2012 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

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2012 ANNUAL REPORT OF THE SOCIAL SECURITY BOARD OF TRUSTEES

THURSDAY, JUNE 21, 2012

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

The subcommittee met, pursuant to notice, at 9:06 a.m. in Room B–318, Longworth House Office Building, the Honorable Sam Johnson [Chairman of the Subcommittee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

Chairman Johnson Announces Hearing on the 2012 Annual Report of the Social Security Board of Trustees

Thursday, June 21, 2012

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 2012 Annual Report of the Social Security Board of Trustees. **The hearing will take place on Thursday, June 21, 2012 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 Deputy Commissioner of Social Security Administration serves as Secretary of the Board.

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 2012 report concluded, "Under the long-range intermediate assumptions, annual cost for the OASDI program is projected to exceed non-interest income in 2012 and remain higher through the remainder of the long-range period. The combined OASI and DI Trust Funds are expected to increase through 2020, and then to decline and become exhausted and unable to pay scheduled benefits in full on a timely basis in 2033. However, the DI Trust Fund becomes exhausted in 2016, so legislative action is needed as soon as possible."

In the absence of intervening Congressional action or changes in projections, the Trustees project that incoming Social Security revenues would be sufficient to pay about three-quarters of scheduled benefits starting in 2033 and over the rest of the 75-year period.

In their "Message from the Public Trustees," the Public Trustees concluded that Social Security's finances had deteriorated primarily because of a weak economy and higher-than-expected inflation. They said, "[t]he Social Security outlook has worsened significantly relative to last year's report. The actuarial deficit in its combined trust funds is now 2.67 percent of taxable payroll, the highest recorded since the last major Social Security financing reforms roughly three decades ago." They also said, "While there is no way to know what mixture of additional revenue and restraints on benefit growth will prove to be the most palatable means of strengthening Social Security's financial position, lawmakers should be aware that it will become increasingly difficult to avoid adverse effects on current beneficiaries, those close to retirement, and low-income beneficiaries in all birth cohorts if legislative actions are delayed much further."

In announcing the hearing, Chairman Sam Johnson (R–TX) stated,**"Americans have long known that without change, Social Security will be unable to**

keep its promises to the hard-working taxpayers who pay into the system. According to this year's report, not only is Social Security's outlook worse, it is clear that the longer we wait the harder it will be to protect benefits for those who rely on them most. I hope this hearing will help lead us to find commonsense solutions to secure Social Security's future."

FOCUS OF THE HEARING:

The hearing will focus on the findings in the recently released 2012 Annual Report of the Board of Trustees of the OASDI Trust Funds, the effect of the trust funds' 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 Thursday, July 5, 2012**. 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. This hearing will come to order. Good morning to both of you. Thank you for being here.

According to this year's report from the Social Security Board of Trustees, Social Security will be unable to keep its promises to the hard working Americans who pay into the system.

We will hear today that not only is Social Security's financing looking worse, but it will also be increasingly difficult to protect benefits for those who rely on them most if we delay action much longer.

As Commissioner Astrue said "This year's Trustee Report contains troubling but not unexpected projections about Social Security's finances, and once again emphasizes that Congress needs to act to ensure long term solvency of this important program."

According to the Trustees, the Old Age and Survivors Program will be unable to pay full benefits beginning in 2035, three years earlier than projected in last year's report.

That means workers who are 44 years old today will reach their full retirement age in 2035, at which point everyone else will face benefit cuts of 25 percent unless Congress acts.

In less than 4 years, Social Security's Disability Insurance Program will be unable to pay full benefits.

The average monthly benefit for a disabled worker today is only $1,111. In 2016, revenues will cover 79 percent of benefits. That is a potential cut of about $233. That is real money for those who are getting by on fixed income.

Social Security's last major reform was in 1983, then Social Security faced an imminent disaster. In their 1982 annual report, the Social Security Trustees said, "Without corrective legislation in the very near future, the Old Age and Survivors Insurance Trust Fund will be unable to make benefit payments on time beginning no later than July 1983."

Members of Congress and the President were able to develop and ultimately pass on a bipartisan basis the Social Security Amendments of 1983.

Despite the near failure of the Greenspan Commission and despite the opposition of senior advocacy groups including AARP, as this year's report makes clear, Social Security is in trouble, but just as in 1983, I believe our nation has the will to again save Social Security.

We should not follow the path Europe has taken by waiting for a financial disaster to force changes that ultimately could end up hurting the most vulnerable.

Today we will hear from Social Security's Public Trustees, but we in Congress are trustees, too, and the public knows the longer we wait, the more difficult the choices will become, and the less time Americans will have to prepare.

With all the financial anxiety that Americans face, we should not increase the burden on them by failing to fulfill our duty in protecting our nation's most important safety net program. We need to act now before it is too late.

Do you have an opening statement?

Mr. BECERRA. I do.

Chairman JOHNSON. What do they say, up from the grave he arose.

Thank you again for listening. I will recognize Mr. Becerra now for any opening statement you have.

Mr. BECERRA. Thank you, Mr. Chairman. I also want to thank Mr. Stark for being here in the event I was not able to make it. I got my daughter to her program on time and I am able to be here. Thank you very much for being here to the two gentlemen, our Trustees who are here.

I would just like to say what I have been saying for quite some time. Social Security, even through the worst recession since the Great Depression, is a program that people have grown to rely upon and can trust.

Between 2007 and 2010, a typical middle class family lost somewhere between $26,000 to $87,000 in their net worth. That is about four out of every ten dollars of their assets and savings.

Between 2007 and 2010, Social Security added $439 billion to its trust fund surplus, while paying Americans their earned benefits on time and in full.

Here we saw Americans with their private savings and retirement pensions watching it go down at the same time during this great recession. We saw Social Security continue to increase the monies it had to pay out benefits to its recipients.

Over 77 years now, through 13 recessions, Social Security has added not one penny to our deficit or to our debt.

In 2011, Social Security provided earned benefits to more than 55 million seniors, widows, disabled workers, and children, while saving all the reserves in its trust fund to pay future benefits.

Six out of ten seniors who get Social Security rely on Social Security for a majority of their income. There are 1,300,000 children who are lifted out of poverty because they receive Social Security.

In the long term, Social Security faces a manageable challenge. It is not now and never will be broke.

This April, the Social Security Trustees warned that without action, Social Security will be insolvent by 2033. Let's be clear about what that means.

In 2033, worker contributions are projected to cover about 76 percent of Social Security's costs. The remaining balance in Social Security's trust fund will pay another five percent of costs. The shortfall is stable. After 2033, Social Security's income will be enough to pay about three-fourths of earned benefits until at least 2087, and likely longer after that.

Social Security's long term shortfall is a problem that we need to address, but even when the reserves building up now run out, Social Security will not be out of money. It will have a shortfall of about .9 percent of GDP, just slightly more than the cost of extending the Bush tax cuts for people who earn more than a quarter of million dollars a year.

Social Security does face a crisis in the short term, one manufactured by a series of budget cuts forced by House Republicans.

If they continue, the cuts could delay benefits and damage Social Security's well earned public image.

In 2011, the Republican-led a four year continuing resolution cut the Social Security Administration's budget by $600 million, despite rising numbers of Americans applying for Social Security.

In 2012, SSA's budget was frozen below the 2010 level.

I strongly oppose these budget cuts which are kind of like the cable company starting to bill you for a service while you are at home waiting for them to show up and connect it.

Social Security's trust fund funds the entire cost of paying Social Security benefits. In 2011, workers contributed over $600 billion to Social Security's trust fund. Because of Social Security's budget cuts in 2011, all Social Security field offices started closing half an hour early each day.

Social Security permanently closed over 300 contact stations and small field offices and waiting times for initial disability decisions rose and are likely to be over 130 days by the end of 2012.

SSA faces an even bigger cut through the sequestration process, automatic cuts scheduled by the Budget Control Act. Although Social Security benefits are protected, if Congress does not act soon, on January 2, Social Security's operating budget will be cut by over $1 billion.

$1 billion in cuts translates into 40 days in which Social Security is shut down. Offices are closed and locked. No one answers the phone. No applications processed. No one makes sure benefit checks are sent to the right place.

Mr. Chairman, Social Security has been there for Americans for 77 years. I hope we can continue to work to make it strong for another 77 years. We can start by addressing the preventable crisis of short-sighted budget cuts.

With that, I yield back the balance of my time.

Chairman JOHNSON. Thank you. We have one witness panel today. Seated at the table are our two Public Trustees, Charles Blahous, Ph.D., and Robert Reischauer, Ph.D.

Robert Reischauer, I would like to congratulate you on your award last night at the National Academy of Social Insurance. We are lucky to have someone with your breadth of experience working as a Public Trustee. Thank you and congratulations.

Mr. Blahous, you are recognized.

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 the Members of the Subcommittee. It is a great honor to appear before you today to discuss the findings of the latest Trustees' reports.

In view of the time constraints we are all under, what I would like to do is gloss over most of the background information in my written remarks and just proceed to some primary points about Social Security financing.

The first simple point is that Social Security costs are rising, most of that cost increase is going to play out from a period that started in 2008 through 2035. The primary driver of those cost increases is demographic.

If you think about Social Security costs, there are really two main pieces. One is growth in the per capita benefit level, and that is driven by the benefit formulas in law, but also just the growth in the number of beneficiaries.

On the revenue side, the primary driver is growth in the number of workers and the wages that are subject to tax. That ratio of workers to beneficiaries is very important for Social Security financing. That ratio is in the process of dropping.

We had 3.3 workers to support each beneficiary in 2007. Now we are down to 2.8, and under our current projections, we will be down to 2.0 by 2035.

Part of that is longevity increases, but the bigger and more immediate factor is simply fertility patterns. We have this big baby boom generation going onto the retirement rolls prior to 2035.

Under our current projections, the combined Social Security trust funds will be depleted in 2033. That is three years earlier than we projected in last year's report. Each year what the Trustees do is they estimate the program's actuarial deficit, usually expressed as a percentage of the tax base, the program's tax base, and this year, our projection is 2.67 percent of worker wages over the next 75 years.

That sounds arcane, but basically what that means is you have a 12.4 percent payroll tax rate now, if you immediately added 2.67 points to that, you would have the program in balance for 75 years, or if you immediately had an equal subtraction in benefit obligations.

That is an average figure. The shortfalls are smaller in the near term, bigger in the long term. It is also a substantial increase from last year's projection.

Last year, we were at 2.22 percent. It may not sound like a big difference, but by Social Security norms, it is a pretty substantial deterioration. We have only had one other report over the previous 30 years that showed as much deterioration in a single year as this year's report does. My colleague, Mr. Reischauer, will review some of the reasons the outlook has grown worse.

Also important, the figures I just cited pertain to the combined trust funds. Social Security has two trust funds, and under law, they each have to be kept solvent to maintain their benefit payments.

The Social Security disability insurance trust fund is in the more severe condition of the two. It is projected to be depleted in 2016.

What is happening over time is the program is going to pose under current law a greater financial strain on the larger budget, and some of the strain is a result of discretionary policy choices, of course, that are made along the way.

One of them, for example, this year, the payroll tax rate has been cut from 12.4 points to 10.4 points. Social Security has been held harmless for that change. There is a provision of that law which transfers general revenues over to Social Security so that its ability to finance benefits is not affected.

Basically, what is happening is that part of the financing responsibility has been moved from Social Security's payroll tax to the general revenue side of the ledger.

A final point, there are significant costs to delay in addressing the financing shortfalls. It is often cited that in 2033, we will have only enough funds to pay 75 percent of scheduled benefits. It is important to bear in mind that does not mean 75 percent of scheduled benefits for those retiring in 2033, that includes everybody. It includes people already on the rolls in 2033, including many people who are drawing benefits today.

If you were to say well, we do not want to cut benefits for people already on the rolls in 2033, what if the benefit reductions were confined to new claimants.

We would not be able to balance the system in that year without a substantial unprecedentedly large tax increase even if we cut off the entirety of benefits to new claimants.

By 2033, it is really too late, far too late to protect previous beneficiaries from substantial dislocations.

If you start working through the problem backwards and you say how soon do we have to act if we want to prevent reductions for people in retirement, near retirement, low income beneficiaries, and prevent a tax increase of a size we haven't countenanced before, we would have to do that pretty soon.

Finally in closing, Mr. Chairman, I would just say that the legislative achievement in creating the Social Security program remains historically a remarkable one.

It has provided critical social insurance protections for hundreds of millions of Americans. It has done this at exceptionally low administrative cost. It has done it with financing methods that are not without their critics but nevertheless have been generally accepted by most of the American public as relatively equitable.

That is a hard thing to do in legislation, and with responsible bipartisan action, Social Security can continue to fulfill its vital role, but such action must be prompt and sufficiently decisive if the program is going to serve future generations as well as it has served previous ones.

Thank you.

[The prepared statement of Charles P. Blahous, III, follows:]

Statement of Charles P. Blahous

Public Trustee for Social Security[1]

Before the Subcommittee on Social Security

of the U.S. House of Representatives Committee on Ways and Means

June 21, 2012

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 Social Security Trustees' report. My written testimony begins with some basics of Social Security finances before describing the causes and magnitude 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. In most recent years the payroll tax rate has been 12.4%, though it was temporarily reduced to 10.4% for the years 2011 and 2012. The tax is currently scheduled to return to 12.4% in 2013 and beyond. The usual 12.4% tax is nominally divided into two 6.2 point halves assessed respectively upon employer and employee, but most economists agree that the entirety of the 12.4% tax is taken from 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 $110,100 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 federal

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[1] I am also a research fellow with the Hoover Institution and a senior research fellow with the Mercatus Center.

[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.

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 is the interest that they earn. The total amount of the trust funds, now roughly $2.7 trillion, represents the interest-compounded value of past annual program balances, including years of surpluses from 1984 to 2009 inclusive.

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 64%) 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. Importantly, one's total Social Security benefit is not limited to the amount of one's own contributions plus interest. 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 greater 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.

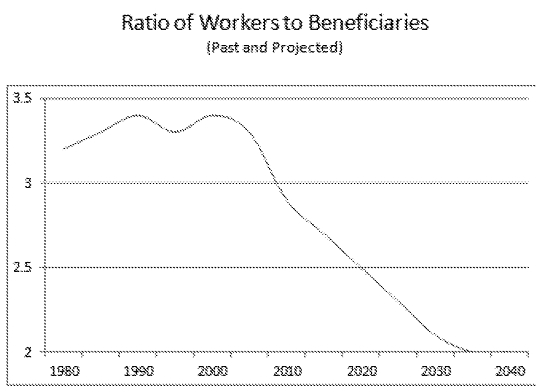
Sources of Financing Strains

Under current financing methods the vast majority of program revenues at any given point in time derives from payroll taxes contributed by current workers. Program benefits, cost rates and demographics can be related by the following formula:

$$\frac{\text{(Individual benefits as \% of current worker wages)}}{\text{(Ratio of workers to beneficiaries)}} = \text{(Cost rate as \% of current worker wages)}$$

For example, if hypothetically a typical benefit were equal to 40% of the average worker's wages, and if there were four taxpaying workers for each beneficiary, then the average program cost rate would equal 10% of the average worker's wages.

Under current law, individuals' initial Social Security benefits are indexed to grow with national average wages while the program's 12.4% tax rate is scheduled to remain constant. But as the preceding formula shows, the ongoing decline in the worker-beneficiary ratio must either result in higher tax burdens upon workers or in benefits that grow less rapidly than worker wages. It is this collision between current benefit and tax schedules, program financing methods and demographics that is at the heart of Social Security's projected financing shortfall.



Various demographic factors contribute to the ongoing decline in the ratio of contributing workers to beneficiaries. Increasing longevity is an important factor, though prior to 2035 a more significant one will be the continued movement of the Baby Boom generation from the ranks of workers to the ranks of beneficiaries.

Current Financing Projections

Social Security expenditures exceeded the program's non-interest income in 2010 for the first time since 1983 and are projected to do so for the indefinite future.[3] In the near term, redemption of trust fund assets from the General Fund of the Treasury will provide the resources needed to offset annual cash-flow deficits of the combined trust funds. Since these redemptions will be less than trust fund interest earnings through 2020, nominal balances of the combined trust funds will continue to grow. After 2020, Treasury will redeem trust fund assets in amounts that exceed interest earnings until depletion of trust fund reserves in 2033, three years earlier than projected last year. Thereafter, tax income would be sufficient to pay only about three-quarters of scheduled benefits through 2086.

Though the nominal balance of the combined trust funds is still rising as a result of annual interest credits, 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.[4] 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.

Also, and very importantly, the results just described pertain to the combined Old-Age and Survivors Insurance and Disability Insurance (OASDI) trust funds. Under law each of Social Security's separate trust funds must have a positive balance in order to maintain scheduled benefit payments. Considered separately, Social Security's Disability Insurance (DI) trust fund faces a much more immediate crisis. DI costs have exceeded non-interest income since 2005 and trust fund depletion is now projected for 2016. Changes to improve the financial status of the DI program are thus needed very soon.

Under current projections, the annual cost of Social Security benefits expressed as a share of workers' taxable earnings will grow rapidly from 11.3 percent in 2007, the last pre-recession year, to roughly 17.4 percent in 2035, and will then decline slightly before slowly increasing after 2050. The projected 75-year actuarial deficit for the combined OASDI Trust Funds is 2.67 percent of taxable payroll, up from 2.22 percent projected in last year's report. This is the largest actuarial deficit reported since prior to the 1983 Social Security amendments, and the largest

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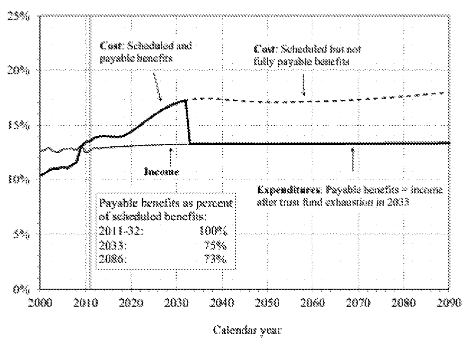
[3] Technically, Social Security would not be permitted to run annual deficits after trust fund depletion due to its lack of legal authority to make payments from financing sources other than the trust funds. The deficits are permanent in the sense that annual benefit obligations are projected to exceed annual revenues.

[4] 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.

single-year deterioration in the actuarial deficit since the 1994 Trustees Report. My colleague Robert Reischauer will provide additional detail about the reasons for this deterioration.

A useful interpretation of the actuarial deficit is that it represents 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 funds into actuarial balance. The actuarial balance equals zero if trust fund assets at the end of the period are equal to the following year's cost. The relatively large deficits at the end of the 75-year projection period—equal to 4.50 percent of taxable payroll in 2086—indicate that sustained solvency would require payroll tax rate increases or benefit reductions (or a combination thereof) by the end of the period that are substantially larger than the average actuarial deficit of 2.67 percent.



The Growing Urgency of Legislative Corrections

By almost any objective measure, the financial health of the Social Security system has entered a concerning decline. While there is no way to know what mixture of additional tax revenues and restraints on benefit growth will prove to be the most palatable means of strengthening Social Security's financial position, lawmakers should be aware that it will become increasingly difficult to avoid adverse effects on current beneficiaries, those close to retirement, and low-income beneficiaries in all birth cohorts if legislative changes are delayed much further.

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 upon those affected. 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 with current formulas in place.

For example, imagine that no legislative action is taken until the Trust Funds' depletion date of 2033 is approached. In 2033, incoming tax revenues would be sufficient only to fund 75% 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, if previous retirees are protected. Accordingly, unless there was then an unprecedented increase in payroll tax assessments, the opportunity to confine benefit changes only to prospective ones would have been long lost. The trustees are currently exploring how the illustrations in the trustees' report might be refined to better capture these practical costs of further delay in legislative corrections.

Budget Implications of Social Security Operations

Concern about the long-range financial outlook for Social Security often focuses on the depletion dates for the trust funds—the time when projected trust fund balances under current law would be insufficient to pay the full amounts of scheduled benefits. A more immediate issue is the growing burden that the program will place on the Federal budget well before depletion of its trust funds. Social Security operations will exert rapidly rising pressure on the Federal budget for the next two decades, as general revenues must cover growing OASDI deficits through 2033.

The 2011 deficit of Social Security tax income relative to cost was $148 billion and the projected 2012 deficit is $165 billion. The large sizes of these deficits are primarily due to a temporary reduction in the Social Security payroll tax for 2011 and 2012. The legislation establishing the payroll tax reduction also provided for transfers of revenues from the General Fund of the Treasury to the trust funds to "replicate to the extent possible" revenues that would have occurred in the absence of the payroll tax reduction. If the payroll tax cut is permitted to expire on schedule at the end of the year, pressure exerted by Social Security on the federal budget will be immediately reduced, but will grow substantially thereafter as the number of beneficiaries and the total cost of benefit payments both rise.

The current policy of lowering the Social Security payroll tax and financing a portion of benefit payments with general revenues represents a substantial departure from historical practice. Under this policy, roughly $217 billion will be transferred from the General Fund of the Treasury to replace foregone Social Security tax collections and to finance Social Security benefit payments. In 2011, due in large part to this change in program financing, payroll tax revenue represented only 70 percent of total Social Security income. Lawmakers should carefully consider whether continued significant General Fund financing for Social Security could threaten to undermine long-standing public perceptions of the program as an earned benefit financed by workers according to contributory social insurance principles.

Conclusion

The legislative achievement in creating the Social Security program remains a remarkable one, in that it has provided critical social insurance protections for hundreds of millions of Americans, at exceptionally low administrative cost, with financing methods that have been accepted historically as generally equitable. With responsible bipartisan action, Social Security and Medicare can continue to fulfill these vital roles, but such action must be prompt and sufficiently decisive if these programs are to serve future generations as well as they have served earlier ones.

Chairman JOHNSON. Thank you. You said “pretty soon.” What do you mean? Do you have a definitive date?

Mr. BLAHOUS. Well, you will get different answers if you ask different experts. My own view is the window of opportunity is closing relatively rapidly.

We already face a shortfall that is significantly larger than the one that was repaired in 1983, which is probably the high water mark politically of what can be accomplished in terms of a short term resolution.

Obviously, each year we wait, the problem grows larger and more difficult to solve.

Chairman JOHNSON. I understand that. When are we going to fall off the cliff? That is what I am asking you. You can answer later.

Mr. Reischauer, you are recognized.

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

Mr. REISCHAUER. Thank you, Chairman Johnson, Ranking Member Becerra, Members of the Subcommittee. I appreciate the opportunity to appear before you to discuss how the Social Security program’s financial outlook has changed since the last Trustees’ report.

To judge whether the financial health of Social Security is improving or deteriorating, the media and the public tend to focus on whether the years in which the two trust funds are projected to be exhausted has receded or advanced.

By this measure, there has been a significant deterioration in the financial health of the Social Security programs since the 2011 report. The exhaustion date, as the Chairman has mentioned, for the

OASI program is now projected to be 2035, three years sooner than was projected last year.

The DI trust fund exhaustion date has advanced two years, from 2018 to 2016, and the exhaustion date for the two trust funds combined has now moved to 2033, three years sooner than projected last year.

A more comprehensive measure of the trust fund's financial condition is the actuarial balance over a 75 year evaluation period.

This measure is essentially the difference between the annual income and costs of the program summarized over the 75 year period and expressed as a percentage of taxable payroll over that period.

A negative actuarial balance, meaning 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 in each of the next 75 years to bring the fund into actuarial balance.

The actuarial deficits of both Social Security trust funds have deteriorated since last year's report. The DI trust fund's actuarial deficit has worsened by seven one-hundredths of a percent of taxable payroll. That for the OASI fund has deteriorated by 38 one-hundredths of a percent of taxable payroll, and the combined trust funds have weakened by 44 one hundredths of a percentage point.

This deterioration in the combined trust funds is the largest decline since the measure was first calculated in 1982, save for the change that occurred in 1994.

There are lots of reasons why the actuarial balance can go up or down from one year to the next. One of them, of course, is that the valuation period changes. We add 2086 to the valuation period and subtract 2011, and that accounts for about nine percent of the deterioration in the actuarial balance.

Clearly, there was no legislation that affected this in a significant way over the past year, so that is not a factor.

Demographic assumptions in this year's report are identical to those that were assumed in the previous report, but we have updated starting values and the transition from those starting values to the ultimate values do affect the actuarial balance.

Specifically, more recent data has shown that birth rates for 2009 and 2010 were lower than assumed in the last report. Immigration in 2010 was a bit lower than was assumed in the previous report. There was a slightly smaller initial population than we assumed before.

A little less than half of the increase in the actuarial deficit between 2011 and 2012 is accounted for by changed economic assumptions and more recent information about the economy's performance.

Two-thirds of this is related to updated starting values and less optimistic assumptions about near term growth of the economy.

Price inflation, as you all know, was higher than anticipated between the third quarters of 2010 and 2011, and rather than a seven-tenths of a percentage point COLA in December of 2011, Social Security gave out a 3.6 percentage point COLA. That makes a huge difference, as you can imagine.

Real interest rates in 2011 and those projected in the 2012 report are lower than assumed before. The new investments that the trust funds make get less interest earnings than we thought they would get when the 2011 report was put together.

Together, these economic factors make the gap between non-interest income and costs over the next few years significantly larger than projected in last year's report, but when the economy has recovered, about the end of this decade, 2020 or so, the gap between what was expected last year and what was expected this year will be close to disappearing.

However, it is important to recognize that we made a new assumption in the 2012 report that causes the gap between income and costs to grow over the long run, and this had to do with what we expect the changes in the average number of hours worked per week to do.

In last year's report, we said hours were not going to change in the future. In this year's report, we assumed they will decline five one-hundredths of a percentage point a year. We did this to reflect the aging of the workforce and the belief that as productivity goes up, incomes go up, people will want to take more leisure, and that will translate into working a few less hours as it has in the past. This assumption obviously acts to reduce taxable earnings and payroll tax revenues from what was assumed in 2011.

We also made a change in our assumptions about the incidence of disability. Compared to last year's report, the ultimate age adjusted disability incidence rates were increased by two percent for males and five percent for women. These are more consistent with what the historical values and trends have been over the last decade.

The deterioration in the actuarial deficits that I have just summarized here today underscore the need for legislative action to put Social Security on a more sustainable path.

The sooner we address this challenge, as Chuck as said, the less disruptive the changes will be. If the reforms are adopted soon, those most adversely affected can be given time to prepare. The burden can be spread more equally across different generations, and political animosity and public anxiety associated with these unavoidable changes can be moderated.

The changes in the trust funds' financial well being that I have discussed also call attention to the importance of maintaining a strong economy and vibrant long term growth.

Let me conclude with a comment about the staffs of the Social Security Administration and the Departments of Treasury, HHS and Labor, with whom we worked to produce the Trustees' reports.

They are an incredibly hard working, talented group of analysts who are dedicated to providing the public and the Congress with as objective and sophisticated set of estimates as is possible, and I think we are all in their debt for the service they provide to us.

Thank you.

[The prepared statement of Robert D. Reischauer follows:]

Statement of Robert D. Reischauer[1]

Subcommittee on Social Security, Committee on Ways and Means

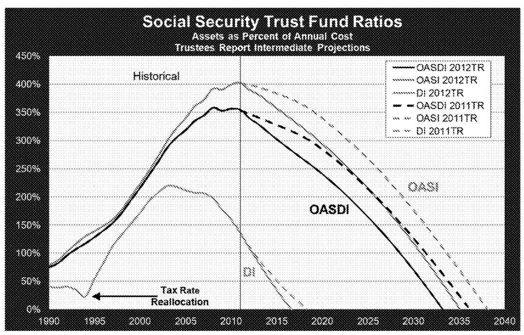
U.S. House of Representatives

June 21, 2012

Chairman Johnson, Ranking Member Becerra, and members of the subcommittee, I appreciate this opportunity to discuss the 2012 Social Security Trustees Report with you. My fellow Public Trustee Dr. Charles P. Blahous covered the basic operations and projected financing shortfall of the program in his presentation. My statement focuses on the changes that have occurred in the program's financial outlook since last year's report and the impact that a weak economy can have on this outlook. To illustrate my points, I have included in my statement a number of charts that were prepared by the Office of the Chief Actuary of the Social Security Administration.

The projections of the financial health of the Social Security program that are contained in the annual Trustees Reports change each year, sometimes by small amounts, sometimes by moderate amounts, and sometimes by large amounts. To judge whether the financial health of Social Security is improving or deteriorating, the media and the public focus on whether the years in which the two trust funds are projected to be exhausted have receded or advanced since the last report. If the movement has been by more than a year or two, the year-to-year changes are regarded as significant.

By this measure, the changes between the 2011 and 2012 Trustees Reports indicate a significant deterioration in the financial health of the Social Security program. (See Chart) The exhaustion date of the OASI Trust Fund is now projected to be 2035, three years sooner than was projected in last year's report. The projected exhaustion date of the DI Trust Fund has advanced two years from 2018 to 2016 and the exhaustion date for the two trust funds combined (OASDI) is projected to come in 2033, three years year sooner than was projected in last year's report.



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[1] President Emeritus of the Urban Institute and Public Trustee of the Social Security Trust Funds. 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.

A negative actuarial balance—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 in each of the next 75 years to bring the fund into actuarial balance. By definition, for a trust fund to be in actuarial balance its income must equal its costs over the valuation period and at the end of the 75th year the trust fund must hold assets equal to the 76th year's cost.[2]

The actuarial deficits of both Social Security trust funds have deteriorated since last year's report. The DI Trust Fund's actuarial deficit has worsened by -0.07 percent of taxable payroll, the OASI fund's deficit has deteriorated by -0.38 percent of taxable payroll and the deficit of the combined trust funds has weakened by -0.44 percent of taxable payroll (See Table). The deterioration in the combined trust funds' deficit is the largest single year decline since this measure was first calculated in 1982.

Long-Range Actuarial Deficit of the
OASI, DI, and OASDI Trust Funds
(percent of taxable payroll)

	OASI	DI	OASDI
2011 Trustees Report	-1.92	-0.30	-2.22
2012 Trustees Report	-2.30	-0.37	-2.67
Difference	-0.38	-0.07	-0.44*

*Difference adjusts for rounded components

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 become available. The 75-year valuation period used in the 2012 Trustees Report adds the year 2086, a year with a large negative balance, and drops 2011, a year with a more modest negative balance, to the valuation period used in the 2011 Report. This change from the previous report accounts for a bit less than 9 percent of the increase in the actuarial deficit. (See Chart)

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[2] Because Social Security's annual deficits, expressed as the difference between the cost rate and income rate, are projected to increase gradually from 2017 to 2037, to decline slightly during the 2038 to 2052 period and then to increase through 2086, the single tax rate increase for all years starting in 2012 sufficient to achieve actuarial balance would result in large annual surpluses early in the period followed by increasing annual deficits in later years. The relatively large deficits at the end of the 75-year projection period—equal to 4.50 percent of taxable payroll in 2086—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 (2012-86).
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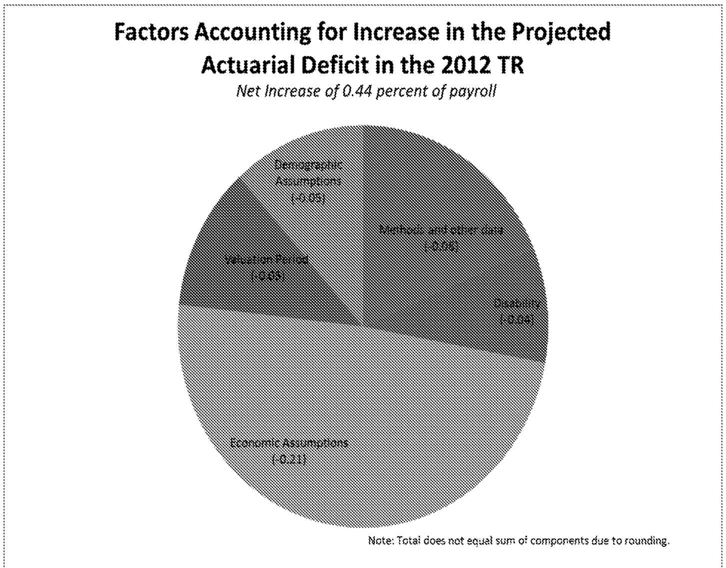


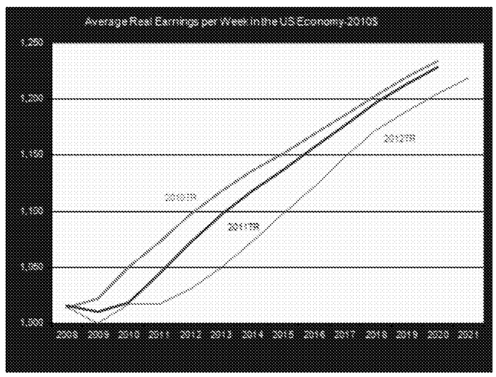
No legislation enacted during the past year significantly affected Social Security's long-range financial position.

While the ultimate demographic assumptions in this year's Report are the same as those in the 2011 Report, updated starting demographic values and the transition from these values to the ultimate assumptions increased the actuarial deficit modestly. Specifically, the availability of more recent data showed lower 2009 and 2010 birth rates, lower 2010 immigration rates, and a slightly smaller initial population than was assumed in the 2011Report.

Almost half of the increase in the actuarial deficit between the 2011 and 2012 Reports is accounted for by changed economic assumptions and more recent information about the economy's performance. About two-thirds of this is related to updated starting values and less optimistic assumptions about the near term growth of the economy. They illustrate how relatively small errors in our ability to forecast short-term economic conditions can have significant impacts on Social Security's financial well-being.

Price inflation between the third quarters of 2010 and 2011was faster than was assumed in the 2011 Report. Rather than a 0.7 percent increase in benefits, as was assumed in the 2011 Report, beneficiaries received a 3.6 percent December 2011COLA, increasing the program's costs.

A weaker than expected economy resulted in average taxable earnings for 2011 that were below the level assumed in the 2011 Report. (See Chart) The assumed levels of average taxable earnings have been adjusted downward from the levels assumed in the 2011 Report by 2.0 percent for 2012 and by lesser amounts in future years in this year's report. (See Chart) These adjustments reduce expected future payroll tax revenue.

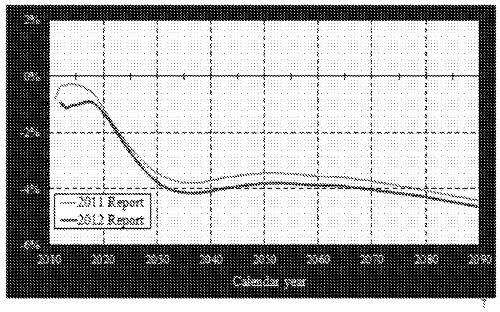


Real interest rates in 2011 and those projected in the 2012 Report for the next few years are lower than was assumed in the 2011 Report. Lower real interest rates reduce the amount of real interest income that the trust funds will receive on their new investments.

The 2012 Report's estimate of the gap between non-interest income and costs over the next few years is significantly larger than that shown in the 2011 Report largely because of these economic factors, in particular a larger than expected COLA and the shortfall in average taxable wages. (See Chart below) The expectation that full recovery from the Great Recession will take one year longer than was assumed last year, with full employment not being attained until 2019, also contributes to the larger gap.

OASDI Annual *Cash-Flow* Balances 2011-2086

(Non-interest income minus cost as a percent of payroll)



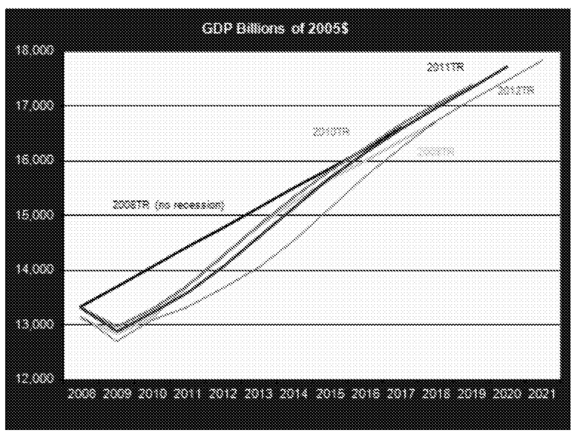
Another change introduced in the 2012 Report has a more significant impact over the longer term. In past reports the Trustees assumed that the average number of hours worked per week would not change in the future. The 2012 Report assumes that after 2021 the average number of hours worked per week will decline 0.05 percent a year, reflecting the aging of the workforce and the belief that future workers will want to take some of their productivity gains in the form of more leisure. This assumption translates into a reduction in the real wage differential—the percentage point difference between the growth of average covered wages and the growth of consumer prices. After 2021, this assumption will act to reduces taxable earnings and payroll tax revenues from the levels assumed in the 2011 report by ever increasing amounts. It accounts for about one-third of the 0.21percentage point increase in the actuarial deficit associated with economic factors and is the primary reason for the reduction after 2021in the cash flow balances shown in the previous chart.

The 2012 Report also revised the assumption made about the incidence of disability. Compared to last year's report, the ultimate age-adjusted disability incidence rates were increased by 2 percent for males and 5 percent for women. These rates are more consistent than were the previous report's assumptions with the disability levels and trends experienced over the past decade. The new assumptions increased the actuarial deficit by -0.04 percent of taxable payroll.

Several improvements in methods and new program data were introduced in the 2012 Report. Two methodological refinements are expected to improve the accuracy of the estimates of the benefits paid to the average worker who retires in the future. Taken together the new data and methodological refinements increase the projected long-run actuarial deficit by 0.08 percent of taxable payroll.

The actuarial deficits detailed in the 2012 Trustees Report and summarized in this statement underscore the need for legislative action to put Social Security on a sustainable path. 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.

The analysis in the 2012 Report of the Trustees also underscores how important a strong economy and healthy long-run growth are to the Social Security program. While the economy should gradually recover from the recession and period of tepid growth it has experienced recently, prolonged periods of economic weakness can affect for decades the economy's potential, the productivity and earnings of the work force and patterns of labor force participation. Some insight into the magnitude of these effects can be gleaned from the following chart which contrasts the economic projection contained in the 2008 Trustees Report, the last report before the Great Recession, with those of subsequent reports. The unavoidable conclusion is that maintaining a strong economy is critical to a sustainable Social Security program.



Chairman JOHNSON. Thank you. You went three minutes over.

[Laughter.]

Mr. REISCHAUER. That is a better performance than last year. I want to be graded on the curve.

Chairman JOHNSON. Thank you. I am going to as customary limit my time to five minutes and ask all my colleagues to do the same.

Social Security was designed so that workers pay into the system and earn their benefits. Franklin Roosevelt understood the importance of making Social Security different from a welfare program.

He once said "We put those payroll contributions there so as to give contributors a legal, moral and political right to collect their pensions and their employment benefits.

With those taxes in there, no damn politician can ever scrap my Social Security program."

Mr. Blahous and Mr. Reischauer, in your messages from this year's annual report, you point out payroll taxes represent only 70 percent of the total Social Security income in 2011 due in large part to general revenue transfers replacing lost income from a payroll tax holiday.

If we continue to replace payroll tax revenues with income tax revenues, how long before Social Security is no longer perceived as an earned benefit, and what is that going to do for public support?

Go ahead, Mr. Blahous.

Mr. BLAHOUS. I would say my answer to the second part of your question is no one can know when that point might be reached obviously, but that statement is in the report obviously because we wanted to call law makers' attention to the fact that Social Security historically has had a certain rationale for its financing, and as you pointed out, it does go back to Franklin Roosevelt.

If you go back and read his early statements, he placed a very high level of importance on the notion that this was an earned benefit. He did not want it to be merged in with the general budget. That is why we have a separate trust fund. That is why we have a separate payroll tax. That is why we have trustees.

He was very concerned. In multiple statements he says if you want to have a universal participation program, it costs a lot of money to do that, so if you have it as part of the general budget, it is going to be competing for funding with other programs and would be subject to great political risk, that the benefits of this program could be cut back.

He was very attentive to the idea of how do you structure this program so it has enduring political support, and not only FDR, but subsequent Social Security advisory councils over the years have repeatedly said that one of the bases of the program enduring political support is the idea that workers have earned these benefits and they came out against—all these advisory councils came out against funding the program from the general fund.

Just speaking for myself as a Trustee, I think one of the things we wanted to do was just draw law makers' attention to the fact that if the program does continue to get transfers from the general fund, it does potentially create a situation where we would have a departure from FDR's intentions on that point.

Chairman JOHNSON. It is not your personal money any more. About $0.45 out of every $1.00 of public debt is held by foreign governments, mostly China.

Mr. Blahous, if we continue the payroll tax holiday and the general revenue transfers to replace lost payroll tax revenue, do we risk turning Social Security from a program paid by Americans to one dependent on the whims of foreigners who invest in our bonds?

Mr. BLAHOUS. I think it is certainly the case that the general revenues that were transferred to Social Security along with the payroll tax cut were financed with debt. They were financed by increasing the deficit. We cut payroll taxes and added that amount to the deficit.

Certainly, while there is an ongoing argument over who really finances the redemption of bonds held in the trust fund, clearly, in this instance, this would be case of the financing for Social Security being provided by the people who invest in U.S. Treasury bonds.

Chairman JOHNSON. Can you tell me why you think tax increases are no answer for fixing Social Security? It seems to me to fix Social Security for good, we need to make sure our reform efforts align tax revenues with benefit outlays on a sustained basis. That did not happen during the last major reform.

Seventy-five year solvency was achieved by building annual surpluses in the near term followed by growing annual deficits in the long term, even though that was not intended at the time. Is that correct?

Mr. BLAHOUS. That is correct, although I have to say that if you were to bring ten experts up here, you would have a few that would disagree with me on the point.

If you go back and study the 1983 reforms, one of the things that is striking about them is that they did not measure financial success the way we do it now.

When they analyzed Social Security's future balance, they did not count the carry over balance of the trust fund. They did not count interest earnings of the trust fund.

They used a different actuarial method that basically presumed that all benefits in the future would be paid by taxing the wages of future earners.

If you read the comments of people who developed the reforms, whether they are Jake Pickle or Senator Pat Moynahan or Robert Myers, who was the Executive Director of the Commission, they said in multiple places that it was their intention to keep the program financed on a pay-as-you-go basis.

The fact that they wound up with a solution that had big surpluses in some years and big deficits in other years, was not as intentional as many people now believe.

What they were trying to deal with was a short term emergency, trying to make sure the benefit checks did not stop in 1983, and they were trying to arrive at an average actuarial balance over the long term.

As you point out, that resulted in an unsustainable solution because as time went on, the surplus years faded into the past and more deficit years appeared on the horizon.

Again, they were trying to do a lot of things under emergency conditions in 1983. The intention is not to critique what they did, but simply to point out that as they defined the long term balance, they did not give the same level of attention to what was happening on an annual basis that we do in the Trustees' reports now.

Chairman JOHNSON. Okay. I presume you agree with him?

Mr. REISCHAUER. Actually, I probably would disagree with all three of the answers that Chuck gave.

[Laughter.]

Mr. REISCHAUER. That is why you have two Trustees. Do you want me to disagree or shall I keep my lips sealed?

[Laughter.]

Chairman JOHNSON. I will let Mr. Becerra ask. My time has expired. Thank you.

Mr. BECERRA. We will just leave it at there is disagreement on that.

Let me ask the two of you—by the way, thank you for your testimony and the work that you do as Trustees, we appreciate that.

Both of you mentioned in part of your testimony the deterioration in the outlook for the program, which is why I think all of us should be trying, as Mr. Blahous said, dealing with this sooner than later.

I think your pie charts in your testimonies, the information you provided, show a great portion of that deterioration occurred as a result of the recession, which hit pretty hard.

It became pretty clear that when you lose jobs in America, you lose workers who are paying their FICA contributions, their Social Security contributions, fewer workers contributing to Social Security, less money going into the pot to pay out benefits.

Job one for Congress should be creating jobs, helping the private sector create those jobs. You get more folks to work. It does not just help them and their families, it helps Social Security because there is more money going into the system, the Social Security system and the trust fund.

Mr. Reischauer, you mentioned immigration passingly. Does the fact that we have had, unlike other countries, a consistent flow of immigrants over the last several decades help the Social Security system and its trust fund when it comes to being able to pay out benefits?

Mr. REISCHAUER. That is a very complicated question. In fact, the influx of immigrants has increased the labor force, it has increased the number of individuals paying payroll taxes, which over the short run, clearly helps the ability of the program to pay benefits to retired and disabled workers and survivors.

Mr. BECERRA. I think the other part of that that you do not mention is in the long run, if they become recipients of Social Security benefits, then they will draw as well.

It is one of those things where it is not plus an automatic plus because they at some point will qualify to receive those benefits as well.

Mr. REISCHAUER. Yes, but it is very complicated and will depend on what their earning patterns are over time and different groups of immigrants have different pluses and minuses in sort of a narrow fiscal sense.

Mr. BECERRA. Or if they stay in the country. Some of these folks will move back.

Mr. REISCHAUER. Many leave and do not end up collecting benefits.

Mr. BECERRA. Right. I have some numbers here that show that between 2007 when the recession was starting and then got really deep through 2010, nearly 6,000 companies in this country terminated their pension plans.

In 2009 alone, those terminated pension plans were short $9 billion of what they needed to pay out in benefits to the workers who had those pensions under those companies.

During that time, 2007 to 2010, Social Security did not lose any money, did it?

Mr. BLAHOUS. No, Social Security continued to make payments in full and the nominal balance of its trust funds continued to rise.

Mr. BECERRA. Right. We all know the examples of Circuit City that shut down its pension plan. We remember Enron when it went bankrupt, and how those companies left their employees and their pensions.

The reason why I think it is so important, you mentioned how we should be acting now to try to resolve any longer term issues for Social Security, is that we do not want to get to the point where you compare Social Security to Enron or Circuit City.

Fortunately, we still have some funds, even if Congress cannot get its act together, to keep the Social Security system going smoothly for the next 20 some odd years, and even after that it would be paying out 75/76 percent in benefits.

I do not think anyone today is paying into Social Security to get 75 percent of what today's beneficiaries are getting.

I hope what you all will continue to do is give us the recommendations that you feel will help us move toward something sooner than later.

I think most people are getting to the point of agreeing it is pretty simple math, as I think you mentioned, Mr. Blahous. You can go to the benefit side. You can go to the revenue side. You can figure out a way to get yourself in an actuarial balance for the next 75 years.

Hopefully, what we will do is we will sit down at some point soon in Congress and try to come up with that tough political response.

Appreciate your testimony here today and your service with the Trustees, and I hope you will continue to come and testify before this Committee. Thank you. I yield back.

Chairman JOHNSON. Thank you. Mr. Brady, you are recognized.

Mr. BRADY. Thank you, Mr. Chairman. We hear these days that everything is doing fine with Social Security on Capitol Hill. No need to act. Things are not fine with Social Security.

As Chairman Johnson pointed out, in the last year, America borrowed roughly $140 billion, much of it from China and other foreign investors, just to pay our Social Security benefits.

This year we will borrow $150 billion roughly from China and other foreign investors just to pay our benefits to seniors. That is not fine.

If you do not like that, get used to it, because your report said we face permanent deficits forever in Social Security programs.

We are told maybe this is due to the recession but truth is we are told the economy is doing better but this had the largest single deterioration since 1994, Social Security, so it is getting worse, not better.

I have three questions. I would hope we could have a no spin zone here and just ask the Trustees, those responsible for the financial stability of Social Security, just to give us your best advice to Congress and the White House. One, should Congress and the White House continue to delay reforms on this important program, or should we act now?

Mr. Blahous.

Mr. BLAHOUS. I am an advocate of acting as soon as possible.

Mr. BRADY. Mr. Reischauer.

Mr. REISCHAUER. I think speedy action is called for.

Mr. BRADY. How much time?

Mr. REISCHAUER. Whether the actual changes in policy you make need to be implemented next year or after is a totally separate issue. This is an area where we generally phase policy in over a long time.

Mr. BRADY. You both made the point that if we do not act soon, it will be impossible to protect current and near retirees. Again, your advice to us. What is the time table? How soon do we need to act? This year? Next year? Your advice to us.

Mr. REISCHAUER. I think you should act when the climate is right, when changes are being made——

Mr. BRADY. I am asking you as a Trustee looking at the numbers, how much time would you say we have to act in your belief?

Mr. REISCHAUER. I would hope that you would act within the next five years.

Mr. BRADY. Mr. Blahous.

Mr. BLAHOUS. Yes, with the disclaimer, if you were to line up ten experts here, I am probably on the pessimistic end of those ten with respect to how bad it is going to be for the future of the program if we delay too long, but I certainly agree definitely within five years. I would hope to do it even faster.

Mr. BRADY. The payroll tax holiday was important to many families, but it did blow a hole in Social Security's revenue stream. It was backfilled by general revenue. We know that cannot continue.

Again, no politics in this, your advice as Trustees, should we continue the payroll tax holiday or should we restore the full stream of revenue to Social Security?

Mr. Blahous.

Mr. BLAHOUS. Here I am speaking very much for myself. I would urge that Social Security go back to its 12.4 percent rate.

Mr. BRADY. Restore to the full stream. We have to deal with how we do that. Your advice would be restore the full amount of money?

Mr. BLAHOUS. That is a personal view. Obviously, not the Board of Trustees.

Mr. BRADY. I understand. Mr. Reischauer?

Mr. REISCHAUER. Mine is obviously a personal view, too, but I would phase it out with all deliberate speed.

Mr. BRADY. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you. Mr. Schock, you are recognized.

Mr. SCHOCK. Thank you, Mr. Chairman. It does not seem like the news is getting much better. I want to get a little parochial here. You said we need to act soon. I am just curious what the younger generation of Americans have in store for themselves if we don't act soon.

Mr. BLAHOUS. Two part answer. The mathematical part of the answer is a net income loss. There is a table in the Trustees' Report that says if you just held all current participants in the system harmless, current benefit formulas, current tax formulas, then people coming into the system would lose a net of about four percent of their taxable wage income to Social Security. That is a net, that is after they receive all benefits.

Those income losses would be higher on the higher income side but they would also be present on the lower income side. You would have whole generations that were losing money net through the program.

That is the mathematical answer. Getting back to the questions that were asked earlier, I think they would also face the risk that we might not be able to generate the political will to keep the program operating on a self financing basis.

Then if we could not keep the program going on a self financing basis and had to merge into the general fund or subsidize it from the general fund, I think they would lose something else, which is sort of the legacy of Social Security as a separate stand-alone self financing system that has a certain degree of political protections that other Federal programs do not have.

Mr. SCHOCK. Mr. Reischauer.

Mr. REISCHAUER. You asked young generations, what should they expect, and the answer is less income in retirement years. Future generations will run more risk with respect to disability as well, payments they would get in disability and as survivors.

They need to divert more of their income into private pension plans or 401(k)s or other retirement vehicles.

Mr. SCHOCK. Why are you saying they would need to do that?

Mr. REISCHAUER. If they wanted to maintain adequate incomes in retirement.

Mr. SCHOCK. Because of Social Security?

Mr. REISCHAUER. Social Security payments would be less for them.

Mr. SCHOCK. How much less?

Mr. REISCHAUER. Well, as Chuck explained and the Chairman and others have mentioned, Social Security would be able to pay about three-quarters of the benefits now promised.

Mr. SCHOCK. That is based on what age category?

Mr. REISCHAUER. This would be across the board for all existing beneficiaries and future beneficiaries starting after 2033.

Mr. SCHOCK. For the next 100 years?

Mr. REISCHAUER. Well, we do not go out that far. We go out through 2086. It stays roughly in that area.

Mr. SCHOCK. Assuming the same number of people live the same number of years and have the same number of children?

Mr. REISCHAUER. No, I mean we do vary this over time in our projections according to the best information that we have available.

Mr. SCHOCK. What happens to people that are not as young, perhaps they are 50, and they are 15 years from retirement? What is going to happen to their Social Security if we do not do anything?

Mr. BLAHOUS. The literal no action scenario is that—literal no legislative action would be a 25 percent benefit reduction in 2033. Those people presumably would collect full benefits for some years and then experience a sudden benefit reduction in 2033.

Obviously, it is unlikely that is the way it would play out in practice. Congress would probably not permit a sudden 25 percent benefit reduction.

There would probably be some alternative mix of pain allocated between beneficiaries and taxpayers, but the literal no action scenario is 25 percent benefit reductions.

Mr. SCHOCK. Are you assuming we would be responsible?

Mr. BLAHOUS. Let's just say there is no historical precedent for Congress allowing a sudden benefit cut of that magnitude.

Mr. SCHOCK. Is there historical precedent for Congress allowing Social Security to become this broke?

Mr. BLAHOUS. No. That is actually a very important question.

Mr. SCHOCK. Has it ever been this broke?

Mr. BLAHOUS. We have never had an actuarial deficit as large as it is now. We have come closer to the insolvency point. In 1983, we were a few months away from not being able to send out the benefit checks, but the size of the current actuarial imbalance is larger than it has ever been, at least since before the 1983 reforms.

There was an indexing mistake that was made in the 1970s, and there was temporarily a huge long term deficit that was created by that indexing mistake that was fixed in the 1977 amendments.

Since that correction, this is the largest actuarial deficit we have seen since prior to the 1983 reforms.

Mr. SCHOCK. Mr. Reischauer, do you agree?

Mr. REISCHAUER. Yes.

Mr. SCHOCK. If you have a Republican and Democrat to agree, maybe we should leave Capitol Hill now.

[Laughter.]

Mr. SCHOCK. Thank you, Mr. Chairman.

Chairman JOHNSON. Every now and then we do. Mr. Stark, you are recognized.

Mr. STARK. Thank you, Mr. Chairman. Thank you for holding this hearing and thank our witnesses for their service.

I have to mention, Mr. Blahous, before you choose to criticize my testimony, we both have the same background. I notice you have a doctorate in physical chemistry.

I also have a great deal of experience in physical chemistry. I think I took ten semesters of it at MIT. However, it was all second semester chemistry that I had to repeat over and over again before I could pass it, but it is a great background.

The Republicans want to kill Social Security. I think that is quite obvious, and turn it into a voucher plan.

Mr. BRADY. Mr. Chairman, if the gentleman would yield on that.

Mr. STARK. I will be happy to.

Mr. BRADY. Mr. Stark, as you know, Republicans are very strongly supportive of Social Security. Our mom's and our dad's——

Mr. STARK. Rich people. Let the poor people pay for it. I do not buy that. The Republicans want to kill Social Security and Medicare and turn them into voucher systems.

Mr. Reischauer, actually, they are stealing your thunder. You are one of the original founders and your thunder, of course, is to have Medicare have premium support.

Fortunately, it also gave you an umbrella for that thunderstorm, which was a guaranteed benefit.

Would you support the idea of premium support without a guaranteed benefit?

Mr. REISCHAUER. As you know, Mr. Stark, the term “premium support” came out of an article that Henry Arron and I wrote in 1995 suggesting that there be private or non-profit options for Medicare beneficiaries along with fee for service, that the benefit be a defined guaranteed benefit, and that the payment be one that was indexed to the growth of health care costs over time.

Our belief was that this might generate more efficient delivery systems and better care for America’s seniors along with some cost savings.

The emphasis was on the quality of care and offering a more diverse set of delivery systems.

Mr. STARK. Thank you. The Affordable Care Act, which the Republicans would like to defeat, according to actuaries, it would extend solvency eight years longer than if the Republicans had their plan to kill health reform.

Would you suggest that is correct?

Mr. REISCHAUER. Yes. There is a projection that HI costs would be reduced and the trust fund would be solvent——

Mr. STARK. I ask unanimous consent to submit for the record a CMS press release with the Trustees’ report which states that “Without the Affordable Care Act, the health insurance trust fund would expire eight years earlier, in 2016.”

Mr. Reischauer, can you put a dollar number—I keep hearing that Social Security is going to go broke in 20 years, something like that. What will the total negative amount be? How many billions would you guess if you project that, it is going to be short over the total period?

Mr. REISCHAUER. Over the next 75 years?

Mr. STARK. Is it going to take 75 years to go broke?

Mr. REISCHAUER. No. It will exhaust the trust funds in 2033 if you combine the trust funds. I do not have a number at the tip of my tongue.

Mr. STARK. Any idea, Mr. Blahous?

Mr. BLAHOUS. The projections have the trust funds solvent through 2033. The shortfall would be 2033 through the end of the 75 year period. We have a present value estimate of that, about $8.6 trillion.

Mr. STARK. $8.6 trillion. Do you have any idea what the two wars we are fighting and not paying for costs over the same period of time?

Mr. BLAHOUS. I do not.

Mr. STARK. Would you be surprised to know it probably cost a lot more than that, and I am not hearing anybody on the other side ask that we pay taxes, particularly those of us who maybe have high incomes, like Members of Congress, we are not being asked to contribute anything to pay for that war. Lower income people maybe are.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you. Without objection, the CMS memo that you referred to will be entered into the record.

[The information referred to follows: The Honorable Pete Stark]

DEPARTMENT OF HEALTH & HUMAN SERVICES
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CMS NEWS

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Contact: CMS Office of Media Relations
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Medicare Stable, But Requires Strengthening

The Medicare Trustees Report released today shows that the Hospital Insurance (HI) Trust Fund is expected to remain solvent until 2024, the same as last year's estimate, but action is needed to secure its long-term future. In 2011, the HI Trust Fund expenditures were lower than expected.

Without the Affordable Care Act, the HI Trust Fund would expire 8 years earlier, in 2016. The law provides important tools to control costs over the long run such as changing the way Medicare pays providers to reward efficient, quality care. These efforts to reform the healthcare delivery system are not factored into the Trustees projections as many of the initiatives are just launching.

"The Trustees Report tells us that while Medicare is stable for now, we have a lot of work ahead of us to guarantee its future," said Acting CMS Administrator Marilyn Tavenner. "The Affordable Care Act is giving CMS the ability to do this work, with tools to lower costs, fight fraud, and change incentives so that Medicare pays for coordinated, quality care and not the number of services."

The report projects that the Supplementary Medical Insurance (SMI) Trust Fund is financially balanced because beneficiary premiums and general revenue financing are set to cover expected program costs. Spending from the Part B account of the SMI trust fund grew at an average rate of 5.9 percent over the last 5 years.

SMI Part D, the Medicare prescription drug program, had an average growth rate of 7.2 percent over the last 5 years. Cost projections for Part D are lower than in the 2011 Trustees report, due to lower spending in 2011 and greater expected use of generic drugs.

HI expenditures have exceeded income annually since 2008 and are projected to continue doing so under current law in all future years. Trust Fund interest earnings and asset redemptions are required to cover the difference. HI assets are projected to cover annual deficits through 2023, with asset depletion in 2024. After asset depletion, if Congress were to take no further action, projected HI Trust Fund revenue would be adequate to cover 87 percent of estimated expenditures in 2024 and 67 percent of projected costs in 2050. In practice, Congress has never allowed a Medicare trust fund to exhaust its assets.

The financial projections for Medicare reflect substantial cost savings resulting from the Affordable Care Act, but also show that further action is needed to address the program's continuing cost growth.

The Medicare Trustees are Treasury Secretary and Managing Trustee Timothy F. Geithner, Health and Human Services Secretary Kathleen Sebelius, Labor Secretary Hilda L. Solis, and Social Security Commissioner Michael J. Astrue. Two other members are public representatives who are appointed by the President, subject to confirmation by the Senate. Charles P. Blahous III and Robert D. Reischauer began serving on September 17, 2010. CMS Acting Administrator Marilyn B. Tavenner is designated as Secretary of the Board.

The report is available at: https://www.cms.gov/ReportsTrustFunds/downloads/tr2012.pdf

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Chairman JOHNSON. Mr. Marchant, you are recognized for five minutes.

Mr. MARCHANT. Thank you, Mr. Chairman. My question is about the actual mechanics of how when you approach let's say 2016 and the disability shortfall begins to appear in the disability program. What is the number that Congress would need to appropriate out of general funds in those threshold years just to maintain the benefit?

Mr. BLAHOUS. Just as a very crude estimate, it is about $30 billion a year, the shortfalls that appear from 2016 through the rest of the decade.

Mr. MARCHANT. We look at things over ten years usually.

Mr. BLAHOUS. They would start in 2016. It would be about $30 billion a year, I guess, over the last six years of that valuation period.

Mr. MARCHANT. Is there a trigger put into the law where the Congress immediately is confronted with having to make that legislative decision, or will it be a legislative decision through the entire Congress and then be signed by the President?

Mr. BLAHOUS. The way the law reads is that the disability insurance program can only make payments from monies that are in its trust funds. If you assume Congress does nothing, then basically you would have—when the trust fund balance got down to zero, you would have delays in outgoing benefit payments until incoming tax revenues came in to finance more benefit payments.

The effect of that through just delaying payments would be to reduce total payments on an annual basis by about 21 percent per year.

If you wanted to maintain full scheduled benefit payments 100 percent, you would have to find other revenues and put them in the trust funds to allow the full scheduled benefits to be paid.

Mr. MARCHANT. You would basically have an appropriation that would be made into the trust fund and the trust fund would basically then make its payments adequately?

Mr. BLAHOUS. Right.

Mr. MARCHANT. If we reach that threshold in the main Social Security trust fund, what would be the amount of money needed that Congress would have to appropriate in that first year, based on the projections that you are making now, to keep the benefit at 100 percent, when we reach the 75 percent threshold? All of us get that warning when we open our yearly statement and look at it.

Mr. BLAHOUS. Right now, I do not have the precise dollar figure off the top of my head, but just to put it in today's terms, it is about 25 percent of scheduled benefits.

Today, the cost of paying benefits is a little bit shy of $800 billion. It is about $790 billion per year.

If you wanted to think of it in today's terms, the amount by which you would be short, in today's equivalent, a little bit shy of about $200 billion a year.

Mr. MARCHANT. $200 billion. That would be the choice Congress would have at that point, to keep benefits basically at the projected level. Congress would have the decision of just simply appropriating the money to go in?

Mr. BLAHOUS. Yes. This cuts to a point I made earlier about the difficulty of the choices Congress would face. Obviously, the path of least resistance at that point is just to turn to the general fund and say here is another $200 billion. It will be much higher in nominal terms in 2033. The equivalent of $200 billion and put it into Social Security.

Obviously, that would end the principle that Social Security was supposed to be financing itself.

If you wanted Social Security to finance itself, you would either have to raise payroll taxes or cut benefit payments by enough to fill in that gap.

Mr. MARCHANT. By doing that, you would completely end the philosophy of a self-paying system, and you would transfer it like many of the states have done. They have gone in and raided their pension plans over the years to where the pension obligations in many of the states now is just a current appropriation.

They have depleted their trust funds, borrowed against them or cashed them in to where instead of it being a payment out of the trust fund based on earnings, they just simply have a fixed liability to them.

Mr. BLAHOUS. That is right.

Mr. MARCHANT. Would that law just become law by the fact that we had not fixed the system?

Mr. BLAHOUS. You would have to take an affirmative legislation action to support the program with general revenues. Under current law, there is no provision for doing that. The program cannot borrow from the general fund, cannot receive, without additional legislation, an appropriation from the general fund.

You would have to change the law in order to have that result.

Mr. MARCHANT. I think it is reasonable to expect that most of us will still be here in 2016. I certainly hope to be.

That threshold that you are talking about in the Social Security retirement fund, we are approaching with the disability fund.

Whether we are acting or not acting, we are making some very conscious decisions on how we are going to handle this disability trust fund.

I suspect the mentality of Congress at this point is well, we will just appropriate the money so that no one loses their benefit.

When you make that conscious decision, are you not making a much bigger decision at that point?

Mr. REISCHAUER. In the past, when faced with this same challenge, the Congress has reallocated tax revenues from the OASI system, the old age survivor system, to the disability system; tweak the division of the total payroll tax between the two trust funds, thereby avoid making a difficult decision.

Mr. MARCHANT. Thank you, Mr. Chairman.

Chairman JOHNSON. The gentleman's time has expired. Mr. Smith, you are recognized.

Mr. SMITH. Thank you, Mr. Chairman, and thank you to our witnesses.

Mr. Blahous, we frequently hear actually that Social Security is a separate account and does not attribute to the deficit. I think my colleague, Mr. Marchant, was touching on some of this.

In your testimony, you indicate that Social Security operations are currently adding to the unified Federal deficit and will add substantially more in the years to come.

Could you expand on that?

Mr. BLAHOUS. I think perhaps the best way for me to answer this is to say the parts of my answer that I think all analysts would agree with, and then I will get into the part that there is some disagreement on among analysts.

I think all analysts agree that to the extent Social Security is supported by its own payroll tax revenue or by the taxation of benefits, to that extent, it is not adding to the Federal budget deficit.

I think most analysts would also agree that to the extent Social Security is receiving a subsidy from the general fund, like the general fund transfers that accompanied the payroll tax cut, that portion does add to the deficit.

Where you get into the murky area where analysts argue with each other has to do with the interest payments that are made to the Social Security trust fund.

Right now, to a very large extent, from now to through 2033 and certainly into the 2020s, Social Security is going to subsist to a large extent based on the interest payments from the general fund.

If you ask two different analysts to interpret what is going on there, you are going to get two different answers.

From a mechanical standpoint, the payments of interest go from the general fund to Social Security. You could say from a mechanical and unified budget standpoint, those interest payments do not represent money coming into the U.S. Treasury and therefore, represent money going to Social Security without reducing the unified budget deficit, and then representing an extent to which Social Security is adding to the overall deficit.

You will also have a school of thought, and I do not agree with this, but there is also a school of thought that says those interest payments represent the extent to which Social Security has reduced the amount of borrowing in the past that the Federal Government has had to do, and therefore, represents a reduction in unified budget interest payments.

Therefore, to the extent Social Security receives interest payments, it is not adding to the unified budget deficit.

You are going to have competing views on that. I am on one side of that discussion and other people are on the other.

I think with respect to other parts of Social Security, there is less ambiguity. I think to the extent that the program is receiving transfers of general revenues, it is clearly adding to the deficit, and to the extent it is relying on its payroll tax income, it clearly is not.

Mr. SMITH. Thank you. I will yield back.

Chairman JOHNSON. Thank you. Mr. Berg, you are recognized.

Mr. BERG. Thank you, Mr. Chairman. Thank you to the witnesses.

Mr. Reischauer, I appreciate your article in 1995 about premium support and where that would go.

My question to you is what happens when—I am sure at the time people called that "vouchers"—people said that is going to wreck Medicare, what was your response back then?

Mr. REISCHAUER. Our response was that changes were unavoidable, that this was a promising approach towards providing beneficiaries with more choice, possibly higher quality coordinated care, and possibly a reduction in Government spending from competition among plans.

Mr. BERG. Thank you. Jumping back, I kind of wanted to follow up on a question that Representative Marchant had on the Disability Insurance Trust Fund.

We talk about how we have one to five years to make some decisions. I am sitting here looking at 2016 and I am saying that is not five years. That is four years. If you are going to not fall off the cliff, you are probably talking one to three years to do something.

As you explained the reality of how things may happen and where money would come out of the other fund to kind of subsidize this fund, if you pooled those two funds, what is the year that we are not going to cover the benefits?

Right now, we are saying the one is 2035 and this one is 2016. If the old age started subsidizing this other one, at what point is it going to bring that down?

Mr. Blahous.

Mr. BLAHOUS. Basically, right now the old age and survivors fund, the so-called "retirement fund," that is scheduled for depletion in 2035. Disability is 2016.

If you put them together, the combined funds would be under in 2033.

Mr. BERG. It would be the same?

Mr. BLAHOUS. 2033 is the figure that we often throw around in the vernacular, because it refers to Social Security as a whole. That is the figure you hear the most.

If you split it into the two funds, one of them is 2035 and other one is 2016.

Mr. REISCHAUER. The 2033 assumes that you re-jigger the allocation of the payroll taxes between the two trust funds?

Mr. BERG. For the old age and survivors, you are seeing today with this report it is still 2035.

Mr. REISCHAUER. It is not "still." It was 2038 last year, right?

Mr. BERG. It has come down from 2038 to 2035. The other point, I just want to be clear, when you present value this unfunded liability, we are talking about $8.6 trillion, which is over two years of all Federal spending, but that includes 2.7 using that money within the trust fund.

Mr. BLAHOUS. You are right. That is basically the size of the actuarial deficit on top of redeeming the trust fund, and redeeming the trust fund, basically you are saying redeeming the trust fund counting it as an asset and then the shortfall from 2033 out to the end of the valuation period is where that $8.6 trillion comes from.

Mr. BERG. If you did not value that Trust Fund amount, you are $10 to $11 trillion in that unfunded liability to make it solvent?

Mr. BLAHOUS. That is right.

Mr. BERG. I think there are a lot of different terms that are being used, and sometimes it makes it confusing. It cash flows for a while here, but it is not solvent.

From my perspective, I just really think we have to look at these facts and the facts are the facts, and if it is not solvent long term, and quite frankly, if we care about Social Security, we need to do some things to ensure it is solvent.

I obviously personally am very open to any ideas from anywhere. I think the solution needs to be bipartisan. I think that is the only way you can present it to the American people. I am just hopeful we will get some of those bipartisan solutions coming forward.

Thank you, Mr. Chairman. I will yield back.

Chairman JOHNSON. Thank you. You can always raise the age to 100, you know. That might take care of it.

I am going to ask one more question. Mr. Blahous, in order to fix Social Security for good, we need to make sure our reform efforts ultimately align tax revenues with benefit outlays on a sustained basis, and that did not happen during the last major reform in 1983.

Then 75-year solvency was achieved by building annual surpluses in the near term followed by growing annual deficits in the long term, even though that was not intended by the reformers at that time. Is that correct? Could you talk about that?

Mr. BLAHOUS. Again, and my colleague, Mr. Reischauer, may want to leap in and disagree, but my read of the 1983 amendments is that what they intended to do and what they actually did were somewhat different.

I think they aimed at avoiding an immediate insolvency problem. The benefit checks were not going to go out in a few months and they wanted to prevent that from happening.

They also aimed at a long term actuarial balance. If you actually go back and read the documents of the deliberations and the memo's of the Greenspan Commission exchanged, and how they measured fiscal success, it is very clear they did not look at it the way we do it now.

When we make a measure of the condition of the trust funds, we count the carry over balance of the trust fund. We count the interest payments of the trust fund. We basically treat the trust fund as an asset in Social Security, and therefore, within that mindset, you could certainly do something that builds up the trust fund and then draws it down over a period of time.

That is not actually how they went about it. What they did is they used a different method for calculating the program's financial condition. It was called the "average cost method," basically.

It assumed that in any given year, you were going to fund the program by incoming wages from workers. They did not count the carry over balance of the trust fund. They did not count the interest payments of the trust fund.

If you read the commentary of the Greenspan Commission members and the staff director, they say it is our intent to keep the program going on a pay-as-you-go basis, not to have big imbalances from one year to the next.

Jake Pickle wrote a letter, my memory is slipping, but either to the New York Times or the Wall Street Journal, saying the public would never stand for a big trust fund build up because they would not trust the Government to control trillions of dollars of investments and save the money, so we want to keep this program going on a pay-as-you-go basis.

What happened instead was they got big surpluses in some years and big deficits in other years, but that result was not fully apparent until so late in the legislative process, that they could not really go back and revisit it.

Obviously, what they were dealing with was a big emergency. They did not want to disrupt the political deal that had been reached, so they got a result where the program's actuarial balance on paper was a little bit more apparent than real, which is why it has slipped since then.

Chairman JOHNSON. If we get a solution this time, there are going to be political consequences as well.

Do you care to comment, Mr. Reischauer?

Mr. REISCHAUER. Yes, I do care to comment. There is a real dilemma here. If you operate a program like this on a strictly pay-as-you-go basis, then you are saying as demography changes and changes may be in unexpected ways or trend economic growth changes, you are going to have to raise taxes or lower taxes or raise benefits or lower benefits.

For a program that is designed to provide the American population with some kind of assurance that it is going to be able to plan its retirement or how much insurance it needs for its potential disability, that is not really a satisfactory way to go.

The other option is you can build up reserves and deplete reserves over time.

I agree with Mr. Blahous that the intent was not to build up these big reserves. The future course of demography was not fully appreciated by those responsible or anybody at that time.

Was the baby bust a permanent phenomenon. We have had huge social changes that have gone on in the last 30 to 40 years. Smaller family size, more immigration, more women in the workforce, et cetera, that make these things very hard to put in place and then stick with your decision for the next 75 years.

I do not think there is a right answer to this question.

Chairman JOHNSON. Thank you, sir. Mr. Becerra, you have one more question?

Mr. BECERRA. Yes. To sort of feed off this, I think often times we have this conversation because we are accustomed to having this conversation.

I think we do not explain it in terms that most Americans will look at it from.

Essentially, back in 1983, when Social Security was nearing a point where it would not be able to pay all benefits, Congress, working with President Reagan, worked to deal with that.

The result was a system where Americans paid a little bit more, those who retired got a little less in benefits. The result was this reserve that was being built up. Americans have since 1983 been contributing more into the system that has been needed to pay recipients, the beneficiaries.

I think most Americans would say if I gave you hard cash, whether you are a bank or any other place where I can store my money, and you tell me you are going to pay me interest on that cash, that you are expecting at some point to get to collect on that cash, essentially by law, that is what we did.

We told Americans that when they deposited their Social Security contributions from their paycheck to the Government for Social Security, what was not used—actually, all of it when it comes in goes into Treasury bonds.

From there, the Social Security system uses what it needs from those Treasury bonds to pay for benefits. It cashes in those Treasury bonds.

Because it has not needed to cash in all of those Treasury bonds to pay for current retirees, it has been building up this surplus, and that surplus has been earning interest, small, because Treasury bonds earn less interest than some more risky investment on Wall Street, but it has been earning interest. That is the $1.6 trillion in interest that has been earned.

Mr. Blahous, you are saying some people would question whether that is real money because it is interest and it was essentially a transaction between one arm of the Government, Social Security, to the other arm of Government, which is the general operating budget of the Federal Government.

Those Treasury bonds are real. As the Chairman pointed out earlier, 45 percent of our debt held by the public is owned by foreigners. They own that debt and they get to collect on it because they own Treasury bonds.

Those who say it is not real money that Social Security holds, guess what, we are in pretty good shape because 45 percent of our debt that is held by foreigners is not real money either, so we do not owe the foreigners.

If you do not owe Social Security to Americans that paid into it, then we do not owe the foreigners either.

That is why I do not understand the logic of those who say it is not real money. Americans paid real money into the system. It was secured by the most secure form of currency there is, which is a Treasury bond.

To say it is not real money simply because it was done by Social Security giving the money to the Government and getting a Treasury bond to hold onto that money, I think is a real either mistake to say or a real injustice to the American people who continue to pay into the system today.

That reserve is going to continue to grow for several more years before we have to start using it to pay for benefits.

I think the public will want to understand—I did the quick math on this. In the 77 years Social Security has been around, you and I and everybody who works and has worked, we have contributed about $14 trillion into Social Security with our paychecks, our FICA contributions.

In that 77 years, the calculation was that we have used up about $13 trillion in paying out benefits. Hard cash left over, simple math, 14 minus 13, there is $1 trillion that Americans have contributed in cold hard cash to Social Security that has never been used.

That has helped produce part of that reserve. Because for decades that reserve has been gaining interest because it is held in Treasury bonds, it has added another $1.6 trillion.

I think most Americans would tell you if you only wanted to give them back their $1 trillion and not the 1.6 they earned in interest, if this were a bank, we would have a big run on that bank. In fact, we would probably burn that bank down.

I think we want to be very careful when we talk about funny money for Social Security. Either we tell China and the rest of the world that we are not going to pay them because they have the same funny money, or we should keep our obligations to Americans who contributed money.

The final point I want to make is this, and my colleague friend from Texas, Mr. Brady, mentioned that Social Security faces a permanent deficit forever, I want to make it clear, and I think Mr. Blahous and Mr. Reischauer would concur, under the law, Social Security cannot run deficits.

Is that correct?

Mr. BLAHOUS. That is correct.

Mr. BECERRA. Social Security will never face a deficit. What we do face, and I think, Mr. Blahous, you have used the right word, an “actuarial deficit.” The actuaries see the difference between what we are collecting and what we hope to pay out, and there is a deficit there, and that is what we have to tackle sooner than later.

Can the Social Security system ever run deficits? By law, it can never run deficits. The cold hard fact is we would have to say—I think Mr. Blahous said, we would have to tell Americans in 2033 guess what, all of a sudden your benefit went from 100 percent of what you have been getting to 75 percent, which would be cruel, and that is what we have to deal with.

Never has Social Security run a deficit and never can it until we in Congress change the law.

With that, I would yield back.

Chairman JOHNSON. Do you want to make a final comment on that?

Mr. BLAHOUS. I certainly do not want to be construed as implying that the bonds in the trust fund are not real assets to Social Security. As my testimony indicates, I think the Trustees' report makes clear those bonds are backed by the full faith and credit of the U.S. Government, true assets to the program.

Where you get into these controversies about the trust fund, it is not really so much about whether they are real assets to Social Security, but it usually has to do with these arguments between analysts as to who is paying for the trust fund bonds.

For example, the interest payments, we did $200 billion plus in general revenue transfers this year to Social Security from the general fund, without collecting any taxes based on that $200 billion.

Those bonds are going to earn $400 billion or so of interest up through 2033. You have this analytical question, who is really paying for that interest, the taxpayer who finances the general fund of the U.S. Government or the person investing in the Treasury bonds.

It is not necessarily the case they were paid for by workers on Social Security and there is just a fierce analytical argument as to whether that portion of Social Security's financing comes from contributions made by workers or some other source.

I certainly do not want to be construed as saying that it is not real money for Social Security.

Mr. BECERRA. Mr. Chairman, this is what I love about hearings. When we actually can have this kind of a discussion, this is what I think the public would love to here, rather than just our doing our five minutes of asking questions and you only getting five minutes to respond or give your testimony, I think actually Chairman Camp has done a great job on this on taxes where he has allowed us to have these informal off the record kind of conversations with experts on tax reform, and I think we could do more of those, maybe even on Social Security.

For example, Mr. Blahous, you pointed out something very important. When we did the payroll tax cut to try to help working families with this recession, you are right, we told them you have to contribute less to your FICA taxes to Social Security.

Congress intentionally said we are not going to damage Social Security. We are going to take money from the general fund and replace the money that otherwise would have gone in.

I would respond to your point, which I think is a valid point, is that real money that should earn interest through these Treasury bonds because it really came from the general fund, and I would say absolutely it should earn interest.

We consciously in Congress said we do not want to undermine Social Security, we want to help the economy and give working families who pay FICA taxes a bit of a break, but we do not want to do that at the expense of Social Security when these folks retire.

I would say the decision was consciously made by Congress that we knew that money would be used to buy Treasury bonds that would then earn interest and therefore, we knew that would become money that the Federal operating budget would owe to Social Security when the time came to collect on those Treasury bonds.

Your point is absolutely well taken. That is the kind of parsing that I think we have to discuss. Otherwise, everyone gets confused about is it real money, is it not real money. I appreciate the point you made.

Chairman JOHNSON. I want to thank both of you for being here today. I think we have had a positive discussion. We do need to fix Social Security and we intend to do it.

I want to thank all the members for being here today as well. Mr. Stark, thank you for coming.

With that, the meeting stands adjourned.

[Whereupon, at 10:28 a.m., the subcommittee was adjourned.]

[Submissions for the Record follow:]

The Honorable Pete Stark

DEPARTMENT OF HEALTH & HUMAN SERVICES
Centers for Medicare & Medicaid Services
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CENTERS for MEDICARE & MEDICAID SERVICES

CMS NEWS

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Contact: CMS Office of Media Relations
(202) 690-6145

Medicare Stable, But Requires Strengthening

The Medicare Trustees Report released today shows that the Hospital Insurance (HI) Trust Fund is expected to remain solvent until 2024, the same as last year's estimate, but action is needed to secure its long-term future. In 2011, the HI Trust Fund expenditures were lower than expected.

Without the Affordable Care Act, the HI Trust Fund would expire 8 years earlier, in 2016. The law provides important tools to control costs over the long run such as changing the way Medicare pays providers to reward efficient, quality care. These efforts to reform the healthcare delivery system are not factored into the Trustees projections as many of the initiatives are just launching.

"The Trustees Report tells us that while Medicare is stable for now, we have a lot of work ahead of us to guarantee its future," said Acting CMS Administrator Marilyn Tavenner. "The Affordable Care Act is giving CMS the ability to do this work, with tools to lower costs, fight fraud, and change incentives so that Medicare pays for coordinated, quality care and not the number of services."

The report projects that the Supplementary Medical Insurance (SMI) Trust Fund is financially balanced because beneficiary premiums and general revenue financing are set to cover expected program costs. Spending from the Part B account of the SMI trust fund grew at an average rate of 5.9 percent over the last 5 years.

SMI Part D, the Medicare prescription drug program, had an average growth rate of 7.2 percent over the last 5 years. Cost projections for Part D are lower than in the 2011 Trustees report, due to lower spending in 2011 and greater expected use of generic drugs.

HI expenditures have exceeded income annually since 2008 and are projected to continue doing so under current law in all future years. Trust Fund interest earnings and asset redemptions are required to cover the difference. HI assets are projected to cover annual deficits through 2023, with asset depletion in 2024. After asset depletion, if Congress were to take no further action, projected HI Trust Fund revenue would be adequate to cover 87 percent of estimated expenditures in 2024 and 67 percent of projected costs in 2050. In practice, Congress has never allowed a Medicare trust fund to exhaust its assets.

The financial projections for Medicare reflect substantial cost savings resulting from the Affordable Care Act, but also show that further action is needed to address the program's continuing cost growth.

The Medicare Trustees are Treasury Secretary and Managing Trustee Timothy F. Geithner, Health and Human Services Secretary Kathleen Sebelius, Labor Secretary Hilda L. Solis, and Social Security Commissioner Michael J. Astrue. Two other members are public representatives who are appointed by the President, subject to confirmation by the Senate. Charles P. Blahous III and Robert D. Reischauer began serving on September 17, 2010. CMS Acting Administrator Marilyn B. Tavenner is designated as Secretary of the Board.

The report is available at: https://www.cms.gov/ReportsTrustFunds/downloads/tr2012.pdf

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NCPA

Statement of

Pamela Villarreal

Senior Fellow

National Center for Policy Analysis

on the

2012 Social Security Annual Report

Ways and Means Committee

Social Security Subcommittee

United States House of Representatives

June 21, 2012

Mr. Chairman and members of the Subcommittee, I am Pamela Villarreal, a senior fellow at the National Center for Policy Analysis. We are a nonprofit, nonpartisan public policy research organization dedicated to developing and promoting private alternatives to government regulation and control, solving problems by relying on the strength of the competitive, entrepreneurial private sector. I welcome the opportunity to share my views about the 2012 Social Security Trustees Report.

Regrettably, the Social Security and Medicare Trustees reports have become reruns of years past, with the combined unfunded liabilities exceeding the capacity of the average American to understand – more than $63 trillion. Little is offered in the way of viable solutions to solve the looming financial catastrophe. In the 2012 report, actuaries estimated that the unfunded liabilities of Social Security are $20.5 trillion. At a minimum, the federal government should have that much in the bank today, earning interest, in order to fund the Social Security programs into the future. Alas, the trustees inform us that there is only $2.6 trillion in the Social Security Trust Fund, nowhere near enough to cover the promises Congress has made to future seniors.

By the way, the Social Security Trust Fund is nothing more than IOUs written to the Treasury while the money has been borrowed and spent on other programs. Technically, this money belongs in the net unfunded liability column, bringing the total unfunded liability into the infinite horizon to more than $23 trillion.

It almost goes without saying (yet nobody seems to be listening) that the current Social Security system is unsustainable because Congress has made promises without paying for them. So what are the options? The NCPA has examined five scenarios (the details can be accessed at http://www.ncpa.org/pdfs/st337.pdf) that should be of interest to the Subcommittee:

(1) **Retain current law benefits**. If Congress decides to continue with the current Social Security system, they should find a way to pay for it. According to NCPA research, an additional 3.2 percent would need to be added to the current 12.4 percent payroll tax to eliminate the unfunded obligation while retaining current law benefits. But a tax hike would have devastating effects on the fragile economy. Increasing taxes on labor (which is what the payroll tax is) during a tepid economic recovery and high unemployment is not advisable.

(2) **Progressive price indexing**. Moving to a price index instead of a wage index for those at the top of the taxable earnings distribution would reduce the unfunded obligation to $3.2 trillion and shrink the Social Security program to about 82 percent of its current size. This option would still require a 0.6 percent increase in the payroll tax, but would result in a more progressive program. Workers at the lower end (below the 30th percentile) would stay with the current wage-indexed formula.

(3) **Change the benefits formula**. Without raising taxes at all, Social Security benefits could be reduced, with the benefits of higher earning workers declining the most. To eliminate the unfunded obligations, overall Social Security benefits would need to shrink to about 77 percent of their current size.

(4) **Raise the retirement age**. If Congress increased the retirement age by one month every two years, the unfunded obligation would shrink to $6.3 trillion. This option would still require a 1.3 percent increase in the payroll tax to achieve solvency. This would result in a Social Security program about 87 percent of its current size. However, an across-the-board increase in retirement age would disproportionately harm low-income workers since the increase in average life-expectancy is largely due to gains made among high-income workers.

(5) **Eliminate the taxable maximum**. By eliminating the current $106,800 cap, the unfunded obligation would shrink to $8.3 trillion. Immediate revenues would be available for Congress to borrow and spend on other priorities, but this option would result in a larger Social Security program over time because of higher future benefits that would accrue in the absence of a cap.

In addition to the five scenarios above, the National Center for Policy Analysis has done substantial work in the area of private retirement accounts. This is a viable solution worthy of the Subcommittee's consideration. In brief:

(1) **Put a portion of payroll taxes in personal retirement accounts**. While temporary payroll tax reductions just increase future debts, diverting those taxes to fund retirement accounts would reduce future government liabilities.

(2) **Transition toward a funded system**. Allow workers and employers to set aside part of their payroll taxes and workers' wages in personal retirement accounts. As balances grow over time, they will replace the government's unfunded promises.

(3) **Wise investments**. Workers and employers who are uneasy about private accounts should not be left to themselves to invest their retirement funds. Instead, funds can be invested in approved, diversified funds managed according to strict accounting and financial standards.

(4) **Reducing risk**. Everyone age 55 or older should receive all promised Social Security benefits. Younger workers could be guaranteed a minimum benefit level. If any qualifying worker's total benefit falls below the minimum, the federal government should supplement it.

There is much more at the NCPA.org website about private accounts and retirement reform. I appreciate the opportunity to submit my views on this important question and I offer any assistance I might give to help solve this significant public policy problem.

MATERIAL SUBMITTED FOR THE RECORD

Questions for the Record:

Charles P. Blahous III, Ph.D.

Attn: Kim Hildred
Staff Director
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
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Questions for the Record of June 21, 2012 Hearing
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
Answers of Charles Blahous

I am pleased to offer these answers to Chairman Johnson's questions for the record. If you have further questions or would like additional information, please do not hesitate to ask.

Charles Blahous

Q1: Disability Insurance (DI) provides an essential income safety net for those who are unable to work due to disability, yet this program won't be able to pay full benefits beginning in 2016. The Subcommittee is conducting a hearing series on securing the future of the DI program. Please explain why the Disability Insurance program financing is in worse shape compared to the retirement and survivors program and give us your recommendations for how to secure the DI program.

A1: There are a number of reasons why the DI trust fund is in more immediate financial difficulty than the OASI trust fund. The first one is simply timing: the large baby boom generation became eligible for disability benefits before they became eligible for retirement benefits. Over the very long term, the trustees' projections for annual cash imbalances in the disability program are no worse than they are for the retirement portion of Social Security. But the financial strains that arise from demographics have hit DI first, with the result that DI insolvency is projected for 2016 while OASI is projected to remain solvent until 2035. In future years more disabled baby boomers will convert to retirement benefits, shifting some current DI costs to the OASI trust fund.

Another contributor to the financial difficulties of the DI program has been the rising percentage of women with working careers of sufficient length to render them eligible for disability benefits. Fewer than 55% of women were disability-insured at the time of the 1983 Social Security reforms, whereas today the number is approaching 70%. Disability incidence rates among women have also risen to be closer to those for men.

By the early 1990s it was already clear that the disability program's share of total Social Security taxes was insufficient to finance its share of total program costs. Policy changes (including liberalization of eligibility criteria in 1984) and economic conditions up through the early 1990s drove up disability incidence rates relative to assumptions operative at the time of the 1983 reforms and for several years afterwards. Estimators also failed to anticipate a decline in disability termination rates that was, in the words of the 1992 Trustees' Report, "In part because of the lower average age of new beneficiaries." The higher share of disability recipients who are women, and/or who receive disability benefits on the basis of mental or musculoskeletal disorders, combined to drive down mortality rates among disabled beneficiaries. A reallocation of program tax rates effective in 1994 staved off immediate DI insolvency but was insufficient to restore the long-term health of the DI program. DI was thus in weaker financial condition than OASI even before the most recent recession precipitated additional disability benefit claims.

Options for restoring the DI system to financial health are in some senses more limited than with the OASI program, but in other senses more diverse. Eligibility age increases that can be used to reduce projected OASI costs will not save money in DI (and could actually increase DI costs). DI options thus essentially consist of changes to its benefit formula, eligibility criteria and tax revenue collections. In view of DI's weaker financial condition relative to OASI, I believe a reallocation of the current tax rate to be appropriate, though this would merely strengthen DI at the expense of the OASI program. I would recommend that any changes to the benefit formula be made concurrently to OASI and DI, to avoid "gaming" issues that could arise if the two formulas were decoupled. I believe it is appropriate to explore changes to the bend points or bend point factors so that scheduled benefits grow more slowly in each program than under current law, with the effects of such cost constraints concentrated on higher-income beneficiaries. As I describe more fully in my answer to your third question here, I also believe that reforms should be considered with attention to work incentives, for example by restructuring the benefit formula so that benefits rise proportionally with every additional year of work.

Q2: When Social Security began, the full retirement age was established at age 65. Social Security's early retirement age was first established at age 62 for women in 1956, and for men in 1961. Today, the early retirement age remains unchanged, however the full retirement age will reach 67 for those born after 1959. Had the full retirement age kept up with increases in life expectancy, what would it be today? Was the system designed for people to live as long as they do today?

A2: The precise answer depends on whether we are referring to life expectancy at birth, upon first receiving benefits or at some other age, because historical life expectancy increases have been unequal at different ages. By any measure, however, Social Security's eligibility ages have not risen to keep pace with U.S. population aging. Since Social Security's inception cohort life expectancy at birth has risen by nearly eleven years. Cohort life expectancy at age 65 has risen by about six years. Thus, even if using a more conservative measure of longevity improvements the full retirement age would need to be at least

71 today rather than the current 66, if indeed the policy goal were to have the normal retirement age keep pace fully with increasing longevity.

With respect to the second question as to whether Social Security was originally designed for people to live as long as they do today, my subjective answer is a qualified no. Though Social Security's designers could make reasonable estimates of future longevity gains, they were not in a position to anticipate other factors that affect population aging, including among them the subsequent pattern of changes in fertility rates that is now producing such dramatic increases in the number of people receiving old-age benefits. We must also remember that the benefits the program now pays at a given age are a function of a number of program design elements, including not only the full retirement age but also early-retirement eligibility, automatic annual cost-of-living adjustments, wage-indexing of the initial benefit formula, and various *ad hoc* benefit increases legislated over the decades. One could thus look at this complex picture in either of two ways; on the one hand one could argue that if Social Security was still limited to its original benefit design, current eligibility ages would be sustainable. If however we instead think of Social Security as the program we know it today -- with its COLAs, wage-indexed benefits, and early retirement options -- its original eligibility ages were clearly not designed for a program with these features.

Q3: Before the 1977 Amendments, the only way initial benefits increased was through an Act of Congress, which has happened 11 times. Under the 1977 Amendments, Congress fixed an unintended error resulting from earlier legislation by changing the benefit formula so that initial benefits would automatically increase with wage growth. As a result, today's retirees are receiving larger benefits in real terms than their parents did. Please discuss some of the options whereby benefits could increase at a sustainable rate, better reward work, and still protect lower earners.

A3: I am currently in process of completing a paper that addresses many of these issues. As you note, the 1977 amendments established a benefit formula that is indexed to growth each year in the national Average Wage Index (AWI). Because over time worker wages tend to grow faster than price inflation, this produces substantial growth in the real (inflation-adjusted) value of individual Social Security benefits. This is a significant driver of program cost growth, and if continued without alteration would result in growing tax burdens for younger generations.

Two features of this benefit formula are often overlooked. One is that in an aging society it causes lifetime worker cost burdens to rise over time, which causes benefits to grow faster than pre-retirement *after-Social-Security-tax* earnings. Assuming for example that current benefit schedules are left in place and that taxes are raised to maintain solvency, a worker with steady earnings retiring in 2055 who receives a benefit equal to roughly 41% of his gross pre-retirement wages would have faced a lifetime Social Security cost rate of over 16% to receive that benefit, whereas the worker retiring in 1985 would have faced a lifetime cost rate of less than 6% for that same 41% replacement rate. Thus, even if the policy goal is to maintain benefits that remain a constant percentage of pre-retirement living standards (a goal that would still require substantial tax increases to meet), the current benefit formula overshoots the mark and a downward adjustment to future benefit growth of roughly 0.25 percentage points per year would be necessary.

A second often-overlooked result of the current indexing method is that it produces benefit replacement rates that *rise* over time for a given real level of earnings. For example, the worker retiring in 2055 and earning the CPI-indexed equivalent of roughly $43,800 today is being promised a benefit replacement rate of 48.7%, in contrast with a $43,800 worker retiring today who receives a benefit replacement rate of 42.9%. This implicitly reflects a value judgment embedded in the current formula, which is that as society grows richer the safety net should expand so that Social Security benefits for a worker with a given level of real income automatically grow more generous relative to his cost of living. This is clearly not the only value judgment that could be made. If the method of indexation were changed to pay the same real level of benefits based on the same level of real earnings across time, a substantial portion of the program's projected financing shortfall could be closed.

Your question also asks whether reforms to bring the growth of benefits to sustainable levels could better reward work. I believe that the answer is yes. The benefit reduction applied to early benefit claims, and the reward applied to delayed retirement claims, could both be increased to reflect the value of payroll taxes contributed by seniors who extend their working lives. Moreover as I mentioned in my answer to the first question the existing benefit formula, currently applied to an average of an individual's top 35 earnings years after indexing for national wage growth, could instead be applied to each *individual* earnings year. As an example, the existing benefit formula could be divided by 38 or 40 and then applied to each year of earnings. As a result, in contrast with the current formula where benefit returns drop precipitously when an individual reaches 35 years of earnings, younger seniors would continue to accrue proportional benefits if they extend their working careers. Finally, the growth of the non-working spouse benefit for higher-income earners could be constrained. Under current law it is possible for the spouse of a higher-income individual, who makes no direct tax contributions to Social Security, to receive a higher spousal benefit than the primary benefit another lower-wage individual might receive after a full career of contributing taxes to the program. This situation both undermines work incentives and creates regressive income transfers. This could be addressed by restricting the growth of non-working spouse benefits, so that the most generous such benefits do not exceed the inflation-adjusted value of benefits received by full-career low-income workers in 2012. All of these reforms would improve system finances while improving the returns to work under Social Security.

Q4: As young people often don't think Social Security will be there for them, what advice do you have for what we should tell them? Can they expect to get back what they paid into the system?

A4: Answering the second question first, unfortunately younger workers cannot expect to receive back the present-value of their contributions to Social Security. A table in the Social Security Trustees' report shows that workers just now entering the system should expect on balance to contribute roughly 4.2% of their wages more than they receive in benefits, if current benefit schedules for older cohorts are left in place. This is a consequence of population aging colliding with Social Security's financing methods. Because Social Security benefits are funded primarily by taxing the wages of current workers, and because the ratio of workers to beneficiaries is declining, the lifetime cost burdens facing younger workers are rising. Another analysis of the Social Security Actuary's office shows that individuals born in 2004, if they marry to form a two-earner couple, would expect to receive back only 82 cents on the dollar if taxes are raised to fund currently scheduled benefits.

This income loss does not mean that Social Security would not be there for younger generations or that it would disappear altogether. Having said that, I am on the pessimistic side of most Social Security experts in fearing for the program's long-term future. For several decades the program's foundation of political support has rested on the perception that Social Security is not welfare but rather an earned benefit, self-supporting through its own separate system of worker contributions. Already the long-term Social Security shortfall is substantially greater (even relative to today's larger economy) than the one corrected with such difficulty in the 1983 program reforms. If more than a few additional years pass without legislative correction, the size of the short-term sacrifices necessary to sustain Social Security as a self-financing program will far surpass historical precedent for enactment in legislation. If Congress becomes unwilling to raise taxes or cut benefits sufficiently to keep Social Security self-supporting, permanent subsidies from the general fund may be required. I fear that Social Security's foundation of public support, and its status as a perceived earned benefit, would both be threatened if Social Security were merged into the general budget in such a way.