance, we realize the fact that there is an imbalance.

Would you say that characterizing our situation with Social Security as an imbalance is accurate?

Mr. REISCHAUER. As looked at over the long run, yes.

Mr. SMITH. Right. And I appreciate that. Because I think, if anything, though, we can add emphasis to the fact that we have a commitment to seniors that we will fulfill. And as we look at trying to address things—I mean, it is fairly cut and dry as to what needs to be done or what could be done to address this imbalance long term.

But I share the concern of my colleagues when I see young people paying out, paying into the system, and, yet, without the assurance that that balance can be achieved, because there are political games played here in Washington that I think come at a huge price

tag for the future of young Americans who want to pursue economic freedom.

And I am one who thinks that economic freedom is one of the fundamental, core principles of our country, that we can make sure that there is the safety net well into the future for those who have been dealt a different hand, certainly no fault of their own oftentimes.

But if we wanted to balance things out long term—obviously, we have to look at it that way—what would be the age—if the retirement age were increased, how much would we have to raise the retirement age for things to be in balance, doing nothing else?

Mr. BECERRA. I want to hear this one.

Mr. BLAHOUS. Yeah, it is a lot. I mean, at this point, it is a lot.

With retirement-age changes, much depends on the rate at which you phase it in. So, you know, a lot of proposals have it going very, very gradually. If you look at the Simpson-Bowles proposal, they start phasing in a retirement-age increase by 1 month every 2 years. You basically run out of the valuation period; the 75-year period runs out before the retirement age gets up fast enough to actually close the imbalance. So you would have to raise it much more dramatically.

But I think, in theory, you would have to get it well up into the mid 70s, the normal retirement age, if you wanted to close the imbalance through retirement-age changes alone. The proposals that are often talked about to raise it to 67, 68, and 69 over time only solve a small fraction of the actuarial deficit.

Mr. SMITH. Thank you.

Mr. REISCHAUER. Just to clarify things, the normal retirement age is the age at which you get full benefits, and that is 66 now. And it will gradually rise, starting in a few years, to become 67. Then there is the early retirement age, at which you are eligible for reduced benefits.

And so the answer to your question could also depend on whether you are moving the early end and the normal retirement age up together or you are just moving the normal retirement age up. And when you move the normal retirement age up alone, the benefits you receive at the early retirement age go down very significantly.

Mr. SMITH. Okay.

Thank you, Mr. Chairman. I yield back.

Chairman JOHNSON. Thank you.

Mr. Berg, you are recognized.

Mr. BERG. Thank you, Mr. Chairman.

Well, first of all, I just really appreciate you being here and presenting. And I can't imagine all the work that has gone into the last 12 months and what your trustees have brought forward.

I don't know where to even start on this thing, but, you know, I got elected to take on some of these problems and fix the problems. And I think we have political agendas, we have financial agendas, we have people on a lot of different agendas here. But I just want to make it really, really simple. And I am not asking you to represent anyone except yourself.

But if I said to you, we have to fix this problem so it is stable, so cash flows for the long term, what specifically would you do if

we said, the next 30 days we have to fix this, what would you do? What are the key things you would do, for both the old age and disability?

Mr. BLAHOUS. Just very visibly and publicly taking off my trustees hat, I tend to think in terms of three main levers on Social Security.

One is the eligibility age. As Dr. Reischauer said, there are moving parts even to the eligibility age. There is normal retirement age, there is early eligibility age. And so, to understand what you get at a given age of claim, you have to know a lot of things, you know, what those are and, also, what the basic benefit is at normal retirement age.

Longevity has increased about 6 years at age 65 since Social Security was first established. But due to the establishment of early eligibility age, people are more typically claiming benefits at 62 now. So a typical beneficiary is getting benefits for about 9 additional years. Even if the early eligibility age went gradually up to 65 and the normal retirement age went gradually up to 70, you would still be in a position—

Mr. BERG. So what would your age number be?

Mr. BLAHOUS. Well, I wouldn't do it all through—I mean, again, this is personal speculation. But I think any eligibility-age changes have to be very gradual. And I happen to be of the view that it is important to raise the early eligibility age at least back to 65 so that people aren't claiming earlier than they were when the system was first established.

Even if the early eligibility age went back to 65 and the normal retirement age went to 70, people would still be claiming benefits no later than they were then and getting a much higher benefit because of the numerous benefit increases since then. So that is one lever.

Another one is just constraining the growth of benefits on the higher-income end. There are sort of two families of plans to do that. There are the so-called progressive indexing plans, where, basically, benefits on the lower-income end rise at the rate of wage growth in the economy, and on the higher-income end they rise at the rate of inflation, and everybody else is somewhere in between. That is one family of plans. Another one sort of surgically gets into the benefit formula and changes the numbers in the benefit formula to target benefit growth on the high-income end. That is basically the Simpson-Bowles approach. They are both valid approaches, and they both have the same intended effect.

And the last category of things I personally would look at is, there are a lot of very skewed work incentives in the current system. The current system, the actuarial penalty for early retirement claims may not be adequate. The actuarial reward for delayed retirement claims may not be adequate. This may incentivize people to leave the workforce earlier.

There are quirks in the way the benefit formula works. The way the benefit formula works now, it is trying to do two things: It keeps track of your wage history so it knows whether you are a high-income person or a low-income person, but it is also trying to be progressive. It is trying to pay a higher return to people on the lower-income end. So what happens is, the longer you work, your

lifetime average earnings rises. And because of the progressivity of the benefit formula, your internal returns drop.

And once you hit 35 earnings years, then your personal returns really plummet. So when you are a senior, you are contemplating whether to a transition job, a part-time job in transition to retirement, the system is basically telling you that if you keep working and paying payroll taxes, there is going to be almost no change if your benefit.

So there are a lot of changes I would make to that just to better incentivize work. But, again, not speaking as a trustee.

Mr. BERG. Thank you.

Take a crack at it?

Mr. REISCHAUER. Yes, I was hoping you were going to run out of time. But I will take off my trustees hat, as well, and say that, were I the czar and asked to go off in a room and try to do this without considering political consequences, I would first of all—

Chairman JOHNSON. We are going to build a wall right here.

Mr. REISCHAUER [continuing]. Would raise the eligibility age and index it to longevity. Do it very gradually and not by huge amounts.

I would increase the computation period over which benefits are calculated. Now we take your top 35 years of earnings and average them, and that leads to a situation where we don't make as much of a distinction as I believe we should between individuals who have very high earnings in a few years versus somebody who works a long career at a relatively low wage. And so I would make an adjustment on that front.

I would adjust the benefits in ways that would probably raise them at the bottom and dampen their growth at the top, and institute some kind of minimum benefit that was more adequate than what we have now.

I would phase in coverage for all State and local workers, about a quarter of whom are now outside the system. And it leads not only to huge administrative complexities but certain inequitable situations.

And I would raise the taxable maximum, which is now indexed to the growth of average wages but has led to a situation where the fraction of total earnings that are covered, which has bounced around at about 91 percent in certain years, is down in the mid to low 80 percent now.

And also make an adjustment for the fact that a larger fraction of total compensation that people are getting now comes in the form of nontaxable fringe benefits, namely health insurance.

And so, making some adjustments that way. And I think, you know, a balance between taxes—

Chairman JOHNSON. The gentleman's time has expired. Can you put that—

Mr. REISCHAUER. As soon as I said "taxes"?

Chairman JOHNSON. Can you put some of that in writing, 1, 2, 3, 4, 5, for us, please?

Mr. REISCHAUER. Yes. Both of us will.

Chairman JOHNSON. I would appreciate it. We probably have it on the record anyway, but thank you.

Mr. Brady, you are recognized.

Mr. BRADY. Thank you, Mr. Chairman.

Today's job numbers are heartbreaking for job seekers, especially coming on a string of bad economic news: first-quarter GDP just anemic; manufacturing index going down. Consumer confidence is almost as low as it was more than 2 years ago. And, in fact, the unemployment rate at 9.1 percent is artificially low. That is because people have given up looking for work. In fact, we have the fewest percentage of Americans in the workforce in a quarter of a century. And a lot of them have given up hope, and, frankly, many of them will struggle to get back into the workforce.

Who would have thought the highlight of the Obama recovery was two Christmases ago? We are in real trouble. And the failure to get this economy going has a direct impact on Social Security.

Today, we have heard two major red flags raised. Dr. Blahous has said this is the first report since 1983 projecting permanent cash-flow deficits. And Dr. Reischauer said that, in looking at the 75-year outlook, this is the largest single-year deterioration since 1994. That ought to be real red flags and certainly, I think, counters the argument that things are just rosy in Social Security. You would have to be in denial to believe we don't have a real problem in this program.

These cash deficits that are now permanent, as I look at the estimations, it looks like Social Security's cash shortfall in the next 10 years will be \$416 billion. My question is, the current deficits we are running, is it fair to say that Social Security's permanent and growing cash-flow deficits are adding to the unified Federal deficit? And, if so, does that increase the burden of debt we are leaving to our kids and grandkids?

Dr. Blahous, is that adding to our debt?

Mr. BLAHOUS. I would say yes. From a trust fund standpoint, the trust fund balances are continuing to rise. So if you looked narrowly at the world of the Social Security Trust Fund, its balances are rising. But if you look at the unified Federal budget, the shortfall of tax income relative to outgoing benefit expenditures adds to the unified Federal deficit.

Mr. BRADY. And, right now, we are borrowing to make up the difference.

Mr. BLAHOUS. That is right.

Mr. BRADY. Dr. Reischauer, is this adding to the unified debt?

Mr. REISCHAUER. Yes, by definition, it is.

Just one comment on your preamble, and that is, I said that the deterioration in the actuarial balance was as large or larger than any since the early 1990s, but a very small portion of that is due to economics, changed economic assumptions. Most of it was due to changes in demographic assumptions and improved data and—

Mr. BRADY. Are you concerned about—

Mr. REISCHAUER [continuing]. Some improved methodologies.

Mr. BRADY. If Congress doesn't act, are you concerned about the future of Social Security?

Mr. REISCHAUER. Yes. No, I mean, I think this is a—

Mr. BRADY. Yes or no?

Mr. REISCHAUER. Yes. No, yes. I said yes—

Mr. BRADY. No, comma, yes. Okay. I get it.

Mr. REISCHAUER. Yes, yes.

Mr. BRADY. I knew that.

Mr. REISCHAUER. You know, this is a challenge going forward. It is not like the debt ceiling, something that has to be addressed in the next few months or even the next few years. As Dr. Blahous has said, the sooner you address it, the better off we will be. The options will be greater, the ability of affected parties to respond will be more.

Mr. BRADY. I know the answer to this, but there is probably a need to clear things up. And I stepped out for a minute. But in the trust fund today, we don't have cash in the trust fund today, correct? We don't have a Social Security Trust Fund comprised of cash?

Mr. REISCHAUER. No, you don't. But your bank account doesn't have cash in it either, and yet, when you put your ATM card in, cash comes out.

Mr. BRADY. Yeah. But that is because you have actually deposited cash before and the bank is holding it. Today—

Mr. REISCHAUER. Well, the bank has actually lent it to somebody. So the bank doesn't always even have it.

Mr. BRADY [continuing]. The U.S. Government is holding those IOUs, correct? And these are nonmarketable securities. So there is a difference between the security sold to a firm or to China versus the nonmarketable securities within the trust fund. Right now, because we are running a deficit, in effect, we have borrowing authority to make up any difference each year in Social Security.

Correct, Dr. Blahous?

Mr. BLAHOUS. Yes, the bonds in the trust fund are special-issue Treasury bonds. And, basically, they earn a rate of interest that is pegged to a market rate of interest. But they are unusual bonds in the sense they are basically called as needed by the Social Security system.

Mr. BRADY. And the call is on taxpayers and the Federal Government.

Mr. BLAHOUS. Right.

Mr. BRADY. So when we are running short, as we are—and you said permanently running short in this program—that means we permanently borrow to make up the difference each year.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you.

Mr. REISCHAUER. But right now the Treasury is giving an interest payment that is larger than the amount that you have to borrow. So—

Mr. BRADY. And that has to be paid back, is another call on taxpayers and the government.

Chairman JOHNSON. Yeah, they sell Treasuries every day. Have you been down there and watched them? We borrow money like it is going out of style.

Mr. Becerra, you are recognized for one quick question. And then, we have a vote, so we will have to adjourn.

Mr. BECERRA. Thanks. Thanks, Mr. Chairman.

I just want to clarify, these nonmarketable special-issue bonds, they are not just held by Social Security, they are also held by foreign governments and other folks, as well.

Mr. BRADY. No, that is not true.

Mr. BECERRA. That is true, absolutely true. It absolutely is true.

Mr. BRADY. You can answer.

Mr. BECERRA. So——

Chairman JOHNSON. Wait a minute. Let him respond.

Mr. BLAHOUS. Well, I mean, I am not an expert in the broader set of securities sold by the Federal Government, but the bonds that are issued to Social Security are sort of a special-issue creation of the Social Security Act that is sort of uniquely created for the Social Security system.

Mr. BECERRA. Right, backed up by the money that taxpayers contribute into the system. It is not as if they are fictitious bonds. They are bonds backed by the money that taxpayers put into it.

Mr. BRADY. But they are different from the securities, the Treasuries that are held by the public.

Mr. BECERRA. If, by that, you mean that the money that foreign countries give us is better than money that American taxpayers give to the Federal Government, then perhaps they are different. But a dollar is a dollar.

One quick question I just wanted to ask because we have—I think everyone agrees that, long term, we want to do something to make sure that we don't have a shortfall in Social Security but that, right now, the Social Security system continues to contribute.

The question I have is this. Has the Social Security system ever contributed a cent to the deficit that the country faces today?

Mr. BLAHOUS. I mean, I would state that it is contributing to the deficit now in 2011 and did in 2010, as well.

Mr. BECERRA. And how is that?

Mr. BLAHOUS. Well, basically, the amount of revenue the program is generating——

Mr. BECERRA. On an annual basis.

Mr. BLAHOUS [continuing]. Is less, on an annual basis, is less than the amount that the program is sending out the door.

Mr. BECERRA. And so, Dr. Blahous, then you are taking the fact that the money that was contributed in the last 10 years—I won't even talk about the last 30 years, but the last 10 years—when taxpayers were contributing more than was being used by Social Security, that no longer exists?

Mr. BLAHOUS. Well, no question, I understand the fundamental point, which is that if you take the total value of Social Security's positive contributions to the budget balance since the 1980s, that far outweighs the negative contribution it is making in 2010 and 2011. So I certainly recognize that point.

Mr. BECERRA. Right, but, I mean, I think it is important for American taxpayers to understand what folks are saying. When they contribute out of their paycheck for Social Security and the government takes that money and says, "We don't need it all today, so we are going to put some of it into Treasury bonds so that now we can use that money today as the Federal Government for other operating expenses, but you are going to hold Treasury bonds so that when you do retire you can collect it"—if you say that we are running deficits today, then you have essentially said that those Treasury bonds that were backed up by the money that same worker contributed last year has evaporated.

Chairman JOHNSON. Yeah, let's call it quits to the interrogation.

And I would like to make one comment. FactCheck.org says it this way: Quote, "Some senior Democrats are claiming that Social Security does not contribute one penny to the Federal deficit. That is not true. The fact is, the Federal Government had to borrow \$37 billion last year to finance Social Security and will need to borrow more this year. The red ink is projected to total well over a half a trillion dollars in the coming decade."

Mr. BECERRA. FactCheck's pants are on fire, I think.

Chairman JOHNSON. And, with that, we are going to close the hearing. We have a vote going on.

I appreciate the two of you being here. That was very good testimony. Thank you.

The committee is adjourned.

[Whereupon, at 10:27 a.m., the subcommittee was adjourned.]

QUESTIONS FOR THE RECORD

Charles P. Blahous III, Ph.D.

August 4, 2011

ATTN: Kim Hildred
Staff Director
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
B-317 Rayburn House Office Building
Washington, D.C. 20515

**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.

Robert D. Reischauer, Ph.D.

Robert D. Reischauer: Additional response to question at June 3, 2011 hearing of the Subcommittee on Social Security of the Committee on Ways and Means.

1. In your testimony, you supported action sooner rather than later to address Social Security's financing shortfalls. In response to a question you also expressed your personal views regarding the combination of options which would best address the 75-year deficit. Since your response time was short, please submit your recommendations for proposals Congress should consider.

Taking off my Public Trustee hat and answering the question from the standpoint of a policy analyst who has studied and written about Social Security for many years, I would craft a package of reforms that included the following elements:

1. Revise the benefit formula so as to:
 - a. moderately reduce benefits for those with high lifetime earnings
 - b. increase benefits for those who had low earnings but worked for many years
 - c. institute an adequate minimum benefit
 - d. reduce the spousal benefit
 2. Start the phase-in of the increase in the full retirement age from 66 to 67 in 2013 and after the full retirement age has reached 67 index it and the early retirement age to the increase in adult life expectancy (e.g. keep the ratio of the full retirement age minus 21 to life expectancy minus 21 constant and do the same for the early retirement age.)
 3. Index benefits to the chained CPI-U (Only if other retirement and tax code indexing also is changed.)
 4. Raise the taxable maximum to cover 90 percent of earnings and adjust the threshold in the future to keep the ratio of average earnings to average total compensation constant.
 5. Phase in the coverage of uncovered state and local workers.
 6. Raise payroll tax rates on workers and employers by 0.5 percentage points.
 7. Increase the number of years earnings are averaged over to calculate benefits from 35 to 38.
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SUBMISSIONS FOR THE RECORD

The Center for Fiscal Equity

Comments for the Record

House Ways and Means Committee

Subcommittee on Social Security

Hearing on the 2011 Annual Report of the Social Security Board of Trustees

June 3, 2011

**by Michael Bindner
The Center for Fiscal Equity**

Chairman Johnson and Ranking Member Becerra, thank you for the opportunity to submit my comments on this topic. I will leave it to the Administration's witnesses to explain the Trustees' Report and will instead confine myself to what needs to be done in the future, with special emphasis on what not to do.

The effect of the trust fund's current cash flow deficit status and future exhaustion

The only observation I will make regarding the Trustees report is that the recent Recession triggered by our continuing asset-based Depression has both temporary and permanent effects on the trust fund's cash flow. The temporary effect is a decline in revenue caused by a slower economy and the temporary cut in payroll tax rates to provide stimulus.

The permanent effect is the early retirement of many who had planned to work longer, but because of the recent recession and slow recovery, this cohort has decided to leave the labor force for good when their extended unemployment ran out. This cohort is the older 99ers who need some kind of income now. The combination of age discrimination and the ability to retire has led them to the decision to retire before they had planned to do so, which impacts the cash flow of the trust fund, but not the overall payout (as lower benefit levels offset the impact of the decision to retire early on their total retirement cost to the system).

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.

The cash flow problem currently experienced by the trust fund is not the trust fund's problem, but a problem for the Treasury to address, either through further borrowing – which will require a quick resolution to the debt limit extension and preferable through higher taxes for those who received the lion's share of the benefit's from the tax cuts of 1981, 1986, 2001, 2003 and 2010.

The cost of delaying actions to address Social Security's fiscal challenges for workers and beneficiaries.

Actions should be taken as soon as possible, especially when they must be phased in, as it is a truism that a little action early will have a larger impact later.

This should not be done, however, as an excuse to use regressive Old Age and Survivors Insurance payroll taxes to subsidize continued tax cuts on the top 20% of wage earners who pay the majority of income taxes. Retirement on Social Security for those at the lowest levels is still inadequate. Any change to the program should, in time, allow a more comfortable standard of living in retirement.

The ultimate cause of the trust fund's long term difficulties is not financial but demographic. Thus, the solution must also be demographic – both in terms of population size and income distribution. The largest demographic 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.

The recommendations for raising net income are within the context of comprehensive tax reform, where the first 25-28 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.

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.

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.

All of the changes proposed here work more effectively if started sooner. The sooner that the income cap on contributions is increased or eliminated, the higher the stock accumulation for individuals at the higher end of the age cohort to be covered by these changes – although conceivably a firm could be allowed to opt out of FICA taxes altogether provided they made all former workers and retirees whole with the equity they would have otherwise received if they had started their careers under a reformed system. I suspect, though, that most will continue to pay contributions, with a slower phase in – especially if a slower phase in leaves current management in place.

Thank you for this opportunity to share these ideas with the subcommittee

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