WHAT WORKERS NEED TO KNOW ABOUT SOCIAL SECURITY AS THEY PLAN FOR THEIR RETIREMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

JULY 29, 2014

Serial 113–SS11

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PUBLISHING OFFICE

92–445 WASHINGTON : 2016

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

DAVE CAMP, Michigan, *Chairman*

SAM JOHNSON, Texas
KEVIN BRADY, Texas
PAUL RYAN, Wisconsin
DEVIN NUNES, California
PATRICK J. TIBERI, Ohio
DAVID G. REICHERT, Washington
CHARLES W. BOUSTANY, JR., Louisiana
PETER J. ROSKAM, Illinois
JIM GERLACH, Pennsylvania
TOM PRICE, Georgia
VERN BUCHANAN, Florida
ADRIAN SMITH, Nebraska
AARON SCHOCK, Illinois
LYNN JENKINS, Kansas
ERIK PAULSEN, Minnesota
KENNY MARCHANT, Texas
DIANE BLACK, Tennessee
TOM REED, New York
TODD YOUNG, Indiana
MIKE KELLY, Pennsylvania
TIM GRIFFIN, Arkansas
JIM RENACCI, Ohio

SANDER M. LEVIN, Michigan
CHARLES B. RANGEL, New York
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
JOSEPH CROWLEY, New York
ALLYSON SCHWARTZ, Pennsylvania
DANNY DAVIS, Illinois
LINDA SÁNCHEZ, California

JENNIFER M. SAFAVIAN, *Staff Director and General Counsel*
JANICE MAYS, *Minority Chief Counsel*

SUBCOMMITTEE ON HUMAN RESOURCES

SAM JOHNSON, Texas, *Chairman*

PATRICK J. TIBERI, Ohio
TIM GRIFFIN, Arkansas
JIM RENACCI, Ohio
AARON SCHOCK, Illinois
MIKE KELLY, Pennsylvania
KEVIN BRADY, Texas

XAVIER BECERRA, California
LLOYD DOGGETT, Texas
MIKE THOMPSON, California
ALLYSON SCHWARTZ, Pennsylvania

CONTENTS

WHAT WORKERS NEED TO KNOW ABOUT SOCIAL SECURITY AS THEY PLAN FOR THEIR RETIREMENT

TUESDAY, JULY 29, 2014

U.S. House of Representatives,
Committee on Ways and Means,
Subcommittee on Social Security
Washington, DC.

The Subcommittee met, pursuant to notice, at 11:00 a.m., in Room B–318, Rayburn House Office Building, the Honorable Sam Johnson [Chairman of the Subcommittee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Chairman Johnson Announces Hearing on What Workers Need to Know About Social Security as They Plan for Their Retirement

B–318 Rayburn House Office Building at 11:00 AM
Washington, July 22, 2014

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 what workers need to know about Social Security as they plan for their retirement. **The hearing will take place on Tuesday, July 29, 2014 in B–318 Rayburn House Office Building, beginning at 11:00 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:

After paying payroll taxes throughout their lifetimes, workers and their families count on the essential income replacement Social Security provides should they retire, become disabled, or die. Nine out of ten seniors age 65 and older receive Social Security benefits, which are a major source of income for most seniors.

Future retirees face far more questions than answers, as according to last year's Annual Report of the Social Security Board of Trustees, unless Congress acts, revenues will cover only 77 percent of scheduled benefits beginning in 2033. Worse, revenues will cover only 80 percent of disability benefits beginning in 2016. These findings will soon be updated in the 2014 Annual Report.

Social Security is central to retirement security, yet Social Security's complex benefit formula is often confusing to workers and their spouses. Lifetime benefit amounts can vary based on income, marital status, and life expectancy, as well as when an individual claims benefits, making it difficult for individuals to know when they should retire and the benefit amount they will receive. In addition to general information on its website, the Social Security Administration makes available online and periodically mails the *Social Security Statement* with estimated future benefits and also provides a Retirement Estimator on its website to allow users to estimate their benefit amounts. Even with these tools, few workers know the amount of benefits they can expect to receive from Social Security.

Further, as workers plan for their retirement security, they should also consider any employer pension they may receive, along with other assets they may accumulate, such as IRAs. Understanding the portion of retirement income Social Security represents is also important for policymakers as they weigh options to strengthen Social Security. It is an increasing challenge to comprehensively measure retirement income, since the amount of monthly income derived from retirement accounts, such as 401(k)s and IRAs, can vary widely and is often underreported.

In announcing the hearing, Social Security Subcommittee Chairman Sam Johnson (R–TX) stated,**"Hardworking Americans are increasingly facing real challenges in being able to achieve a secure retirement. Not only will Social Security be unable to pay full benefits in 2033 unless Congress acts, but the**

rules are so complex that workers need help in figuring out their benefits. Americans want, need, and deserve a Social Security program they can count on and understand."

FOCUS OF THE HEARING:

The hearing will focus on the financial status of Social Security programs, the factors influencing the benefits paid, the status of Americans' retirement readiness and how workers can be helped to better plan for their retirement.

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 Tuesday, August 12, 2014**. 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. Well, good morning and welcome. Yesterday the Social Security Board of Trustees, folks who provide us with results of Social Security's annual financial check-up, again sounded the alarm over the Social Security financial health.

Unless Congress does its job, full benefits can't be paid on time beginning in just two years for those receiving disability benefits. Further, when today's 48 year-old workers reach their full retirement age in 2033, they and everyone else receiving retirement and survivor benefits will see a 23% cut. Today, 9 out of 10 seniors, age 65 and older receive Social Security benefits, which is a major source of income for most seniors.

Since I've been Chairman, I've been committed to making sure that Social Security will be there, not just for today's seniors, but for their children and grandchildren. The price of delay gets higher every year, so the sooner we act the better.

As public trustees informed us yesterday, the changes needed today are bigger than what Congress passed in 1983. It is no wonder that young people don't believe they will ever receive benefits.

A recent survey by Transamerica Center for Retirement Studies survey found that 81% of those between the ages of 18 and 34 today don't believe Social Security will exist when it comes time for them to retire.

As a result, these young people expect most of their retirement to be self-funded, resulting in 70% of them already saving for retirement. With the retirement of the baby boomers, the decline in traditional pensions, stagnant wages that make it even harder for Americans to save and Social Security impending inability to pay full benefits, Americans face a challenging retirement security landscape.

Bottom line, Americans want, need, and deserve a Social Security program they can count on. But just as important, a program they can understand.

For instance, older workers getting ready to retire are trying to determine when they should retire, and what benefits they should apply for, yet deciding when to take Social Security benefits isn't just a question of how old you are. Workers have to answer questions like "How long am I going to live? Do I want to keep working? How much will my spouse receive from Social Security?"

As we will hear today, taking benefits at the wrong time can cost thousands of dollars. While Social Security has some tools to help, sometimes these tools aren't all that helpful. So what happens when well-meaning programs become so complex that Americans need paid help to figure out what their benefits are? Americans pay.

In the disability program many pay lawyers to help them receive disability benefits, while others pay financial planners to help them figure out retirement benefits. Worse, those who can't afford the help pay with fewer or lower benefits than they deserve. And that is just wrong. There has to be a better way.

Today's hearing isn't just about ensuring that Social Security will be there for current and future generations, but starting a much needed conversation about what workers need to know about Social Security as they plan for their retirement.

I want to thank all of our witnesses for being here today and I look forward to hearing your testimony. And I now recognize ranking member, Mr. Becerra for his opening statement.

Mr. BECERRA. Mr. Chairman, before I begin my opening statement, I want to again, register my concern that we will be discussing the Social Security Trustees report which was released yesterday without hearing from the author of and the foremost expert on that report. That's the Social Security Chief Actuary, Stephen Goss. I would like to insert into the record the letter that I sent to you registering the Democrats' concern that Chief Actuary Goss was not invited to testify at our hearing to provide a neutral, nonpartisan explanation of the facts before we are presented with partisan policy recommendations. I'd like to submit that into the record Mr. Chairman.

Chairman JOHNSON. You could have invited him. You know.

Mr. BECERRA. Mr. Chairman, we had one witness out of five or six——

Chairman JOHNSON [continuing]. You could have invited him——

Mr. BECERRA [continuing]. And we chose to invite someone as well an official witness is usually invited.

Chairman JOHNSON. Does anybody object to having it put in the record? Okay.

[The information follows:]

Congress of the United States
House of Representatives
COMMITTEE ON WAYS AND MEANS
WASHINGTON, DC 20515

SUBCOMMITTEE ON SOCIAL SECURITY

July 28, 2014

The Honorable Sam Johnson
Chairman, Subcommittee on Social Security
B-317 Rayburn House Office Building
Washington, D.C., 20515

Dear Mr. ~~Chairman~~: Sam,

I appreciate the opportunity we had last week to discuss the witnesses invited to testify at Tuesday's hearing. Your decision not to invite the author of the 2014 Social Security Trustees Report, Mr. Stephen Goss, Social Security's Chief Actuary, to testify is troubling. One of the stated purposes of this hearing, scheduled to take place the day after the 2014 Social Security report is released, is to "focus on the financial status of the Social Security programs". The only witness you invited with some level of involvement in the report will be a political appointee, Charles Blahous.

Mr. Blahous, the Republican appointee to the board that oversees the report, is a long-time advocate of privatizing Social Security and cutting its guaranteed benefits, including cutting COLAs for current seniors using the chained CPI. While Republicans and Democrats have different policy views on Social Security, Americans regardless of political affiliation rely on it. They earn their Social Security benefits by working and paying into the Trust Fund -- thereby ensuring foundational economic security for themselves and their families in the event of retirement, career-ending disability, or premature death.

The continued success and strength of Social Security can be undermined by a lack of bipartisan support and action in Congress. That's why our subcommittee's role overseeing and fact-finding on Social Security is so important and indispensable. To do our work properly, we need to hear from the nation's foremost expert on the 2014 Social Security report, the Chief Actuary for Social Security.

I strongly urge you to reconsider your decision to exclude Chief Actuary Stephen Goss from our hearing. He is available to testify. Chief Actuary Goss would provide a neutral, non-partisan recitation of the facts before we are presented with partisan policy recommendations.

Sincerely,

XAVIER BECERRA
Ranking Member
Subcommittee on Social Security

Mr. BECERRA. Thank you, Mr. Chairman. For most Americans Mr. Chairman, Social Security is the heart of retirement security. Six out of ten seniors rely on Social Security for more than half of their income. For almost half of Americans over 80, nearly all of their income comes from Social Security. Without Social Security nearly half of women over the age of 65 would be poor. Americans have earned that vital retirement security. Over 160,000,000 Americans today pay into Social Security with their paycheck tax contributions every week in exchange for economic security for themselves and their families.

Over its lifetime, Social Security has raised through those tax contributions 17.2 trillion dollars and paid out 14.4 trillion dollars; thereby, accumulating a surplus of 2.8 trillion dollars for future benefit payments.

Now, only the highest income earners, 25% of retirees, receive any significant income from something other than Social Security, like an IRA or work-based retirement plan. And that's even despite the substantial subsidies that are provided for retirement savings through the Tax Code.

So, Mr. Chairman, the best way for Congress to improve retirement security for all Americans is by protecting Social Security from benefit cuts and making sure it is as strong for future generations as it was for their parents and grandparents.

I am deeply concerned about the proposal several of our witnesses have put forth to cut Social Security's annual cost of living adjustments for current seniors. The so called chained CPI would result in deep benefit cuts for those who need them the most.

I also disagree with the proposals four of our witnesses have made in the past to privatize Social Security, cutting its guaranteed benefits.

Mr. Chairman, I know I've said this before, in fact I said it at our hearing on the Social Security Trustees report back on June of 2011. The biggest challenge facing Social Security right now is Republican budget cuts in the House of Representatives.

At our hearing in 2011, I and other Democrats on the subcommittee asked you to hold hearings to find out how Americans were affected by a $622,000,000 cut to the Social Security Administration's budget.

We never had that hearing, even though prior to 2011, our committee had a bipartisan tradition of holding oversight hearings on SSA's budget and its ability to serve the American public. The cuts continued.

Since the beginning of 2011 the number of Americans receiving Social Security has actually grown by almost 4 million people, but the Social Security Administration budget is still lower today than it was four years ago in 2010.

We now know some of the ways the cuts are affecting Americans who rely on Social Security. Social Security has lost 11,000 employees as a result of these cuts, almost 15% of its workforce. Some local Social Security offices are operating with staff shortages of more than 25%.

Budget cuts forced Social Security to reduce the number of hours their offices are open to the public by one fifth, including closing offices completely on Wednesday afternoons.

Disabled workers today are waiting longer and longer to receive their earned benefits. 14% of Americans who try to call Social Security's 800 number get a busy signal and those who get through are usually put on hold. Seniors who need help are waiting in long lines that stretch out the door of the Social Security office sometimes in the heat or icy cold.

Mr. Chairman, I again urge you to schedule a hearing on the Social Security Administration's budget so that we can examine these budget cuts and make sure Social Security can continue its long tradition of providing Americans with the services they paid for.

Let me enter into the record Mr. Chairman, a letter that the Democrats on the subcommittee sent to you today, reiterating our concerns, and requesting that we act now before the situation gets worse.

The best thing that we can do if we do really care about Social Security and we care about those Americans who have contributed every month through their paychecks a tax contribution to the Social Security system, is to make sure we don't undermine the ability of the Social Security Administration to dispense the services these Americans have paid for.

The money is there. We have challenges policy-wise to Social Security that are long term. Today we face operating budget deficits in the billions, but Social Security has a surplus in the trillions.

And so, we have an opportunity to work together bipartisanly to try to resolve these issues. But, Mr. Chairman, I urge you and I submit this letter to the record that again urges this subcommittee to do its oversight responsibility under the Constitution. To hold the hearing on the SSA's budget so we don't find ourselves falling into situations where Social Security fails to provides the benefits that it always has, on time and in full.

With that Mr. Chairman, I request Mr. Chairman to submit this letter into the record. And I yield back the balance of my time.

Chairman JOHNSON. Are there any objections? There's none.

[The information follows:]

Congress of the United States
House of Representatives
COMMITTEE ON WAYS AND MEANS
WASHINGTON, DC 20515

SUBCOMMITTEE ON SOCIAL SECURITY

July 29, 2014

The Honorable Sam Johnson
Chairman, Subcommittee on Social Security
Committee on Ways and Means
B-317 Rayburn House Office Building
Washington, D.C., 20515

Dear Chairman Johnson:

We are writing to urge you to schedule a hearing on Social Security's service delivery budget as soon as possible. As you know, our Subcommittee has a constitutional responsibility (Article 1, Section 8) to oversee Social Security's operations, as well as a moral obligation to ensure that all Americans receive the Social Security they paid for. Our Committee last fulfilled its obligation to assess Social Security's budget more than four years ago, when Democrats chaired the Committee.

For nearly 80 years, the Social Security Administration (SSA) has provided renowned customer service at an extremely cost-effective price – less than one percent of Social Security's annual expenditures go to administrative costs – all without adding a penny to our deficit or our debt. Over its lifetime, Social Security has collected $17.2 trillion and paid out $14.4 trillion, accumulating a surplus of $2.8 billion for future costs and benefit payments.

But it is increasingly clear that even Social Security's talented and hard-working employees can't maintain the level of service Americans need and have paid for if Congress fails to do its job. The number of Americans receiving Social Security has grown by more than 10 million over the past decade as the Baby Boom generation has aged. But in 2011, House Republicans slashed SSA's budget, and every year since then, Social Security has received about a billion dollars a year less than it needs to keep up with its rising workload. The funding shortfall has had real consequences for American families – Social Security's local offices have lost more than 10 percent of their staff that serve the public, and that means longer waiting times when Americans visit or call the Social Security office, Social Security office closings, a 20 percent reduction in the hours SSA offices are open to serve the public, and delays in disabled workers receiving their full earned benefits.

The Honorable Sam Johnson
July 29, 2014
Page 2

The most immediate threat to Social Security is the continued failure of Congress to provide an adequate budget to ensure that all Americans receive the correct benefit, on time and in full. This Subcommittee should avoid any further delay in undertaking its constitutional responsibility to hold oversight hearings on the Social Security Administration's budget. It is our duty to be accountable stewards of Social Security.

Sincerely,

XAVIER BECERRA
Ranking Member
Social Security Subcommittee

LLOYD DOGGETT
Member
Social Security Subcommittee

MIKE THOMPSON
Member
Social Security Subcommittee

ALLYSON SCHWARTZ
Member
Social Security Subcommittee

Chairman JOHNSON. You know on the issue of Social Security Administration needing more money, I'd like to make two points. One, in the last decade, Social Security received a 34% increase in budget since GOP control. And all but one budget has been bipartisan and all were signed by President Obama, your president. Just last——

Mr. BECERRA. Our President. Our President.

Chairman JOHNSON [continuing]. Just last week we learned Social Security spent $300,000,000 on failed implementation of a new computer system for the State Disability Determination Services. That's $300,000,000 that was wasted. We need to watch out for——

Mr. BECERRA. Mr. Chairman——

Chairman JOHNSON [continuing]. That, too

Mr. BECERRA. I'm intrigued, query. I understand the Chairman has a prerogative to make additional remarks. We are working outside the regular order. I just want to make sure that if the Chairman is going to make some remarks, we have an opportunity to have an opportunity do the same as well. Chairman has always been gracious in allowing that, I just want to point that out.

Chairman JOHNSON. Well, as is customary any member is welcome to submit a statement for the hearing record and as we move to testimony today, I want to remind our witnesses to please limit your oral statements to five minutes. However, without objections all the written testimony will be made a part of the hearing record.

We have one witness panel today, and seated at the table are: Charles P. Blahous, III, Ph.D., he is a public trustee, Social Security and Medicare Boards of Trustees. Welcome aboard.

Sylvester Schieber, independent consultant.

C. Eugene Steuerle, Ph.D., Institute Fellow and Richard B. Fischer Chair, Urban Institute.

Joan Entmacher, is that correct? Vice President, Family Economic Security, National Women's Law Center.

Andrew G. Biggs, Ph.D., Resident Scholar, American Enterprise Institute.

And Laurence J. Kotlikoff, is that correct? Ph.D., William Fairfield Warren Professor, Boston University, Boston Massachusetts.

Welcome and thank you all for being here.

Dr. Blahous, please go ahead with your testimony.

Mr. BLAHOUS. Thank you Mr. Chairman, Mr. Ranking Member, and all the Members of the Subcommittee. It's a great honor to appear before you today again to discuss the recently released projections of the Trustees and the implications for workers' retirement planning.——

Chairman JOHNSON. Turn on your microphone.

Mr. BLAHOUS. The light says it's on,

*The CLERK. It was on, just bring it closer.

Mr. BLAHOUS. Okay.

Chairman JOHNSON. Thank you.

STATEMENT OF CHARLES P. BLAHOUS, III, Ph.D., PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES

Mr. BLAHOUS. With your permission, my written testimony has a longer analysis, but I'd like to use my oral remarks to simply make four quick points.

The first point is simply that Social Security faces a substantial financing shortfall and as of yesterday we reconfirmed that part of that shortfall has become an immediate problem.

In our latest projections released yesterday we projected that the Disability Insurance Trust Fund will be depleted in the 4th quarter of 2016. What is important to remember about that is that this is not an indication that we only have a problem on the Disability side. In fact what we found was that the long term shortfall in the Old Age and Survivors Insurance Trust Fund is actually larger than it is on the Disability side.

The reason it is showing up first on the Disability side is primarily, not solely, but primarily, because the baby boomers move through their ages of peak disability incidence before they hit retirement age.

So rather than interpreting this as a problem that is solely confined to DI I would urge the interpretation that it is basically the first manifestation, the first element of financial crisis associated with problems that are afflicting the program as a whole.

The second point I would make is that uncertainty as to how the shortfall is going to be resolved is a threat to workers' retirement security for a number of reasons. One is that as long as workers don't know how we are going to resolve it, the means of resolution is unknown, workers can't make their plans, they don't know what is going to be required in terms of additional tax contributions, they don't know what their benefits are going to be. And also, the longer we delay, the larger the relative sacrifice that we require from each birth cohort, because we have fewer birth cohorts that can contribute to the solution.

Another very important factor in my judgment is that the closer we come to say, 2033, the greater the uncertainty becomes that we are going to be able to repair the shortfall at all within the historical financing structure of Social Security.

Just for purposes of illustration, consider that if we wanted do a solution today, and we wanted to not raise taxes and we wanted not to cut benefits for people now in retirement, we'd have to, reduce the benefits of people newly coming onto the rolls by 21%. But if we wanted to employ that same strategy in 2033, even cutting off the entirety of their benefits would not solve the problem then.

So clearly, by 2033, our opportunity has long passed. And there's a point between now and then that our opportunity to close the shortfall within the historical financing structure disappears. And that's a problem, because if we can't maintain Social Security finances under the historical financing structure, then we'd have to find a different means of doing it and programs financed for example from the General Fund tend to be more changeable than Social Security, they tend to be more subject to sudden eligibility changes, benefit changes, means tests, that sort of things, things that Social Security has generally escaped in the past.

The third point I'd make is that the costs of Social Security are rising faster than our economic output. That wouldn't be a problem if it reflected a greater national capacity to finance these benefits. But because Social Security is not a savings program but rather an income transfer program, basically, any benefit gains that come to one group have to come at the cost of a different group, at least from a financial perspective. So what is happening is we're increasing our commitments to paying higher benefits without increasing our national capacity to finance them. And that's an issue.

The final point I would make, Mr. Chairman, is that this may seem paradoxical, but there certain ways in which we could actually enhance retirement security by slowing the growth of costs. You have to remember that retirement security is not only a function of annual income and assets, but is also a function of the number of years over which you have to stretch your retirement resources.

And there is a lot of evidence that the current design of Social Security is causing people to withdraw prematurely from the workforce and run greater risk of outliving their savings.

If we could possibly repair some of the inducements and incentives in the course of slowing the growth of costs, we could simultaneously put the program on a sounder financial footing and increase retirement security at the same time.

We also have a problem in the sense that the rising cost of financing the current benefit formula is depressing the relationship between workers' pre-retirement earnings and their post-retirement benefits, and that is an issue as well.

That is particularly an issue for low income people because you have many people who are in the situation now where they actually expect better standards of living in retirement than they have as workers. And this has terrible implications for their ability to put aside savings, their labor force attachment and other problems. We see the results of that in the paucity of savings that a lot of groups have outside of Social Security.

In conclusion, Mr. Chairman, the financing shortfall facing Social Security, creates substantial income risks for Americans who are planning for retirement. We can minimize this risk by enacting financing reforms that preserve historical financing structure or reducing cost growth to rates that can be financed within a stable tax rate. Retirement income security would also be enhanced by reforms that increase labor force attachment and remove disincentives to saving.

Thank you.

[The prepared statement of Mr. Blahous 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

July 29, 2014

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 recently-released projections of the Social Security trustees and their implications for workers' retirement planning.

Social Security's Financing Challenges

Americans tend to think of retirement benefits first when thinking of Social Security. This is understandable given that the majority of benefit payments (about 65%) are made to retired workers. But Social Security also provides for a number of other 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. This linkage helps avoid discontinuities in benefit levels when an individual changes status, for example if a disabled worker reaches the age of full entitlement to old-age benefits.

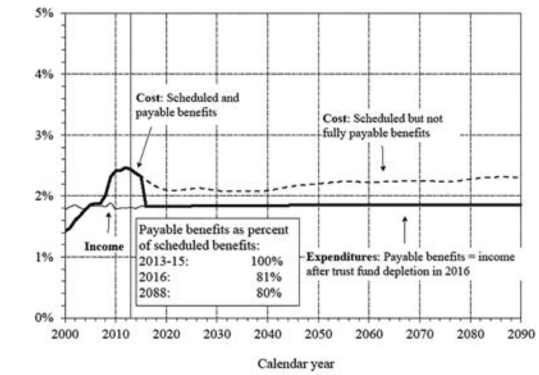
Payments for retired workers as well as their spouses, children and survivors are made from the Old-Age and Survivors Insurance (OASI) trust fund. Payments for disabled workers and their dependents are made from the Disability Insurance (DI) trust fund. Although it is common to refer to the total finances of Social Security by combining the operations of these two funds into a theoretical single trust fund (OASDI), by law each of Social Security's separate trust funds, OASI and DI, can only make benefit payments from revenues allocated to that specific fund.

Of Social Security's two trust funds, its DI trust fund faces the more immediate threat of depletion. Under our latest projections released yesterday, DI reserves will be depleted in the fourth quarter of 2016, at which time there will only be sufficient revenues to finance 81 percent of scheduled benefits.

---

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

Figure 1: Projected DI Income, Cost and Expenditures
(As a Percentage of Taxable Payroll)



The significance of the DI fund's imminent depletion is that the financing crisis facing the Social Security program, of which trustees' reports have warned for several years, is now beginning to be realized. Although under current law the program's OASI fund can finance benefit payments for several more years, this does not mean that it is in stronger long-term condition than DI. To the contrary, the projected long-term financing shortfall in OASI is larger, in both absolute and relative terms, than it is for DI.

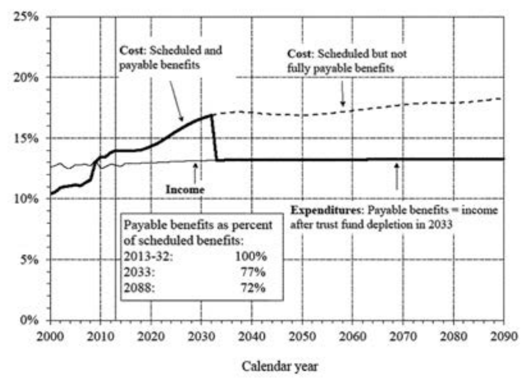
	OASI	DI
75-year average income rate	12.02	1.87
75-year average cost rate	14.57	2.20
Actuarial balance	-2.55	-0.33

All figures given as a percentage of taxable worker wages.

Although there are policy challenges unique to DI that warrant attention, the current situation is very different from 1994 when lawmakers reallocated taxes from the OASI fund to the DI fund, responding then to the fact that DI's sooner-projected depletion date reflected a larger relative shortfall. By contrast, the earlier depletion date now projected for DI primarily reflects the fact that the baby boomers are moving through the ages of peak DI incidence before reaching retirement age. This impending trust fund depletion is the first crisis triggered by factors that affect DI and OASI alike, and signals the urgency of enacting financial repairs to Social Security as a whole.

If lawmakers took no action other than to reallocate taxes between the Social Security trust funds, then in 2033 all program beneficiaries would be subject to a sudden benefit reduction of 23% upon depletion of the combined trust funds. Historically, lawmakers have never permitted benefits to be reduced or delayed as a result of trust fund insolvency. Thus, for practical purposes, more likely outcomes are either that lawmakers will act with dispatch to repair the financing shortfall, or that it will simply be left uncorrected, forcing an eventual abandonment of Social Security's historical financing structure.

Figure 2: Projected Social Security Income, Cost and Expenditures
(Theoretical Combined Trust Funds, as a Percentage of Taxable Payroll)



Some numerical illustrations may help to illuminate the toll associated with further delaying legislative corrections. Historically, lawmakers have been reluctant to reduce Social Security benefits for those already receiving them. If lawmakers continued to protect current recipients from benefit reductions under a solution enacted today, the benefits of future recipients would need to be reduced by roughly 21% to avoid a Social Security tax increase.[2] If, however, financing corrections were postponed until 2033, even the complete elimination of payments to new beneficiaries would be insufficient to maintain solvency while permitting the uninterrupted flow of benefits to those already receiving them.

For additional perspective, consider that Social Security's current financing shortfall has grown substantially larger than that corrected in the landmark program amendments of 1983. The current shortfall of 2.88% of taxable worker wages well exceeds that of 1.82% projected in the 1982 trustees' report. This comparison actually understates the difference because the trustees' actuarial methodology has changed substantially since then. Employing actuarial methodology similar to that used in 1983 would show a financing shortfall today of roughly twice the size of the previous crisis, even relative to today's larger economy and tax base. Thus closing the current shortfall

[2] This would not be a reduction of 21% from today's levels but rather from the higher level of future benefits scheduled under current law.

would require legislators to enact measures roughly twice as severe as those of 1983; those measures included delaying COLAs by six months, exposing benefits to income taxation for the first time, bringing newly hired federal employees into the system to contribute payroll taxes, raising the eligibility age for full retirement benefits, accelerating a previously-scheduled increase in the payroll tax rate, and other measures. Continuing delay would ultimately require even more severe measures. Thus we are already at the point where it has become uncertain whether lawmakers will act quickly enough to sustain Social Security's historical financing design, or whether it will eventually need to be abandoned in favor of a new design in which the program is subsidized permanently from the government's general fund.

Risks for Participants

As the previous illustrations suggest, continued delay in addressing the Social Security financing shortfall poses substantial risks for beneficiaries. As long as the means of closing the shortfall remains unidentified, participants are deprived of critical information with respect to their own eventual contributions to program financing, and cannot adjust their retirement planning accordingly. Moreover, the longer legislative corrections are postponed, the fewer the number of birth cohorts that can contribute to the solution, and the greater the likelihood that affected cohorts will suffer substantial net income losses.

Program participants face mounting risks to their incomes both as taxpayers and as beneficiaries. Projections in this year's trustees' report show that the current shortfall results from an excess of scheduled benefits over tax contributions for individuals who have already entered the Social Security system. This shortfall equals 4.4 percent of projected future wages. In other words, if current formulae remain unchanged for those now in the system, future workers will be subjected to a net income loss through Social Security equal to 4.4 percent of earnings. Whether this net income loss is imposed on them as higher taxes during their working years, or as lower benefits than now scheduled, it will cause the same net reduction in their lifetime income – unless, that is, action is taken to slow the rate of benefit growth for older generations.

The declining certainty of legislative corrections adequate to preserve Social Security's historical financing structure exposes beneficiaries to additional risk. If lawmakers ultimately prove unable or unwilling to balance scheduled benefits with dedicated program taxes, the gap might have to be filled from the federal government's general fund, which Americans fund largely with their income taxes. Because not every American pays income taxes, and because Social Security benefits are not and are unlikely to ever be based on income tax contributions, this would destroy the historical link between contributions and benefits, and with it the philosophy of an "earned benefit." Historically, programs financed from the general fund have been much more prone to frequent changes in eligibility rules and benefit levels than Social Security has historically been. Programs financed from the general fund are also often formally means-tested, suggesting that in this scenario individuals' other retirement saving could cause them to lose Social Security benefits. In general, a continued failure to repair Social Security's finances reduces Americans' retirement income security in part because of the increased risk that the program will eventually need to be supported with income taxes, support that has historically come with strings attached.

Problematic Implications of Rising Social Security Costs

Under current formulae Social Security costs have risen and will continue to rise faster than our national economic output. In 2007, before the baby boomers began to enter retirement, program costs equaled 4.1% of GDP. Costs have already risen to 4.9% of GDP this year, and will continue to rise swiftly as the baby boomers swell the retirement rolls. Under current projections these costs will exceed 6% of GDP in 2030. This unsustainable trajectory of cost growth will be temporarily interrupted in the years 2040-55 as low-birthrate cohorts join the beneficiary rolls. Afterwards costs will resume rising relative to GDP due to increasing longevity interacting with fixed eligibility ages and scheduled benefits that grow faster than price inflation. Such cost growth is inherently problematic because it means program finances are not sustainable within a stable tax rate. Unless cost growth is slowed, Americans are continually at risk of unspecified income losses in the form of further tax increases.

Rising Social Security costs would be less of a problem if they reflected a greater capacity to finance higher retirement benefits as a result of increased retirement saving. Social Security, however, operates as an income transfer program rather than a savings program. Each generation's benefits are financed primarily from taxes collected from subsequent generations. One generation's financial gain through the system is another's financial loss. As scheduled benefits and costs rise, an increasing share of our national resources is committed to financing benefit payments without increasing our stock of capital available to finance them. Thus, instead of increasing our overall retirement preparedness, rising pay-as-you-go Social Security obligations reduce the amount of saving otherwise available to finance retirement income.

Problematic results of current policy include the paucity of other savings held by groups most reliant on Social Security, and are reflected in academic literature finding that Social Security has a negative effect on saving. These adverse effects would be exacerbated if lawmakers react to projected financing shortfalls by increasing taxes rather than by containing cost growth. Long before the point of combined OASDI trust funds depletion, these rising costs exert increasing pressure on the government's general fund, which provides the resources to make cash payments of interest as well as to redeem bonds held in the program's trust funds. Thus even during a period of solvency, Americans are at risk of further income losses as a result of rising income tax burdens or because of slower income growth resulting from rising federal indebtedness. Rising income tax burdens in particular would interfere with Americans' ability to accumulate retirement saving outside of the Social Security system, a problematic effect because only by increasing saving can the total resources available to finance retirement income be increased.

Retirement security depends heavily not only on retirement income and assets but on the number of years over which financial resources must be stretched. Thus, policies that induce Americans to leave paid employment prematurely undercut retirement security. Research has shown that the current structure of Social Security creates ample incentives for Americans to leave the workforce and thereby increase their risk of outliving their retirement savings. When Social Security was first established more than three-quarters of a century ago, 65 was the youngest age at which old-age benefits could be claimed. Today the most common age for benefit claiming is 62, despite substantial improvements in health and longevity since Social Security's inception. Research by Andrew Biggs has shown that seniors who extend their working lives only receive 2.5 cents in lifetime Social Security benefits for each additional dollar of taxes contributed. Research by Jeff Liebman *et al* has shown that individuals are more likely to retire at times when such marginal Social Security tax rates are relatively high. These inducements for premature retirement are a major threat to Americans' long-term retirement security, and lawmakers would do well to correct them in the course of repairs to Social Security's financial outlook.

One possible reform is to apply the program's progressive benefit formula to each year of wages rather than to one's lifetime average as under current law. This would strengthen work incentives, especially for seniors contemplating retirement. This would reap dividends not only for Social Security but for the broader budget and for the economy as a whole. It would also target a higher fraction of system resources on steady, lower-wage earners, reducing benefit growth for intermittent workers.

Stabilizing the Rate of Benefit Growth

It may seem paradoxical at first to suggest that slowing the rate of scheduled Social Security benefit growth would improve workers' retirement income security. But there are multiple reasons why this is the case. First and foremost, it does not enhance workers' retirement security to promise benefits that cannot be financed under current law. In such a circumstance, workers remain uninformed of the level of benefits they will actually receive, as well as the tax contributions that will ultimately be required of them. Unsustainable benefit schedules can also further a sense of false security, reducing the amount of retirement saving Americans otherwise do. Also, as previously mentioned, Social Security is not a savings program in which the total stock of capital available to finance retirement benefits is increased; it is instead an income transfer program that somewhat depresses national saving. Thus, net benefits for some come only at the cost of lowering net income for others.

Certain methods of reducing cost growth would likely have straightforward effects of reducing poverty among elderly seniors. For example, raising the age (62) of early eligibility for Social Security benefits would result in fewer seniors being subject to the largest actuarial reductions in annual benefits, increasing lifetime Social Security benefits for seniors who live longer than average and who face greater risk of outliving their other retirement savings. It would also remove a powerful current incentive for premature withdrawal from the labor force.

Beyond this, there are several reasons to believe that the current rate of Social Security benefit growth exceeds what is optimal from an equity or income security perspective. One is that the current benefit formula aims for benefits that grow as rapidly as average worker wages. For a nation with our demographics, and with Social Security's current eligibility rules, this formula imposes costs that grow more rapidly than average worker wages. This in turn causes benefits to rise faster than after-Social-Security-tax worker wages. In other words, the current rate of Social Security benefit growth progressively depresses pre-retirement standards of living relative to post-retirement standards of living. This growth rate would need to be slowed simply to stabilize the relationship between pre-retirement and post-retirement living standards.

Current Social Security Benefit and Cost Schedules

Year Worker Turns 65	Benefit as % of Pre-Retirement (Wage-Indexed) Earnings	Approximate Social Security Cost Burden During Working Years	Benefit as % of After-Social-Security-Tax Pre-Retirement (Wage-Indexed) Earnings
1985	41.5%	5.9%	44.1%
2020	40.0%	11.8%	45.4%
2055	41.1%	16.2%	49.0%

Secondly, Social Security costs and benefits have already grown to the point that they force many low-income workers into suboptimal income and consumption patterns. Whereas a retirement income replacement rate of roughly 70% of the real value of pre-retirement income is widely recommended, research by Syl Schieber has shown that individuals in the bottom two income deciles receive income replacement rates from Social Security of over 80% at normal retirement age. While this is a modest income level in absolute terms, the high replacement rate does represent a policy problem; it means that Social Security ties up the scarce income resources of lower-income Americans to an extent that undermines their savings opportunities and reduces their labor force attachment, both of which reduce their overall income security. A better calibrated policy would aim to smooth the relationship between pre-retirement and post-retirement income, support labor force attachment, and encourage the accumulation of savings.

Thirdly, it is sometimes inaccurately assumed that, because Social Security benefits are tied to wage growth, individuals with the same real wages receive the same real benefits. This is not true. The current benefit formula causes Social Security replacement rates to rise over time relative to a given level of real wages. It is designed to pay the same replacement rates to workers at similar positions in the wage distribution relative to their chronological peers, not to workers with the same real wages born in different years. This growth rate reflects a subjective value judgment that as society grows generally richer, the federal safety net should expand so that benefits for workers with a given real earnings level automatically become more generous. This is clearly not the only value judgment that could be made. One could alternatively conclude that a given level of real wages should always return the same level of real benefits. One could just as reasonably argue that as society grows wealthier and more self-sufficient, individuals should receive relatively less in government benefits rather than more, relative to the real value of their Social Security contributions. Under either of these latter approaches, considerable reductions in Social Security benefit growth would be in order.

Recent Changes to the Social Security Trustees' Report

Changes were made to the Social Security trustees' report this year to lessen misunderstanding of the level of pre-retirement income replacement provided by Social Security. Since 2002, the annual trustees' reports had contained a comparison between benefit levels for retirees of different wage histories with the earnings of workers then in the contemporary workforce. For example, a table in the 2013 trustees' report indicated that a typical "scaled medium earner" retiring in 2015 at the normal retirement age would receive a benefit equal to 41.2% of the earnings of a worker still in the labor force who was deemed comparable. This presentation had been widely misread as indicating that a typical worker received a benefit at the normal retirement age that was roughly 40% of his *own* previous earnings. In actuality, Social Security's rate of replacement of the worker's own previous earnings is substantially higher.

The trustees addressed this confusion by redesigning the presentation this year to present scheduled benefits alongside estimates of the national average wage index. This enables readers to compare projected benefit levels both to the levels of wages in the surrounding workforce at the time benefits are received, as well as to earlier wage levels when that hypothetical worker was moving through the workforce. Because there is no universally agreed-upon method of measuring replacement rates, the trustees did not choose to provide a replacement rate calculation, instead removing the previous measure that had caused confusion.

Conclusion

The financing shortfall facing Social Security creates substantial income risks for Americans planning for retirement. This risk can be minimized by the prompt enactment of financing reforms that preserve Social Security's historical financing structure while reducing cost growth to rates to those that can be financed within a stable tax rate. Retirement income security will also be generally enhanced by reforms that increase labor force attachment, remove disincentives to saving, and reduce reliance on pay-as-you-go income transfers.

Chairman JOHNSON. Thank you.
Dr. Schieber, welcome. Please proceed.

STATEMENT OF SYLVESTER J. SCHIEBER, INDEPENDENT CONSULTANT

Mr. SCHIEBER. Mr. Chairman. Mr. Becerra. Members of the Subcommittee, thank you for inviting me here today. In the opening section of my submitted testimony, I discussed the major approaches to assessing how workers are doing in the retirement preparations. Life cycle and similar models are good tools to facilitate policy makers' and analysts' understanding of how the retirement system is working, but beyond the grasp or the interest of most workers.

Plan sponsors and administrators who are at the nexus of workers' retirement savings will generally depend on earnings replacement rate models for plan design and communications for broad participant population, because broad rule of thumb direction is often the best that can be offered to the large group of workers participating in these plans.

Indeed, the Social Security Administration introduces its own retirement planner on its official website, discussing retirement planning in terms of target earning replacement rates. In the early 20th Century, plan sponsors focused on retirees having income that would allow them to maintain their career standard of living. Over the last 40 years or so, replacement rates have been used explicitly in plan design and communication by plan sponsors.

Conventional replacement rate targets have been estimated to allow workers to have spendable income in retirement that is equivalent to that achieved toward the end of the career. For most plan designers and retirement counselors, the pre-retirement earnings measure used in defining replacement rate targets is a salary-level retirement or average earnings over the last five years of the career.

For researchers, price index career average earnings or price index earnings a few years prior to retirement are often used because earning patterns toward the end of the career tend to decline. So using the final years gives you a misimpression of what is going on.

Social security earnings replacement rates presented by the trustees are not equivalent to the conventional replacement rate measures. I understand they have been taken out of this year's prestige report, but they have been in prior reports. And there was a doctoral note released yesterday regarding these.

They are based on career average wage indexed earnings for which most workers, especially lower earners, are significantly higher than the career average real earnings. The Social Security actuaries did publish a note on this yesterday. But let us consider the hypothetical median workers retiring at age 65. Using their assumptions from last year's trustees report, this worker earned $22,295 in 1990, the equivalent of $39,811 in today's dollars, because of CPI indexing.

But they counted the earnings at $47,740 in calculating this worker's replacement rate. Now, when workers go to the grocery store, the auto repair shop, or wherever, they do not spend wage index dollars. They spend the real dollars they have in their pocket. And so it is not clear why we want to treat these standards of living they never achieved during their working career as the standard of living against which we are judging benefits.

In table one of my submitted remarks, you can see the conventional measures of Social Security replacement earnings result in replacement rates that are higher than those presented by the trustees for full-career workers retiring at normal retirement age.

I understand that benefits are developed using career average wage indexed earnings, but have found that even economists that have studied Social Security for years often do not understand that the trustees' replacement rates are calculated using a different base year than the index used to determine their benefits.

Some analysts even apply wage indexing to all pre-retirement income and retirement income targets, suggesting that workers should be saving beyond what is needed to maintain their pre-retirement standard of living. Our retirement system should not expect workers to become slaves to financing retirement living standards they never achieved while working. My analysis of the 31 and 38 birth cohorts of Social Security beneficiaries summarized in table two suggests this problem may become accentuated over time as average age indexed earnings rise more rapidly than real wages for workers. Replacement of real earnings is increasing under this system.

One reason for the widely perceived inadequacy of workers' savings for retirement outside of Social Security today is a series of reports published by the Social Security Administration summarizing survey data gathered by the Census Bureau in its current population survey. We heard a summary of this in the opening remarks this morning.

Comparison of the reported income provided by pension annuity plans and IRAs to Social Security from IRS tax filings shown in table three of my submitted remarks proves that as much of the pension and IRA income paid to Social Security beneficiaries is not being captured by the current population survey. This is a problem the Census Bureau and Social Security has known about for twenty years.

If the full income being paid to Social Security beneficiaries by supplemental retirement plans was being reported, it would be roughly equivalent to Social Security benefits instead of less than half of that amount, and it would be above Social Security benefits for the top half of the income distribution of retirees. These benefits distribute much more broadly down the income distribution than Social Security reporting indicates. It is impossible to clearly understand who is doing well and who is doing poorly under the current arrangements if the official government reports on the income status of retirees ignores hundreds of billions of dollars of their income.

I have a formal analysis of this issue that was published in the Journal of Retirement earlier this year that I would be happy to submit to the committee if you are so interested.

[The prepared statement of Mr. Schieber follows:]

Statement before the United States House of Representatives
Committee on Ways and Means
Social Security Subcommittee

29 July 2014

What Workers Need to Know about Social Security as They Plan for Retirement

Sylvester J. Schieber, Ph.D.
Independent Consultant

Mr. Chairman and members of the Social Security Committee, thank you for inviting me here to testify before you today regarding the role of Social Security in providing retirement security to U.S. workers and retirees. This is an extremely important matter pertaining to our citizens' future physical wellbeing and peace of mind.

I am not representing any specific individuals or organizations regarding the matters I address in the following discussion. I have worked more than 40 years on both practical and policy issues related to retirement security. I began my career working for the Social Security Administration, spent some time as the research director at the Employee Benefit Research Institute and have spent 30 years in the consulting industry during which I have worked with many plan sponsors on the design and related issues pertaining to their retirement plans. I have focused on both Social Security and supplemental retirement provisions in my employment, service on various commissions, advisory councils and in extensive research and writing related to the U.S. retirement system.

Summary

There are many technical elements to determining whether workers are adequately preparing to meet their retirement income needs. How various analysts deal with these can play a significant role in their conclusions about the retirement income security prospects of workers and the current welfare of retirees.

- Retirement income replacement models are used widely in retirement plan design and communications for broad participant populations because generalized rule-of-thumb directions are the best vehicles available to plan sponsors and administrators.
- More microscopic lifecycle and similar models are beyond most workers' reach but can help policymakers and analysts understand whether the cruder measures are effectively helping workers achieve reasonable retirement savings goals.
- Social Security earnings replacement rates presented by the Trustees are not equivalent to conventional replacement rate measures and may be confusing to many participants and analysts.

- Conventional measures of Social Security replacement of earnings result in replacement rates 15 to 20 percent higher than those presented by the Trustees for full-career workers retiring at normal retirement age (see Table 1).
- Some analysts even apply wage indexing of all preretirement income in defining retirement income targets suggesting that workers should increase saving beyond what is needed to maintain preretirement living standards in retirement with the implication that normal working-period living standards would be reduced in order to finance much higher living standards after retirement. This problem may be accentuated over time (see Table 2 with accompanying discussion).
- The Social Security Administration regularly publishes summary survey data gathered by the U.S. Bureau of the Census in its *Current Population Survey* each year shows that employer-sponsored retirement plans and individual retirement savings make little contribution to the retirement security of most of the elderly.
- Comparison of the reported income provided by pension/annuity plans and IRAs to Social Security from IRS tax filings proves that as much as 60 percent of the pension and IRA income paid to Social Security beneficiaries is not being captured by the *Current Population Survey* (see Table 3) a problem the Census Bureau and the Social Security Administration has been aware of for some time.
- It is impossible to clearly understand who is doing well and who is doing poorly under the current arrangements if official government reports on the income status of retirees ignore hundreds of billions of dollars of their income.

Retirement Income Adequacy

Over the years, retirement researchers, policy analysts and retirement plan designers have come to think of an adequate retirement income as the level of income needed to allow retirees to maintain their preretirement standard of living. For a small segment of the elderly population, even this level of income is considered to be inadequate. Some workers live on an income for extended periods considered to be less than necessary to sustain even a basic living. For these people, there are assistance programs that help with needed food purchases, housing, health care and the like. For such individuals, it is likely that assistance outside of the benefits provided by contributory pensions and retirement savings is necessary to support them in retirement. For the remainder, an adequate retirement income is generally considered to be one that allows them to maintain their career living standards.

Economists often focus on whether workers are going to accumulate adequate resources to meet their retirement needs in the context of a life cycle model. The adaptations of these models are highly variable but can allow for borrowing early in life for education, as households are established, children are born, and so forth. As the career progresses, debts are paid off and savings for retirement accumulated. Then in retirement, the combination of Social Security, defined benefit pensions and retirement savings finance consumption. These models can account for expenses that are unique to both the working and retirement periods. Some analysts who use this approach to assess whether workers are saving properly take into account whether households have children or not during the working period. Evidence suggests that such households have elevated consumption while children are present and higher savings rates after the children move out. For workers, wages are subject to payroll taxes while retirement benefits are not and income taxes may be higher during the working period. Retirees have risks of health and long-term care expenses that can be higher or more variable than incurred when younger.

Retirement planners and consultants who design retirement plans for individuals and employers generally rely on an alternative model where preretirement spendable income is determined by subtracting work-period taxes and work-related expenses from gross earnings. To maintain the preretirement standard of living, a retiree's spendable income level post career must equal the level achieved before retirement. This spendable income is divided by gross earnings to calculate a target earnings "replacement rate" that will fulfill the goal of leveling consumption levels over the pre- and post-retirement periods.

The Retirement Security Projection Model developed by Jack VanDerhei and Craig Copeland at the Employee Benefit Research Institute is not a lifecycle model but it has many stochastic features that are similar to those found in lifecycle models. In their modeling, VanDerhei and Copeland estimate retirees consumption needs and then assess whether the combination of annuity pensions including Social Security and employer-sponsored plans plus other assets will be sufficient to cover the expected consumption needs of workers at various income levels. My personal view is that VanDerhei and Copeland have made particularly valuable contributions by more realistically modeling a much broader spectrum of uncertainties that workers face in preparing for retirement than any of the other models widely reported.

Each of the approaches to considering whether workers are preparing adequately for retirement or retirees have adequate income has strengths and weaknesses. The Retirement Security Projection Model and the lifecycle model recognize that every household faces a unique set of circumstances as it progresses through its employment and retirement periods. The amount that each household should save, what its consumption should be in the preretirement period and during retirement are unique to that household. The replacement rate models are typically applied on a generalized basis and are often estimated on an individual worker basis instead of at the household level. For example, it is common for the consulting firms that help employers sponsoring plans with plan designs and assessments to estimate target earnings replacement rates for workers at various specified earnings levels. In developing these models, the analysts project earnings and retirement benefit accumulations to retirement age, estimate taxes unique to the working period and other work-related expenses to estimate spendable income which is then used to estimate the replacement of gross earnings required to maintain living standards in retirement. The adequacy of workers' retirement preparation is assessed by determining whether the combination of Social Security and retirement plan benefits will be sufficient to allow retirees to maintain spendable income during retirement.

There are a number of methodological problems with each type of model that are relatively technical and which are beyond the scope of the current discussion.[1] Beyond these, the problems with the models that focus on individual household units are that the assessments of their retirement income preparations result in a one-size-fits-one answer to whether workers are adequately preparing for retirement whereas the replacement rate assessments result in a one-

[1] Many of the methodological problems with the models are explored in Gaobo Pang and Sylvester J. Schieber, "Why American Workers' Retirement Income security Prospects Look So Bleak: A Review of Recent Assessments," *Journal of Retirement* (Summer 2014), vol. 2, no. 1, forthcoming.

size-fits-many answer. The Retirement Security Projection Model and lifecycle models are superior to the replacement rate model in assessing how individual households are doing but are of little practical use to a large sponsor of a retirement plan with many participants where the sponsor has limited information beyond the participants' own earnings levels, age, expected retirement age and other salient information. The structuring of generalized retirement plans fitting large populations or the generalized educational support that goes along with them has to utilize generalized rules-of-thumb to help workers assess whether they are accumulating the needed resources to meet their retirement needs. This is true for Social Security as well as for employer-sponsored retirement plans. The more microscopic analysis used in lifecycle model assessments can help policymakers and other interested parties understand whether the cruder measures used by plan sponsors and advisors are effectively helping workers along the way.

Career Income and Replacement Rate Measurement Issues

Because Social Security is a national system that applies to millions of workers at any point in time, the Trustees regularly include estimates of the extent to which the program's retirement benefits will replace preretirement earnings. The *2013 Trustees Report* estimated that a worker with career-average medium earnings who retired at his or her normal retirement age in 2013 received benefits equal to 44.5 percent of "career average earnings, indexed by national average wage growth to the year prior to retirement."[2] Despite the fact that the replacement rates are calculated using the average of the high-35 years of wage-indexed earnings based on the average wage index in which the worker turned age 64, the benefits in the table presenting the rates are shown in CPI-indexed dollars. Regarding the replacement rates that are presented in the annual report, the trustees noted, "this method of calculation produces percentages that may differ significantly from those that would be produced by comparing benefits to these representative workers' recent average earnings levels or to other more common measures of pre-retirement income."[3] There is no explanation in the report on how or why the replacement rates presented by the trustees "may differ significantly" from "more common measures" of such rates. The differences are significant.

The "more common" measures of earnings replacement rates that the Social Security trustees refer to in the 2013 report are the measures typically used by employer retirement plan designers and sponsors and by retirement advisors and those used by lifecycle modelers focusing on retirement accumulations and provisions. Employers sponsoring retirement plans and their advisors virtually always consider the earnings replacement of their retirement plans on the basis of projected final earnings of the workers participating in their plans. In some instances this will be the annual wage or earnings level at the time of retirement and in others an average of the last three or five years of full earnings before retirement. But the earnings projections that they use in estimating replacement rates generally assume relatively stable wage growth trajectories over workers' careers.[4] Among representative samples of retirees receiving Social Security benefits,

---

[2] *The 2013 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, p. 145.

[3] Ibid., p. 143.

[4] For example, see Aon Hewitt, 2012, "The Real Deal: 2012 Retirement Income Adequacy at Large Companies," found on October 29, 2013 at: http://www.aon.com/human-capital-consulting/thought-leadership/retirement/survey_2012_the-real-deal.jsp.

however, covered earnings records show that typically even nominal wages tend to decline, on average, as workers approach retirement[5] which suggests that earnings levels immediately before retirement may not be the best indicator of the standards of living workers have achieved during their careers. An alternative measure that both Scholz and Seshadri[6] and Pang and Schieber conclude is a better indicator of peak earnings late in the career is the average of fifth through ninth years of positive earnings prior to retirement indexed by the CPI. The lifecycle model premises that households base their consumption over their lifetimes on the basis of their real earnings over the full period of retirement and often use the average of inflation indexed earnings during a household's working years as the appropriate measure.

Pang and Schieber have compared the method for computing the replacement rates presented by the trustees with some of the more common measures of replacement rates used by retirement plan designers, counselors and many researchers using a sample of Social Security beneficiaries receiving benefits at the end of 2004.[7] To look at how the alternative measures of earnings might affect replacement rates for real workers, they used a sample of beneficiaries and their earnings records from the Benefits and Earnings Public-Use File, 2004, released by the Social Security Administration in 2005. This file contains information about beneficiaries of the OASDI program from Social Security's Master Beneficiary Record (MBR) file.[8]

In order to compare alternative measures of earnings replacement provided by Social Security to real workers, Pang and Schieber focused on individuals receiving "retired worker" benefits from the 1931 through the 1942 birth cohorts. For these cohorts, the historical earnings records covered retirees at least from age 20 through their retirement. The average indexed monthly earnings (AIME) on which each person's benefits were based was indexed to 2004 using the national average wage index to put them on a consistent basis. Then the sample of retired workers was distributed into 10 equal sized groups (deciles) based on their AIME ranking. In the segment of the analysis focused on the earnings replacement capacity for workers roughly matching the trustee's hypothetical workers, long-career workers with at least 35 years of covered earnings were included which comprised 64 percent of all beneficiaries receiving retired benefits at the end of 2004.[9] The remainder had shorter periods of covered employment.

Pang and Schieber calculated replacement rates two ways for comparative purposes in the analysis. In the first, they used actual benefits at retirement compared to a range of alternative measures of preretirement earnings. In the second, they recalculated benefits that would have been paid at normal retirement age assuming the long-career workers had not taken benefits until then. These latter calculations might have resulted in slightly lower benefits in some cases than retirees would have received had they deferred retirement until then but it is likely the

---

[5] Gaobo Pang and Sylvester J. Schieber, "Understanding Social Security's Income Replacement Measurements," Social Science Research Network (2014) available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2433181.

[6] Scholz, John Karl and Ananth Seshadri, 2009b, "What Replacement Rates Should Households Use?" University of Michigan Retirement Research Center, Working Paper WP 2009-24.

[7] Pang and Schieber, "Understanding Social Security's Income Replacement Measurements."

[8] Social Security Administration, "Benefits and Earnings Public-Use File, 2004," (October 2005), found at: http://www.ssa.gov/policy/docs/microdata/earn/.

[9] Pang and Schieber also analyzed beneficiaries with shorter covered careers in their analysis not included in the current discussion because they do not align with the trustees' hypothetical workers' career profiles.

differences are minimal since all the retirees considered had at least 35 years of covered earnings when they actually retired. Because the trustees' hypothetical workers' replacement rates are shown at age 65 and normal retirement age, for comparison purposes, only the replacement rate calculations for retirements at normal retirement age are considered in the following discussion.

Table 1 shows four sets of replacement rates each based on a different definition of pre-retirement earnings. The rates are shown for each of the AIME decile groupings described earlier. The first column of replacement rates was developed using the method used in deriving the rates shown by the trustees in their reports, namely, the rates are calculated using the average of the high-35 years of wage-indexed earnings based on the average national wage index in which the worker turned age 64. The second column of replacement rates is based on the benefit paid at retirement divided by the average of the nominal wages paid the workers in their last five years of positive earnings. The third column of rates is based on benefits divided by the average of fifth through ninth year's positive earnings prior to retirement indexed for price inflation. While this measure does not literally correspond with the measures of final earnings that retirement plan sponsors and their advisors typically consider in estimating replacement rates, I believe this is a better implicit proxy for their final-salary measures of replacement rates when applied to a general population like that of Social Security participants and beneficiaries. The fourth column is the average of the high-35 years of price indexed earnings over the workers' careers reflecting the average real lifetime earnings of the worker that is often used in lifecycle analyses. I believe this is the best measure of the average earnings capacity over workers' lifetimes that can be used for leveling consumption in the lifecycle context.

Table 1: Median Re-estimated Social Security Replacement Rates for Beneficiaries at the End of 2004 Who Had Long Careers Assuming They Had Been Paid Normal-Retirement-Age Benefits

	Measures of preretirement income used to estimate replacement rates			
AIME deciles	SS Trustees' Age-64 based AIME	Final 5-year average	Average of years 5-9 pre-retirement CPI-W indexed	Hi-35 CPI-W indexed average
1	85.8	115.5	105.3	103.7
2	71.0	101.4	93.2	86.0
3	57.6	82.9	71.2	69.8
4	50.6	70.1	59.7	60.6
5	46.0	64.4	54.2	54.9
6	42.9	60.9	50.7	50.9
7	40.6	58.6	47.9	48.1
8	38.3	52.9	42.4	45.2
9	34.8	43.3	34.8	41.1
10	31.7	31.3	29.4	36.6

Source: Gaobo Pang and Sylvester J. Schieber, "Understanding Social Security's Income Replacement Measurements," Social Science Research Network (2014) available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2433181, Table 8.

Considering the measures derived using the Social Security Trustees' method shown in Table 1, the median of the distribution of replacement rates would be the average of the rates shown for the fifth and sixth deciles or 44.5—(46.0 + 42.9) ÷ 2 = 44.45.—almost precisely equal to the rate shown for the medium worker in the *2013 Trustees Report*. The median for the distribution of replacement rates using the average of the final-five years of positive earnings is 62.7 percent, nearly 20 percentage points higher than the trustees' measure. The medians for the average of real earnings in years five-to-nine of positive earnings prior to retirement is 52.5 and that for the average of real career earnings is 52.9 percent. The latter two medians are about 15 to 20 percent greater than the average posited using the trustees' estimates.

According to the Social Security Administration's official website, "Most financial advisors say you will need about 70 percent of your pre-retirement earnings to comfortably maintain your pre-retirement standard of living. If you have average earnings, your Social Security retirement benefits will replace only about 40 percent. The percentage is lower for people in the upper income brackets and higher for people with low incomes. You'll need to supplement your benefits with a pension, savings or investments."[10] Some retirement plan designers and advisors suggest that workers need to shoot for an 85 replacement of preretirement earnings[11] or even higher. Whatever the target deemed appropriate, the challenge to workers in accruing adequate resources to maintain living standards is one of filling the gap not covered by Social Security. In order for them to do so effectively, it is important that they have a reasonable understanding of the gap that they need to fill. If the total target that an average earner is 70 percent of preretirement earnings and Social Security covers 52 percent of real earnings replacement, then the worker must come up with resources to cover the other 18 percent. However, if Social Security only covers 44 percent of the earnings replacement target, then the worker has to come up with the residual 26 percent—44 percent more than the balance needed to replace the real average career earnings. For families trying to act responsibly regarding saving for their retirement security, the difference in what is commonly thought to be reasonable savings patterns and what is implied by the Social Security Trustees is not trivial.

Some research and policy analysts take the Social Security Trustees' approach to estimating preretirement earnings replacement rates and even apply it to the supplemental savings targets that workers should be aiming to fill. For example, Boston College's Center for Retirement Research wage-indexes all preretirement income, including asset income, in calculating replacement rate targets in developing the widely publicized National Retirement Risk Index. The underlying model used to develop this risk index is supposedly based on the lifecycle model of consumption and saving used by many economists.[12] I believe that workers

[10] Social Security Administration, "Retirement Planner: Learn about Social Security Programs," found on July 23, 2014 at: http://www.ssa.gov/retire2/r&m6.htm.

[11] Fidelity Investments, 2013, "Fidelity Outlines Age-Based Savings Guidelines to Help Workers Stay on Track for Retirement," found on August 7, 2013 at: http://www.fidelity.com/inside-fidelity/employer-services/age-based-savings-guidelines and Aon Hewitt, 2012, "The Real Deal: 2012 Retirement Income Adequacy at Large Companies," found on October 29, 2013 at: http://www.aon.com/human-capital-consulting/thought-leadership/retirement/survey_2012_the-real-deal.jsp.

[12] Center for Retirement Research at Boston College, 2006, "Retirement at Risk: A New National Retirement Risk Index," found at: http://crr.bc.edu/wp-content/uploads/2011/09/NRRI1.pdf and Munnell, Alicia H., Anthony Webb and Francesca Golub-Sass, 2012, "The National Retirement Index: An Update," *Issue Brief*, Boston: Center for Retirement Research at Boston College, no. 12-20.

saving to meet the targets devised by wage indexing all preretirement income in this fashion almost certainly would be acting irrationally in the context of the lifecycle model.

Consider a worker at the beginning of her career who anticipated earnings that will average $50,000 per year in real terms over her working life. Assume she calculates that her combined payroll tax payments and savings should be $12,500 per year and that these will finance a retirement income of $37,500 per year all in real terms—75 percent of her preretirement earnings. Further assume that if she realized economy-wage growth, her wage-indexed career-average earnings would be $60,000 per year. If she aspires to having a total retirement income based on the $60,000 average, she will have to increase her retirement contributions to $15,000 per year. This would reduce her working-consumption levels to $35,000 per year to finance retirement consumption of $45,000 per year. For her to save for retirement as though her wages grow more rapidly than they do in real terms will result in an irrational outcome in the lifecycle context.

The practical situation that workers face during their working lives is that when they go to the grocery store, buy clothes, purchase a house or get their car repaired they have to spend real dollars not wage-indexed dollars. The real dollars they earn while working define the standard of living they can achieve prior to retiring unless they are getting welfare transfers which most career workers do not. Why their historically wage-indexed earnings levels should define their consumption targets in retirement is a question not explained by either the Social Security Trustees or the authors of models like the National Retirement Risk Index.

The situation of the hypothetical worker in the example would likely be exacerbated across time if workers are expected to maintain reasonable steady replacement rates relative to wage-indexed average earnings. Using the data files that Pang and I used in our analysis cited earlier, we compared the rates of growth of wage-indexed and real wages over the high-35 year career average earnings for Social Security beneficiaries who were from the 1931 and 1938 birth cohorts. The results of the exercise are shown in Table 2.

Clearly, the wage-indexed career average earnings were growing much more rapidly than workers' real earnings capacity across much of the earnings spectrum. In the top two deciles the opposite was true, but it was here, especially the top decile, where real wage growth was dragging up the national average wage index benefitting workers further down the distribution who were benefitting from wage growth (for which they were not accountable) used to determine their Social Security benefits. I am not disputing the current method of calculating Social Security benefits here, but I do believe that wage indexing total income for purposes of setting retirement replacement rate targets will lead to the same irrational result for the majority of workers as the example above showed it did for the exemplary hypothetical worker. If workers are going to be expected to save on their own so they can keep up with wage growth across the economy at retirement from one birth cohort to the next, each successive cohort will be expected to give up an increasing portion of their career earnings so they can live a higher lifestyle in retirement than they could achieve while working.

Table 2: Percent Increase in the Average of High-35 Years of Earnings Wage Indexed with the National Average Wage Index at Age 60 and CPI-W Indexed to Age 64 for the 1931 to the 1938 Birth Cohorts

AIME deciles	Wage-indexed AIME	Price-indexed AIME
1	14.4%	3.9%
2	27.4	16.1
3	26.8	15.9
4	34.3	23.0
5	33.1	22.0
6	32.3	21.4
7	30.4	20.0
8	31.4	21.1
9	4.0	20.5
10	5.2	31.5

Source: Derived by the author as described in the text.

Retirement Savings and Retirement Income

Today there is a somewhat pervasive perception that we face a "retirement crisis" in the United States. One reason is the notion that a significant majority of retirees receive most if not all of their retirement benefits from Social Security and that supplemental plans make little contribution to the retirement security of most of the elderly. A major piece of evidence pointing to this conclusion is widely used estimates published by the Social Security Administration (SSA) of the prevalence and level of benefits provided to the retiree population based on a periodic Census Bureau Survey, the *Current Population Survey* (CPS)

According to SSA, among families with a person 65 years of age or older in 2010, 39.7 percent of households received regular income or annuities from a retirement plan other than Social Security. Among all families with an elderly person, public pensions accounted for 5.5 percent of total money income and private pensions 7.6 percent. By comparison, Social Security benefits comprised 58.5 percent of the elderly's income. For the elderly receiving retirement benefits, they were a much more important component of retirement income than the population averages suggest. Those receiving public pensions received 44.5 percent of their total income from their retirement plan; for those receiving private pensions it was 28.4 percent; and for those receiving Social Security benefits, it accounted for 66.0 percent of their income.[13]

In order to assess the reporting of pension and other retirement income on the CPS, Miller and Schieber compared the survey results with data from a representative sample of

[13] Trenkamp, Brad, *Income of the Population 55 or Older, 2010*, Social Security Administration (2012), found at: www.socialsecurity.gov/policy/docs/statcomps/income_pop55/2010/incpop10.pdf, pp. 50, and 235-236.

federal income-tax filers for whom the IRS releases a data file each year.[14] They assumed that federal income-tax filings were likely less prone to reporting errors than survey responses. Miller and Schieber compared various components of reported income from the IRS tax files for 1988, 2000, and 2008, the latter being the most recent year available, with the same income elements from the CPS Income Supplement files for the same years.

According to the tax files, in 2008 an estimated 23.4 million filing units reported Social Security income. According to the CPS, 32.9 million family units received Social Security. The number of units receiving Social Security was higher in the CPS than in the tax files because the IRS tracks a population subset, tax filers, while the CPS supposedly represents the entire civilian, non-institutionalized population.

The IRS files do not include indicators of filers' ages so Miller and Schieber used the reporting of Social Security income on both the CPS and tax filings as an indicator that someone in a filing unit was retired either due to age or disability although they could not distinguish for which reason in the IRS files. They compared the reporting of pension/annuity or retirement saving income received by filing units from the two sample files for the various years they had data from both sources. The results are shown in Table 3.

The CPS captures very little of the IRA income being reported on tax filings: 3.5 percent in 2000 and roughly 6 percent in 2008. The CPS has done a better job of capturing reported pension and annuity income but still comes up short by around half, and the underreporting appears to have worsened considerably in recent years. In aggregate, the CPS for 2008 captured only 40 percent of the pension/annuity or IRA income received by family units that were receiving Social Security benefits. Considering that the tax filings do not capture all income paid by employer-sponsored retirement plans and IRAs—because low-income recipients do not have to file tax forms and Roth-type benefits are not taxable—aggregate benefits from these plans likely exceeded the Social Security benefits retirees received in 2008. This is a far cry from the relative levels of retirement income reported by Social Security as noted above.

Recognizing that retirees at the bottom of the income distribution were not included,[15] Miller and Schieber used the 2008 tax files to evaluate the distribution of income derived from pensions and retirement savings. They split the tax-filing units into deciles (ten equal groups) based on total income. Both the prevalence and level of benefits were quite low in the bottom decile. By the second decile, 60 percent of the filing units reported receiving pension income or income from an IRA or similar individual retirement savings plan. For those receiving the benefits, at the median their pension/IRA income equaled 50 percent of the median Social Security benefits, a nontrivial supplement to their retirement income. Above the second decile, three quarters of filing units or more reported annuity or individual account income and from the fifth decile and above, the median income levels from the retirement plans consistently exceeded median Social Security benefits.

[14] Billie Jean Miller and Sylvester J. Schieber, "Contribution of Pension and Retirement Savings to Retirement Income Security: More than Meets the Eye," *Journal of Retirement* (Winter 2014), vol. 1, no. 2, pp. 14-29.

[15] The number of income-tax filers reporting Social Security income in 2008 was about 25 percent smaller than the number of households reporting they received Social Security benefits in that year.

Miller and Schieber also found that among tax filers reporting Social Security income but no other retirement income that 69 percent overall and 74 percent of the top 80 percent of tax filers by income were still reporting wage or salary income in 2008. For many of these people, the lack of reported pension or retirement saving income may be more of an indication of prudence in retirement planning than that they will not benefit from supplemental retirement benefits to their Social Security once they fully retire.

Table 3: Reported Pension/Annuity Income and Distributions from IRAs on Federal Income Tax Forms and the CPS for Social Security Beneficiaries for Selected Years

	IRA distributions	Pensions/annuities (Dollar amounts in millions)	Total benefits
1988 IRS	$4,788	$74,376	$79,164
1988 CPS	$597	$79,683	$80,280
CPS/IRS	12.5%	107.1%	101.4%
2000 IRS	$59,358	$258,764	$318,122
2000 CPS	$2,083	$143,909	$145,992
CPS/IRS	3.5%	55.6%	45.9%
2008 IRS	$110,920	$457,311	$568,231
2008 CPS	$5,564	$222,248	$227,812
CPS/IRS	5.0%	48.6%	40.1%

Source: Billie Jean Miller and Sylvester J. Schieber, "Contribution of Pension and Retirement Savings to Retirement Income Security: More than Meets the Eye," *Journal of Retirement* (Winter 2014), vol. 1, no. 2, p. 19.

A major reason the CPS does such a poor job reporting IRA and other individual retirement account distributions is because the Census Bureau does not believe that distributions that are not paid on a regular periodic basis should be counted as income. The idea that retirees who only tap these funds as needed or as required by law are not receiving economic benefits is inconsistent with virtually all economic modeling of retirement preparedness which routinely considers accumulated wealth as a source of economic security without regard to how people choose to distribute it in retirement.

There are legitimate reasons to believe that some workers are not adequately preparing for retirement and that some retirees have inadequate resources to meet their economic needs, and the shift from defined benefit to defined contribution plans is widely considered to have made retirement more financially precarious for workers and retirees. It is impossible, however, to clearly sort out who is doing well and who is doing poorly under the current arrangements if official government reports on the income status of retirees ignore hundreds of billions of dollars of their income.

Chairman JOHNSON. Please do. Thank you.
[The information follows:]

Contribution of Pension and Retirement Savings to Retirement Income Security: *More Than Meets the Eye*

Billie Jean Miller and Sylvester J. Schieber

Billie Jean Miller
is a research associate at Towers Watson in Arlington, VA.
billiejean.miller@towerswatson.com

Sylvester J. Schieber
is a former chairman of the Social Security Advisory Board, retired from Towers Watson, and is currently an independent consultant in New Market, MD.
syl.schieber@gmail.com

Angst about the U.S. retirement system has been growing in recent years, with most concerns focusing on the sources and sufficiency of retirees' income. The major components of the retirement system are Social Security, employer-sponsored pensions and retirement savings plans, and individual savings. The government also sponsors a variety of welfare plans for those with relatively low incomes, although the welfare benefits generally fall far short of what most people would consider necessary for a comfortable retirement. In addition to income supports, the retirement system provides health insurance under Medicare and means-tested Medicaid benefits.

One set of concerns focuses on Social Security. Since the mid-1980s, trustees' annual assessments have consistently pronounced the system insufficiently funded to pay benefits under current law for the baby boom generation. Although some groups believe we should trim future Social Security benefits to keep the system afloat for future workers (Bipartisan Policy Center [2010]; National Commission [2010]), others make a case for expanding benefits to cover a larger share of retirement income for beneficiaries. The latter generally contend that the current system does not replace sufficient preretirement income to meet retirees' needs and that alternative sources of income are unreliable or skewed toward higher-income workers and retirees (Lind [2013]; Rhee [2013]).

The perspective that other income sources are insufficient largely derives from survey evidence that supposedly measures retirees' various sources of income. For several decades now, the Social Security Administration has published a biennial report that focuses on the non-institutionalized U.S. population 55 and older. A segment of the report focuses more narrowly on people ages 65 and older because most of them are retired and receive some pension income or draw on retirement savings.

Exhibit 1 shows income sources for the population 65 and older and the percentage of income provided by each source from 1976 through 2010, taken from several periodic Social Security publications. The results suggest that Social Security is by far the most prevalent and most important aggregate source of income for the elderly. Since the early 1990s, income from personal assets and employer-sponsored pensions has played a diminishing role as older Americans and the elderly have become more dependent on wage and salary income.

Although Exhibit 1 gives a sense of the aggregate sources of retiree income, it does not suggest the distribution of income across the population. According to the Social Security Administration's estimates, in 2010,

EXHIBIT 1

Percentage of People Ages 65 and Older Receiving Income from Specified Sources and Percentage of Aggregate Income from Each Source, 1976–2010

Year	Social Security	Assets	Pensions	Earnings	Public Assistance
Percentage receiving income by source					
1976	89	56	31	25	11
1980	90	66	34	23	10
1984	91	68	38	21	9
1988	92	68	42	22	7
1992	92	67	45	20	7
1996	91	63	41	21	6
2000	90	59	41	22	5
2004	89	55	41	24	4
2008	87	54	41	26	4
2010	89	52	40	26	4
Percentage of aggregate income from each source					
1976	39	18	16	23	2
1980	39	22	15	19	1
1984	38	28	15	16	1
1988	38	25	18	17	1
1992	40	21	20	17	1
1996	40	18	18	20	1
2000	38	18	18	23	1
2004	39	13	20	26	1
2008	37	13	19	30	1
2010	37	11	19	30	1

Source: Data for 1976 through 2000 are from Hungerford et al. [2001/2002]. Data for 2004 are from Fisher and Pascua [2006]; data for 2008 are from Fisher and Trenkamp [2010]; data for 2010 are from Trenkamp [2012].

nearly one-quarter of family units with a member older than 65 relied solely on Social Security for income and 43% received 80% or more of their income from the program. On average, families with at least one member 65 or older received two-thirds of their income from Social Security, and those with the lowest incomes were most dependent on the program. In 2010, Social Security provided 84% of income to those in the bottom 20% of the income distribution, 83% of income to those in the next 20%, and 66% of income to those in the middle third (Trenkamp [2012]).

Using the same underlying data as in Exhibit 1, the Social Security Administration publishes a fact sheet on its website summarizing the relative importance of its benefits to the elderly (Social Security Administration [2013]). Other prominent players in discussions about retirement and Social Security policies often rely on the Social Security analysis of the Current Population Survey (CPS) or develop their own analysis off of the CPS.

The Center on Budget and Policy Priorities [2012], for example, used Social Security's 2010 report on income sources of the elderly in its 2012 report claiming that Social Security provides the majority of income for 65% of the elderly and more than 90% of income for 36% of them. These numbers differ from those on the Social Security website because the center treats each family member 65 or older as an individual observation, whereas Social Security treats married couples as one unit.

The National Academy of Social Insurance [2013] summarizes the data similarly to the Center on Budget and Policy Priorities: "About nine in 10 Americans aged 65 and older receive Social Security. For nearly two out of three of those beneficiaries (65%), Social Security was more than half their total income, and for one in three (36%), it is all or nearly all of their income." Caldera [2012], writing for AARP, tallied the CPS herself to show that 13.7% of older Americans live on Social Security alone, 9.9% rely on Social Security for 90% to 99.9% of their income, and 25.5% receive between 50% and 89.9% of their income from the program. Many other interest groups offer similar renditions of this theme.

The dominance of Social Security as the primary income source for the elderly is often used as the basis for arguing that program benefits should be further enhanced. Virginia Reno, the vice president for income security at the National Academy of Social Insurance, recently argued for more generous Social Security benefits before the Social Security Subcommittee of the House Ways and Means Committee, and she used the Social Security Administration's 2008 analysis to support her testimony (Reno [2010]).

In testimony before the Senate Committee on Health, Education, Labor and Pensions, Professor Eric Kingson [2011] of Syracuse University, who is also co-director of the interest group Social Security Works, used the same data to support his claim that the overwhelming majority of retirees obtain most of their income from Social Security. He argued that 6 out of 10 private-sector workers have no pension other than Social Security. Kingson used the evidence of the elderly's overwhelming dependence on Social Security benefits to oppose the use of an alternative consumer price index to calculate benefits.

Michael Lind, a policy director at the New America Foundation, and three colleagues cite data from Social Security for 2010 to claim that the elderly receive only 18% of their income from traditional pensions and defined-contribution plans and that among the middle 20% of the income distribution, fewer than half of retirees receive pension income from either defined-benefit or defined-contribution plans. This evidence forms the basis of their argument for scrapping current tax preferences for retirement savings, which would dramatically curtail employer-sponsored retirement plans and individual retirement accounts (IRAs), and then financing a new tier of Social Security benefits with the resulting tax revenues (Lind et al. [2013]).

BENCHMARKING CPS RETIREMENT INCOME MEASUREMENT

To develop its estimates of the sources and amounts of retiree income, the Social Security Administration uses data from the Current Population Survey, and many researchers use the CPS data to study the income of U.S. residents in a wide variety of analyses. To develop the CPS, the Census Bureau surveys a representative sample of U.S. households each month, which serves as the basis for monthly estimates of the civilian labor force, employment levels, and unemployment rates by the Bureau of Labor Statistics. Each March, the Census Bureau also administers a special "Annual Social and Economic Supplement," which gathers detailed information on income sources, income levels, and labor force activities over the prior year for all sample household members 15 or older. The March 2011 survey included approximately 57,000 households, and the supplement gathered income data for 2010. Machine-readable versions of the responses are available to government analysts and to outside researchers as well. The survey is used to analyze many characteristics of the U.S. non-institutionalized population and their activities, and the results over time enable analysts and policymakers to understand major economic and social trends.

It is well known that surveys are susceptible to response errors arising from a variety of causes. Sometimes respondents' answers reflect denial or wishful thinking about the subject. In surveys about weight and height, for example, people tend to underestimate the first and overestimate the second. It is not clear whether they are trying to categorize themselves into some perceived "socially acceptable" range of heights and weights, or they simply wish they were taller and thinner. In the CPS March Supplement, however, erroneous income information is likely due to factors other than wishful thinking. People are asked in March to provide information on income sources and amounts over the previous year, so some might not remember these amounts or might miscalculate the annual totals of weekly or monthly payments. In a household survey like the CPS, one person may be providing information about other household members, thus complicating matters further.

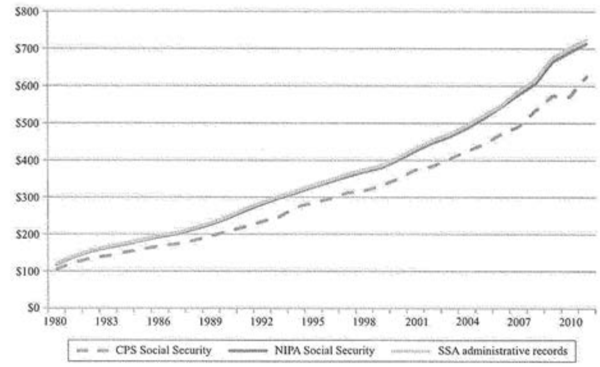
To gain a sense of how accurately the CPS measures retirement income, we benchmarked it against other data sources that may be more reliable. Exhibit 2 compares aggregate Social Security income in annual March CPS income supplements from 1980 to 2010 with data compiled by the Bureau of Economic Analysis for the national income and product accounts (NIPA) and from the Social Security Administration. Since 1980, the amount of Social Security income captured in the CPS has averaged around 85% of the benefit amounts paid out by the Social Security Administration, and the difference has never varied by more than three percentage points.

Some of the differences among the three data sources shown in Exhibit 2 might reflect the CPS focus on people living in U.S. households, which thus misses institutionalized beneficiaries and those living outside the United States. These two groups might account for 4% or 5% of total benefits, so the survey appears to have done a fairly consistent job of capturing roughly 90% of benefits paid by Social Security, according to the administrative accounting. The NIPA data track very closely with the Social Security Administration's accounting data, which is not surprising because the Bureau of Economic Analysis tracks administrative data in compiling annual totals for the NIPA.

Exhibit 3 compares the CPS with the NIPA in terms of aggregate income paid from employer-sponsored retirement plans, including defined-benefit pensions, other annuities, and various individual account plans. In this case, there is no counterpart summary administrative data, but distributions from private tax-qualified plans can be tracked by Form 5500 reports that plans submit to the Internal Revenue Service (IRS) and by insurance industry data on retirement plans offered through insurance companies. Distributions

EXHIBIT 2

Comparison of Estimated Annual Social Security Benefits from March Income Supplements of the CPS, NIPA, and Social Security Administration, 1980–2010



Note: U.S. dollars in billions.

Source: Authors' tabulations of various years of the CPS March Supplement; the Bureau of Economic Analysis; U.S. Department of Commerce; NIPA; and the Social Security Administration's reporting of combined benefit payments by the Old Age and Survivors Insurance program and the Disability Insurance program as found at www.socialsecurity.gov/OACT/TR/2013/VI_A_cyoper_hist.html#215892.

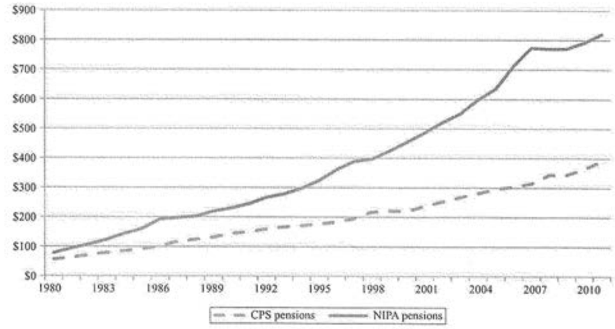
from public plans can be accumulated from the U.S. Census Bureau's Survey of Government Finances. In developing the NIPA, the Bureau of Economic Analysis at the U.S. Department of Commerce pulls data from various sources to estimate annual contributions to employer-sponsored defined-benefit pension plans and defined-contribution arrangements, as well as distributions to participants. In 1990, the NIPA estimates of benefits paid from employer-sponsored retirement plans were 60% greater than all non-Social Security retirement income reported in the CPS, and by 2010, the estimates were twice those from the CPS.

The discrepancy in the estimated income flowing from employer-sponsored retirement plans as well as the increasing differences over recent decades suggest that the CPS is undercounting this income. However, the two streams are not as directly comparable as they might appear. Some of the retirement benefits reported in the NIPA may include preretirement distributions from 401(k) or similar retirement savings accounts. The NIPA estimates are built off of reports from plan sponsors and administrators, and any payment that is not rolled over into an IRA or another tax-qualified plan is considered a benefit payment. Respondents to the CPS questionnaires who are cashing out their own contributions from employer-sponsored or individual account plans may not report such payments as retirement income. Thus, there is an inconsistency in what the NIPA and the CPS are measuring.

Other datasets shed some light on how well the CPS is picking up retirement plan income, but getting historical time series data is either impossible or too cumbersome and costly compared with the bases used in compiling Exhibits 2 and 3. One dataset that is likely less prone to reporting errors than surveys is sample files released by the IRS annually of income tax filers' reported sources and amounts of income. The sample files represent the population of filers for each tax year, and the reported income is likely more precise than survey data because most people refer to accurate

EXHIBIT 3

Comparison of Estimated Annual Pension and Defined Contribution Plan Income from March Income Supplements of the CPS and NIPA, 1980–2010



Note: U.S. dollars in billions.

Source: Authors' tabulations of various years of the March Supplement to the CPS and Bureau of Economic Analysis, U.S. Department of Commerce, and NIPA.

source documents to calculate their tax returns, and they know that errors can result in an audit and potential penalties.

We tabulated various components of reported income from the IRS tax files for 1988, 2000, 2007, and 2008, the latter being the most recent year available, and compared them with CPS March Income Supplement files for the same years. Based on the sampling weights of individuals in the tax files, in 2008 an estimated 23.4 million filing units reported Social Security income, and an estimated 31.6 million filing units reported either pension/annuity income or taxable income from a tax-favored IRA. Based on the CPS, an estimated 32.9 million family units received Social Security, and 17.3 million received some form of pension or other retirement income.

The number of units receiving Social Security was higher in the CPS than in the tax files because the IRS tracks a population subset, while the CPS supposedly represents the entire civilian, non-institutionalized population. The lower CPS number of units reporting pension or other retirement income suggests that the Census survey does not capture a potentially significant portion of retirement income. Once again, however, some income from pensions and retirement savings plans may be preretirement distributions that are not "retirement" income for recipients, despite being reported that way on their tax forms.

Exhibit 4 shows Social Security benefits reported on 1040 files and the CPS for four years: 1988, 2000, 2007, and 2008. Since 1983, Social Security benefits have been taxable if half the benefit value plus other income reaches $25,000 or more for singles ($32,000 or more for married couples filing jointly). Up to 85% of the benefit is included on total incomes above $34,000 for single taxpayers and above $44,000 for couples.[1] These income amounts have been fixed at their nominal level since 1994, and the growth in other income and Social Security benefits due to inflation and productivity levels has subjected an increasing proportion of benefits to taxes.

The administrative data on benefit payments are from the Social Security Administration. These data show that the CPS has consistently reported a larger

Exhibit 4

Reported Levels of Social Security Income on Federal Income Tax Forms and the CPS for Selected Years

	Year	Social Security Benefits Reported (millions)	Administrative Record of Benefit Payments (millions)	Share of Benefits Reported on Tax Filings
	1988	$83,800	$217,100	38.6%
	2000	$183,779	$407,600	45.1%
1040 filings	2007	$370,195	$584,900	63.3%
	2008	$405,736	$615,300	65.9%
	1988	$183,127	$217,100	84.4%
	2000	$350,509	$407,600	86.0%
CPS	2007	$489,910	$584,900	83.8%
	2008	$532,739	$615,300	86.6%

Source: Authors' tabulations of the sample of Form 1040 filings and the CPS for selected years and Social Security administrative data from Social Security Bulletin Statistical Supplement for various years.

share of total Social Security benefits than federal tax filings. That would be expected even if people were reporting properly, because low-income Social Security recipients are not required to file income tax returns but should report their income on the CPS. Reporting of Social Security benefits appears to be fairly consistent from one year of the CPS to the next. The share of Social Security benefits being reported on annual federal income tax filings increases over time because the dollar thresholds are fixed, while incomes are rising gradually.

Exhibit 5 shows distributions from pension/annuity plans and from IRAs reported on federal income tax forms and on the CPS. Although the CPS showed higher Social Security payouts than the tax files, in this case the tax filings show considerably more income than the CPS. The left two columns of data include reported IRA and pension income for all tax filers and for all family units responding to the CPS. As in the Social Security reporting discussed in Exhibit 4, the number of people receiving retirement income in Exhibit 5 should be greater in the CPS than in the tax filings because some relatively low-income retirees receive pension income, although prevalence rates are higher for those with higher incomes. Some preretirement distributions from employer plans are cash-outs, some of which are not being preserved for retirement and may not be considered income by CPS participants. But research by Munnell, Kopcke, Golub-Sass, and Muldoon [2009] estimated that in 2007, 40% of job changers took cash-outs from their employer-sponsored 401(k) plans, but the cash-outs amounted to only 16% of total assets in the accounts. The rollovers into IRAs of funds from 401(k) and similar accounts are not considered income for tax filing purposes and thus are not included in taxpayers' 1040 filings, so the IRS totals in Exhibit 5 do not reflect rollovers.

Roth plan distributions are not taxable, so IRS data do not reflect retirement income from employer-sponsored and individual Roth accounts. Alternative surveys to the CPS do not generally pick up whether income from these plans is from traditional IRAs and 401(k)s, where contributions are made with pretax dollars and ultimate distributions are taxable, or whether the income is from Roth accounts, where contributions are made with post-tax dollars and distributions in retirement are tax-free. Since 2004, the Federal Reserve Board's Survey of Consumer Finances

Exhibit 5

Reported Pension/Annuity Income and Distributions from IRAs on Federal Income Tax Forms and the CPS for Selected Years

	Total Reported by All Respondents		*Total for Social Security Beneficiaries*	
	IRA Distributions	Pensions/ Annuities	IRA Distributions	Pensions/ Annuities
1988 IRS	$11,109	$173,890	$4,788	$74,376
1988 CPS	$706	$123,443	$597	$79,683
CPS/IRS	6.4%	71.0%	12.5%	107.1%
2000 IRS	$99,380	$546,114	$59,358	$258,764
2000 CPS	$3,211	$216,443	$2,083	$143,909
CPS/IRS	3.2%	39.6%	3.5%	55.6%
2007 IRS	$142,750	$833,570	$102,700	$460,500
2007 CPS	$8,373	$306,430	$6,056	$200,431
CPS/IRS	5.9%	36.8%	5.9%	43.5%
2008 IRS	$155,270	$811,701	$110,920	$457,311
2008 CPS	$7,712	$336,304	$5,564	$222,248
CPS/IRS	5.0%	41.4%	5.0%	48.6%

Note: U.S. dollars in millions.

Source: Authors' tabulations of the sample of Form 1040 filings and the CPS for selected years.

has been asking respondents to report the extent to which their IRA balances are Roth accounts. In 2004, 7.4% of IRA balances were reported as Roth-type accumulations, with the percentage climbing to 8.1% in 2007 and to 11.1% in 2010. Thus, the IRS data are missing a non-trivial and growing share of retirement income paid by tax-qualified plans to retirees. This means that the CPS results shown in Exhibit 5 are doing an even poorer job of capturing retirees' tax-qualified retirement income than the exhibit indicates.

Until 1997, IRS tax files had an indicator on the records of individuals claiming an extra exemption for each person in the filing unit 65 or older. That allowed an analysis of the same subset of the population, as included in Exhibit 1 from the Social Security reports on income of the population ages 65 and older. Where one or more individuals in the tax filing unit claimed the 65-and-older exemption in 1988, reported total pension plus IRA income was $89.6 billion in the tax files versus $73.6 billion for the comparable CPS population. After 1997, however, pension reporting appears to have started declining on the CPS compared with the IRS filings.

Of the 1988 totals shown in Exhibit 5, tax file retirement plan income included $4.8 billion in IRA distributions to elderly filers, while the CPS files captured only $597 million of such income. But the combination of pension or annuity income together with IRA distributions from the CPS were nearly identical to the amounts reported on the tax files. An earlier analysis by Schieber [1995] found that, for the 1990 tax year, pension and IRA income was $112 billion according to tax files versus $88 billion estimated from CPS elderly filers. The discrepancy between the pension and retirement savings income reported on the CPS compared with the tax files increased between 1988 and 1990.

Because recent tax files no longer identify taxpayers 65 and older, we focused on those receiving Social Security benefits who thus might be considered retired. The overwhelming majority of Social Security recipients are 62 or older or disabled. In either case, Social Security beneficiaries might also qualify for retirement income from a tax-qualified plan. In Exhibit 5, the IRA and pension income amounts in the two right-hand columns were paid to people who also reported receiving Social Security income. It seems reasonable to assume that people who receive Social Security retirement benefits might also be receiving benefits from their supplemental retirement savings accounts.

But the CPS captures very little of the IRA income being reported on tax filings: 3.5% in 2000 and roughly 5%–6% in 2007 and 2008. The CPS has done a better job of capturing reported pension and annuity income but still comes up short by around half, and the underreporting appears to have worsened considerably in recent years. In aggregate, the CPS for 2008 clearly captured less than half the pension/annuity or IRA income that accrued to family units that were receiving Social Security benefits. Considering that the tax filings do not capture all income paid by employer-sponsored retirement plans and IRAs—because low-income recipients do not have to file tax forms and Roth-type benefits are not taxable—aggregate benefits from these plans almost certainly exceeded the Social Security benefits they received in 2008. This is a far cry from the relative levels of retirement income reported by Social Security, as shown in Exhibit 1.

SHARING THE PIE

The tax data clearly show that many more people are receiving both Social Security benefits and retirement income from employer-sponsored and private retirement accounts—and the income from the latter sources is much greater than the CPS would have us believe. But many of those using the CPS to analyze retirement income also stress the importance of how benefits are distributed across the income spectrum and contend that pension/annuity and IRA income accrues mostly to well-off retirees. To examine segments of the population by income, our analysis splits filing units in both the IRS and CPS files for 2008 into 10 equal groups, called deciles, by income level. Exhibit 6 shows income levels for 2008 tax-filing units and for family units that reported income in the CPS for the same year. Despite lower-income individuals not having to file federal income tax forms, the income deciles for the CPS participants were consistently higher than those for the tax filers. Exhibit 6 also shows income ranges for family units with at least one member receiving Social Security benefits.

In the 2008 federal tax filings, recipients of Social Security had higher incomes at every decile than the total population covered in the CPS. For example, the third decile includes those whose incomes fall between the 30th and 40th percentile of the distribution. Within this third decile, among tax-filing units who received

EXHIBIT 6

Income Ranges within Each Income Decile of All Tax-Filing Units and for Those Units Reporting Social Security Income from the 2008 Federal Income Tax Files and Comparable Reported Income for 2008 on the CPS

	All Reporting Units Income Levels		*Units Reporting Social Security Income*	
Decile	From IRS Tax Files	CPS Respondents	From IRS Tax Files	CPS Respondents
1	Up to $6,767	Up to $9,324	Up to $18,133	Up to $10,663
2	6,768 to 13,749	9,325 to 16,598	18,134 to 25,966	10,664 to 14,357
3	13,750 to 20,550	16,599 to 24,010	25,967 to 32,449	14,358 to 18,617
4	20,551 to 27,888	24,011 to 32,021	32,450 to 39,503	18,618 to 23,777
5	27,889 to 36,370	32,022 to 41,612	39,504 to 47,171	23,778 to 30,014
6	36,371 to 47,141	41,613 to 53,746	47,172 to 56,339	30,015 to 38,179
7	47,142 to 61,355	53,747 to 69,782	56,340 to 68,849	38,180 to 49,504
8	61,356 to 82,008	69,783 to 90,561	68,850 to 88,603	49,505 to 66,857
9	82,009 to 121,311	90,562 to 127,200	88,604 to 130,202	66,858 to 97,000
10	121,312 or more	127,201 or more	130,203 or more	97,001 or more

Source: Authors' tabulations of the sample of Form 1040 filings and the CPS for 2008.

Social Security benefits, incomes ranged from $25,967 to $32,449, while the range for the total population in the CPS was $13,750 to $20,550. Among the CPS units reporting Social Security income, those in the bottom decile had a higher median income than the general population, but among those in the second decile and higher, the general population had higher income levels than Social Security recipients.

In the 2008 IRS tax filings, an estimated 23.4 million units reported receiving Social Security benefits versus 32.9 million in the CPS. To make the data from both sources more comparable, we eliminated the bottom 20% of the income distribution from the CPS, thereby arriving at an estimated 24.5 million units with Social Security income for 2008. This is not to suggest that the income status of those with the lowest incomes is not important from a retirement income security standpoint; our goal was simply to make the two populations as comparable as possible in order to assess their respective reporting of pension/annuity or retirement account income. We acknowledge that low-income Social Security recipients excluded from Exhibit 7 are unlikely to have significant income from pensions or IRAs. The point here, however, is that we are missing much of the retirement income that is available to retirees in the upper 70–80% of the income distribution. If aggregate income levels and the distribution of income are important in setting retirement policy, then we first need to understand the retirement resources available to retirees at various income levels.

While the altered CPS file might not map directly to 2008 tax filers, it must be more comparable than the full CPS population because many low-income units do not file federal tax forms. Exhibit 7 shows the median reported Social Security benefits in each income decile from the 2008 federal tax files and the CPS for the top 80% of all units based on income. Those in the first four deciles of the CPS have somewhat higher median Social Security benefits than the same deciles from the tax files, and the overall distribution is flatter in the CPS than in the tax files.

Almost 30% of Social Security beneficiaries in the bottom income decile on both the IRS and CPS files reported having received some annuity or IRA income in 2008. In the second decile, the prevalence of reported annuity/IRA income among Social Security beneficiaries in the tax files was 1.6 times that reported by the CPS and, at every higher decile, the prevalence of annuity/IRA income in the tax files was considerably higher than that in the CPS.

Moreover, across much of the income distribution, the median annuity or IRA income in the tax files was significantly higher than in the CPS—30%–40% higher in the third through sixth income deciles and nearly 50% higher in the seventh and eighth deciles. In the tax files, the median reported annuity or IRA income in the bottom half of the income distribution was somewhat less than the median Social Security income, and benefits were quite significant among those receiving them. In the second decile of the income distribution, the median annuity/IRA income was 50% of the median Social Security benefit.

Some people who qualify for retirement benefits might not be receiving them in a specific year because they continue to work. For example, workers in 2008 could draw their full Social Security benefits at age 66 while continuing to earn income from employment. Exhibit 8 focuses on Social Security beneficiaries who reported no annuity or IRA income but reported wage, salary, or self-employment income in the tax files and

Exhibit 7

Median Social Security Income for Beneficiaries, Percentage of Filing Units with Social Security Income Reporting Pension or Annuity Income, and Median Pension Income Reported for 2008 from Tax Files and the CPS, Excluding the Lowest 20% of Income Reporters

	Income Reported on 2008 Tax Files			*Income Reported for 2008 on CPS*		
Decile	Median Social Security Income	Percentage with Annuity/IRA	Median Annuity/IRA	Median Social Security Income	Percentage with Annuity/IRA	Median Annuity/IRA
1	$8,940	29.4%	$2,903	$15,413	28.8%	$3,840
2	13,100	59.6%	6,613	16,757	34.4%	5,664
3	14,440	73.4%	10,510	16,800	42.6%	7,392
4	15,690	78.3%	13,440	17,189	48.8%	9,600
5	17,030	81.3%	17,500	17,157	55.6%	12,600
6	18,430	82.5%	20,730	16,692	55.7%	16,032
7	19,130	83.5%	28,030	18,394	53.2%	18,600
8	19,270	83.2%	34,380	16,800	54.2%	23,520
9	21,200	86.7%	46,800	17,656	56.8%	26,400
10	22,860	83.9%	74,760	18,072	53.4%	30,000

Source: Authors' tabulations of the sample of Form 1040 filings and the CPS for 2008.

Exhibit 8

Family Units Reporting Social Security Income in 2008 Who Reported No Annuity or IRA Income and Those Who Reported Earnings and Median Earnings from 2008 Tax Files and the CPS, Excluding the Lowest 20% of Income Reporters

	Income Reporting from 2008 Tax Files			*Income Reporting for 2008 on CPS*		
Decile	Percentage Not Reporting Annuity/IRA Income	Percentage with No Pension/IRA Who Report Earnings	Median Earnings Income of Those with It	Percentage Not Reporting Annuity/IRA Income	Percentage with No Pension/IRA Who Report Earnings	Median Earnings Income of Those with It
1	70.6%	43.2%	$4,128	71.2%	20.3%	$6,260
2	40.4%	56.2%	9,661	65.6%	27.5%	10,000
3	26.6%	64.6%	15,370	57.4%	35.2%	12,000
4	21.7%	75.2%	21,250	51.2%	52.9%	16,940
5	18.7%	76.7%	27,500	44.4%	70.1%	21,684
6	17.5%	79.6%	35,130	44.3%	78.9%	29,000
7	16.5%	77.1%	44,260	46.8%	81.1%	38,000
8	16.8%	77.4%	56,060	45.8%	89.8%	52,000
9	13.3%	74.7%	76,150	43.2%	93.1%	70,900
10	16.1%	64.2%	121,400	46.6%	94.1%	112,000

Source: Authors' tabulations of the sample of Form 1040 filings and the CPS for 2008.

the CPS. The exhibit also shows the median earnings of those who reported receiving such income.

In the 2008 tax files, most filers who reported no pension or IRA income reported earnings, including roughly three-quarters of those in the fourth through tenth income deciles. Relative to the median Social Security benefits reported in Exhibit 7, the earnings are quite significant across most of the income distribution. In the CPS, somewhat smaller percentages who reported no pension or IRA income also reported earned income at the lower income levels, but higher percentages reported earned income in the sixth through tenth deciles.

These data do not identify how many people with substantial earned income but no reported pension/annuity or IRA income had a private retirement benefit but were deferring distributions until they fully retired. Many healthy older people might prefer to work past typical retirement age to build up their retirement savings, especially if they believe they might outlive their life expectancy. In other words, the non-receipt of private retirement benefits may be a demonstration of financial prudence as opposed to a failure of private retirement plans.

READING THE FINE PRINT AND ASKING THE RIGHT QUESTIONS

As we noted earlier, the Current Population Survey serves as the basis for estimates of income sources and amounts for retirees at all income levels. The widespread conclusion drawn from the survey is that the elderly—especially those at lower income levels—depend on Social Security for all or most of their income. For example, Lind, Hill, Hiltonsmith, and Freedman [2013] cite the 2010 Social Security report on income sources of the elderly indicating the following:

> The combination of traditional pensions and defined contribution plans such as 401(k)s and IRAs provide 18 percent of all income for older Americans. Both defined benefit and defined contribution plans are much more important to more affluent elders: They provide 25 percent of all income for older Americans in the second-highest income quintile compared to just 3 percent of income for those in the lowest income quintile.

Statements like these suggest that the cited income measures are comprehensive. But comparing the retirement income of Social Security recipients reported on federal income tax filings with those from the CPS casts the survey data about income levels and sources into doubt. In fact, the underreporting of retirement plan income on the CPS has been understood for some time.

In a critical review of Schieber's [1995] comparison of 1990 pension and IRA reporting from the IRS tax files and the CPS, John Woods [1996] of the Social Security Administration indicated the following:

> Undoubtedly, the biggest problem in estimating pension benefits based on the CPS is its conceptual orientation to measuring income as regular, periodic payments. The questionnaire does not ask about lump-sum payments, which we know from other data sources constitute a large and growing component of payouts from pension plans.

Although Woods conceded that the CPS was missing some income being paid by tax-qualified retirement plans, he developed an analysis that suggested that most of the unaccounted income in the CPS was being paid to people in the upper half of the income distribution and concluded that, "The system of employer-sponsored pensions in the United States ... has been doing a poor job of providing widespread retirement income security to lower wage workers and their families" (Woods [1996]). His conclusion notwithstanding, Woods indicated that the Census Bureau had recently added questions to another of its income surveys, the Survey of Income and Program Participation (SIPP), to elicit information on "lump sum" payments from retirement plans, and that Social Security intended to examine these data in future analyses. He also indicated that the Social Security Administration intended to make recommendations to the Census Bureau for improving its measurement of pension benefits on income surveys as a result of the analysis he had developed with input from the Census Bureau, the IRS, and others.

Since Woods acknowledged that the CPS was not capturing income from sources that were not making "regular, periodic payments," the Social Security Administration has published at least seven subsequent reports on the sources and income of the elderly. In the most recent report in this series, "Income of the Population 55 or Older, 2010," Trenkamp [2012] pointed to the reason why the retirement plan income discrepancies between federal tax filings and the CPS persist. In the 2010 report, Trenkamp wrote:

> We do not publish statistics differentiating between DB and DC pensions because a significant portion of payments from DC plans are not collected in the Current Population Survey. The Census Bureau only includes "regular payments" from retirement, survivor and disability income in its definition of total money income. Many people do not choose to annuitize their pension accounts and instead make withdrawals from their pension accounts on their own. These withdrawals are not part of total money income, and data are not collected on withdrawals from pension accounts in the March Supplement to the Current Population Survey.

Although many analyses of the income status of the elderly and retirees rely on the CPS or Social Security's own publications, the shortcomings of the CPS in capturing retirement income have been documented elsewhere. Sabelhaus and Schrass [2009] compared 2007 withdrawals from IRAs as reported in federal income tax filings with the CPS, the Survey of Consumer Finances sponsored by the Federal Reserve Board, and the Investment Company Institute's Tracking/IRA survey.

Using a published IRS analysis, Sabelhaus and Schrass [2009] estimated that of 2006 taxable IRA distributions of \$124.7 billion, \$105.7 billion went to filing units with a primary taxpayer age 55 or older. The comparable estimates of distributions were \$6.4 billion in the CPS, \$95.2 billion in the Survey of Consumer Finances, and \$71.6 billion by the Investment Company Institute. Our own tabulations of the Survey of Consumer Finances suggest that it is picking up at least twice as much pension/annuity and IRA income as the CPS and that the IRA distributions reported on the Federal Reserve Board's Survey of Consumer Finances are nearly equivalent to the amounts reported on the tax files.

Czajka and Denmead [2011] compared the CPS income supplement with two other regular surveys conducted by the Census Bureau. The American Community Survey (ACS) is an annual survey,[2] and the SIPP includes households that are interviewed on a recurring basis over 30 to 48 months.[3] Each survey uses somewhat different sample frames and question formats to gather information on income sources and levels for representative samples of the U.S. population.

Compared with the SIPP, the CPS comes up particularly short on retirement income from 401(k) and 403(b) types of plans and from all IRAs, including traditional IRAs, Roth IRAs, simplified employee pensions (SEPs), and savings incentive match plans for employees (SIMPLE) IRAs established through employers, according to Czajka and Denmead. The ACS also comes up short relative to the SIPP but generates somewhat higher income estimates than the CPS from these plans. Czajka and Denmead found that 46.6% more family units or unrelated individuals reported receiving some retirement income other than Social Security or Supplementary Security Income on the SIPP than on the CPS and that the aggregate amounts reported on the SIPP were 39% greater than those on the CPS.

Czajka and Denmead argued that all three surveys would benefit from revisions to their "income questions to reflect recent shifts in sources of retirement income, especially the increasing importance of IRAs as a source of regular distributions, even if such distributions occur as infrequently as once a year." They maintain that the CPS should consider adopting the approach taken by the Federal Reserve's Survey of Consumer Finances, which asks respondents to identify up to six of their retirement plans or accounts and then answer questions about their balances, regular or periodic payments, and so forth.

Czajka and Denmead's analysis of the three separate Census Bureau income surveys indicates considerable variation in the data being collected from one survey to the next. When the Census Bureau reports its results from these three surveys, however, it does not report the distributions from retirement accounts. For example, as Iams and Purcell [2013] noted, "The SIPP asks about distributions from retirement accounts, but it does not include those distributions in its summary measure of total family income." So, even though the SIPP data collection process and resulting database include information on distributions from retirement savings accounts, that information is missing from the summary reports published by the Census Bureau on the survey results.

Iams and Purcell's assessment of the reporting of income from retirement accounts suggests that whatever efforts the Social Security Administration has made to encourage the Census Bureau to collect this information have been unsuccessful. But they also rationalize that getting reliable estimates of retirement income taken infrequently from retirement-account plans is more difficult than collecting information on annuity benefits paid to retirees. They also suggest that distributions from account-based retirement plans are not treated as income during retirement because, "Employees' contributions to their retirement accounts were part of their gross income in earlier years, and a general rule of accounting states that a dollar of income in one year should not be counted again as income in a later year" (Iams and Purcell [2013]). Applied consistently, this latter rationale would mean that a large portion of Social Security benefits would not be counted as retirement income either, because half the payroll taxes—the workers' share of contributions that entitle them to retirement benefits—are counted as part of workers' income when the benefits are earned.

Iams and Purcell [2013] estimated that if the SIPP results reported distributions from retirement-account plans in total family income, it would raise the median income of survey participants receiving such dispersals by 18%. Writing in the March 2012 *Social Security Bulletin*, Anguelov, Iams, and Purcell concluded:

> The shift toward greater distributions from DC plans and IRAs raises important questions about the accuracy of the CPS measures of the number of households that take such distributions and the proportion of household income derived from such accounts... The major nationally representative surveys of household income must accurately measure annual distributions from retirement accounts in order to provide a complete picture of the economic well-being of the aged and the general U.S. population.

It is clear that analysts in the Social Security Administration unit that regularly publishes "Income of the Population 55 or Older" have been aware of the underreporting of retirement income on the CPS for quite some time. They also have acknowledged that failing to account for the growing share of retirement benefits paid out of individual account plans is distorting the "complete picture" of retirees' economic status.

MAKING A MOLEHILL OUT OF A MOUNTAIN

To understand the ramifications of ignoring the retirement income value of defined-contribution or individual account plans in these analyses, it is important to focus on the relative size of private retirement savings in forms where "many people do not choose to annuitize... and instead make withdrawals from their pension accounts on their own," as Trenkamp [2012] observed. We often think of retirees' individual account plans as holding the savings they have accumulated by participating in some sort of defined-contribution plan during their working years. But many retirees end up with significant personal account balances from both defined-benefit and defined-contribution plans sponsored by their former employers.

The largest share of retirees receiving annuities from employer-sponsored plans are those still covered by defined benefit plans. But many traditional defined-benefit plans have allowed retiring workers to take lump-sum distributions from their pension plans over the past couple of decades. And many other plan sponsors have converted their traditional defined benefit pensions into hybrid forms in recent years. The Pension Benefit Guaranty Corporation (PBGC [2011]) estimated that in 2010, 37.3% of private pension plan participants were in hybrid plans, up from 20.5% in 2001. Hybrid plans tend to offer lump-sum payments to terminating workers, and the available evidence suggests that most terminating or retiring workers take the lump sum rather than an annuity. Even in those traditional defined-benefit plans still standing, at least a quarter of workers have the option of a lump sum at retirement (Bureau of Labor Statistics [2010]), and some plan sponsors have recently allowed retirees already drawing an annuity to cash out the lump-sum value of future benefits.

As measured by assets in the private, tax-qualified retirement system, defined-benefit plans have been rapidly losing ground to defined contribution plans and IRAs. Copeland [2013] estimated that in 2011, rollovers accounted for roughly half the balances in traditional IRAs. But he also estimated that approximately 1.6 million people contributed an average of roughly $3,700 to their IRAs in 2011, while 1.1 million rolled over an average of slightly more than $72,000. With aggregate rollovers reaching nearly 13 times aggregate contributions, we are clearly on a path where most of the money in the IRA system will have started out as benefits in defined-contribution and defined-benefit plans.

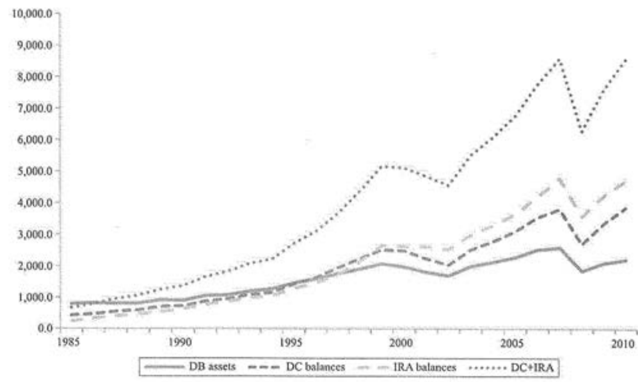
Exhibit 9 shows accumulated asset balances in private defined-benefit, defined-contribution, and IRA accounts separately and then the sum of defined-contribution and IRA balances for 1985 through 2010. In 1985, 54% of all private plan assets were in defined-benefit plans, and most of those assets were in traditional plans that paid out annuities at retirement. By 2010, only 20% of assets were in defined-benefit plans and at least half the plan participants were eligible for lump-sum cash-outs when they terminated employment.

Assets in IRAs, in contrast, grew from 16% to 44% of all private retirement assets between 1985 and 2010. So IRAs have become the single largest component of the private retirement system, and most accumulated balances in employer-sponsored defined-contribution plans and a considerable share of the balances in defined-benefit plans are destined for IRAs when workers retire.

In other words, while the IRA system has become the largest component of the private retirement system

EXHIBIT 9

Assets in Private Tax-Qualified Retirement Plans of Various Types, 1985-2010



Source: Compiled by the authors from Federal Reserve Board, Flow of Funds data from various years, found at www.federalreserve.gov/apps/fof/.

by far, as Trenkamp said, almost none of the income paid from IRAs is ever counted by the Social Security Administration, the Census Bureau, and many policy analysts and advocates. The expanding role of defined-contribution plans and IRAs in providing retirement income is clear and indisputable, but the shift is particularly consequential for the baby boomers now retiring or approaching retirement.

Using data from the Health and Retirement Study sponsored by the National Institute of Aging, Gustman, Steinmeier, and Tabatabai [2010] estimated that 68% of the population ages 51 to 56 in 1992 were either in a defined-benefit pension plan or had earned such a benefit based on prior employment. That percentage had dropped to 60% by 1998 and to 49% by 2004. Among the oldest group in this set, 58% reported having a defined-contribution account in 1992, while 72% of the youngest group reported having one in 2004. The prevalence of defined-contribution accounts is much higher for the baby boomers than it was for earlier generations. But even if we do a better job of counting dollars flowing out of IRAs and other account-based plans in the future, we may be missing some fundamental dynamics of retirement income security decisions being made by retirement account holders.

Anguelov, Iams, and Purcell [2012] found that among SIPP respondents 65 and older who reported having either an IRA or a 401(k) account, withdrawals were strongly skewed by age. In 2006, only 22% of 65- to 69-year-old account holders took distributions compared with 72% of those 70 or older. Poterba, Venti, and Wise [2012] used the SIPP database to analyze the utilization of retirement accounts by retired households and found consistent results over an extended number of years. Between 1997 and 2010, around 20% of households with a household member 60 to 69 years old took a distribution from their personal retirement account. Among households with a member 72 to 85 years old, the distribution rate jumped to around 70% per year over the period. The one exception was 2009, when the rules requiring individual account holders to take mandatory distributions after age 70½ were suspended for a year, and the distribution rate for 72- to 85-year-olds dropped to around 56%.

The apparent failure of employer-sponsored and private savings plans to deliver retirement income to a broad cross-section of the retiree population is often cited as a reason to curtail the tax preferences accorded these plans and to switch to a tax credit system. For example, Michael Lind and his colleagues at the New America Foundation are proposing to essentially dismantle the private retirement saving system, replacing it with a system of tax credits heavily skewed to lower-earning workers. Their rationale is that the private retirement system largely ignores the bottom 60% of earners (Lind et al. [2013]). The same rationale served as the basis for recommendations to enhance or expand Social Security benefits by Virginia Reno, the vice president for income security at the National Academy of Social Insurance, which she presented to the Social Security Subcommittee of the House Ways and Means Committee (Reno [2010]).

CONCLUSION

Concerns about the accuracy of self-reports of sources and levels of retirement income on surveys that most people have never heard of might seem like some medieval theological debate over how many angels can fit on the head of a pin. But ignoring an ever-growing component of retirees' private retirement savings and the income it generates distorts the perceived role that various parts of the retirement system play in providing income security to the elderly. The underreporting results in an inaccurate picture of retirees' economic status and affects policy analysts' and policymakers' perspectives on potential solutions to the challenges posed by an aging population, an underfunded retirement system, and existing claims on workers that already limit their ability to improve their standard of living.

There are legitimate reasons to believe that some workers are not adequately preparing for retirement and that some retirees have inadequate resources to meet their economic needs, and the shift from defined-benefit to defined-contribution plans is widely considered to have made retirement more financially precarious for workers and retirees. It is impossible, however, to clearly sort out who is doing well and who is doing poorly under the current arrangements if official government reports on the income status of retirees ignore hundreds of billions of dollars of their income.

For 2008, distributions from pensions, annuities, and IRAs paid to taxpayers who reported also receiving Social Security benefits were vastly higher than the comparable amounts reported on the Consumer Population Survey: \$568.2 billion versus \$227.8 billion—a difference of more than \$340 billion (Exhibit 5). Moreover, some retirement benefits paid to those with low incomes are not reported on tax filings, suggesting that as little as one-third of retirement benefits supplementing Social Security are reflected in the income sources and levels of the elderly used to evaluate current policies.

Some surveys do a better job than the CPS of capturing the retirement benefits paid out by tax-favored retirement plans today. Those other surveys, however, are generally based on smaller, less-representative samples of the U.S. non-institutionalized population than used in the CPS, thus limiting their use. The tax filing information we used to document the poor job being done by the CPS in measuring retiree income cannot be used for the distributional analyses that are clearly essential in evaluating the public policies that govern retirement income security. And even the IRS data on income distributed from tax-qualified plans provide an incomplete picture of retirement income being delivered to tax filers because of its failure to capture Roth IRA and 401(k) plan payouts as retirement income, a problem that will grow larger over time. The underrepresentation of low-income individuals and couples in the tax administration system makes it impossible to gather the demographic and other information required for such analyses.

A survey with the large sampling frame used in developing the CPS is important for the kinds of analyses that are essential to understanding how our retirement system is working and evolving. The future of U.S. retirement policy is too important to continue relying on inaccurate measures of retirement income that ignore individual accounts, the largest and fastest-growing component of the system. If the U.S. Census Bureau is unwilling to modify its process of collecting retirement plan income, including income from individual accounts, to provide more accurate estimates of retirees' income sources, then the Social Security Administration should use alternative surveys, such as the Health and Retirement Study or the Survey of Consumer Finances.

If the Social Security Administration continues to use the CPS in its current form because its large sample allows detailed analysis of various subsections of the population, it should include strongly worded caveats in bold type on any statistical presentation material that warns of misleading pension income levels for retirees. Otherwise, policymakers, analysts, and the public will continue to be deceived regarding how large segments of the elderly population are faring and how to ensure that today's workers are on a solid path to a financially secure retirement.

ENDNOTES

The conclusions and recommendations presented here are the authors' alone and should not be construed to be those of Towers Watson or any of its associates. The authors wish to thank Robert Clark and Jack VanDerhei for helpful comments on an earlier draft and Susan Farris and Nancy Campbell for editorial assistance in finalizing the article. We also thank two anonymous commenters who reviewed the paper for *The Journal of Retirement*.

[1]Since 1993, there have been two calculation methods for married couples filing jointly: one for couples with incomes between \$32,000 and \$44,000 and another for those with incomes of \$44,000 or higher. In the former case, Social Security benefits included in income are the lesser of one-half the benefit or one-half of total income over \$32,000. For the latter, it is the lesser of 85% of the benefit or \$6,000 plus 85% of total income over \$44,000. For singles, the comparable limits are \$25,000 and \$34,000.

[2]The American Community Survey is an ongoing survey conducted by the U.S. Census Bureau that is designed to provide reliable and timely demographic, housing, social, and economic data annually. Private and government planners use the survey to assess the adequacy of existing infrastructure or consider new development. Policymakers use it to assess the needs of communities and the effectiveness of existing programs. Sampling is done at the housing unit level, and residents in more than 2 million units across the country were interviewed in 2011.

[3]The Survey of Income and Program Participation is a Census Bureau survey that follows sample "panels" of households over periods ranging from 2.5 to 4 years where residents in sample households are interviewed periodically. The sample sizes range from 14,000 to 36,700 households. A panel started in 2008 is now underway, and households are scheduled to complete their final interviews in December 2013.

REFERENCES

Anguelov, C.E., H.M. Iams, and P.J. Purcell. "Shifting Income Sources of the Aged." *Social Security Bulletin*, Vol. 72, No. 3 (March 2012), pp. 59-68.

Bipartisan Policy Center. "Restoring America's Future." Report, Debt Reduction Task Force, Bipartisan Policy Center, 2010. Available at http://bipartisanpolicy.org/projects/domenici-rivlin-debt-reduction-task-force.

Bureau of Labor Statistics. "Employee Benefits Survey." U.S. Department of Labor, August 2, 2010. Available at www.bls.gov/ncs/ebs/detailedprovisions/2010/ownership/private/table38a.pdf.

Caldera, S. "Social Security: Who's Counting on It?" Fact sheet, AARP Public Policy Institute, March 2012. Available at www.aarp.org/content/dam/aarp/research/public_policy_institute/econ_sec/2012/Social-Security-Whos-Counting-on-It-fs-252-AARP-ppi-econ-sec.pdf.

Center on Budget and Policy Priorities. "Top Ten Facts about Social Security." *Policy Basics*, November 6, 2012. Available at www.cbpp.org/files/PolicyBasics_SocSec-TopTen.pdf.

Copeland, C. "Individual Retirement Account Balances, Contributions, and Rollovers, 2011: The EBRI IRA Database." EBRI Issue Brief No. 386, May 2013.

Czajka, J.L., and G. Denmead. "Getting More from Survey Income Measures: Empirically Based Recommendations for Improving Accuracy and Efficiency." Paper presented at the Association of Public Policy Analysis and Management, Washington, D.C., 2011. Available at http://www.fcsm.gov/12papers/Czajka_2012FCSM_III-D.pdf.

Fisher, L., and N. Pascua. "Income of the Population 55 or Older, 2004." SSA Publication No. 13-11871, May 2006. Available at http://www.ssa.gov/policy/docs/statcomps/income_pop55/2004/incpop04.pdf.

Fisher, L., and B. Trenkamp. "Income of the Population 55 or Older, 2008." SSA Publication No. 13-11871, April 2010. Available at http://www.socialsecurity.gov/policy/docs/statcomps/income_pop55/2008/incpop08.pdf.

Gustman, A., T. Steinmeier, and N. Tabatabai. *Pensions in the Health and Retirement Study*. Cambridge, MA: Harvard University Press, 2010.

Hungerford, T., M. Rassette, H. Iams, and M. Koenig. "Trends in the Economic Status of the Elderly, 1976–2000." *Social Security Bulletin*, Vol. 64, No. 3 (2001/2002). Available at www.socialsecurity.gov/policy/docs/ssb/v64n3/v64n3p12.html.

Iams, H.M., and P.J. Purcell. "The Impact of Retirement Account Distributions on Measures of Family Income." *Social Security Bulletin*, Vol. 73, No. 2 (2013).

Kingson, E. Testimony before the Subcommittee on Primary Health and Aging, Committee on Health, Education, Labor and Pensions, U.S. Senate, October 18, 2011. Available at www.help.senate.gov/imo/media/doc/Kingson1.pdf.

Lind, M., S. Hill, R. Hiltonsmith, and J. Freedman. "Expanded Social Security: A Plan to Increase Retirement Security for All Americans." Report, New America Foundation, April 2013. Available at http://newamerica.net/sites/newamerica.net/files/policydocs/LindHillHiltonsmith-Freedman_ExpandedSocialSecurity_04_03_13.pdf.

Munnell, A.H., R.W. Kopcke, F. Golub-Sass, and D. Muldoon. "An Update on 401(k) Plans: Insights from the 2007 Survey of Consumer Finance." CRR Working Paper 2009-26, Center for Retirement Research at Boston College, 2009.

National Academy of Social Insurance. "The Role of Benefits in Income and Poverty," Website, July 16, 2013. Available at www.nasi.org/learn/socialsecurity/benefits-role.

National Commission. "Moment of Truth." Report, National Commission on Fiscal Responsibility and Reform, December 2010. Available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

PBGC. *Pension Data Book*. Tables, Pension Benefit Guaranty Corporation, 2011. Available at www.pbgc.gov/documents/pension-insurance-data-tables-2011.pdf.

Poterba, J.M., S.F. Venti, and D.A. Wise. "Were They Prepared for Retirement? Financial Status at Advanced Ages in the HRS and AHEAD Cohorts." NBER Working Paper 17823, 2012. Available at http://www.nber.org/papers/w17824.

Reno, V.P. Testimony before the Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, July 15, 2010. Available at www.nasi.org/sites/default/files/research/Statement%20of%20Virginia%20Reno%20-%20Subcommittee%20on%20Social%20Security%20Committee,%20U.S.%20House%20of%20Representatives%20-%207-15-10.pdf.

Rhee, N. "The Retirement Savings Crisis: Is It Worse Than We Think?" National Institute on Retirement Security, 2013. Available at www.nirsonline.org/index.php?option=com_content&task=view&id=768&Itemid=48.

Sabelhaus, J., and D. Schrass. "The Evolving Role of IRAs in U.S. Retirement Planning." Research perspective, Investment Company Institute, 2009.

Social Security Administration."Fact Sheet." 2013. Available at www.ssa.gov/pressoffice/factsheets/basicfact-alt.pdf.

Schieber, S.J. "Why Do Pension Benefits Seem So Small?" *Benefits Quarterly*, Fourth Quarter 1995, pp. 57-70.

Trenkamp, B. "Income of the Population 55 or Older, 2010." SSA Publication No. 13-11871 Social Security Administration, 2012. Available at www.socialsecurity.gov/policy/docs/statcomps/income_pop55/2010/incpop10.pdf.

Woods, J.R. "Pension Benefits Among the Aged: Conflicting Measures, Unequal Distributions." *Social Security Bulletin*, Vol. 59, No. 3 (1996), pp. 3-30.

Chairman JOHNSON. Dr. Steuerle, please go ahead.

STATEMENT OF C. EUGENE STEUERLE, INSTITUTE FELLOW AND RICHARD B. FISCHER CHAIR, URBAN INSTITUTE

Mr. STEUERLE. Thank you, Mr. Chairman, Mr. Becerra. It is an honor to be here with you again. And also the Members of the Subcommittee. Contrary to the popular argument that we live in an age of austerity, I would like to suggest that we live in an age of extraordinary opportunity. Yet, as I argue in a book, Dead Men Ruling, that I sent to each member of this Subcommittee, we block Congress by constantly re-fighting yesterday's battles.

As only one reflection, in 2009, every dollar of revenue had been committed before that new Congress walked through the Capitol doors. Looking to Social Security after three quarters of a century of continual growth, it has largely succeeded in providing basic protections to most, though not all, older people. Now, as psychologist Laura Carstensen suggests, we should be redesigning our institutions around the new possibilities that improved health care and long lives provide.

But the eternal automatic growth of Social Security is not conditioned on any assessment of society's opportunities or needs. Not making the best use of the talents of people of all ages, not child or elderly poverty, not educational failures or the incidence of Alzheimer's or Autism. Let me focus on three problems caused by this past, rather than future focus.

And I should point out that these are problems that apply regardless of whether one is a progressive or a conservative, because neither conservative principles would allow these types of problems to persist. The first is the ways that Social Security provides unequal justice to many. The second is the consequence of providing ever larger shares of Social Security resources to the middle aged. And the last is how each year that reform is delayed adds to the burden passed on to younger generations.

First to unequal justice. Social Security redistributes in many ways, both progressive and regressive. And many fail to provide equal justice. Among the most outrageous, working single parents, often abandoned mothers, are forced to pay for spousal and survivor benefits they cannot receive, often receiving at least $100,000 fewer lifetime benefits than some who do not work, do not pay Social Security tax, and raise no children.

Similarly, the system discriminates against younger couples, against spouses who divorce before ten years of marriage, against long term workers, and those who beget or bear children before age 40.

To the second point, middle aged retirement. People today retire about a decade longer than they did when Social Security first started paying benefits. Let me be clear. The biggest winners of this multi-decade policy have been people like the witnesses at this table and the members of Congress who, if married, now get about $300,000 in additional lifetime benefits. This is not a way to redistribute to people in need or people with shorter life expectancies.

But there are other consequences. A decline in employment rate, as reflected in Congressional Budget Office reports, a decline in the rate of growth of GDP and of personal income, as well as lower Social Security benefits for the truly old, when they start receiving benefits so much earlier in their lives. Meanwhile, within a couple decades, close to one third of the adult population will be on Social Security for one third or more of their adult lives.

There is no financial system, public or private, that can provide so many years or retirement for such a large share of the population without severe repercussions, both for the individuals' wellbeing in retirement and for the workers upon whose backs the system relies.

Finally, the impact on the young. Today's lifetime Social Security and Medicare benefits approximate about $1 million for a couple with average incomes throughout their working lives. That large number comes about largely because of the number of years of support. Rising by about $18,000 a year, benefits for a couple in 2030 are scheduled to grow to about one and a third million dollars. Meanwhile, the rate of return on contributions falls continually for each generation.

Each year of delayed reform shifts more burdens to younger generations from older ones, with the largest impact on groups like blacks and Hispanics, in part because they comprise a larger share of those future generations who are scheduled to get lower returns than current generations retiring.

In summary, each of year of delay in reforming Social Security continues a pattern of unequal justice under the law, threatens the well-being of the truly old, increases the share of benefits going to the middle aged, leads government to spend ever less on education and other investments, contributes to higher non-employment, lower personal income and revenues, not just in Social Security but throughout the system, and increases the burden that is shifted to the young and to people of color. Thank you.

[The prepared statement of Mr. Steuerle follows:]

What Every Worker Needs to Know About an Unreformed Social Security System

Statement before the
Subcommittee on Social Security
Committee on Ways and Means
United States House of Representatives

July 29, 2014

C. Eugene Steuerle
Institute Fellow and Richard B. Fisher chair at the Urban Institute

Any opinions expressed herein are solely the author's and should not be attributed to any of the organizations with which he is associated.

Social Security reform is inevitable because of its imbalances. Still, today's workers almost certainly will get higher benefits than today's retirees. Even so, delayed reform is a threat to the ability of today's and tomorrow's workers to prepare better for their retirement.

In this testimony I would like to focus on the fairness, efficiency, and adequacy questions that arise almost no matter how much growth Congress maintains in Social Security. In particular, I wish to address three troubling aspects of an otherwise very successful program:

- **Unequal Justice:** ways that Social Security fails to provide equal justice under the law, at times allocating benefits and discriminating in ways that would be considered illegal in the private sector;

- **Middle Age Retirement:** the consequences for today's workers and older retirees of lower economic growth, employment, personal income, and resources for those who really are old when Social Security, the flagship of our social welfare system, devotes ever larger shares of its resources to middle-age rather than old age; and

- **The Impact on the Young**: how Social Security's (and Medicare's) design imposes ever lower returns on each generation of retirees and how each year that reform is delayed adds to the burden older generations pass onto younger ones.

In a newly published book, *Dead Men Ruling,* I argue that many of our budgetary and economic problems arise from continual efforts to fight yesterday's battles. Let me apply that lesson to the evolution of our old age programs. After three quarters of a century of continual growth as a share of GDP, these programs have largely succeeded in their core mission of providing basic protections to most, though not all, older people. But they have done this at times in a haphazard, unfair, and inefficient way—issues that have been dodged in most Social Security debates and reforms. More problematic, their eternal automatic growth—for example, lifetime Social Security and Medicare benefits for new retirees today are more than three times what they were for those retiring in 1960—is not conditioned on any assessment of the needs of the public or of the elderly themselves. Not child poverty. Not the crimping of education programs. Not ways that the youth of today are falling behind. Not growth in the incidence of Alzheimer's or autism. Not the rise in the percent of the population that will be truly old, say, in the last five years of life. Not new opportunities to invest in different forms of technology or infrastructure.

I conclude that not only can Social Security's problems be fixed, they can be fixed in a way that provides greater flexibility to respond to new needs and opportunities and yet provides even stronger protection to the poor, the middle class, and the truly old. Moreover, these gains can be attained regardless of whether Congress enacts tax increases, benefit reductions, or both. And I remind you that one fix doesn't require either tax rate increases or annual benefit cuts: simply encouraging people to work longer so we reduce Social Security's increasingly negative impact on our employment rate and on the revenues workers provide.

Unequal Justice

Social Security redistributes in many ways as a result of its broad array of benefit features and of program changes that have occurred over the years. Only some are progressive. Others are regressive (box 1). And many fail to provide equal justice—that is, equal treatment of those similarly situated.

The following are among the most telling and unfair of these redistributions:[1]

- Working single parents (often abandoned mothers) are forced to pay for spousal and survivor benefits that others can and they cannot receive. If they haven't been married to any one individual for at least ten years, they often receive at least $100,000 fewer lifetime benefits that some spouses who don't work, pay fewer or no Social Security tax, and raise no children.

- Two-earner couples (e.g., two persons earning $40,000 a year each) can also receive more than $100,000 fewer benefits than one-earner couples (e.g., a couple with one earner at $80,000 a year) who have the same lifetime earnings and pay the same tax.

- A person who mistakenly divorces at nine years and eleven months likely will get more than a $100,000 fewer dollars of benefits than one who divorces at ten years and one month.

- A person who works 40 years for $30,000 will get tens of thousands of dollars fewer benefits than someone with the same lifetime earnings, but works 30 years at $40,000.

- Older men (and some women) begetting children receive unique access to tens of thousands of dollars of lifetime dependent benefits not available to most other parents.

---

[1] These redistributions are reviewed in Steuerle, Smith, and Quakenbush (2013); Favreault, Sammartino, and Steuerle (2002); and Steuerle and Spiro (1999).

Box 1

Progressive and Regressive Aspects of Social Security's Redistribution

1. *Pay as You Go Financing* redistributes from younger to older generations. Benefits are based on earnings history rather than contributions, and each succeeding cohort of workers has faced higher average lifetime OASDI tax rates than the cohorts already retired.

2. *The Progressive Benefit Formula* redistributes from high lifetime earners to low earners. The first dollar of indexed earnings contributes more to one's final benefit than the last dollar.

3. *Forced annuitization*—the requirement to claim benefits as a perpetual stream of payments on or after reaching the eligibility age rather than as a lump sum—redistributes from those with shorter lifespans to those with longer lifespans because those who live longer in retirement get benefits for more years.

4. *Disability insurance* redistributes from the healthy to the less healthy.

5. *Spousal, and survivor benefits* redistribute to married couples (and in the largest amounts to the spouses of the richest workers) from never-married households and those with marriages too short to qualify for such auxiliary benefits. No additional tax is paid to receive those benefits.

6. *Benefits to dependents* of the elderly, disabled, or deceased redistribute from smaller families to larger families and from most families to those with older parents.

7. *The crediting only a limited number of years of contributions* toward workers' benefits effectively redistributes from longer-term workers (those who work more than 35 years) to shorter-term workers (Steuerle and Spiro 1999).

One can remove many of these inequities while at the same time maintaining or increasing the progressivity of the overall system. For instance, a good minimum benefit could provide a higher benefit to those with greater needs, while a bump up in benefits in later years could deal with the additional threats facing the very old.

Middle Age Retirement

People today retire for about a decade longer than they did when Social Security first started paying benefits (figure 1).

Some argue that we needed and continue to need to provide ever more years of retirement support to make the system more progressive. This is like arguing that money should be thrown off the highest roof in a city to solve poverty. Actually, increasing years in retirement has not been a progressive policy at all. Though lower income individuals on average have higher mortality rates, they are also more likely to claim disability benefits, and those benefits are not reduced when the retirement ages increases. In the end, the biggest winners of this multi-decade policy have been people like the witnesses at this table and members of Congress, who, as a result of the failure to adjust more than a tiny bit over the past three quarters of a century, now get at least $300,000 or more in additional lifetime benefits. The person who dies before age 62 gets nothing more in benefits but pays higher taxes while alive.

But there are other consequences when people work for many fewer years. When baby boomers and women were entering the workforce, the effect on the economy as a whole was hidden. But now that the baby boomers are retiring and women's employment rate has reached a stage of maturity, the Congressional Budget Office and others predict a decline the nation's overall employment rate and a corresponding decline in the rate of growth of GDP and of personal income (CBO 2014). Among other directly related consequences, people now save for many fewer years and withdraw their savings for many more.

For individuals such early retirement creates a real threat for when old age really does hit (box 2). What looks adequate when in good health in the early 60s may be quite inadequate when in one's 80s or 90s. The average couple will see at least one spouse living to about age 90, and many individuals will live years beyond 90.

Projections show that within a couple of decades close to one-third of the adult population will be on Social Security. That number excludes other adults who rely on other government assistance. The retirement of so many people, in turn, this has a significant effect on revenues. For instance, our analysis at the Urban Institute shows that the biggest effect on the U.S. budget from early retirement is not on Social Security but on income tax revenues (Butrica, Smith, and Steuerle 2006).

Social Security is a flagship of the nation's social welfare system. It sets norms and expectations that reverberate everywhere. Yet in past Social Security reforms, these effects on GDP, employment, and income tax revenues were barely taken into consideration, if at all.

Any future Social Security reform must deal with this issue. There is no financial system, public or private, that can provide so many years of retirement for such a large share of the population without severe repercussions both for individuals' well-being in retirement and for the workers upon whose backs the system depends for support.

Box 2

What Does "Aging" Mean?

The term "aging" is constantly misused. A society does not get older when its people live longer even if the average chronological age rises. Only a decline in the birth rate leads to an increase in the share of the population, say, in their last one-seventh or last ten years of life. Social Security has never really adjusted its earliest retirement age upward for longer lives (it only adjusted the earliest retirement age downward). Yet it tells people they are "old"—qualify for "old age" insurance—when they hit age 62 even though today that means an average remaining life expectancy of about 20 years and even higher for the healthy and future retirees.

As baby boomers retire, they will indeed add to the numbers of those who would be considered old by some appropriate measure, such as those in the last ten or fifteen years of life. But the very large growth in percent of the population eligible for "old age" insurance in the century from 1935 when the Social Security system was first adopted, to 2035, when the baby boomers will be "old" by Social Security's definition, has nothing to do with any real "aging" of the population. In 1935, about 6 percent of the population was age 65 or older. By 2035, 23 percent of Americans will be at least age 62, the earliest age one can collect benefits under current law.

The Impact on the Young

For many years now, I have led a team of researchers at the Urban Institute to calculate lifetime benefits and taxes for both Social Security and Medicare.[2] These numbers are shown below (figure 2). Three points stand out:

First, lifetime Social Security and Medicare benefits in 2010 already approximated $1 million for a couple with average incomes throughout their working lives, in no small part due to numbers of years of benefits. And those benefits currently grow on average by about $18,000 a year, so that by 2030 a couple can expect to receive an extra $1/3 million relative to one retiring in 2010. Outside of interest on the debt, Congress and Administration have decided indirectly that all the growth in government spending in the next couple of decades will go for retirement and health programs, mainly Social Security and Medicare.

Second, the rate of return on contributions falls continually for each generation. For Social Security, future generations will get back less than they put in, though, there is a simple

[2] For background on these calculations, see http://www.urban.org/socialsecurity/lifetimebenefits.cfm

reason for this. Every expansion of our system of support for the elderly has required older workers to contribute at a higher tax rate only for some or no years of their working lives, whereas the youngest must contribute at that higher rate for their entire working lives.

One caution. Calculations of lifetime benefits and taxes for Social Security and Medicare often lead to debates over how much people are "owed" based on what they "paid in" to Social Security and Medicare. But in fact, Social Security and Medicare are transfer systems from young to old, and always have been, with transferors and transferees. We may feel that because we transferred money to our parents, our kids, in turn, owe us. But we must also consider how much they can afford, and government should spend on this task, relative to other current needs for themselves and their children. Imagine a one-family society, where three kids support their parents, but then those three kids have only two children of their own. What the second generation of three kids gave the first generation of parents informs us only slightly about what the third generation of two children can do or should be required to do to support the second generation, especially given all the other changes also taking place in society.

The calculation of benefits and taxes do allow us to make a judgment as to whether the allocation of future burdens meets standards of fairness and efficiency across generations.

Third, though by many measures many new retirees will now get back less in lifetime Social Security benefits than they contributed in lifetime taxes to Social Security, plus some modest rate of return (in figure 2, calculated at 2 percent real), the law still provides substantial windfalls to older workers by shifting substantial Medicare costs to the young. However, even there, the same long-term dynamic must play out in dealing with imbalances; that is, the more windfalls given to middle-age and older workers as they retire, the more that must be paid in the form of fewer benefits or higher taxes by younger workers and their children.

Every year of delay effectively involves a decision that older generations will not pay the cost through a lower rate of benefit growth or a higher tax rate. But the young—those already scheduled to get less—will bear an ever higher share of the cost of getting this system back into order.

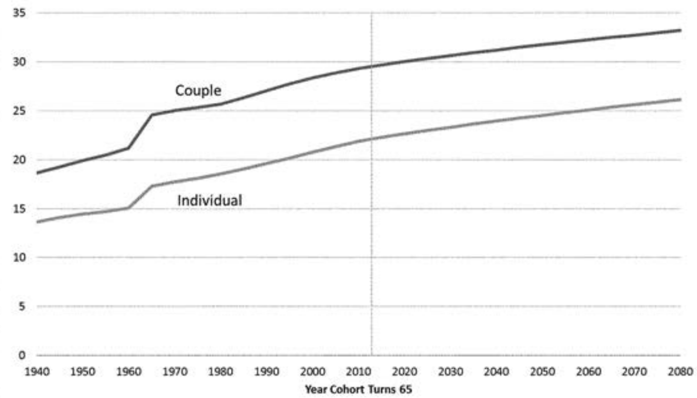
This creates some interesting distributional consequences as well. Earlier I presented many of the progressive and regressive features of Social Security, features that in combination make the old age part of the system barely progressive if at all. It turns out that the shift of burdens to future generations has its largest impact on groups, like blacks, who historically had larger families, and to more recently immigrated citizens, like Hispanics. That is, these groups have comprised smaller shares of the higher return, windfall generations, and will comprise a larger share of the lower-return populations of the future (Steuerle, Smith, and Quakenbush 2013).

Summary

In summary, each year of delay in reforming Social Security:

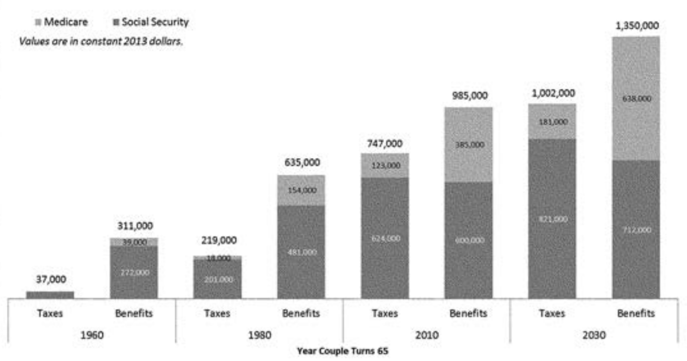
- Continues a system of unequal justice for single heads of household, two-earner couples, and others;
- Misleads yet another cohort to believe that what looks to be adequate for retirement at age 62 or 65 will be sufficient by age 85, 90, or 95;
- Decreases the share of old age supports given to the truly old rather than those who are middle aged;
- Adds to the pressure for government to invest ever less in education, the young, and the basic functions of government;
- Adds to the nonemployment rate in the economy, with further repercussions for personal income, income tax revenues, the benefits that Social Security and Medicare can pay at any given tax rate, and the sustainability of government policy more generally; and
- Increases the burden that is shifted to the young and to people of color who will form a more preponderant part of future populations.

Figure 1. Expected Years of Retirement Benefits, Earliest Retirement Age
Couple (at least one partner living) and Individuals



Notes: Calculations based on mortality data from the 2013 OASDI Trustees' Report. Calculations for a couple assume that at least one partner is still living. ERA was set at 62 for women in 1956 and men in 1961. C. E. Steuerle and C. Quakenbush, Urban Institute 2013.

Figure 2. Lifetime Social Security and Medicare Taxes and Benefits at Age 65
Married Couple Earning the Average Wage ($44,800 each in 2013 dollars)



Source: C. E. Steuerle and C. Quakenbush, Urban Institute, 2013. Based on earlier work with Adam Carasso and Stephanie Rennane. Calculations based on data from Social Security and CMS trustees reports and supplements. Totals are expected present values at age 65 and assume a constant 2 percent real discount rate.

References

Butrica, Barbara A., Karen E. Smith, and C. Eugene Steuerle. 2006. "Working for a Good Retirement." *Retirement Project Discussion Paper* 06-03. Washington, DC: The Urban Institute.

Congressional Budget Office (CBO). 2014. *The Budget and Economic Outlook: 2014 to 2024*. Pub. No. 4869. Washington, DC: CBO.

Favreault, Melissa M., Frank J. Sammartino, and C. Eugene Steuerle. 2002. "Social Security Benefits for Spouses and Survivors: Options for Change." In *Social Security and the Family: Addressing Unmet Needs in an Underfunded System*, edited by Melissa M. Favreault, Frank J. Sammartino, and C. Eugene Steuerle (177-228). Washington, DC: Urban Institute Press.

Steuerle, C. Eugene, and Caleb Quakenbush. 2013. "Social Security and Medicare Taxes and Benefits over a Lifetime: 2013 Update" Washington, DC: The Urban Institute.

Steuerle, C. Eugene, and Christopher Spiro. 1999. "Should the Social Security Benefit Formula Include Every Year Worked?" *Straight Talk on Social Security* 13. Washington, DC: The Urban Institute.

Steuerle, C. Eugene, Karen E. Smith, and Caleb Quakenbush. 2013. "Has Social Security Redistributed to Whites from People of Color?" *Program on Retirement Policy Brief* 38. Washington, DC: The Urban Institute.

Chairman JOHNSON. Thank you, sir.

Ms. Entmacher, welcome. Please proceed.

STATEMENT OF JOAN ENTMACHER, VICE PRESIDENT FOR FAMILY ECONOMIC SECURITY, NATIONAL WOMEN'S LAW CENTER

Ms. ENTMACHER. Thank you Chairman Johnson, Ranking Member Becerra, and Members of the Subcommittee. Thank you for giving me this opportunity to testify today on behalf of the National Women's Law Center. For a large majority of Americans, Social Security is not only their major source of retirement income but the most secure and predictable. Benefits are modest but incredibly important. The average Social Security benefit for women 65 and older is about $13,000 a year. It is about $17,000 for older men. As Mr. Becerra said, without Social Security, half of women 65 and older would be poor.

And for two thirds of seniors, Social Security provides at least half of their retirement income. It is virtually the only source of income for over one third of seniors. These data are from the Current Population Survey. While Mr. Schieber has criticized this survey for not fully reflecting income distributions from retirement accounts, other surveys confirm that most seniors cannot expect much support from their retirement savings. The Federal Reserve Board Survey of Consumer Finance shows that half of households between ages 65 and 74 had no assets in retirement accounts.

Two thirds of those over 75 had no retirement assets. Younger generations are not doing much better. 45 percent of all working age families and 40 percent of families near retirement have nothing in retirement accounts. These data show that today's workers will also be heavily reliant on Social Security. They cannot afford benefit cuts, whether it is part of privatization plans that would replace secure benefits with risky private accounts, a lower and less accurate cost of living adjustment, or further increases in the retirement age.

We do need to increase retirement savings for average Americans, and the surest and most effective way to do it is to protect and enhance Social Security. Social Security is already virtually universal and provides lifelong benefits that are adjusted for inflation. In addition, it provides life and disability insurance for workers and their families, imposes few responsibilities on employers, and is highly efficient.

There are several reforms that would improve the adequacy and equity of Social Security, as Mr. Steuerle has testified, and which I mentioned in my written testimony. What I want to emphasize is that they are affordable. The report of the Social Security trustees shows that there is a long term shortfall. But Social Security is fundamentally sound. On a combined basis, it can pay promised benefits in full until 2033, and 77 percent of benefits after that. It would be irresponsible for Congress to wait until the trust funds are within six months of exhaustion, as it did in 1983 before taking action to strengthen Social Security. But two decades provides time for Congress to enact reforms that raise revenue and improve benefits.

Polls show that a large majority of Americans favor this approach. However, there are two issues that require immediate attention. Congress should prevent cuts to disability benefits in 2016 and reassure all workers that if they are seriously injured and can no longer work, that Social Security will be there for them. It can do this through the simple and routine step of reallocating payroll taxes to rebalance Social Security's two trust funds. Congress has done this 11 times in the past and in both directions.

Second, Congress needs to restore adequate funding to the Social Security Administration. Cuts in services are already jeopardizing timely access to the benefits Americans have earned, and fall especially hard on the most vulnerable people. Moreover, at least in part for budgetary reasons, Social Security plans to rely even more on conducting its work through online interactions. But this strategy has its limits, even for those who are internet savvy. The Social Security website touts how quick and easy it is to sign up for benefits online.

But deciding when to take benefits is a major financial decision and applicants should be able to consult with well-trained staff to get help understanding their options and their consequences. In addition, access to and ability to use online services is more limited among the population of elderly people and people with disabilities that Social Security serves. And even people that have no problem applying for benefits online at 66 may not be able at age 90 to go online to correct an erroneous deduction for Medicare premiums.

In announcing this hearing, Chairman Johnson, you said Americans want, need, and deserve a Social Security program they can count on and understand. I could not agree more and I thank you again for inviting me.

[The prepared statement of Ms. Entmacher follows:]

NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

Committee on Ways and Means, Subcommittee on Social Security
What Workers Need to Know About Social Security as They Plan for Retirement
July 29, 2014

Testimony of Joan Entmacher
Vice President for Family Economic Security, National Women's Law Center

Chairman Johnson, Ranking Member Becerra, and members of the Subcommittee, thank you for giving me the opportunity to testify today on behalf of the National Women's Law Center.

In announcing this hearing, Chairman Johnson stated, "Americans want, need, and deserve a Social Security program they can count on and understand." That is exactly right.

For a large majority of Americans, Social Security is their major source of retirement income—and the most secure and predictable. Defined benefit pensions are disappearing, and more than half of all seniors have no savings in retirement accounts. Social Security is what Americans count on to provide retirement income for life that is adjusted for inflation.

Through wars and recessions, Social Security insurance payments have been made on time and in full to support workers and their families when workers retire, become disabled, or die. That's why 84 percent of Americans agree that they don't mind paying Social Security taxes.[1]

My testimony will discuss the importance of Social Security to Americans' retirement security; the need to enhance, not cut, Social Security benefits; how to strengthen Social Security's finances to ensure that all benefits, including disability benefits, can be paid in full; and, finally, the need to provide the Social Security Administration adequate resources to serve the millions of Americans who depend on Social Security.

Social Security is the basis of retirement security for most Americans.

Last month, over 58 million Americans received income from Social Security.[2] Retired workers and their families make up the largest group, over 70 percent; 19 percent are people with disabilities and their families; and a little over 10 percent are surviving spouses and children.

Benefits are modest. The average Social Security benefit for women 65 and older is about $13,100 per year; about $17,200 for men 65 and older.[3] About 40 percent of female retirees receive worker benefits that would not provide a poverty-level income, compared to less than 20 percent of male retirees.[4]

Yet these modest payments are critically important. Social Security lifts 22.2 Americans out of poverty, including 15.3 seniors (65 and older) and over 1 million children.[5] Over 870,000 Texans and nearly 1.3 million Californians are lifted out of poverty by Social Security.[6] It's especially important to women; without Social Security, half of all women 65 and older, and two-thirds of women 65 and older living alone, would be poor.[7]

For most Americans, Social Security is the main source of retirement income.[8] For two-thirds of seniors in households that receive it, Social Security provides at least half of their retirement income. It's virtually the only source of income (90 percent or more) for over one-third (36 percent) of seniors. Only for seniors in the top 20 percent of the income spectrum is Social Security not the largest source of retirement income; their earnings are. But as seniors age, other sources of income shrink or disappear as they stop working and exhaust their savings. Thus, reliance on Social Security increases with age: nearly half (47 percent) of seniors 80 and older receive virtually all of their income from Social Security.

The data above are based on the Census Bureau's Current Population Survey (CPS). Some have criticized this survey for not fully reflecting distributions that seniors receive from Individual Retirement Accounts and 401(k)s.[9] However, other surveys that measure these distributions confirm that most seniors are receiving limited support from their retirement savings. It is true that, overall, there are trillions of dollars in retirement accounts. But retirement savings are unequally distributed; much of that wealth belongs to a small percentage of wealthy individuals.[10]

An analysis of data from the Survey on Income and Program Participation (SIPP) found that only about one in five families headed by seniors received any money from retirement accounts in 2009, and among those did, typical distributions were modest. [11] Among the 19 percent that received any distributions, the median amount for the year was $3,300.

The Federal Reserve Board's Survey of Consumer Finance—a survey that measures assets in detail—also shows that retirement accounts are a limited source of retirement security for most retirees.[12] In 2010, slightly less than half (49 percent) of households between ages 65 and 74 had any assets in retirement accounts; among households over 75, slightly less than one-third (32.8 percent) had any assets in retirement accounts. For the minority who had retirement accounts, the median holding was $100,000 for those ages 65 to 74, $54,000 for those over age 75. Put another way, three-quarters of families ages 65 to 74 have less than $100,000 in retirement accounts; nearly 85 percent of families 75 and older have less than $54,000.

Poverty among seniors is more extensive than many people realize, because it is underestimated by the official poverty measure. A more accurate—and disturbing—measure of poverty among seniors is provided by the Census Bureau's Supplemental Poverty Measure (SPM). The SPM takes account of certain out-of-pocket expenditures, including health care and work-related expenses such as child care, and noncash and after-tax resources received by a household, such as Supplemental Nutrition Assistance Program (SNAP) benefits and the Earned Income Tax Credit.[13] Under the SPM, the poverty rate for people 65 and older jumps from 9.1 percent under the official measure to 14.8 percent – an increase of 63 percent.[14]

The main reason for the increase in poverty among seniors under the SPM is that even with Medicare, out-of-pocket medical expenses consume a large share of seniors' budgets – 14 percent, nearly three times the share of health spending of non-Medicare households.[15] That means that seniors don't have much left to pay for food, housing, utilities, transportation and other basics.

These statistics demonstrate what most Americans already understand: that's why nine out of ten agree that "Social Security benefits now are more important than ever to ensure that retirees have a dependable income."[16]

Social Security should be protected and enhanced—not cut—to improve Americans' retirement security.

Social Security will continue to be vital for future retirees. Defined benefit pensions that provide income for life are disappearing; only 19 percent of private sector workers have access to a defined benefit pension, according to the Bureau of Labor Statistics.[17] And the prospects for retirement savings accounts filling the gap when today's workers retire are not encouraging. Data from the Federal Reserve Board's Survey of Consumer Finance show that 45 percent of all working-age families (ages 25 to 64), and 40 percent of families near retirement (ages 55 to 64), have no retirement savings.[18] When all families are considered—including those without retirement accounts—the median retirement account balance for all working-age families is $3,000; for all near-retirement families, the median balance is $12,000.[19]

These data show that today's workers also will rely on Social Security to provide a modest base of income they can count on for life when they retire. They can't afford cuts, whether as part of privatization plans that would replace secure benefits with risky private accounts, a lower and less accurate Cost of Living Adjustment that would hit the oldest beneficiaries—mostly women—especially hard,[20] or further increases in the retirement age, which are simply across-the-board benefit cuts. A one-year increase in the retirement age cuts benefits by about seven percent, regardless of the age at which benefits are claimed.[21]

Proposals to cut benefits are especially troubling because Social Security benefits are already shrinking under current law. Changes enacted in 1983 and 1993–primarily the increase in the retirement age which is only partially phased in–will continue to erode benefits. By 2050, benefits will be 24 percent lower than they would have been without these cuts.[22]

The nation's retirement savings and pension systems are failing millions of Americans; most of the tax benefits for retirement savings go to those who need them least.[23] They should be reformed. But if the goal is to increase retirement security for average Americans, the surest and most effective way to do it is to protect and enhance Social Security. Social Security is already virtually universal. It provides secure benefits that can't be outlived and are protected against inflation and the ups and downs of the market. In addition, it provides life and disability insurance for workers and their families, imposes few responsibilities on employers, and is highly efficient.

Since Social Security was created, Congress has built on its strong foundation: expanding coverage, adding disability benefits, creating and expanding eligibility for divorced spouses, making cost-of-living adjustments automatic, increasing benefits for widowed spouses.[24] These improvements have made a major difference in people's lives: indeed, a careful study found that all of the reduction in elderly poverty between 1967 and 2000 can be attributed to improvements in Social Security benefits, not to workers' labor market experience.[25]

Congress can and should continue the work of improving Social Security benefits to further reduce poverty and increase economic security. Experts and advocates have proposed reforms[26] and Members of Congress have introduced a variety of proposals to enhance benefits, including using the Consumer Price Index for the Elderly, which takes account of elders' higher health care spending, to determine the annual COLA; adjusting the formula to increase benefits overall; reforming the Special Minimum Benefit to improve benefits for workers with low lifetime earnings; giving credit for lost or reduced earnings due to caregiving; restoring student benefits; and reforming the benefit for surviving spouses to provide more adequate and equitable benefits for the survivors of low-and moderate-income couples. These are the kinds of reforms that Congress should consider.

Protecting and improving Social Security is affordable.

The 2014 Report of the Social Security Trustees shows that although Social Security faces a long-term shortfall, it is fundamentally sound—and with modest adjustments, can be strengthened and improved for decades to come. The Trustees project that on a combined basis, the program's dedicated revenues and the $2.76 trillion reserves in its two Trust Funds—the Old-Age and Survivors Insurance (OASI) Trust Fund and the Disability Insurance (DI) Trust Fund—can pay all promised benefits in full until 2033.[27] After that, Social Security won't be broke—its continuing revenues will cover 77 percent of promised benefits. Such a reduction in vital benefits would be unacceptable, and the long-term shortfall should be addressed. But first Congress must address a more immediate issue.

The Trustees project that the DI Trust Fund will be exhausted in 2016, and income to the DI program will only cover 81 percent of benefits. The depletion of the DI Trust Fund is the result of predictable demographic trends, not abuse of the program; in fact, nearly 20 years ago, the Trustees projected that the DI Trust Fund would run short in 2016.[28] The increase in the number of DI recipients is largely the result of the growth of the working-age population; baby boomers moving into more disability-prone years; the increase in women's labor force participation, which brought their participation in the DI program close to that of men; and the increase in Social Security's full retirement age, which kept workers with disabilities between ages 65 and 66 in the DI program, rather than the retirement program.[29]

If Congress fails to act by 2016, insurance payments to disabled workers and their families would be cut by one-fifth. But there is a simple step that Congress can take to prevent these devastating cuts and reassure all workers that if they are seriously injured in a car accident or suffer a devastating stroke and can no longer work, that Social Security will be there for them and their families. It can do this by reallocating payroll tax revenue to rebalance Social Security's two Trust Funds. Currently, of the 6.2 percent of wages that employees pay for Social Security, 5.3 percent goes into the OASI Trust Fund and 0.9 percent goes into the DI Trust Fund. Changing the allocation of the payroll tax to rebalance the Trust Funds is a step Congress has taken 11 times in the past, and in both directions: shifting from OASI to DI six times and from DI to OASI five times.[30]

Beyond that, Congress should consider reforms to strengthen the financing of the combined Social Security program and improve the adequacy of benefits. Waiting until the Trust Funds are within six months of exhaustion, as was the case when the 1983 reforms were enacted, would be irresponsible. But the Trustees Report shows that Congress has the time to consider any changes carefully—and, in particular, to consider how changes would impact the millions of Americans who depend on Social Security.

Strengthening Social Security's finances is important to assure workers and retirees that they will get the benefits they have earned and are counting on for themselves and their families. But making Social Security's books balance over a particular period is not an end in itself. It's possible to restore solvency simply by cutting benefits deeply enough—but that is no way to provide Americans with the Social Security program they "want, need, and deserve," in the words of Chairman Johnson.

Social Security is affordable. The Trustees Report shows that as the baby boom generation retires, the costs of Social Security will rise as a percentage of the economy from about 5.0 percent of GDP in 2012 to about 6.2 percent in 2035 when all baby boomers have retired, then level off. To put an increase in spending of 1.2 percentage points of GDP into perspective: between 1950 and 1975, when the baby boomers were children, spending on public education increased by 2.8 percentage points of GDP, with little advance warning.[31] In contrast, Social Security's actuaries have seen the retirement of the baby boom generation coming for a long time—and Congress has taken steps to prepare for it.

What the actuaries and policy makers did not foresee in 1983, when they enacted a plan they projected would secure solvency for Social Security for 75 years, was slow and unequal wage growth. These trends not only have strained average working families; they have eroded Social Security's payroll tax base and account for a substantial share of the long-term shortfall.[32] So it is particularly appropriate to strengthen Social Security by requiring high earners to pay their fair share, rather than by cutting benefits for working Americans.

That is the approach most Americans favor. A national survey by the National Academy of Social Insurance found that seven out of ten Americans, across generations and income groups, preferred a package of changes that would raise revenue by gradually eliminating the cap on taxable earnings and gradually increasing the payroll tax rate, and that would increase—not cut—benefits.[33]

There are various options for increasing revenues for Social Security. A report by Social Security's Office of the Chief Actuary presents several.[34] Bills introduced by several Members of Congress would improve benefits, raise revenue, and extend the solvency of the Trust Funds.[35] And immigration reform and other policies that would expand the economy, create jobs, and boost wages for average workers would also improve the solvency of Social Security.

The Social Security Administration needs adequate funding to ensure that Americans receive the benefits they have earned in full and on time.

The Social Security Administration (SSA) is responsible for seeing that Americans receive the benefits they have earned. It has a proud history of delivering world-class service—but its ability to continue to do so is in serious jeopardy.

Despite the substantial and continuing increase in Social Security's caseload, Congress has reduced funding for SSA over the last few years—and the services Americans need and have paid for through their contributions to Social Security are suffering. Field offices have been closed and hours cut back; staffing and training reduced; phone lines are overloaded; wait times for disability determinations and appeals are unacceptable; and public education efforts have been dramatically reduced. [36]

In response to pressure from the public and some Members of Congress, some cutbacks have been reversed, at least in part. In 2011, SSA stopped mailing the annual benefit statements that explain what workers can expect to get from Social Security for budget reasons; it recently announced that it would resume mailing statements, but only at five-year intervals and only to workers who have not signed up to view their statements online.[37] It also recently reversed a decision that Social Security offices would no longer issue benefit verification letters to people who came to their offices.[38] These developments are welcome—but fall far short of what is needed.

Increasingly, SSA has been relying on conducting its work through online interactions, and it plans to continue in that direction.[39] But while it is important to improve online services, this strategy has its limits, even for people who are comfortable getting information and conducting business online. For example, for several years, the Social Security website has touted how quick and easy it is to sign up for benefits online. And it is a convenient option. But deciding when to claim benefits—and what benefits to claim, especially for those who are entitled to benefits both as workers and as spouses or widow(ers)—is not a simple decision. It can dramatically affect the payments that workers, and a surviving spouse if they are married, will receive for life.[40] Applicants should be able to consult with well-trained staff to get help understanding the consequences of different choices.

In addition, access to and ability to use online services is more limited among the population of elderly people and people with disabilities that Social Security serves. The most vulnerable beneficiaries are likely to have the most difficulty. And, though future retirees will, in general, have more experience conducting their business online than current retirees, they'll need to continue to maintain internet access and keep up with changing technology to be able to continue to conduct their business online. The ability to apply for benefits online at 66 is no guarantee that at 90, they'll be able to go online to correct an erroneous deduction for Medicare premiums.

It is SSA's responsibility to ensure that all Americans—especially those who are poor or vulnerable—have access to the benefits they deserve. And it is Congress' responsibility to ensure that they have the resources to do the job.

Thank you for giving me this opportunity to testify.

---

[1]Jasmine Tucker, Virginia Reno, and Thomas Bethel, National Academy of Social Insurance (NASI), *Strengthening Social Security: What do Americans Want?* (2013), http://www.nasi.org/sites/default/files/research/What_Do_Americans_Want.pdf.

[2] All data in this paragraph are from Social Security Administration (SSA), *Monthly Statistical Snapshot, June 2014*, http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/2014-05.html.

[3]SSA, *Annual Statistical Supplement to the Social Security Bulletin, 2013* (Feb. 2014), Table 5.A16, http://www.ssa.gov/policy/docs/statcomps/supplement/2013/5a.html. The average monthly benefit for all female beneficiaries 65 and older was $1,090.82, or about $13,090 per year as of December 2012, compared to $1,431.23 per month, or $17,175 per year for all male beneficiaries 65 and older.

[4] National Women's Law Center (NWLC) calculations based on SSA, Annual Statistical Supplement 2013, *supra* note 3, Table 5.B9, http://www.ssa.gov/policy/docs/statcomps/supplement/2013/5b.html, and Census Bureau official poverty thresholds (about $918 per month in 2012 for a single elderly individual).

[5]Paul N. Van de Water, Arloc Sherman, and Kathy Ruffing, Center on Budget and Policy Priorities (CBPP), *Social Security Keeps 22 Million Americans Out Of Poverty: A State-By-State Analysis* (Oct. 25, 2013), http://www.cbpp.org/cms/index.cfm?fa=view&id=4037.

[6] *Id.*

[7] NWLC, Women and Social Security (Apr. 2014), http://www.nwlc.org/resource/women-and-social-security.

[8] All data in this paragraph are from SSA,, Income of the Population 55 or Older, 2012 (Apr. 2014), http://www.ssa.gov/policy/docs/statcomps/income_pop55/.

[9] See, e.g., Sylvester Scheiber and Andrew Biggs, "Retirees Aren't Headed for the Poor House," *Wall St. Journal* (Jan. 23, 2014), http://online.wsj.com/news/articles/SB10001424052702304603704579329012635470796.

[10]Monique Morrissey and Natalie Sabadish, Economic Policy Institute (EPI), *Retirement Inequality Chartbook: How the 401(k) revolution created a few big winners and many losers* at 27 (Sept. 2013), http://www.epi.org/publication/retirement-inequality-chartbook/

[11]All data in this paragraph are from Howard M. Iams and Patrick J. Purcell, "The Impact of Retirement Account Distributions on Measures of Family Income," *Social Security Bulletin*, Vol. 73 No. 2 (May 2013), http://www.ssa.gov/policy/docs/ssb/v73n2/v73n2p77.pdf .

[12] All data in this paragraph are from Jesse Bricker, et. al., Federal Reserve Board, "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, Vol. 98, No. 2, Table 6.B. (June 2012) , http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf.

[13] Kathleen Short, U.S. Census Bureau, *The Research Supplemental Poverty Measure: 2012* (Nov. 2013), http://www.census.gov/prod/2013pubs/p60-247.pdf.

[14] *Id.* NWLC calculation of percentage increase based on Table 1.

[15] Juliette Cubanski, Christina Swoope, Anthony Damico, and Tricia Neuman, Kaiser Family Foundation, *Health Care on a Budget: The Financial Burden of Health Spending by Medicare Households* (Jan. 2014), http://kff.org/medicare/issue-brief/health-care-on-a-budget-the-financial-burden-of-health-spending-by-medicare-households/.

[16] *Strengthening Social Security: What do Americans Want?, supra* note 1. http://www.nasi.org/sites/default/files/research/What_Do_Americans_Want.pdf.

[17]Bureau of Labor Statistics, *Employee Benefits Survey, Retirement Benefits: Access, Participation and Take-Up Rates,* Table 2 (Mar. 2013), http://www.bls.gov/ncs/ebs/benefits/2013/ownership/private/table02a.pdf.

[18] Nari Rhee, National Institute on Retirement Security, *The Retirement Savings Crisis: Is It Worse Than We Think* (June 2013), http://www.ebri.org/pdf/briefspdf/EBRI_IB_397_Mar14.RCS.pdf.

[19] *Id.*

[20] Joan Entmacher and Katherine Gallagher Robbins, NWLC, *Obama Plan Fails to Adequately Protect Long-Term Social Security Beneficiaries from Chained CPI* (Apr. 2013), http://www.nwlc.org/sites/default/files/pdfs/chainedcpipresidentobamabumpup.pdf, and *Cutting the Social Security COLA by Changing the Way Inflation Is Calculated Would Especially Hurt Women* (June 2011), http://www.nwlc.org/resource/cutting-social-security-cola-changing-way-inflation-calculated-would-especially-hurt-

women.
[21] Kathy A. Ruffing & Paul N. Van de Water, CBPP, *Social Security Benefits Are Modest: Policy Makers Have Only Limited Room to Reduce Benefits Without Causing Hardship* (Jan. 2011), http://www.cbpp.org/files/1-11-11socsec.pdf.
[22] Virginia Reno, NASI, *What's Next for Social Security* (Oct. 2013), http://www.nasi.org/sites/default/files/research/Whats_Next_for_Social_Security_Oct2013.pdf. The other reductions are from taxing a growing share of Social Security benefits and delaying the COLA from July to January.

[23] Chuck Marr, Nathaniel Frentz, and Chye-Ching Huang, CBPP, *Retirement Tax Incentives Are Ripe for Reform: Current Incentives Are Expensive, Inefficient, and Inequitable* (Dec. 2013), http://www.cbpp.org/cms/?fa=view&id=4063.

[24] *See* SSA, *Social Security History*, http://www.ssa.gov/history/.
[25] Gary Engelhardt and Jonathan Gruber, National Bureau of Economic Research, Social Security and the Evolution of Elderly Poverty, NBER Working Paper 10466 (May 2004), http://www.nber.org/aginghealth/summer04/w10466.html.
[26] For a discussion of such proposals, *see, e.g.,* Joan Entmacher and Amy Matsui, *Addressing the Challenges Women Face in Retirement: Improving Social Security, Pensions, and SSI*, 46 John Marshall Law Review 749 (2013); Center for Community Change and Older Women's Economic Security Task Force of the National Council of Women's Organizations, *Expanding Social Security Benefits for Financially Vulnerable Populations* (October 2013), http://gvfrs.retirementsecurityvoices.org/wp-content/uploads/2013/10/cccfinalweb10_29.pdf; National Committee to Preserve Social Security and Medicare, National Organization for Women Foundation and Institute for Women's Policy Research, *Breaking the Social Security Glass Ceiling: A Proposal to Modernize Women's Benefits* (May 2012), http://www.ncpssmfoundation.org/Portals/0/embargo_breaking_ss_glass_ceiling.pdf; Commission to Modernize Social Security, *Plan for a New Future: The Impact of Social Security Reform on People of Color* (October 2011), http://www.insightcced.org/New_Future_Social_Security_Commission_Report_Final.pdf; Virginia Reno and Joni Lavery, NASI, *Fixing Social Security: Adequate Benefits, Adequate Financing* (October 2009), http://www.nasi.org/research/2009/fixing-social-security.
[27] Board of Trustees, *The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (2014), http://ssa.gov/oact/TR/2014/tr2014.pdf.
[28] Kathy Ruffing, CBPP, *How Much of the Growth in Disability Insurance Stems From Demographic Changes?* (Jan. 2014), http://www.cbpp.org/cms/index.cfm?fa=view&id=4080.,
[29] *Id*.
[30] Kathy Ruffing and Paul Van de Water, CBPP, *Congress Needs to Boost Disability Insurance Share of Payroll Tax by 2016, Traditional Step Would Avert Trust Fund Depletion, Benefit Cuts* (Jul. 2014), http://www.cbpp.org/cms/index.cfm?fa=view&id=4168
[31] *What's Next for Social Security*, *supra* note 22.
[32] Monique Morrissey, EPI, *Is an Aging Population—or Slow and Unequal Wage Growth—Our Biggest Challenge?* (July 25, 2014), http://www.epi.org/blog/aging-population-slow-unequal-wage-growth/ and

Dean Baker, Center for Economic and Policy Research, *The Impact of the Upward Redistribution of Wage Income on Social Security Solvency* (Feb. 3, 2013),

http://www.cepr.net/index.php/blogs/cepr-blog/the-impact-of-the-upward-redistribution-of-wage-income-on-social-security-solvency.
[33] *Strengthening Social Security: What Do Americans Want?,* supra note 1.
[34] Office of the Chief Actuary, SSA, *Summary of Provisions that Would Change the Social Security Program* (Oct. 2013), http://ssa.gov/oact/solvency/provisions/summary.pdf.
[35] Analyses by the Office of the Chief Actuary of various proposals by Members of Congress and others affecting Trust Fund Solvency are available here: http://ssa.gov/oact/solvency/index.html.
[36] *See* Strengthen Social Security Coalition, *Transition Report for the New Commissioner of Social Security: How to Ensure the World-Class Service the American People Deserve* (March 2013), http://www.strengthensocialsecurity.org/sites/default/files/Transition-Report-Web-FINAL.pdf.

[37] Mark Miller, Reuters, "Social Security to Resume Benefits Statement Mailings" (Apr. 19, 2014), http://www.reuters.com/article/2014/04/19/us-social-security-idUSBREA3I0GL20140419.
[38]Press Release, Social Security Administration, "Social Security Extends Access to Benefit Verification" (Jul. 17, 2014) http://www.ssa.gov/news/press/releases.html#!/post/7-2014-1
[39]SSA, *Agency Strategic Plan, 2014-2018* (2014), http://www.ssa.gov/agency/asp/materials/pdfs/plan-2014-2018.pdf.
[40] See NWLC, *Making the Most of Your Retirement Income: Social Security Worker Benefits* (May 2014), http://www.nwlc.org/resource/making-most-your-retirement-income-social-security-worker-benefits and NWLC, *Making the Most of Your Retirement Income: Social Security for Spouses, Divorced Spouses and Widow/Widowers* (May 2014), http://www.nwlc.org/resource/making-most-your-retirement-income-social-security-spouses-divorced-spouses-and-widowswidow.

Chairman JOHNSON. Thank you, ma'am.
Dr. Biggs, welcome.

STATEMENT OF ANDREW G. BIGGS, PH.D., RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE

Mr. BIGGS. Mr. Chairman, Congressman Becerra, and Members of the Subcommittee, thank you very much for inviting me to speak to you this morning. Much of what Americans need to know about Social Security and retirement is difficult to understand. Worse, much of what we think we know turns out not to be true. I would start by saying we should not panic and we should not pass far-reaching policy changes in haste. For instance, some have proposed substantial expansions to the Social Security program, with others arguing that these expansions should be financed by reducing tax advantages for private retirement savings plans such as IRAs and 401Ks.

This would be a mistake. The state of retirement security in the U.S. is substantially better than you probably think. While some studies claim that Americans face a so-called retirement crisis, these articles make a number of methodological choices that, in my view, are unsupportable. They overestimate what Americans need for retirement, understate what Americans have saved, and misunderstand how family structures and health costs affect the amount that one must save for retirement.

Other high quality research, including projections from the Social Security Administration itself, show a much more positive view of Americans' retirement saving. For instance, the Social Security Administration's office of retirement disability policy maintains what is surely the most comprehensive model of retirement income in the country. This model simulates on a person by person, year by year basis, employment, pension offerings and participation, individual investment decisions, and of course the accrual of Social Security benefits.

The SSA model estimates that Americans who were born in the depression had a total retirement income at age 67 equal to 109 percent of their career average earnings indexed for inflation. We cannot judge for ourselves whether that amount is enough. What is significant in this context, though, is SSA does not forecast a large decline in retirement going forward.

For instance, fast forward to the Generation X'ers, who are widely assumed to be dramatically under saving for retirement. The SSA model projects that the median Gen X'er will, at age 67, have a retirement income equal to 110 percent of his career average earnings adjusted for inflation. Retirement income will come from different sources, from defined contribution plans rather than defined benefit plans, but the SSA model, which I believe is the best in the business, does not produce numbers that scream out, retirement crisis.

But there is much more than we can do to provide individuals with better information about the retirement savings decisions they make. As my testimony details, the benefit estimates provided in the annual Social Security statement are expressed in a form, so called wage index dollars which are essentially meaningless from a retirement planning point of view and which almost no users of the statement could possibly understand.

The figures published by the SSA, which include both the benefit estimates published in the statement and replacement rate calculations, which Dr. Schieber discussed in his testimony, are potentially very useful in retirement planning, but are current calculated in a way that is simply incorrect. For instance, for a 30 year old worker today, the benefit estimate he will receive on his Social Security statement understates the true inflation index value of that future benefit by around 35 percent.

The agency needs to get these figures right. But the biggest problem with retirement security today is not America's savers. It is America's legislators, who literally for decades have ignored the need to fix Social Security's finances. According to Social Security's trustees, the programs 75 year deficit has risen by 66 percent since 2008. The Congressional Budget Office's figures are even worse. According to the CBO, Social Security's long term deficit has nearly quadrupled in the past 6 years. While the CBO once projected that Social Security would be solvent until mid-century, today both CBO and SSA project insolvency in the early 2030's.

In other words, the insolvency date for Social Security, according to CBO, at least, has moved forward by nearly two decades just in the past six years. How much worse does this problem have to get before both political parties step up to the plate and fix Social Security? Saving for retirement is our job as individuals. Fixing retirement programs is your job as members of Congress, and I respectfully suggest that we all get down to business. Thank you.

[The prepared statement of Mr. Biggs follows:]

American Enterprise Institute
for Public Policy Research

Statement before the United States House of Representatives
Committee on Ways and Means
Subcommittee on Social Security

"What Workers Need to Know About Social Security as They Plan for Their Retirement"

Andrew G. Biggs, Ph.D.

Resident Scholar

American Enterprise Institute

July 29, 2014

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Mr. Chairman and Members of the Subcommittee: Thank you for inviting me to address the question of "What Workers Need to Know About Social Security as They Plan for Their Retirement."

I am a resident scholar at the American Enterprise Institute. Previously I served as the Principal Deputy Commissioner of the Social Security Administration, the Deputy Commissioner for Policy, and the Associate Commissioner for Retirement Policy. In 2005 I worked on Social Security policy on the staff of the White House National Economic Council, and in 2001 I was on the staff of President Bush's Commission to Strengthen Social Security. The views I express today are my own.

Much of what Americans need to know about Social Security is difficult to understand. Worse, much of what we think we know about the program turns out not to be true.

- The state of retirement security in the U.S. is substantially better than you think. While some studies claim that Americans face a "retirement crisis," these studies make a number of methodological choices that, in my view, are unsupportable. Other high-quality research, including projections from the Social Security Administration, show a much more positive view of Americans' retirement saving.
- However, Americans nevertheless face retirement risks. Social Security's financial status has worsened considerably in recent years. The insolvency of Social Security is by far the largest risk facing American retirees, but Congress has done nothing to address the issue.
- Social Security is needlessly complex, such that even many Americans on the verge of retirement have little idea what they will receive prior to receiving their first check. Many near-retirees significantly overestimate what they will receive from Social Security, while many underestimate their benefits. These errors complicate decisions on how much to save and when to retire.
- Social Security benefits themselves can vary considerably, even for households with the same career earnings and contributions to the program. This variability, which derives from facets of the benefit formula, undermines the social protections provided to low earners. A simpler benefit formula could provide more reliable benefits at comparable cost.
- The Social Security Statement mailed to workers each year systematically understates the benefits individuals are likely to receive in retirement by expressing future dollar amounts in a form – "wage-indexed dollars" – that is neither meaningful for retirement planning nor commonly used outside of the agency. For a younger worker, the Statement underestimates the inflation-adjusted value of their future benefits by around 35 percent.
- Social Security does not do enough to encourage delayed retirement. A typical near-retiree who chooses to work an additional year receives less than 3 cents in extra benefits for each dollar of additional taxes he or she pays. Likewise, the Retirement Earnings Test is viewed as a 50-percent tax on work by early retirees. Changing policies to encourage longer work lives could improve retirement security and ease the way to a financially sustainable program.

The Retirement Crisis is Overstated

A number of recent studies claim that vast numbers of Americans are underprepared for retirement and that the nation faces a "retirement savings gap" of up to $14 trillion. However, as I detailed in an article co-authored with Sylvester J. Schieber in the summer 2014 issue of *National Affairs*, most of these claims are difficult to support and, in many cases, are contradicted by research conducted by academic economists using better data and more sophisticated methods.[1]

But perhaps the most compelling results come from the Social Security Administration's Office of Retirement and Disability Policy, which has for almost two decades built and improved the most detailed model of retirement income in the country. SSA's Mint model – which stands for "Modeling Income in the Near Term" – was constructed in cooperation with researchers from the Urban Institute, the RAND Corporation, the Brookings Institution and elsewhere, and it is regularly updated and reviewed by outside analysts.

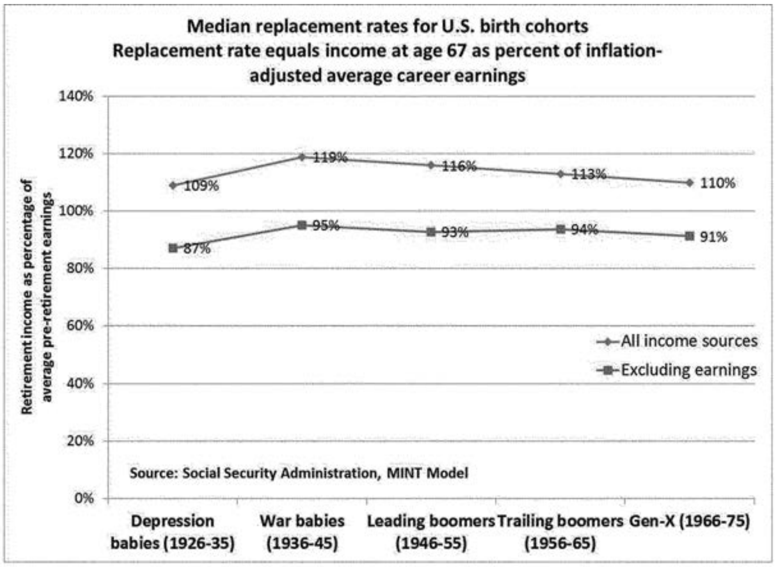
MINT simulates individuals over their full working lives, incorporating education, work, marriage, divorce, and saving—practically the full range of factors that affect individuals' preparations for retirement. The MINT model reports not simply Social Security benefits, but also pensions, welfare benefits, housing equity, and other potential sources of retirement income. In terms of sophistication, MINT is a quantum leap beyond the models used in popular retirement-crisis literature.

In a 2012 study, analysts from SSA and the Urban Institute used the MINT model to project retirement income for four groups: "Depression Babies," born from 1926–1935; "War Babies" (1936–1945); "Leading Boomers" (1946–1955); "Trailing Boomers" (1956–1965); and "GenXers" (1966–1975).[2] For each group, the study calculated replacement rates relative to inflation-indexed average lifetime earnings. The median, or typical, replacement rate for Depression Babies was 109%, rising to 119% for War Babies, then gradually declining to 116% for Leading Boomers, 113% for Trailing Boomers, and 110% for GenXers. These figures hardly support political scientist Jacob Hacker's dire contention that "we live in the waning days of the Golden Age of Retirement."

---

[1] Andrew G. Biggs and Sylvester Schieber. "Is There a Retirement Crisis?" *National Affairs*. Issue Number 20 ~ Summer 2014.

[2] Barbara A. Butrica, Karen E. Smith, and Howard M. Iams. "This Is Not Your Parents' Retirement: Comparing Retirement Income Across Generations." *Social Security Bulletin* 72 (2012): 37.



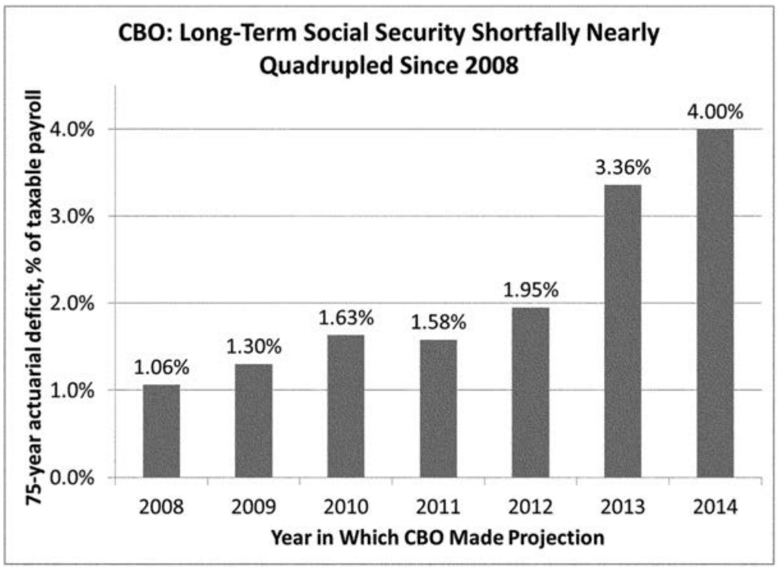
Nor do the MINT model's projections show an emerging underclass in terms of retirement security, a group that lives in poverty even as others do well. For instance, MINT estimates that only 26% of Depression Babies had replacement rates below 75% of their average pre-retirement earnings, and only 8% had replacement rates below 50%. MINT's comparable figures for the supposedly under-saving GenXers are 25% and 8%.

In other words, SSA's premier retirement model projects that despite significant changes in the composition of retirement income—future retirees will rely more on asset income and less on traditional defined-benefit pensions than do present retirees—the overall level and distribution of retirement income will remain roughly the same.

This is not to deny that many Americans are falling short in preparing for retirement. But high-quality studies tend to find that far fewer Americans are falling short, and by a smaller amount, than the cruder, but more attention-grabbing, studies conclude. Thus, hasty or drastic policy responses are unwise; rather, policy attention should focus on subsets of the population – for instance, single women – who appear to be less prepared for retirement than other groups.

But Americans Do Face Retirement Risks

According to the Congressional Budget Office, Social Security's 75-year funding shortfall has nearly quadrupled over the last six years, from around 1 percent of payroll in 2008 to 4 percent of payroll today.[3] I estimate the present value of this shortfall at approximately $15 trillion, which is nearly the value of the entire publicly-held federal debt. Perhaps more importantly in a practical sense, while CBO once projected that Social Security would remain solvent until nearly 2050, today it projects insolvency in 2030.



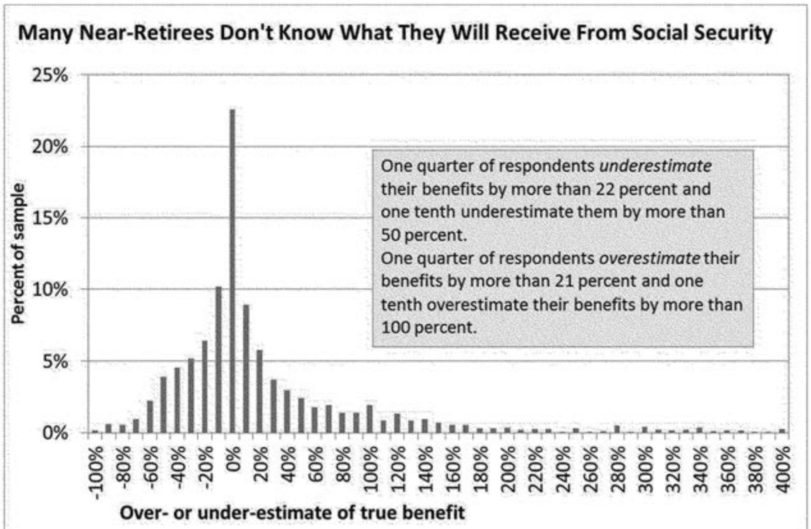
One might assume that a quadrupling of the long-term deficit would bring both parties together to finally take Social Security reform seriously. Instead, a number of Congressional proposals would use tax increases that once had been seen as a way to buttress Social Security's finances to instead expand the program and increase benefits. For instance, a proposal from Sen. Tom Harkin (D-IA), for instance, would add just 10 years to the trust fund's life, while a separate plan from Sens. Mark Begich (D-AK) and Patty Murray (D-WA) would address just 3 percent of Social Security's unfunded liability.

But there is more to Social Security risk than just solvency. Even assuming Social Security could pay full scheduled benefits forever, there are many retirees – particularly low-income retirees –

[3] See Congressional Budget Office. "The Long-Term Budget Outlook." July 15, 2014.

who will receive very different benefits from what they might anticipate. One reason for this is simply that Social Security benefits are extremely hard for ordinary Americans to predict, due to the complexity of the program's benefit formula.

In a 2010 study, I compared the benefits that near-retirees *predicted* they would receive to the benefits they *actually* received just a year or two later.[4] Large numbers of near-retirees either over- or underestimate their actual benefits by a significant amount. This "predictability risk" imposes costs on Social Security participants. Simply put, what is the use of a "defined benefit" if actual individuals do not understand how it is calculated and cannot predict what they will actually receive? Under these circumstances, how can they decide how much to save on their own or when to retire?



Source: Biggs, Andrew (2010) "Improving the Social Security Statement." RAND/Wharton/Dartmouth Financial Literacy Research Center. Based on 2000-2006 HRS waves.

One might think that the Social Security Statement would address this issue by providing benefit estimates to workers each year. However, my 2010 research paper showed no improvement in Americans' ability to predict their benefits even with wider distribution of the Statement.

---

[4] Andrew G. Biggs, "Improving the Social Security Statement." RAND/Wharton/Dartmouth Financial Literacy Research Center. 2009-2010.

A second reason benefits are uncertain is that individuals with the same lifetime earnings can often receive very different levels of benefits. This is particularly true for low earners, which makes Social Security a social insurance program that may or may not pay off when it is needed the most.[5] Social Security is progressive on average, meaning that low lifetime earners tend to receive higher replacement rates than high earners. But it is not *consistently progressive*: at any given level of lifetime earnings, there can be considerable variation in the replacement rates paid by Social Security. Some will receive replacement rates far above the average for their income level, while others will receive much lower replacement rates.

The reason for this is that, in the program's benefit formula, many other factors matter. For instance, imagine two households who had the same total earnings and paid the same taxes into Social Security over their working careers. A household in which one spouse worked and the other stayed home would receive significantly higher benefits than a two-earner couple with the same total household earnings. Likewise, workers with shorter careers receive higher benefits than workers who earned the same total amount over their lifetime, but had longer working careers. A number of other aspects to the benefit formula have similar unintended consequences. And in total, it is these other factors – *not* the household's lifetime earnings – which have the greatest influence on the replacement rate the household receives. This makes very little sense from the perspective of providing social insurance.

Both the United Kingdom and New Zealand have moved toward pension systems in which a flat benefit is allocated to all retirees regardless of earnings level. This flat benefit is then supplemented by defined contribution accounts, similar to IRAs or 401(k) plans. I outlined a similar program for the United States in a 2013 article.[6] Such an approach would provide a superior safety net to the current benefit formula, which leaves roughly 9 percent of seniors in poverty. Moreover, it would be far simpler and easier for workers and retirees to understand.

The Social Security Statement

In 2009, the Social Security Advisory Board stated that "it is imperative that the Social Security Statement provide the most accurate information possible and that information be communicated in a clear and objective manner." But this does not seem to be happening. The problem is not in how SSA estimates the benefit amounts that today's workers are likely to receive when they retire. The problem is that SSA *expresses* these benefit amounts in a form – so-called "wage indexed dollars" – that are incomprehensible to most Americans and essentially useless in terms of retirement planning.[7]

[5] This section follows Andrew G. Biggs "Will Your Social Insurance Pay Off? Making Social Security Progressivity Work for Low-Income Retirees." AEI Retirement Policy Outlook 1 (2009).
[6] Andrew G. Biggs. "A New Vision for Social Security." *National Affairs* Number 16, Summer 2013.
[7] The discussion here draws on Andrew G. Biggs, "Exploring Alternate Ways to Express Estimated Future Retirement Benefits in the Social Security Statement." RAND/Wharton/Dartmouth Financial Literacy Research Center. 2010.

Ordinarily, a future dollar amount would be expressed either in nominal dollars (meaning the actual dollar amounts that will be written on benefit checks) or in inflation-adjusted dollars, which represents the current purchasing power of those future benefits. Either approach can be useful, and ideally both figures would be provided.

But the SSA's Social Security Statement does neither. The Statement expresses benefit amounts in "wage-indexed dollars." To the best of my knowledge, wage-indexed dollars are never used in financial planning calculations, are difficult to explain in plain English and are irrelevant to the "life cycle model" through which most analysts view retirement saving decisions.[8]

The effects of wage-indexing on the estimated Social Security benefits an individual sees in his Social Security Statement can be substantial. For instance, a typical worker retiring 30 years from today will receive a nominal Social Security benefit of about $64,750 per year. Adjusted for inflation, that future benefit will be $27,683. That's a figure that a person planning for retirement can more easily understand. But that's not the figure he will see on his Social Security Statement. Rather, because the SSA wage-indexes his future benefits, the figure on his Statement will be just $17,982, which is 35 percent lower than the true purchasing power of his benefits.

I first pointed out this issue publicly in 2008.[9] The agency's response was not to correct the way projected benefits are expressed. It was to remove the phrase "in today's dollars" from the Statement. As a result, recipients are now left with no explanation whatsoever of what the dollar amount on the statement means. Some might interpret the figure to mean inflation-adjusted dollars while others might see the estimates in nominal dollar terms. But almost no one would understand the Statement's estimates as "wage indexed" dollars nor know how to employ these figures if they did know what they meant. This makes these benefit estimates of very little value to individuals are planning how much to save on their own for retirement.

To be very frank, the benefit estimates presented in the Social Security Statement are wrong. But no one – be it an individual or a government agency – wishes to acknowledge that its figures are incorrect, and so the SSA continues to generate them. That may save the agency a little embarrassment, but in the process does a disservice to millions of Americans who are attempting to prepare for retirement.

[8] Specifically, wage-indexing discounts (or reduces) the future benefit amount by the rate of annual wage growth in the economy, which is generally around 4 percent. Inflation, by contrast, is generally around 3 percent which means that the wage-indexed figure will be lower than the inflation-indexed figure by around 1 percent for each year between today and the time the Statement recipient will collect benefits. Perhaps the most intuitive way wage of thinking about wage-indexing of future benefit amounts is that it calculates the projected benefit as a percentage of the average economy-wide wage at the time the benefit will be collected; the wage-indexed equivalent is the same percentage of *today's* economy-wide average wage. Leaving aside that this figure is difficult to understand, it is not very meaningful from the standpoint of a person planning their own retirement saving.

[9] Andrew G. Biggs. "Good News on Social Security?" *Christian Science Monitor*. April 15, 2008.

Encouraging longer work lives

While most Americans appear to be adequately preparing for retirement, for those who approach retirement with insufficient resources the most effective way to increase retirement income is to work a few additional years. Longer working lives increase retirement savings while reducing the number of years over which those savings must generate retirement income. A study published by the Urban Institute concluded that an additional five years in the labor force would raise total retirement income for the typical individual by roughly 60 percent; for an individual in the lowest earnings quintile, total retirement income would almost double, with a 98 percent increase.[10]

However, the Social Security program itself does little to encourage delayed retirement. Yes, benefits are increased for those who choose to delay claiming, but not nearly enough to compensate for the additional payroll taxes the individual will pay if he or she continues to work. In a 2009 analysis co-authored with David Weaver and Gayle Reznik of the SSA, we found that for each dollar of additional taxes paid by a near-retiree who works an additional year, he or she will receive only around 3 cents in additional lifetime benefits.[11] Put another way, the rate of return on this additional contributions was around -50 percent.

There are two reasons behind the poor marginal returns provided to near-retirees: first, Social Security benefits are based upon the highest 35 years of work, so an additional year of work increases benefits only to the degree that year's earnings exceed the lowest of the previous 35; and second, most women continue to receive a benefit based upon their spouse's earnings, in which case they are unlikely to receive any additional benefits in return for working longer.

The best way to make the program actuarially fair for near-retirees and to encourage longer work lives would be to reduce the payroll tax rate for older workers. While such a policy would reduce Social Security revenues slightly, greater labor supply from older workers would increase federal income tax and Medicare tax revenues, along with state income taxes. Based on academic studies of the sensitivity of near-retirees' labor supply to changes in after-tax wages, I estimate that a payroll tax cut for older workers would be revenue-neutral if state tax revenues were included, and would have only a small cost to the federal budget if counting only federal income and Medicare taxes.[12] Some of these ideas have been incorporated into S. 2336, the Let Seniors Work Act of 2014 introduced by Sen. Marco Rubio.

But there is a second impediment to longer work lives: the Retirement Earnings Test.[13] For individuals claiming benefits who are between age sixty-two and the full retirement age, Social

---

[10] Barbara A. Butrica, Karen E. Smith, and C. Eugene Steuerle, "Working for a good retirement," Retirement Project Discussion Paper No. 06-03, (Washington, DC: Urban Institute, 2006).

[11] Gayle Reznik, David A. Weaver, and Andrew G. Biggs. "Social security and marginal returns to work near retirement." Social Security Issue Paper 2009-02 (2009).

[12] See Andrew G. Biggs. "A Payroll Tax Cut Could Help Social Security." *Wall Street Journal*. April 24, 2012.

[13] Much of the following discussion is derived from Andrew G. Biggs, "The Social Security Earnings Test: The Tax That Wasn't," AEI Tax Policy Outlook (July 2008).

Security withholds fifty-cents of benefits for every dollar in earnings above $15,480. While most people claiming early Social Security benefits stop working, about three-quarters of those who work earn enough to trigger the earnings test.

To seniors, the earnings test appears to be a significant tax on work. Consider a sixty-three-year-old who receives a Social Security benefit while continuing to work at an annual salary of $35,000. This worker pays a marginal federal income tax rate of 15 percent, a Social Security tax of 6.2 percent, and a Medicare tax of 1.45 percent. State income taxes might add another three percentage points, creating a total marginal tax rate of around 25 percent. On top of this, however, the Social Security earnings test reduces benefits by fifty cents for each dollar by which earnings exceeded the threshold. This can amount to a perceived fifty-percentage-point increase in the marginal tax rate on earnings. Put simply, this worker perceives he is being taxed at 75¢ on the dollar, leaving him less than 25¢ in take-home pay for each dollar he earns. Many workers reduce their earnings or leave the workforce to avoid this "tax." Data shows a "bunching" of earnings just below the $13,560 threshold, indicating that seniors recognize the earnings limit and take steps to avoid triggering it.[14]

The reality is that retirees need not reduce their work to avoid a "tax." At the full retirement age, Social Security not only stops withholding benefits but increases monthly benefits to replace those taken by the earnings test. The benefit increase at the full retirement age works through the "reduction factors" that Social Security generally uses to reduce benefits for early retirees. Over a individual's full retirement, total benefits are about the same. That is to say, the earnings test delays benefits but does not tax them away.

Unfortunately, the SSA does a poor job of conveying how the RET works. During my time working at SSA, I was quoted in a news article explaining the benefit adjustment at the full retirement age.[15] At least one reader called the agency's toll-free number to inquire about this statement; he was told it was untrue and that there was no adjustment to benefits at the full retirement age. The agency's publications with regard to the earnings test are better today than in the past, but I am not confident that the earnings test is explained adequately on a day-to-day basis.

Thus, it might be better simply to eliminate the earning test. Research indicates many retirees would increase their labor supply in response.[16] However, due to the quirks in Social Security's benefit formula discussed above, most would not receive additional benefits in exchange.

---

[14] See Leora Friedberg, "The Labor Supply Effects of the Social Security Earnings Test" (Working Paper 7200, National Bureau of Economic Research, Cambridge, MA, June 1999). See also David Loughran and Steven J. Haider, "Do the Elderly Respond to Taxes on Earnings? Evidence from the Social Security Retirement Earnings Test" (Working Paper 223, RAND Corporation, Santa Monica, CA, January 2005).
[15] Glenn Ruffenach, "The Baby Boomer's Guide to Social Security," Wall Street Journal, November 28, 2007.
[16] For a discussion of the literature, see Olsen, Anya, and Kathleen Romig. "Modeling Behavioral Responses to Eliminating the Retirement Earnings Test." *Social Security Bulletin 73* (2013): 39.

Moreover, some individuals might choose to claim benefits earlier if the earnings test was withdrawn; the logic here is that the pseudo-"tax" imposed by the earnings test dissuades a certain number of individuals from claiming benefits until they have ceased working. If so, incomes after the Full Retirement Age could end up being lower as the result of repealing the earnings test.

Conclusions

In simple terms, everyone needs to do better:

First and foremost, Congress needs to fix Social Security, not merely to make it solvent but also to improve its function as a safety net for those who need it the most.

Second, the Social Security Administration needs to improve its publications and other communications with the public to make them understandable and useful. Expressing Social Security benefit levels in ways that are inconsistent with common financial planning usage slants the public discussion on Social Security policy and makes basic financial planning more difficult. Likewise, the agency should ensure that it gives the public full and understandable explanations of policies such as the retirement earnings.

Third, policy analysts must also improve their work. It is tempting to generate newspaper headlines with alarming stories stating that vast majorities of Americans face a retirement crisis, but if not based upon the best research methods and data, these claims serve to frighten Americans and skew the public policy debate.

Finally, the American public must do their part as individuals, by preparing for retirement to the best of their abilities, and as citizens, by demanding that their elected officials do their jobs as stewards of Social Security and other entitlement programs.

Chairman JOHNSON. Thank you, sir. We appreciate your comments.

Dr. Kotlikoff, you are now recognized.

STATEMENT OF LAURENCE J. KOTLIKOFF, PH.D., WILLIAM FAIRFIELD WARREN PROFESSOR, BOSTON UNIVERSITY, BOSTON, MASSACHUSETTS

Mr. KOTLIKOFF. It is a great honor, Chairman Johnson and Mr. Becerra, and other distinguished Members of the Committee, to be with you. I guess I am on the left side of this table, because I am facing a Republican. I might be viewed as a Republican because I was probably invited by the Republican members.

Chairman JOHNSON. You are on our right.

Mr. KOTLIKOFF. Okay. Well, let me just tell you, I have been voting on the left for my entire adult career. I voted for every Democratic president, including our current president. So I just want the Democratic members to realize, and also the Republican members, that I am speaking here today not as a political person. I am an academic. I am an economist and I am here to tell you that I am here to tell you things that you have not heard so far and you may not hear from anybody else about Social Security solvency and about its complexity and inequities. Although some of these I have heard mentioned.

I think the first thing I want you to realize is that we have issues of generational inequity, unfairness, and we also have issues of intragenerational inequity and unfairness. And I think these things keep getting kind of confused. The Democrats, I sense, are very concerned about fairness within a generation, with the rich who are the same age being treated unfairly relative to the poor, and that is an important issue.

But I want you to set aside that and assume that everybody within a cohort is exactly the same. So Mr. Becerra, suppose everybody your age was exactly the same and looked just like you. And everybody who was a year younger was the same and looked just like that person. And so we have old people and young people, and there are no differences within the cohort. So, would we want to leave enormous bills for our children and future generations? Wouldn't we want to engage in social insurance policies, other kinds of policies, that may do enormous good and may be very important because insurance markets are not operated very well? There are good economic arguments.

But then the question is, getting the government involved to fix some of these problems is one thing. Another thing is leaving future generations to pay for those fixes. To pay the bills for future generations. And we have, really, a generational crisis here of enormous proportions. And the way economists look at this is we look at the fiscal gap. We look at, over the entire future of the economy, how much are the projected expenditures compared to the projected taxes measured in present value? What is the gap? What is the fiscal gap?

This is what economists measure. The fiscal gap in the U.S. is current $210 trillion. That is according to the CBO's alternative fiscal scenario data released last week. That is 58 percent of the present value of revenue. So this country is 58 percent underfinanced. Detroit is about 20 percent underfinanced. Social Security by itself is 33 percent underfinanced. If you look at table F61 in the trustees' report released yesterday, you will see that there is a $24.9 trillion unfunded liability over the infinite horizon. It is not over 75 years. Nothing in economics tells us to look at 75 years and ignore the future.

I have children. I am sure many of you do as well. I started a little bit late, so I have young children who will be alive in 75 years. We cannot ignore the commitments to them and there is nothing in economics that allows us to do that, in economic theory. So we have to measure things correctly. And economic theory is very clear that we should be measuring infinite horizon fiscal gap. The trustees' report is burying that number. They have been calculating it since 2002. The trustees don't even mention it in their summary statement.

We just heard a statement that says Social Security is fundamentally sound. A system that is in worse shape than Detroit's pension systems is not fundamentally sound. A system that is 58 percent underfinanced, according to the trustees' report, that's the entire country. The Social Security system is 33 percent underfinanced. This stuff is not fundamentally sound.

We have to start thinking about things from a generational perspective, and that does not mean that you should not also focus on intragenerational equity. I am all for that. Okay? I have been a lifelong Democrat in terms of voting. I am with you. And we have to look at that, too. We have to look at fairness within and across generations. But we cannot keep confusing these things. We cannot in the name of intragenerational equity ignore what we are doing to all the children, poor and rich alike.

So what I am going to do is show you Social Security's formula for the benefits of a spouse. Ten mathematical functions. This is the first time anybody has actually expressed this in math. Ten functions. One is in four dimensions. One is a maximum function. There is also side conditions that are very complicated. Many, many functions to determine the side conditions and the variables that go in here. One of those side conditions is a maximum of a min function.

It could not be complex. People are making all kinds of crazy mistakes, and Social Security people in the offices are providing all kinds of bad advice because the thing is just crazily complex. We need a new system that is not going to go broke.

[The prepared statement of Mr. Kotlikoff follows:]

Testimony to the House Committee on Ways and Means

Subcommittee on Social Security

Laurence J. Kotlikoff

Professor of Economics, Boston University
President, Economic Security Planning, Inc.

July 29, 2014

Chairman Johnson and Other Distinguished Members of the Ways and Means Subcommittee on Social Security,

It is an honor to testify to you today about Social Security. I view Social Security as a fantastic, yet catastrophic success. The system has been a lifeline for generations of Americans who would otherwise have spent their retirements in abject poverty. And it has provided essential disability insurance, survivor insurance, divorce insurance, spousal dependency, child dependency, and parent dependency insurance.

But Social Security's amazing achievements don't erase its enormous problems. To begin, the Social Security system is insolvent. And it's not bankrupt in 30 years, or 20 years, or 10 years. It's bankrupt today.

This is not my opinion. This is only conclusion one can draw from Table IVB6 of the 2013 Social Security Trustee's Report. This table reports that Social Security has a $23 trillion fiscal gap measured over the infinite horizon.

Social Security is in Worse Shape than Detroit's Pensions
Twenty-three trillion dollars is 32 percent of the present value, also measured over the infinite horizon, of Social Security's future revenues. Hence, Social Security is 32 percent underfinanced, which means it is in significantly worse financial shape than Detroit's two pension funds taken together.

Social Security's $23 trillion debt, which Congress has chosen to keep off the books, swamps the $13 trillion of official debt in the hands of the public. The value of any debt is larger the closer in time it must be paid. And in Social Security's case, every passing year brings us to the point that the baby boomers will all be retired and all collecting their benefits. Consequently, the system's off-the-books debt is growing at leaps and bounds – by $1.6 trillion between 2012 and 2013 -- thanks to the approaching retirement of vast numbers of baby boomers.

Economics Doesn't Let Us Pick Which Debts to Count and Which to Ignore

The value of a government I.O.U., whether Congress labels it official and puts it on the books or labels it unofficial and keeps it off the books, equals the present value of the future expenditures needed to fulfill that I.O.U. Thus, the current value of all outstanding 30-year U.S. Treasury bonds, which is counted as part of official debt, is, itself, a present value. In this case, it's the present value of all future payments required to service those 30-year bonds.

Some payments the government will make in the future will occur with more or less certainty. But this uncertainty doesn't make the obligation go away or imply that the obligation's value has no present value. It simply means that, in forming the appropriate present value of the obligation one needs to adjust for its risk.

Social Security benefit commitments are, actually, much more certain than are the commitments to repay, say, 30-year U.S. Treasuries. Thirty-year Treasuries aren't protected against inflation. Nor are they protected by the political power of the AARP with its 50 million members. Hence, were I forced, based on the surety of the obligation, to choose between a) including the present value of Social Security's benefit obligations as an official debt or b) including the present value of the obligations to pay off U.S. Treasuries as an official debt, I'd put Social Security's debt on the books.

But economics doesn't let us pick and choose which debts to include and which to exclude in properly present valuing the government's future liabilities. Nor does it let us pick and choose which assets, including which future revenue streams, to include in properly present valuing the government's ability to meet it's future liabilities. Economics tells us that we need to consider the present value *all* future government spending obligations, no matter their risk or timing, and net them against the properly formed present value of *all* future government revenues, no matter their risk and timing.

In the context of Social Security, this means we need to form and take seriously the system's infinite horizon fiscal gap. The need to do fiscal gap accounting, *over the infinite, not 75-year or any other finite horizon,* isn't a matter of my opinion. It's a dictate of economic theory. This is why 17 economics Nobel Laureates and over 1,000 economists, from every political persuasion and from every top economics department in the country, have endorsed The Inform Act at www.theinformact.org.

The Inform Act – H.R. 2967 and S. 1351 -- is a bipartisan bill that requires the CBO, GAO, and OMB to do infinite horizon fiscal gap and generational accounting on an ongoing basis and for every major fiscal bill introduced in Congress. The Inform Act would revolutionize government accounting and show in stark relief the enormous fiscal bills we are leaving for our children to pay. I strongly urge all members of Congress to support and pass The Inform Act.

Social Security's Trustees Are Ignoring the System's Infinite Horizon Fiscal Gap
Economic theory doesn't wear blinders and doesn't endorse blinders. It doesn't tell us to look at obligations only over the next year, or only over the next 10 years, or only over the next 75 years. It tells us to properly present value all future government obligations net of receipts over the infinite horizon.

It is now 31 years since the Greenspan Commission met and chose to "fix" Social Security over a 75-year horizon. Today, we are looking, in the current 75-year projection widow, at 31 years of negative cash flows, which the Greenspan Commission knew were coming and willfully ignored. It should be no surprise then that Social Security is in worse financial shape today than when the Greenspan Commission "fixed" it.

To their great credit, Social Security's actuaries have been reporting the system's infinite-horizon fiscal gap every year since 2002. And to their great shame, Social Security's Trustees have been ignoring this comprehensive measure of the system's insolvency every year since 2002. You will, for example, find no mention of the infinite-horizon fiscal gap in the 2013 Trustees Report summary of the system's finances.

Instead, the Trustees have been focusing on the system's 75-year fiscal gap. Unfortunately, the 75-year fiscal gap captures only 42 percent of the system's true shortfall. Hence, the Trustees have been warning us only about two fifths of Social Security's funding problem. This is a terrible dereliction of their fiduciary duties as Trustees of the country's primary saving system.

How Broke Is Social Security?
To pay its scheduled benefits in full through time, the Social Security system needs a 32 percent immediate and permanent increase in the future path of payroll tax revenues. Based on the current covered earnings ceiling, this represents a 4-cent-on-the-covered-dollar higher payroll tax *starting today and continuing forever*.

Alternatively, to prevent having to raise its FICA payroll tax rate, the system needs to immediately and permanently cut all benefits payments by 22 percent. Delay in raising the OASDI tax rate or cutting OASDI benefits will require even larger percentage adjustments in the future.

The bottom line is that Social Security does not have small problems that can be easily and gradually fixed as many people, including the President, believe thanks to years of disinformation provided by the Social Security's Trustees. Instead, Social Security is in dire financial shape. Nothing short of a fundamental reform of the system will preserve Social Security for today's and tomorrow's retirees.

Chairman Johnson and other Subcommitee Members, I invite you to visit www.thepurplesocialsecurityplan.org. This website lays out a very simple (postcard length), but fundamental reform of Social Security. In conjunction with other simple, but radical reforms, laid out at www.thepurpleplans.org, the Purple Social Security Plan can help put our country back on a safe fiscal path.

One final point about Social Security's finances. Social Security cannot be bailed out by the rest of our fiscal system. The rest of our country's fiscal affairs are in worst financial shape than Social Security. Indeed, based on CBO's recently released Alternative Fiscal Forecast, which includes all expenditures and taxes, our government has a $210 trillion infinite-horizon fiscal gap. This colossal shortfall represents 58 percent of the present value of all future federal revenues. Clearly, Social Security, which is 32 percent underfinanced, cannot be rescued by an overall fiscal system that is 58 underfinanced.

Unfortunately, those who proclaim the strongest desire to preserve and protect Social Security, particularly its Trustees, are doing their level best to destroy the system by ignoring or substantially understating its financial problems.

Social Security's Complexity

With these financial facts of life, let me now turn to Social Security's second terrible problem, namely its truly unbelievable complexity. Social Security is our nation's basic saving system. But it is so complex that no one can figure out, without the help of sophisticated software, which benefits they can claim, when they can claim them, when they must claim them, and when they should claim them.

I know a lot about Social Security's complexity. In addition to being a professor of economics at Boston University, I have a small financial planning software company called Economic Security Planning, Inc. One of our products is called Maximize My Social Security, which we market at www.maximizemysocialsecurity.com. The program suggests to users what benefits to collect and when to collect them to maximize their lifetime benefits from the system.

In addition to developing this program in conjunction with my software engineers and in consultation with technical experts from Social Security, I also write a weekly column for PBS NEWSHOUR in which I answer highly detailed questions about Social Security.

Social Security's "Simple" Benefit Formula

Social Security's Handbook has 2,728 rules and its Program Operating Manual has tens of thousands of rules to explain these rules. The rules and the rules to explain the rules are written in a language that no one can remotely understand unless they have spent years immersed in the system's provisions.

To give you a sense of Social Security's complexity, consider the formula determining the benefits at age a of a married spouse. Let's call the left hand side of this equation $B(a)$ to stand for the spouse's benefit at age. This formula, when written down as a mathematical expression is:

$$B(a)=PIA(a)x(1-e(n))x(1+d(n))xZ(a)+max((.5xPIA^*(a)-PIA(a)x(1+d(n)))xE(a),0)x(1-u(a,q,n,m))xD(a)$$

The formula has 10 mathematical functions on the right hand side. One of these is in four dimensions. One is a maximum function. What's not shown here is that there are addition complex mathematical functions, one of which – my favorite – involves a maximum function defined over a minimum function, that restrict the values of the variables that can enter these 10 functions.

Some people looking at this formula would say, "Well, democracy is messy. And this is the price of democracy." This, frankly, is hogwash. New Zealand has a very fine democracy and its social security system couldn't be simpler. You reach retirement age, you get a monthly check. It's the same check for everyone.

I'm advocating the Purple Social Security Plan, not the New Zealand's system. The Purple Social Security Plan shows we can redesign Social Security from scratch, make it fair across and within generations, protect lower-earning spouses, but also make it extremely simple.

The Implications of Social Security's Complexity

We have 10,000 Baby Boomers retiring every day. I wish I could say all 10,000 were using my company's software to make appropriate claiming decisions. They aren't. We have the top ranked, least expensive, and best-known software. But if 20 people buy it on a given day, that's a lot.

What most people are doing is relying on Social Security's calculators and staff in making their collection decisions. But Social Security's calculators tell you about your own benefits, not about the benefits you can collect based on your current, ex, or deceased spouse. Consequently, they don't handle most households' collection decisions. Moreover, Social Security's benefit calculators, which are used by Social Security's telephone and local office staff, produce benefit estimates that are generally incorrect. This is thanks to the calculators' default assumptions that the economy will experience no future wage growth or inflation.

In addition, Social Security staff, although extremely well meaning, are not sufficiently well trained to render correct or appropriate benefit collection information or advice. Finally, the information that one can glean from Social Security's website is often highly misleading if not outright wrong. It appears that Social Security is limiting what it presents on its website because it realizes that making any general statements about benefit collection is fraught with danger. With Social Security the exception is always the rule, so saying anything requires saying everything.

The combination of a fantastically complex set of benefit provisions, Social Security online calculators that are incomplete and biased, Social Security staff that are constantly providing misinformation and wrong advice, the outrageous fact that divorcees and widow(er)s don't have access to their ex's and deceased spouse's earnings records, and a range of extremely nasty Social Security gotchas makes Social Security benefit collection a lottery. If you get the right information and make the right decisions, you can get far more benefits than if you don't.

Let me illustrate the dollars at stake in making the right decisions by using my company's software.

The Importance of How and When Someone Chooses to Claim Benefits

Consider a 62 year-old couple that's contributed the maximum amount to the system each year they worked. If they do what far too many people do, namely take their retirement benefits at the earliest possible date (age 62), their lifetime benefits will total $1.2 million. But if they wait until 70 to collect and if a) one of the two spouses files for a retirement benefit at full retirement age, but suspends its collection, b) the other spouse files just for a spousal benefit, and c) both spouses take their retirement benefit at 70, the couple's lifetime benefits total $1.6 million. The $400,000 difference is enormous. It's also at the upper end of the dollar gain that making smart Social Security decisions can mean. For most households, the increase in lifetime benefits from maximizing Social Security are either smaller or much smaller. But they are generally significant for all households.

Where are the gains coming from? In the main, the gains are coming from waiting a relatively small number of years to collect much higher benefits for potentially a very long number of years. Social Security will tell you that, on an actuarial basis, when you take your benefits is pretty much a wash. But none of us are insurance companies. We have only one life to live. And we have to plan to live to our maximum ages of life for the simple reason that they might. Because of this longevity risk, Social Security can't be valued as a standard investment. It's a longevity insurance policy and its value to households has to incorporate the value of this insurance.

Economic research on this valuation problem dates back 60 years. This research tells us to value a household's Social Security benefits using simple discounting, i.e., without applying actuarial factors.

Valuing insurance products in a special manner is not restricted to longevity insurance. To see this, consider valuing homeowners insurance. No one values homeowners insurance simply as an investment. Were we to do so, we'd apply actuarial/break-even analysis and conclude that buying homeowners insurance doesn't pay.

What Factors Does a Worker Need to Consider in Determining When to Claim Social Security Benefits?

This is another important question. The answer is multifaceted. There are so many different and major factors that come into play that I would take a book to fully respond. Instead, let me illustrate, via examples, three of the many factors workers need to consider.

The first factor is that workers need to understand the benefits for which they may be eligible. Take my friend Jerry who is 65 years old and a high earner. His wife recently passed away. When we were having dinner in January he told me he planned to retire at 70 and take his Social Security at that time. He had no idea that he could collect widower benefits based on his deceased wife's earnings record, which was quite high. Indeed, he was astounded when I told him that by taking his widow's benefit starting at age 66, when the earnings test no long applies, he would be able to collect roughly $120,000 prior to age 70. Needless to say, he paid for dinner.

Now why should my friend, who by chance learned about his rights to collect widower benefits, receive an extra $120,000 from the system whereas someone in his same shoes would have, out of ignorance, lost $120,000 for good? This is an example of the capricious and unjust redistribution and inequity arising from Social Security's terrible complexity.

My second example involves a marvelous doctor, who I just met by shear accident. The example illustrates the need to know how benefits are calculated. The doctor is age 68. One month ago he was diagnosed with pancreatic cancer. He figures he has two years left to live. He's married, his wife is 64, and she had a very limited earnings history. Upon learning his diagnosis, the doctor went to the local Social Security office where the representative told him he should try to get as much out of the system as possible before he passes away and that he should immediately begin collecting his retirement benefit.

The doctor followed this advice and signed up for his retirement benefit. It was the wrong advice. In taking his retirement benefit before age 70, the doctor reduced his wife's future widow's benefit by 16 percent. Neither the doctor nor the Social Security representative understood that the Delayed Retirement Credits the doctor would accrue between ages 68 and 70 would extend to the wife in the form of higher widow's benefit. Had I not accidently met this doctor, who is now suspending his retirement benefit, his wife would have spent, perhaps decades, receiving 16 percent lower widow's benefit than would otherwise have been the case.

A third thing that workers need to know in collecting benefits is that they can't trust much of anything they read online from Social Security or are told at the local office. I get emails on a daily basis from people who tell me they were misled by Social Security personnel. Here is an email I just received from Donna Strong, a divorcee living in Huntington Beach, CA.

"Larry, I'm currently 63. My ex is older than me and has earned much more. Over the past year, I tried to determine what benefits I could collect. I spoke with three different Social Security reps. One told me I couldn't receive divorcee spousal benefits unless my ex applied before 66, and since my ex is quite well off, I knew that wouldn't happen. This, I discovered, was wrong. All my ex needs to be is over 62 for me to collect a spousal benefit on his work record provided we are divorced for two years (which we are). So I got that right. But no one told me about deeming. I applied for my retirement benefit five months back thinking I'd be able to collect my full spousal benefit at 66.

I just learned about deeming and that I was, without my knowledge, forced to take my divorcee spousal benefit early. Had I been made aware that I would be deemed and be forced to take a permanently reduced spousal benefit, I would never have applied for an early retirement benefit. People really shouldn't have to deal with this kind of stress to receive a benefit for their retirement. I do also acknowledge that with Social Security cutting its hours, providing less training and more turnover, the situation is guaranteed to get worse for us all. Best, Donna"

Let me conclude my testimony by answering several questions either raised by Subcommittee staff or posed by me.

How can Social Security's rules for file and suspend and deemed filing affect the benefits someone receives? Do most Americans know about these provisions?

File and suspend can be used by one spouse to help another spouse file exclusively for a spousal benefit once that other spouse reaches full retirement age. But it can also be used by workers to accrued Delayed Retirement Credits while leaving open the option of taking one's suspended benefits as a lump sum if there is a sudden need for a large infusion of cash. File and suspend is not the only way that a spouse can receive a full spousal benefit at full retirement age while letting his/her own retirement benefit continue to grow via the accumulation of Delayed Retirement Credits. If one's spouse has filed for, but not suspended his/her retirement benefit, one can collect a full spousal benefit at full retirement age. Also, divorced spouses can collect full divorcee spousal benefits starting at full retirement age without anyone having filed for and suspended a retirement benefit.

Deemed filing can force spouses and divorced spouses to file for their spousal benefits early if they file for their retirement benefits early and force them to file for their retirement benefit early if they file for their spousal benefit early. This provisions keeps people who file early from being able to collect one benefit first while letting the other benefit grow.

Most people appear not to know about these and many other Social Security provisions. But those that do are not necessarily taking advantage of the system. One can argue that all the benefits that people can collect based on their own and their current and former spouses' contributions to the system were fully paid for by those contributions. In this case, the injustice is not in people claiming all their benefits, but rather in many people not knowing enough about the system to ensure that they get back what they paid for.

What are common questions workers ask when they are trying to decide when to apply for benefits?

The most common question that workers appear to ask is no question. Instead, they figure out when is the earliest date they can take their retirement benefit and apply at that date. They appear to have little or no idea about their eligibility for spousal, widow(er), divorcee spousal, and divorced widow(er) benefits, little or no idea about deeming provisions, little or no idea about Delayed Retirement Credits, file and suspend options, start-stop-start strategies, family benefit maximums, the Adjustment of the Reduction Factor that can mitigate the Earnings Test, and the list goes on.

Should We Eliminate the Option to File and Suspend?

Social Security is such a maze of provisions that it is very difficult to claim that one option, like File and Suspend, is either fair or unfair. It certainly benefits certain households. But those households that are benefited can, as indicated above, be viewed simply as being given the same benefit collection opportunities as other households who don't need to use file and suspend to, for example, get a full spousal benefit or provide their spouse with a full spousal benefit.

Certainly, restricting File and Suspend for high-income households, as the President proposed in his budget, will save the system money. But the system is so broke and so poorly structured that only a truly radical reform will cure what really ails it.

Should We Eliminate Deeming?

Deeming is a particularly nasty gotcha that differentially harms lower-earning households who can't afford to wait until full retirement age to collect a full spousal benefit while letting their own retirement benefit accrue Delayed Retirement Credits. Presumably those who thought up deeming had their reasons. But at least to me, Deeming is just another crazy Social Security provision that traps unsuspecting workers like Donna and makes the system complex beyond any reasonable person's belief.

$$B(a) = PIA(a) \times (1 - e(n)) \times (1 + d(n)) \times Z(a) + \max((.5 \times PIA^*(a) - PIA(a) \times (1+d(n))) \times E(a), 0) \times (1 - u(a,q,n,m)) \times D(a)$$

Chairman JOHNSON. Thank you, sir.

As is customary for each round of questions, I will limit my time to five minutes and ask my colleagues to also limit their questioning time to five minutes, as well. Dr. Blahous, according to this year's report, if Congress doesn't act, come 2033, everybody receiving benefits will face a 23 percent cut. Worse, in just two years, everybody receiving disability insurance will face a 19 percent cut in benefits. Some of my friends on the other side like to say that 2033 is way off in the future, and that Congress has plenty of time. Social Security is well and good right now.

First, based on the trustees' report, would it be right to say that Social Security is in crisis right now?

Mr. BLAHOUS. Well, we certain face a crisis on the disability side. And I would certainly say that we face a shortfall that is bigger than we have ever successfully corrected before. And so yes, I think it is a very pressing and urgent policy concern.

Chairman JOHNSON. Well, is it fair to say, then, that we are already facing the largest shortfall Social Security has ever faced, and can you explain that in simple terms? How big is this Social Security shortfall right now?

Mr. BLAHOUS. I have discovered in my public life that I am terrible at this, making complex issues as simple as that. But I would say, I think Dr. Kotlikoff did it pretty well. You can think of it in terms of the fraction of current benefit obligations that are unfinanced. When you go out to 2033, you are talking a quarter of the benefits that we are promising are not financed. Or you could look at it another way. You could say that people's tax revenues that they are paying are short by a third of what they need to be to fund promised benefits.

So if you look at your tax return, the amount of payroll taxes you are paying, and imagine yourself paying an additional third on top of that, you get a sense of how big the problem is.

Chairman JOHNSON. Yeah, I hear you. And something my Democrat friends like to say. There is plenty of money in Social Security, so we have nothing to worry about. Do you want to address that?

Mr. BLAHOUS. I would say that the date of trust fund depletion and the amount of money in the current trust fund does not provide very useful information about how much time we have. Because if you wait to the point where it is drawn down and run out, it is too late to fix it.

Chairman JOHNSON. Right.

Mr. BLAHOUS. Because the gap is too big. So I would urge that you think in terms of, how much longer is the problem still at a soluble level. And when you think about it that way, you realize that time is much shorter than the large trust fund balance might suggest.

Chairman JOHNSON. Well, what price will beneficiaries and today's workers pay if it is not fixed before this president leaves office?

Mr. BLAHOUS. Well, let me give you a two part answer, if I could. There is a part that I think most experts would give and then I think there is a part that I would give that most experts wouldn't. But I think most experts would say they are going to pay a very high financial price for delay. That young Americans entering the system are going to lose about 4 percent of their lifetime wage income through the program as a net income loss, even net of all the benefits they got.

But I would say there is another risk that they face. And I think a lot of the policy community has been slow to recognize this. Which is that they run the risk of having a Social Security system that is not structured the way it has been in the past. Historically, for better or for worse, there has been pretty good bipartisan acceptance of the way we finance Social Security. And so benefits have been relatively safe from sudden changes because of the way we pay for Social Security out of the payroll tax.

But if we go to a system that we cannot balance that way and we have to subsidize it permanently from the general fund, then all those bets are off. Then suddenly, people are subject to much greater income insecurity because of the fact that programs financed from the general fund tend to be much more subject to sudden benefit changes and means tests and things of that nature than Social Security has been.

Chairman JOHNSON. Well, I am not sure we can increase taxes enough to cover it. Dr. Schieber and Dr. Biggs, is there anything that you want to add to that statement?

Mr. SCHIEBER. Well, if you think about it, 4 percent of a worker's earnings is kind of an abstract concept, unless you are a worker facing 4 percent additional taxes on your earned income each year. If you think about it, over a 40 or 45 year career, someone starts working in their early 20s, they work until 65, 66, 67, 45 years, we are talking about taking 2 more years of their earnings to pay for a benefit that is essentially the equivalent of the benefit we are paying to people of my generation right now.

And that seems to be a very substantial levy against them, knowing how hard it is for young people today to get a start in life. There is no reason to expect that the kids matriculating through high school and even the ones in grade school are necessarily going to have that much easier time to start. So there is a limit. I think there is an equity issue here that we need to think about if we are going to talk about delay.

Chairman JOHNSON. Thank you. My time has expired. Mr. Becerra, you are recognized.

Mr. BECERRA. Thank you, Mr. Chairman. And thank you all for your testimony today. Where should we go? It is interesting. Mr. Chairman, let me clarify something for you. Democrats do not think that we should be hunky dory, going around town just thinking that we should do nothing on Social Security. I think Democrats have said for a long time, we should keep the most successful program that has ever been devised in America to help Americans have economic security stay strong moving into the future.

And so we are prepared to meet the challenge that faces Social Security. And there is a challenge. We have heard it discussed here. In about 20 years, we are going to be hitting the challenge. I would not call it a crisis. I would call it a crisis what happened to all of Enron's employees who put money into their pensions and found out when they woke up one day that Enron no longer had any of their money that they were counting on for retirement. That is a crisis.

I call it a crisis that we go to war in Iraq, never pay a dime of it with real money, using the government credit card. Spend over $1 trillion. Still have not paid for it. And if you want to talk about infinite horizons, the so called projection into the future of however, I don't know how you do that. But apparently some folks think you can project infinitely into the horizon. What is the cost of never having paid for a trillion dollar war and what will that cost be in infinity?

The issue is this. It is, how do you make sure you give Americans that security? Ms. Entmacher made a really good point. The average benefit is about $1200 a month under Social Security. No one is going to get rich off of that. And I know we use euphemisms. Mr. Blahous, you used the euphemism of slowing the growth of cost. That is another way of saying cutting benefits. So yeah, you can slow the growth of cost in Social Security, which means cutting a

Social Security recipient's $1200 benefit. You want to talk about a crisis, talk about someone who depends almost exclusively on Social Security, about cutting their benefits. And that is a crisis.

Especially for women in America, who as Ms. Entmacher pointed out, earn less than men do when they retire. Because they have done their business of helping raise the next generation. And they get penalized for not being able to stay in the workforce as long as men do. Those are the crises that we have to address. But Social Security? With $2.8 trillion in reserves? Is that a crisis today? No, I would call a federal budget operating deficit in the hundreds of billions as something that we have to tackle today. I think we have time to deal with Social Security on a bipartisan basis. But we should not try to panic Americans, especially young Americans, who today do not know where they are going to have their retirement savings. Because now these defined contribution plans could be like Enron. Where poof, it is gone if that company does not make good investment decisions.

And so I think we should be careful about how we discuss Social Security. Because I do not think anyone can name me a private sector program that works as a retirement benefit, disability insurance, and a life insurance policy all at the same time and over 78 years, never having once failed to pay on time and in full. So I can name a lot of Enrons in the private sector. We can talk about the crisis in the Veteran's Administration. Social Security is not one of those. But the important thing is, we should not let Social Security become one of those failures by underfunding it with its budget.

It is growing in the number of people that it has to serve. Yet its budget is smaller today than it was 4 years ago. And Mr. Chairman, whether our Republican majority in the House of Representatives wishes to hold a hearing, as it should because of our oversight responsibilities under the Constitution, to determine how the Social Security Administration is doing, this will come back to haunt anyone who wishes to hide under the rocks about this budget for Social Security.

Ms. Entmacher, women have a tougher time in retirement because they live longer than men and they earn less in retirement, whether it is through a private pension plan or through Social Security. What would happen to that population of women, who are going to continue to outlive men, if we were to cut benefits by, say, doing the chained CPI and also continue to see the budget for the Social Security Administration be well under what it needs to be able to provide sufficient services to those Americans?

Chairman JOHNSON. The gentleman's time has expired, so please be brief.

Ms. ENTMACHER. I will. The chained CPI is a way of computing the annual cost of living adjustment that is lower, and I would say less accurate, than the current rate is computed. That adds up every single year you live. It is kind of like compound interest in reverse. And we calculated that for a single elderly woman receiving the median benefit, by age 80, her benefit would be cut by $54 a month. Which may not sound like a lot, but it is the equivalent of one week's worth of food every single month that she can no longer afford.

So that is a severe cut in benefits. Of course, the service cuts mean that it may be more difficult to access the Social Security benefits that you have earned if there is a problem, that you are receiving accurate benefits, if you need to change your bank account, it is just that much harder to get hold of someone to get it straightened out and make sure that you continue to get your benefits that you count on on time and in full.

Chairman JOHNSON. Thank you, ma'am. Mr. Tiberi, you are recognized.

Mr. TIBERI. Thank you, Mr. Chairman. Thank you all for being here today. I had a former governor in Ohio, a friend of mine, also a U.S. Senator, George Warner, when he became governor, said, "We need to do more with less." That does not mean we need to do less with less. We need to do more with less. And he succeeded in doing that. Let me share with you, because the budget has been talked about, these are numbers from the Social Security Administration. This makes a lot of sense. A higher number than ever, customers, Social Security recipients, use the Social Security online tools more than ever.

Which, there is obviously a cost savings. 50.9% in fiscal year 2013. Another great statistic. This is a survey. This is an annual survey, fiscal year 2013, from again, Social Security customers. 80.2 percent said that the Social Security office that they worked with provided services of excellent, very good, or good in 2013. 80.2 percent.

And I know that is true in the office near my hometown of Worthington, Ohio, just outside Columbus. So I think those are good things to remember as we talk about the Social Security budget. Mr. Chairman, I would like to submit for the record, two articles from the Columbus Dispatch. The first title, Democrats' Plan Won't Save Social Security, Congress's Budgeters Say, written on Thursday, July 17th by Jack Torre.

In that article, it says that a Senate plan that is designed to both preserve Social Security and expand its benefits for some by raising payroll taxes on the wealthy. The report by the Congressional Budget Office concludes that to make the Social Security solvent for the next 75 years, payroll taxes would need to be raised on all working Americans who pay Social Security taxes.

And in response to that, Mr. Chairman, a Tuesday, July 22nd editorial in the same newspaper, Stop Ignoring Good Advice: CBO Report Renews Calls For Leaders To Fix Financial Fundamentals. And in the text of the editorial, it says, "Promising people more benefits at no cost isn't new, especially in an election year. The Democrat-backed plan that purports to expand Social Security payments at no additional cost to most Americans simply isn't realistic, a fact backed by the Congressional Budget Office report last week that also provided a sobering reminder for the need to get serious about entitlement reform overall.

"Senate Democrats recently backed a plan that they said would preserve Social Security and expand benefits for many. They said that the increase would be paid for by payroll taxes on those making more than $117,000 per year, the current threshold above that Social Security taxes aren't levied. Unfortunately for the CBO, the math doesn't add up. The non-partisan research arm of Congress said to simply keep Social Security solvent for the next 75 years, payroll taxes would need to be raised on all working Americans."

And it goes on. I'd like to submit both of those for the record, without objection.

[The information follows:]

Columbus, Ohio • Aug 27, 2014 • 88° Partly Cloudy

The Columbus Dispatch

» Hot Links:

Democrats' plan won't save Social Security, Congress budgeters say

Sen. Sherrod Brown

By Jack Torry

The Columbus Dispatch • Thursday July 17, 2014 6:22 AM

Comments: 20 6 4 166

WASHINGTON — A fresh nonpartisan report casts doubt on a plan backed by Sen. Sherrod Brown that is designed to both preserve Social Security and expand its benefits for some by raising payroll taxes on the wealthy.

The report by the Congressional Budget Office concludes that to make the Social Security system solvent for the next 75 years, payroll taxes would have to be raised on all working Americans who pay Social Security taxes.

The findings appear to dampen hopes among Senate Democrats who want to increase monthly benefits by $70 for many Social Security beneficiaries while requiring higher payroll taxes on wealthier people.

Workers pay Social Security taxes on the first $117,000 of their annual pay. But the report concludes that even if workers were required to pay payroll taxes on income as high as $241,600 a year, it would not be enough to eliminate the projected shortfall in the Social Security trust fund.

The report concludes that even by taxing the first $241,600 a year in pay, Congress would have to raise payroll taxes by as much as 2 percent on people earning $50,000 a year.

Meghan Dubyak, a Brown spokeswoman, said that Brown's plan is designed to keep Social Security solvent through 2049. By contrast, she noted that the CBO was calculating what Congress would need to do to keep the system solvent for the next 75 years.

Brown's "approach has the overwhelming support of the American people, especially when compared to alternatives like cutting benefits or raising the retirement age further," Dubyak said.

Last week in a speech in Washington, Brown said, "Debate over Social Security should not be about raising the retirement age or limiting benefits. The debate over Social Security should be about retirement security."

The CBO report makes clear that without changes by Congress and the White House, the Social Security trust fund will be exhausted by 2033. According to the CBO report, the Social Security Administration "would no longer have legal authority to pay full benefits when they are due."

Under current law, working people pay 6.2 percent of their wages into Social Security, and their employers match that. The CBO concluded that to make the system solvent without requiring people to pay payroll taxes on income greater than $117,000, a worker earning $50,000 a year would face an additional $900 a year in payroll taxes.

Sen. Rob Portman, R-Ohio, has urged that Congress modernize Social Security, Medicare and Medicaid.

Last month at the National Press Club in Washington, Portman called on lawmakers to adopt President Barack Obama's 2013 plan to change the formula used to calculate the cost-of-living increase for Social Security. That would reduce the rate of growth in monthly payments to recipients.

Obama's plan was opposed by many congressional Democrats, and he dropped the idea from his budget plan this year.

jtorry@dispatch.com

Columbus, Ohio • Aug 27, 2014 • 88° Partly Cloudy

The Columbus Dispatch

» Hot Links:

Stop ignoring good advice

CBO report renews call for leaders to fix financial fundamentals

Tuesday July 22, 2014 4:25 AM

Comments: 11 0 0 28

Promising people more benefits at no cost isn't new, especially in an election year. But a Democrat-backed plan that purports to expand Social Security payments at no additional cost to most Americans simply isn't realistic, a fact backed up by a Congressional Budget Office report last week that also provided a sobering reminder of the need to get serious about entitlement reform overall.

Senate Democrats, including Ohio's Sherrod Brown, recently backed a plan that they said would preserve Social Security and expand benefits for many. They said the increase would be paid for by raising payroll taxes on those making more than $117,000 per year, the current threshold above which Social Security taxes aren't levied.

Unfortunately, the CBO found that the math doesn't add up. The nonpartisan research arm of Congress said that to simply keep Social Security solvent for the next 75 years, payroll taxes would need to be raised on all working Americans.

A spokeswoman said that the Democrats' plan "has the overwhelming support of the American people, especially when compared to alternatives like cutting benefits or raising the retirement age further." But that is the problem: People say they're worried about the nation's $17.5 trillion debt, but they also don't want to make the adjustments that will be necessary if we are to avoid fiscal disaster. Things such as raising the future retirement age slightly and adopting a different way of calculating cost-of-living increases, known as chained CPI (consumer price index), are two reasonable alternatives.

President Barack Obama was open to chained CPI in 2013, but removed it from his budget this year under political pressure. Lawmakers in both parties know the reality that entitlement reform will require some sacrifice, but most seem to lack the political will, out of fear of voter backlash, to face that head-on.

The Concord Coalition, a 22-year-old nonpartisan group promoting fiscal responsibility, got it right in its assessment to the CBO report. "CBO's long-term budget outlook shows there are no gimmicks to get around demographics," the organization said in a statement following the report's release. Concord Executive Director Robert L. Bixby called the CBO report "an invaluable reminder that elected officials in both parties must spend less time cooking up budget gimmicks and more time working together to figure out how to put the nation on a more responsible and sustainable path."

The same is true of all entitlements. Last month, Ohio Sen. Rob Portman, a Republican, reminded people that such nondiscretionary spending programs as Medicare, Medicaid and Social Security make up two-thirds of the federal budget, and that will climb to three-fourths within 10 years, to the point where it will consume 100 percent of U.S. tax revenues. That would mean an ever-deeper debt hole, weakened economic growth and spending diverted from other vital areas such as education and infrastructure.

This is no time for small tweaks or gimmicks that promise people what they'd like to hear: that there is an endless stream of money available to pay out more and more benefits. People should be able to count on vital benefits being there when they need them, but there simply is no free lunch — and that is a commonsense, bipartisan issue.

Favorite Print Story 4

WEEKLY ADS

ABOUT OUR EDITORIALS

Dispatch editorials express the view of the *Dispatch* editorial board, which is made up of the publisher, the president of *The Dispatch*, the editor and the editorial-writing staff. As is the traditional newspaper practice, the editorials are unsigned and intended to be seen as the voice of the newspaper. Comments and questions should be directed to the editorial page editor.

ABOUT THE DISPATCH

An independent newspaper serving Ohio since July 1, 1871.

- John F. Wolfe: Chairman and Publisher
- Michael J. Fiorile: President and Chief Executive Officer
- Jon B. Schwantes: Corporate Director of News
- Benjamin J. Marrison: Editor
- Glenn Sheller: Editorial Page Editor

ALSO IN OPINION

- Editorials
- Op-Ed Columns

Mr. TIBERI. Which brings me to a point I am going to make, and maybe Dr. Biggs, you can help me. Because in your testimony, you kind of touched on this. Some say, well, the crisis is not here. I have a 47 year old sister. She is a woman. She is my sister. She retires, her full retirement is in 20 years. Coincidentally, that is the same year that the report that you all provided, the CBO provided, said that the jig is up if we don't do anything.

Now, my sister does not have a whole lot of confidence, my 47 year old sister, as she is planning for her retirement today with two kids, that she is going to be taken care of. My even younger sister, who is 40, has less enthusiasm, to your point, about fixing the current system for what she is thinking about in terms of retirement. Let alone my four daughters, 5 through 11, in what this report means to them.

And so the Senate Democrat plan, I don't know if you have seen it, which the article and the editorial take issue with. If we are to expand benefits, raising payroll taxes on wealthier Americans to do it, wouldn't we be right back where we are today? Kicking the can down the road and impacting my four daughters? Since we are concerned about the wages of women?

Mr. BIGGS. Thank you for your question. In a sense, you wouldn't be right back where you were. You would be worse off. And the reason is this. I am not in favor of fixing Social Security by raising or eliminating the so called tax max on payroll taxes. I think that cap was put in place by Franklin Roosevelt for a reason so the system does not look like a welfare plan, so it is something that everybody pays and everybody receives out in reasonable measure. That it is not just a take from the rich, give to the poor kind of thing. And I think Roosevelt said this is for political reasons, to make it supportable.

On the sort of economics side, I do not think it is a particularly good idea, because eliminating the tax max effectively raises the top marginal tax rate by 12 percentage point, so you are going from, say, 43 percent today to somewhere in the mid 50's. I just think that is too high. But raising the tax max or eliminating the payroll tax ceiling in order to increase benefits actually makes things worse off. Because you are taking off the table one of the options that could have been used to make the system solvent. In other words, you cannot raise or eliminate the tax max twice.

So if you do that in order to raise benefits, then we have to come back and address solvency. And one of those options that was on the table is no longer on the table. And so then the folks who are sponsoring these plans have to say, okay, now that we have taken that off the table, what are we going to do to fix the system so that your sister or, by the way, me can have that when we retire. So I think that you really have to think, first, how do we pay for what we have promised? To promise additional benefits before you have paid for what you have already promised, it just confirms all the stereotypes people have about politicians. No offense.

Chairman JOHNSON. The time of the gentleman has expired.

Mr. Doggett, you are recognized.

Mr. DOGGETT. Thank you very much, Mr. Chairman, and thanks to each of our witnesses for your testimony.

My feeling is that Social Security is one of the most effective programs that we have ever approved in this Congress. I think one would be hard-pressed to find a family across America that has not had a family member who has obtained dignity in retirement as a result of Social Security; and, if they look back in the past, who suffered greatly when Social Security was not there.

Many of these families have a neighbor who is able to survive after a serious injury or a disability, because of Social Security disability; or, a child who would never have completed high school without the survivor benefits of Social Security.

Vital programs, and yes there are improvements that need to be made. I believe you have outlined what some of them may be. I'm willing to work as I believe my democratic colleagues, for the most part, are willing to work to make constructive changes to improve Social Security and be sure that it is there—not just for grandparents, but for our grandchildren.

There are some obstacles to doing that, and one of those obstacles is the fact that while we are told today that there is a broken piggy bank in the trust fund, there are always those who are out there who see that trust fund and the assets in it as an incredible profit center for privatizing Social Security. And right through the last round of elections we're advocating that the only solution to this impending crisis as it has been described is to privatize the Social Security system and break the bond that some were opposing in 1935—and have ever since—about an effective social insurance program.

And then there are those who suggest that Social Security has an impending crisis; and, therefore, the only solution is to cut everyone's benefits. If the only issues at stake are how much can we cut and how much should we turn these public assets, these benefits paid into the social insurance system to Wall Street, we will never get the changes that are necessary. I think some of them are modest. Some are more controversial and politically difficult to undertake, but we will never get the changes needed to ensure that we have longer term solvency for Social Security.

The suggestion has been made that the Social Security system is just so complex that it can't be fully understood and utilized. There are some changes that are necessary that relate to some of those complexities. I think the complexity mainly affects people at the other end of the income scale for whom Social Security is probably not the principal source of retirement security.

I think that for most Americans, like the women that Ms. Entmacher was talking about earlier, it's all pretty simple. You work hard. You pay in to the Social Security system. When you retire, when you become disabled or you lose a spouse or parent, you get Social Security benefits; and, relative to the complexities, we have Social Security offices around the country staffed with people—as my Republican colleague was just saying—who seem to be doing a pretty good job at 1200 local offices in explaining, based on their expertise, how the Social Security system works. And we have an 800 number that people can call if they're close by a Social Security system.

That means though that over the past four years that cuts have occurred in the Social Security budget that we have lost about one in 10 of the people who answer the phones or who are available to answer the questions. One in 10 of the people who answer the phones or who are available to answer the questions, and that's why the request that Mr. Becerra has made about the need for us to exercise our oversight responsibilities and look at the budget of the Social Security system is so very important.

As far as the complexities of this, Ms. Entmacher, you are an expert on how our Social Security policy affects older women, nearly half of whom would live in poverty without Social Security. Is the main problem that these women are having with Social Security's complexity, is that the real barrier that they face, that it's just too confusing and complex to make the right choices?

Ms. ENTMACHER. No. It is not. I mean the main problem that women have with retirement security is lower wages throughout their working life, caregiving responsibilities, the high cost of child care which often means that they can't really afford to work, because the wages that they get barely pays for child care.

And, yet, that means time out of the work force and less opportunity to build up Social Security benefits or retirement savings. It's just many women struggle to make ends meet throughout the working life, and Social Security is what they have to count on. And that's the main problem. And, unfortunately, many women work in very demanding jobs.

You know, people don't think of retail work as physically tough, but people are on their feet for many hours. People who are nurses' aides, that's an incredibly hard job, and they simply can't—even if they know that they can get more by waiting until their full retirement age to claim benefits, they just can't make it. And, of course, for both older women and men who have lost jobs in the recession, it takes much longer to find another job. And so many people, if they can't get reemployed, they have to claim at 62, because they have no other income. I think those are the major challenges that many people face.

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

Mr. RENACCI. First, I want to thank the chairman for holding this hearing. I want to thank the witnesses for their testimony. I am glad that we are here to discuss the role Social Security plays in Americans' retirement security. I think this is a very important topic, considering the solvency of the program and the rate at which older workers are retiring. According to the trustees' report, Social Security's present value of unfunded liabilities over the next 75 years equals 10.6 trillion, which is one trillion more than last year.

I have to be honest. I am shocked to hear our friends across the aisle when they say there is no cause for immediate action. Instead of addressing the issue we continue to kick the can down the road for future generations. This unfortunate reality is that government officials and American people do not have a good grasp of really our dire financial situation. Our country is more than 17 trillion in debt and digging our way out is not as simple as cashing in on Treasury securities.

If the Social Security obligations were added to our debt, our true liabilities could be well over 50 trillion. As a CPA and former businessman, I came to Washington to really bring business perspective to an institution that sorely lacks it. We cannot continue to jump from budget crisis to budget crisis, and as many of the witnesses have talked about—Mr. Kotlikoff and Mr. Biggs—we really have to start addressing some of these problems.

To help us really get on the right track, I introduced the Federal Financial Statement Transparency Act, which is a bipartisan bill that will lead to a more honest depiction of our nation's finances.

The Federal Government—think about this—requires public companies to have an honest depiction of their finances to sell securities, and the Federal Government should be able to meet those same standards and really show what our true liabilities are.

Mr. Blahous, what would the impact be on the Social Security trust fund if all unfunded liabilities needed to be paid out; and, is there cause for concern?

Mr. BLAHOUS. Well there absolutely is cause for concern and I think a point that was made here earlier today, although we do report the 75-year, what we call, the open group obligation, which is the $10.6 trillion obligation, I think the actual amount of unfunded obligations within the Social Security system is actually substantially higher than that.

The reason for that is that the excess or the shortfall is not something that actually sort of plays out gradually over time. It is actually something that is on the books now. There is an excess of benefit obligations over contributions for people who are already in the system, and that is actually about $24 trillion, and that is about 4.4 percent of future wages going forward. And that is a number we report in the Social Security trustees' report. So if you were to take this—what some people call the closed-group obligation and add that to the books now, you would add about $24 trillion to our current liabilities.

Mr. RENACCI. So will Social Security taxes this year be adequate to fund benefit obligations, current benefit obligations?

Mr. BLAHOUS. They will not.

Mr. RENACCI. Okay. How far short will they come this year?

Mr. BLAHOUS. About $80 billion.

Mr. RENACCI. Okay. So where will that money come from to make up the difference?

Mr. BLAHOUS. Well when the payroll taxes fall short of benefit obligations, the difference has to be made with payments from the general fund. Right now, they would be in the form of interest payments from the general fund to the trust fund; and, a large share of those interest payments would go out the door immediately to pay beneficiaries.

Mr. RENACCI. So you are saying that the money flows from the Government's general fund to the trust fund?

Mr. BLAHOUS. Yes.

Mr. RENACCI. Does that portion of Social Security spending add to the federal deficit?

Mr. BLAHOUS. Yes, it does.

Mr. RENACCI. So 80 billion is added to the federal deficit this year?

Mr. BLAHOUS. That's right.

Mr. RENACCI. Why doesn't that get highlighted more in the trustees' report?

Mr. BLAHOUS. Um, well, there are a lot of different perspectives that the trustees' report takes, and a lot of the trustees' report is just devoted to diagnosing the actuarial status of the trust funds irrespective of the effect on the overall federal budget. Now there are certainly those of us who believe that we as trustees have a duty to put before lawmakers the implications of honoring Social Security obligations for the Government's general fund; but that is obviously something that if there was a feeling that we need to do more of that, that is something I can take back to the other trustees.

Mr. RENACCI. So we have 17 trillion in debt. We have potentially 10 to 20 trillion in unfunded liabilities. We could have over 50 trillion total liabilities just in those two areas; and we have 80 billion each year, at least this year, that is going to exceed what comes in. I would somewhat believe we have a current problem that we need to fix and it is something we can't kick down the road, as I continue to hear. This is an issue that we need to start looking into. And, Mr. Kotlikoff, I know you have mentioned some of those issues too.

Mr. KOTLIKOFF. Yeah. Well you are an accountant, so we have a kindred interest here. More than 1,000 economists, including 17 Nobel Prize winners, have endorsed something called the Inform Act. If you go to the InformAct.org, you will see that they have an endorsed bill, which is a bipartisan bill called H.R. 2967, and that bill requires Infinite Horizon Fiscal GAAP Accounting by the CBO, the GAO and the OMB on an ongoing basis. And what we are seeing here is the entire economics profession, with the exception of people like Paul Krugman on one extreme and Art Laffer on another extreme.

If you look at the names of these people, they are on the right and the left. You have got people like Glenn Hubbard and Jeff Sachs agreeing to do Infinite Horizon Fiscal GAAP. So the economics profession is not confused about how to do the right accounting. The trustees of the Social Security Administration are hiding the right accounting.

In their Appendix, they have actually moved it back this year to Table F–61 in the Appendix used to be not in the Appendix. Now it is buried in the Appendix. And that says what is really going on is that the end funded liability of Social Security is actually 60 percent larger than the 75-year number you are focused on. So this system is actually in far worse shape, and it is part of the country's fiscal policy that is in far worse shape.

And, yes, Mr. Becerra, it is absolutely true that when you run a trillion-dollar war, okay, over 10 years, and you get nothing out of it for real in terms of any real success, that adds a trillion. And if you don't pay for it, that adds a trillion dollars burden to your kids and my kids and everybody else's kids. So we have to understand that we are engaged in take as you go policy. It is not pay as you go, but take as you go policies on a wide-scale basis.

We have been changing the tax structure to lower taxes on asset income that shifts, and more on wage income that shifts taxes away from older people towards younger people. We are doing a lot of things that are burdening everybody's children. So there is the issue of generational equity. There is the issue of intragenerational equity. We have to look at both of these.

And if you go to the PurplePlans.org, one of the websites they send you to, you will see a set of plans that have been endorsed by a lot of economists that I developed. Each one is post-card length. It does involve the reform for Social Security, for taxes, for healthcare, comprehensive for the financial system. This is what economists would do to get rid of our overall fiscal gap, and you guys could agree on it, because it is including blue and red considerations here.

That's why it is called purple. And many, many economists, including Nobel Prize winners, have endorsed these plans. So I encourage you, A, to vote to pass the Inform Act. So we started doing proper fiscal accounting, comprehensive fiscal accounting, Infinite Horizon Fiscal Accounting, which is the only proper thing that economic theory says to do, and then also to adopt the Purple Plans, which will get rid of the fiscal gap.

Chairman JOHNSON. Yeah. The gentleman's time has expired.

Mr. KOTLIKOFF. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you.

Ms. Schwartz, you are recognized.

Ms. SCHWARTZ. Thank you, Mr. Chairman.

As Mr. Becerra here, like where do you start in the conversation we are having. Let me first say that I don't think this is a surprise to anyone. We have this recent report, but we know that Social Security has issues going forward that really is not a divide between Republicans and Democrats. It really isn't. How we solve it is, which is why we keep having hearings about what the problem is, rather than how we are going to solve it.

That is really what we are dealing with, yet again today. I can tell you the number of hearings I have been to that describe the fact that whether it has actually gone with a longer time. We have until 2033. That's a good thing to have time to work it out. But no one disagrees that we should tackle this issue. The issue is how do we tackle it. And we, as Democrats, believe that Social Security has been a strength for this country to be able to say to people as they age that you will not die in poverty, and it has worked.

We start there, and we start with an understanding, particularly having just gone through the recent recession, that in fact converting it to a 401–K does not provide that kind of security. And that's been suggested, to privatize it, give people a right to invest it any way they might. You go through another 2008, how many of you have lost money in your 401-Ks? I assume every one of you have one, and you all lost money in it. Now, maybe you are young enough to be able to make up for that, but if you were 70, maybe not so much.

So what we need to be focusing on, really, I am interested that none of you are also offering solutions. I know you have talked about two very important aspects that we have to take into account here. One is the demographics of what is happening for seniors. We have a lot more of them, 10,000 more a day, 40 million more seniors. You call Social Security, they tell you that. They say there are 40 million seniors out there who are calling us right now. So you might have to wait. And I don't think they are all calling every minute, but sometimes many of them are. And we don't have enough people to answer the lines, but they do get back to you.

And that is a huge problem for the next 20–25 years, maybe 30 if medical science is really, really good, and we diet and exercise. But we're not going to live forever. This is not a problem for 75 years. It's a really important blip, which is why we have a surplus in the Social Security trust fund. We occasionally have to put it back in, because we borrow against it, but the fact is that money is there. We raised it in 1983.

Congress realized that they needed to put some extra money in for all those millions of extra seniors. So the fact is we reasonably don't want to talk about the crisis because of what some of you have been saying, is that we want young people, and those approaching retirement, to understand that Social Security will be there for them, because we are committed to making sure it is.

Those benefits have been important to America. It keeps seniors out of poverty, particularly women who get lower wages and have less Social Security benefits. So we have work to do. So one of the other things you have not mentioned in addition to the issue about the demographics is income inequality and wage inequality in this country. So you can talk about four percent. Who said we have to add four percent wages?

The fact is that in the last two, three decades wage disparity may be unpredicted by the great economists of this nation, but certainly it was a deliberate result of particularly tax cuts to the very wealthy and the way we treat unearned income in this nation. So it is we have to understand that there are few people earning money; but, we are now taking out of Social Security, my staff tells me, 82.5 percent of payroll is what we tax—America taxing a lot of payroll. You all nod, say yes. Is that correct? You talked about that.

Ms. ENTMACHER. Yes.

Ms. SCHWARTZ. We have. That's right. So one of the ways to look at this is are we being fair to the workers you have talked about? Not just our children and grandchildren, but right now are we being fair to workers if we are actually the cap has not been growing as quickly as it might, given the wage disparity and income disparity in this nation. So while you keep talking about cutting benefits and making Social Security a private system and other ways to do it, you have really not talked about the fact that there is a lot of wealth and a lot of income that we are not touching out there that could help solve this problem.

And I would say to the Chairman I would love to see this committee actually have a hearing about how we would solve this problem. Because what we do by just talking about it as a crisis is to scare people, and we scare people, we don't make very good decisions. So while some of you said let's not rush into it—I think you said that—let's not do it because you are scaring people that Social Security won't be there for them. It will be there for them if we actually make a commitment as a Congress to protect Social Security benefits and the legacy going to the future.

So it is hard to ask a question, because I am not sure that you will answer it the way I wanted to given the balance——

Chairman JOHNSON. Well your time is expired.

Ms. SCHWARTZ [continuing]. but my time is expired. So the question to each and every one of you is to really work on solutions to this, not just the crisis, and to ask the Chairman to actually focus on what will work to protect and secure Social Security into the future. That's what we want to be discussing today. And I yield back.

Chairman JOHNSON. Thank you.

Mr. Kelly you are recognized.

Mr. KELLY. Thank you, Mr. Chairman, and thanks for having the hearing. And thanks to all our panel for being there.

I sometimes get confused. I came out of the private sector. And so when you start talking about who provides the revenue for all these programs, I think sometimes it is the government. And we all know that that is not true. These are based on wage taxes or transfer from the general fund, which are based on taxes that are levied onto every single hardworking American taxpayer.

So as we put this back and forth, and while we don't want to politicize, we absolutely do. Is there anybody that would disagree with me that the only way, the only way to get this fixed is to look at where the revenue streams come from and understand that that flow has been interrupted with an economy that just hasn't recovered in a nation that has unbelievable assets. So we can go back and forth with this about Republican/Democrat problem. This is not a Republican and Democrat. This is an American problem.

Am I mistaken? I have signed pay checks for a long time. 6.2 percent of every person I signed a pay check for, I also matched what I paid them. They put 6.2 percent in. The dealership puts 6.2 percent in. It was 12.4 percent. So am I misunderstanding where the revenues come from? Mr. Schieber, go ahead.

Mr. SCHIEBER. Well most of the revenue does come out of payroll taxes.

Mr. KELLY. Right.

Mr. SCHIEBER. Now, of course, there is interest being accrued on the trust fund balance. Certainly, a portion of the kind of immediate growth in the unfunded liabilities, the immediate—the reduction in the period of benefits that are going to be paid—is related to what's happened to the economy over the last several years. But since 1994—we are actually celebrating the 20th anniversary this week, I guess, with the release the trustees' report—the trustees have been telling us that there is a big demographic problem, that the system has to be rebalanced. There is a demographic problem. So a major portion of it is the demographics.

Mr. KELLY. No. I get it. It's like the navigator on the Titanic saying, listen. There's an iceberg out there. Maybe you ought to change where you are going and actually maybe scale it back a little bit. And the captain saying, oh, the heck with that. You don't understand. Not even God could sink this boat. Now, having said that, because I'm worried about this—workforce participation is at the lowest rate it has been in 36 years. Now, I'm looking at these taxpayers the same way.

There's an old adage about don't worry about the mule, just load the wagon. The mule's about ready to unhitch himself and say I can't pull this load. It's too heavy. Or that, add another mule to help me pull it. When you have that many people, when you have almost 92 million Americans opting out of the labor force, do you think over the course of time that could have effect on the revenues we need to run this country? Is there anybody that disagrees with that? Because I am trying to figure out, you know, we have all these willing hearts but we have weak wallets. Where does the money come from? Is there anybody out there? Forget about the government paying for this stuff. The government doesn't pay for one red cent. American taxpayers do.

We have gone so far away from what this—how it works. It just drives me nuts. We sit around here almost arguing how many angels we can fit into the head of a pin, and the meanwhile we have got a program that is a great program, but it is not funded the right way. And we also, by the way, not everybody deriving a benefit has put any money in. So let's not get to out of whack on that.

Mr. KOTLIKOFF. Yes, sir.

Mr. KELLY. Yeah, Mr. Kotlikoff?

Mr. KOTLIKOFF. Well, yeah. I think there is a resource everybody here could use, which is economists. And I know we don't have the greatest reputation in the world, but——

[Laughter.]

Mr. KOTLIKOFF. But, you know, if you do look at the PurplePlans.org, you will see a fix for Social Security for the tax system. We can do things on the tax system. We can do things on the tax system that the Democrats would like, the Republicans would like. You know, for example, that would actually, I think, improve the progressivity of the system, but in the process shift the corporate tax from the corporations onto the households, the shareholders, in a way that would bring more business back into the country, keep businesses from leaving, get more jobs here. We have a very difficult international competitive situation. We have a very difficult problem with smart machines taking people's jobs.

But on the Social Security issue, Ms. Schwartz, the solution—there is a solution that is different from just maintaining the current system, which, if I actually sat down with you for a day and went through the inequities and mistreatment of low income people, high income people, middle income people, this is like a random lottery, what you get out of the system, because it is so complicated.

If you don't know—and you can't call the Social Security system—whether they are well paid or not, whether they have more people or not, they are giving the wrong answers routinely. I know this because I have a little company that does Social Security software. I also write a column every week for PBS News Hour about Social Security. I get people e-mailing me and writing me every day about the mistakes Social Security is making. These are the people that are getting to the people on the phone. It is too complicated.

So one idea on the Purple Social Security Plan—and this is not privatization as you know it, but it is individualization—but it is progressive—think about taking, freezing the old system in place, paying off everything that is accrued, and by putting zeroes in the earnings record, and then going to a new system for Social Security where everybody contributes eight percent of their pay to a single account, where they have their own name on each account, but the contributions are divided 50–50 between spouses and legal partners.

The government makes matching contributions on behalf of the poor. It is all invested in one way—not by Wall Street, but by a computer, a laptop, in a global market weighted index fund with a floor. So the government would guarantee a zero rate of return, so if we have a crash, but everybody gets the same rate of return.

And at the end of the accumulation phase, the government would annuitize the account balances on a cohort basis.

Chairman JOHNSON. The gentleman's time has expired.

Mr. KOTLIKOFF. That's okay.

Ms. SCHWARTZ. And I do want to apologize. I believe this was Mr. Kelly's time. So you may want to be answering his question. I apologize, Mr. Chairman. This was not my intention.

Mr. KOTLIKOFF. No. I am trying to give you a solution.

Ms. SCHWARTZ. I am curious to know whether his plan actually taxes people above the 170,000 cap that is now in your system.

Mr. KOTLIKOFF. One of these plans just eliminates the ceiling on the payroll tax, if you look at the Purple Tax Plan. So it is a set of plans.

Ms. SCHWARTZ. Well you may want to speak to Mr. Kelly about this. He was saying everyone was treated exactly the same, and people are not, because there is a cap on the income.

Mr. KOTLIKOFF. I guess what I am trying to say, really quickly, is that we have a lot of——

Chairman JOHNSON. Okay.

Mr. THOMPSON. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you.

Mr. Thompson, you are recognized.

Mr. THOMPSON. I would hate to deprive you of the opportunity to mention the Purple Plan a couple more times.

[Laughter.]

Mr. THOMPSON. I want to just comment on a couple of things that have been said today. We are at the time of the hearing where just about everything has been said. My friend from Pennsylvania, I don't want you to think you are the only person who has come out of the private sector. A lot of us have, and some of us are still writing checks on our private sector businesses. And we know well how things operate. Some things, while the private sector is great, I wouldn't trade my business for anything.

There are some things that need to be left to the government, and I think everybody would agree with that to some degree. And I don't know how far out that iceberg was when whatever exchange happened between the captain and the observer. We don't have black boxes back then. So probably we will never know, but I doubt strongly if it was 19 years out. And that is a point that I——

Mr. KELLY. Well we can get a different rate of speed than the Titanic, though.

Mr. THOMPSON. I think that is a point that has to be reiterated, because any failure to do that does put us in a position where a number of people have mentioned it becomes an issue of frightening people. And we should be ashamed of ourselves if we are frightening senior citizens. And I don't think my district is made up of people any different than anybody else on this dais, but when the rhetoric gets ramped up, I have people come to me all the time worried about whether or not Social Security is broken, broke, bankrupt. The wheels aren't falling off of this call for a while.

Now, granted, we do have problems that need to be worked on as Ms. Schwartz said. That's what we should be doing is trying to figure out how to solve these problems, not trying to figure out how to whip up everybody into some fear position where it benefits somebody politically. In regard to the Social Security, every one of us in this room factors Social Security into our retirement. Every constituent we represent factors Social Security into the retirement. This is not something that we only talk about in this hearing or in political ads, but I can tell you that my constituents want a Social Security office that is open. So if they need something, they can go down there. They can sit and talk to the people.

Ms. Entmacher mentioned the computer stuff. You know. I have young Social Security recipients who feel better about going in the office and sitting down with a human being rather than trying to do a calculation online. And I think we do a terrible disservice when we deprive folks of that opportunity.

I want to ask Mr. Blahous. You are talking about this shortcome. Do you factor in the interest on the trust fund in your calculations? Because your numbers are a nine-day difference between the numbers that I got from our staff, and we show a $19.3 billion surplus.

Mr. BLAHOUS. Well it depends on what you are asking.

Mr. THOMPSON. I know it always depends on how you figure. Figures never lie, but——

Mr. BLAHOUS. Well I was asked the question as to what was the relationship between payroll tax revenue and expenditures. So that answer, of course, excluded the interest.

Mr. THOMPSON. So is it accurate that we have a $19.3 billion surplus factoring in the tax revenues of 883.4 billion, interest of 99 billion, operating expenses of 5.7 billion?

Mr. BLAHOUS. It is accurate that the trust fund had an increase in its balance. The amount of trust fund assets increased. From a trust fund perspective, we had a surplus. If you are asking me from an overall budget perspective did we have surplus, the answer is no, because the interest payments are from one government account to the other.

Mr. THOMPSON. Well, Mr. Chairman, I would like unanimous consent to put these accurate numbers into the record, because I think it was very misleading to go down that road. And I'm assuming staff can put a proper draft together for you, but again it just feeds into the idea that we are going to frighten people, and I don't think that is right. I think right would be all of us sitting down and figuring out what sort of tweaks we needed to make to make the system work. And could you just by a show of hands, how many of you on the witness table believe we should privatize Social Security?

Mr. KOTLIKOFF. You need to define what you mean.

Mr. THOMPSON. No. No. I didn't ask for any commentary. So nobody thinks we should privatize Social Security?

Mr. KOTLIKOFF. Well I think we should individualize it. I am not sure we should—I wouldn't privatize it the way President Bush proposed.

Mr. THOMPSON. My time has expired. Thank you.

Chairman JOHNSON. Yes, it has. Thank you. And we will put this in the record.

[The information follows:]

Operations of the Combined Social Security Trust Funds, 2014

<u>Income</u>:

Worker contributions (FICA and income tax): $783.4 billion

Interest Income (Trust Fund-owned Treasury bonds): $99 billion

Total income: $882.4 billion

<u>Cost</u>:

Benefit payments: $852.8 billion

Administrative Costs: $5.7 billion

Total cost: $863.1 billion

Projected 2014 surplus: $19.3 billion

Source: 2014 Social Security Trustees Report (Table IV.A3)

Chairman JOHNSON. How about Mr. Griffin? Are you?

Mr. GRIFFIN. Thank you, Mr. Chairman. Appreciate it. It was great to hear my colleagues say that they would never use Medicare or Social Security to scare people. Make sure your party leadership knows that. That will probably be a news flash.

Mr. Blahous, I want to ask you from a practical standpoint, let's say we get to the point where the trust fund does not have the money to pay out. I think a lot of people, a lot of Americans sort of feel like, yeah. Well, on paper that will happen at some point, but maybe my benefits will never be affected because we will just borrow it. Right? So I want you to walk me through what the practical impact would be in terms of where the money would come from if there are benefit cuts. So I assume we would have to find in general revenue the money to shore up the fund, the way sort of we have done with the Highway Trust Fund.

That would come out of discretionary fund and we wouldn't have that money, most likely. So that would be borrowed. Could you sort of walk through what the practical implications of that would be? Could we even borrow that much? How much money are we talking about borrowing when we get to the point where we don't have enough money to pay out? And all the bad things that we have heard—you know, benefits being cut and all that? What would we have to do if reforms do not occur? What would we have to do to continue on the path that we are on?

Mr. BLAHOUS. Right. At the point where the combined trust funds, assuming we reallocate taxes between the trust funds and then they are depleted in 2033, one of the common methods that the trustees use to describe quantities within the Social Security system as a percentage of the program's tax base. So, for example, in 1983 when we had a shortfall to close, the long term shortfall was described as 1.8 percent of the program's tax base.

In order to fill that, they delayed the COLAs by six months. They exposed benefits to taxation for the first time. They brought in newly hired federal employees. They raised the eligibility age, et cetera. They did all these things, and that added up to about 1.8 percent of the tax base. And they did about half of it on each side, half of it on the revenue side, half of it on the benefit side.

If we wait until 2033, our shortfall, our annual shortfall will be about 4.2 percent of taxable payroll. So we would have to make changes. Again, heeding the admonition about not wanting to scare people, but you may have to make changes over twice as severe, about two and a half times as severe. And the question is would our political system, would the people on the right be over twice as willing to raise taxes as they have ever been willing to do before. Would people on the left be over twice as willing to cut benefits—both of them twice as willing?

Mr. GRIFFIN. What about people who would say—and I am not advocating this, but we would just borrow that money. How much are we talking about here?

Mr. BLAHOUS. Right. Well, yeah, exactly. Again, it is in dollar figures. It's going to be much, much bigger, because we are looking way into the future. And so that is why we tend to do it as a percentage of GDP or as a percent of taxable payroll. But you would have to borrow—if you wanted to do it through borrowing—you would have to borrow an amount that equaled over four percent of what workers are earning, and that is a tremendous amount of money.

Mr. GRIFFIN. Right. That is not an option is the point. Is that what you are saying? In terms of getting that money, borrowing that sort of money, adding that to the debt?

Mr. BLAHOUS. My personal view—and this is not necessarily a consensus view among experts, my personal view is that at that point it is a bridge too far to balance system finances. And we wouldn't be able, politically——

Mr. GRIFFIN. Right.

Mr. BLAHOUS [continuing]. to sustain the system without turning it into a program that is financed from the general fund. And then we would lose a lot of the things that have made Social Security a stable, reliable benefit over the years.

Mr. GRIFFIN. Well that is scary to me, and I am not a senior yet. I hope I make that, but that is scary to me in and of itself. Let me ask you real quickly. Could you talk a little bit about our culture and the role that Social Security played in the early days versus now in terms of whether people had in the early days other sources of income for retirement versus today? Has there been a movement? And I think I know the answer to this. Has there been a movement over the years to rely solely on Social Security for a bigger percentage of the population, or is it the same, general—I'd like to know that. I see you shaking your head.

Mr. BLAHOUS. I think the first point I would make is that if we still had the system that was left to us by FDR we wouldn't have a financial shortfall right now. It is the subsequent expansions that have put us in financial trouble. You know. We added the disability component, later on. Perhaps it was an appropriate thing to do. Then we added early eligibility. People are now collecting at 62 more often than any other age.

Originally, they could only collect at 65. So we are collecting three years earlier and we are living a lot longer. And then in the 1970s we expanded. We added a 20 percent benefit increase and we started wage-indexing the benefits. And so now we have cost issues that we didn't have under the original design of Social Security. So when people talk about sort of the historic legacy, I guess, of Social Security, it is not the FDR legacy that is really in jeopardy. The program he left to us is stable. It is the subsequent expansions that are causing us the trouble.

Mr. GRIFFIN. I am out of time, Mr. Schieber, but the Chairman in his mercy might allow you to respond.

Mr. SCHIEBER. In 2008 there were $532.87 billion paid in Social Security benefits, that combined, IRA and pension annuity benefits paid to Social Security beneficiaries was $568 billion. So the benefits paid out of pensions and IRAs was actually larger than Social Security benefits. Last year we got tax data on both of them, and none of these tax qualified benefits existed or very minuscule amounts of them existed in the 1930s.

So there is a much greater dependence, now, on these tax qualified benefits, people's personal savings or personal pensions than we have had in the past. Of course, we haven't been reporting it. We have only been reporting 40 percent of it. So in terms of what you are generally being told, you have no idea what this other part of the retirement system is really about. It would seem to me that might be important when you think about retirement income security.

Chairman JOHNSON. Thank you. Ms. Entmacher, you look fidgety. Did you want to say something?

Ms. ENTMACHER. I would. Thank you very much.

First of all, yes. It is not Franklin Roosevelt's retirement program and that is a very good thing. I know that many people have pointed to what a great job Social Security has done in reducing elderly poverty since Franklin Roosevelt's days. And what may be less understood is that most of that decrease has come through the improvements that were made to Social Security that were just discussed, particularly for women, the automatic COLA, increased benefits for widows, those have been incredibly important and valuable.

Second, what is causing the shortfall in Social Security is not rising benefits. As has been indicated, benefits are actually going down from what they would have been because of the 1983 cuts. And in 1983 people tried to, and did for a couple of years, establish solvency for 75 years. What has created much of the shortfall is the growth in inequality, the shrinking of wages for ordinary Americans and the growth and wages at the top, which was not foreseen by people in 1983.

And, lastly, because trillions of dollars are really frightening, I would like to point out that the growth in Social Security's cost is about 1.2 percent of GDP over the next several decades and then levels off. 1.2 percent of GDP is less than what we had to come up with when the baby boomers were kids and public education was more expensive.

We spend about—I have the CBO estimates of tax expenditures, the tax expenditure for giving preferential rates on capital gains is one percent of GDP per year. We can afford to cover the shortfall and make improvements in Social Security. We shouldn't wait to do it, and we don't have to do it all at one blow, but we can reassure people that Social Security will be there.

Chairman JOHNSON. Thank you for your comments, ma'am.

And without objection I will insert into the record my response to Mr. Becerra's letter which was inserted into the record earlier.

[The information follows:]

Congress of the United States
House of Representatives
COMMITTEE ON WAYS AND MEANS
WASHINGTON, DC 20515

SUBCOMMITTEE ON SOCIAL SECURITY

July 28, 2014

The Honorable Xavier Becerra
Ranking Member, Subcommittee on Social Security
B-316 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. ~~Becerra~~: Xavier

Thank you for your letter requesting that Stephen Goss, Chief Actuary of the Social Security Administration be invited to testify at tomorrow's hearing.

As you know, the title of tomorrow's hearing is not "Hearing on the 2014 Annual Report of the Social Security Board of Trustees." Rather the title of the hearing is: "Hearing on What Workers Need to Know about Social Security as They Plan for Their Retirement." The financial status of the Social Security programs is just one of the many topics that will be discussed at the hearing.

Since I became Chairman of the Subcommittee on Social Security in January 2011, the Subcommittee has had two hearings focused solely on the findings of the Annual Report of the Trustees, one on June 3, 2011, and one on June 21, 2012. At both hearings testimony was received from the current two Public Trustees, Charles Blahous and Robert Reischauer, not Stephen Goss. The trustees sign the Annual Report, not the Chief Actuary. The trustees are the public officials who stand behind the report for the U.S. taxpayer and as Mr. Goss works for them, it is only correct that they appear as the official witnesses.

Both Dr. Blahous and Dr. Reischauer were nominated by President Obama and confirmed by a Democrat-controlled Senate via voice vote on September 16, 2010.

As always, the minority is welcome to invite a witness of their choosing to the hearing, and I fully respect any witness decision you choose to make.

Committee on Ways and Means
Subcommittee on Social Security
July 28, 2014
Page 2

I hope this information is helpful, and I look forward to working with you to address the many challenges facing Social Security.

Sincerely,

SAM JOHNSON
Chairman

Chairman JOHNSON. In closing, I want to thank all of you for your testimony and thank our members who are still here for being here.

Social Security is facing the biggest challenge since 1983, and the longer we wait the harder it is going to be to fix. In the meantime, workers can't be sure how to plan for their retirement, because they don't know what to expect from Social Security. We have got real work to do. Americans deserve a Social Security program they can count on with benefit amounts they can understand.

With that, the Committee stands adjourned.

Mr. KELLY. Mr. Chairman, I know we have just adjourned. I would like to hear you.

I know somebody who still wanted to respond I would like to stay and hear. I heard what you said, ma'am. I do not agree with you. And I think there are a number that would not. So I will stay and listen. I want to hear what you have to say. If this isn't a crisis, we had better look up in the dictionary what a crisis is.

Mr. KOTLIKOFF. This is a huge crisis. The country is broke and Social Security is broke too. It is not broke in 30 years.

Mr. BECERRA. Mr. Chairman, are we still in hearing?

Chairman JOHNSON. I will withdraw my adjournment. Go ahead.

Mr. KOTLIKOFF. Social Security is not broke in 30 years or in 20 years or in 10 years. It's broke today. We need according to the trustees' report Table F61, just go look at it. It's buried, but you can find it. We need a 4.1 percent hike in the payroll tax rate. That is a 33 percent hike in the payroll tax rate for Social Security, starting today, immediately and permanently, 33 percent tax hike.

That is in the trustees' report. This is what a thousand economists at every top school—Stanford, Harvard, MIT, Chicago, you name it, Princeton—17 Nobel Prize winners, and they are not Republicans. They are not Democrats. They are both. Okay? That is what they are saying to look at, guys. You guys keep talking about the 75-year numbers. Economics doesn't support that. It says you have to look at the Infinite Horizon. Now, this does not mean the system is broke.

Mr. BECERRA. Mr. Chairman, if we want to have more discussion, I think that is fine. I think it is always important as I think members have pointed out we want to get to the solutions rather than just talking about the issues. And so I think we can do that, but I think we have to do it in a way that is organized and constructive.

If we are going to have every witness comment, we can do that, but that is going to take more time. Mr. Chairman, so long as we can just establish how you want to do this, do you want to give them a chance?

Chairman JOHNSON. Well, what I would prefer to do is let you all submit something for the record. If you would care to, we will put it in.

And with that the Committee stands adjourned.

[Whereupon, at 12:50 p.m., the Subcommittee was adjourned.]

Questions For The Record
Charles P. Blahous III, Ph.D.

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

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

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

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

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

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

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

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

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

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

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

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

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

Each of the two measures referenced in this question compares the projected magnitudes of program costs to program income, one measure summarizing over the next 75 years, the other over all time going forward. A critical disadvantage of the measure truncated after 75 years (or after any limited time frame) is that it understates financial imbalances for a program financed in the manner of Social Security. The reason for this is that each cohort's payroll tax contributions are mostly spent immediately on current benefit obligations to older participants, while at the same time creating new entitlements to benefits that will not be paid out until a future date. Thus any limited time window will count many years of payroll taxes contributed by several birth cohorts, but not the benefits earned by those same payroll tax contributions, thereby understating total costs relative to income. This is one reason why Social Security's 75-year unfunded obligation of $10.6 trillion (in present value or PV) falls considerably short of its infinite horizon unfunded obligation of $24.9 trillion (PV), which does not suffer from this problem. On the other hand the infinite horizon measure has the disadvantage that "the degree of uncertainty" in the calculations "increases substantially for years further in the future," as noted in our report.

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

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

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

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

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

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

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

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

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

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

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

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

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

Sylvester J. Schieber, Ph.D.

6925 Meadowlake Rd.
New Market, MD 21774
(301) 865-6382

September 3, 2014

Mr. Sam Johnson, Chairman
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives
Congress of the United States
Washington, DC 20515

Dear Mr. Johnson:

Here are my responses to the questions you posed to me in your letter of August 21, 2014 as a follow-up to the July 29, 2014 hearing on "What Workers Need to Know about Social Security as They Plan for Their Retirement."

1. The complexity of the Social Security program means that many workers do not know how much they can expect to receive in benefits. How can the SSA make it easier for people to know what to expect in benefits so that they can adequately prepare for retirement?

Most people think about their income requirements in the context of their weekly or monthly budget needs. For people close to retirement, having a fairly close estimate of the level of Social Security benefits they will qualify to receive at various ages allows them to assess the gap between those benefits and their budgetary requirements to live in the fashion to which they are accustomed. For younger workers, it impossible to anticipate all the contingencies that workers will face that will have a bearing on benefits many years into the future—what might happen to Social Security policy, sectoral and cyclical changes in the economy that might affect their earnings prospects, and personal experiences that can affect their earnings capacities.

In 2009, the Social Security Advisory Board published an analysis of the Social Security Statement, and among other things, found that projections of benefits for workers close to retirement age were more precise estimates of actual benefits than those provided to younger workers. The Board suggested that for younger workers, an estimated benefit that assumed no further earnings—something akin to a disability benefit they would receive if eligible—might give workers a better sense of the benefits they would receive based on their recent earnings levels than one projected some decades into the future.

Mr. Sam Johnson
September 3, 2014
Page 2

In any event, benefits should be described in terms that workers can relate to in the context of their income needs. Most workers cannot consider the standard-of-living sustaining value of nominal dollars many years into the future that are not equivalent to the dollars they currently spend buying groceries, paying the utility bills, car and house payments, etc. At the same time, projecting benefits relative to wage-indexed earnings distorts the presentation of the real purchasing power that benefits will provide for workers who will not reach retirement for a few or many years into the future. Future benefits should be stated in real (price-indexed) dollars to put them on a consistent basis with the purchasing power that workers earn at the time any estimate is provided to them so they have a sense of the relative value of the benefits they will potentially receive.

2. Research like yours provides important insights into the Social Security program. Does Social Security make needed data available to researchers to enhance their ability to further examine the impacts of the program? What should change?

The answer to the first question is yes and no. It does provide substantial data to researchers to whom it has provided research funding. For example, most of the researchers associated with the Research Consortia that is spends millions of dollars per year funding have access to covered earnings record histories matched to survey respondents participating in the Health and Retirement Study. Individuals, like me, who do not have access to that significant research funding are also denied access to the to earnings histories matched to the survey data.

Social Security is a massive administrative operation and some of the data collected by the agency is used to produce a variety of recurring statistical reports. The reports this year look just like the ones last year for the most part. Occasionally someone suggests a new way of looking at the data that gets institutionalized as an added table in the *Trustees Report* or the *Statistical Bulletin*. Rarely, someone at the agency will develop special analyses that widen the understanding of the program. For example, the actuaries recently developed an analysis of benefits relative to various measures of lifetime earnings for claimants in 2011. They developed this analysis and published it as an actuarial note in the interest of defending their own particular definition of Social Security earnings replacement rates. But this analysis does not allow any outsider to analyze the same data to see how different perspectives might alter the results.

In 2005, the Social Security Administration released a 1 percent sample file of the Master Beneficiary Record (MBR) with a link to each beneficiary's historical earnings record—the *Benefits and Earnings Public Use File*. The sample was of all beneficiaries as of the end of

December 2004. Gaobo Pang and I have used this file to analyze earnings and benefits patterns of "retired worker" claimants across the spectrum of the AIME distribution. We have found that the Social Security actuaries' "very low" hypothetical earner and the "low earner" career earnings, to a lesser extent, developed by the Social Security actuaries are not representative of claimants who end up with low average earnings at the end of their careers. Our analysis also suggests that the wage-indexed replacement rates favored by the Social Security actuaries significantly underestimate the Social Security earnings replacement capacity for long-career workers relative to the real earnings levels these workers achieved during their careers.

This sort of analysis helps to clarify some of the questions raised by the Social Security Trustees and others regarding the extent to which Social Security benefits aid retirees in maintaining their standards of living. But the data we have available are 10 years old and a great deal has happened in the intervening time that is of considerable interest. No one has documented how the Great Recession resulted in changing claiming behavior of retirement benefits and what the implications of the changing behavior will mean for the adequacy of benefit levels over recent retirees' remaining lifespans.

Social Security should be making this data and other relevant administrative data, such as earnings records of active workers not yet old enough to claim benefits available for researchers like us. There are people besides those at the agency or those sponsored by the agency who have a critical role in understanding how Social Security affects current workers and retirees and how alternative policies may change how it does so in the future.

We have not sought or received any Social Security Administration resources to develop our analyses. Our results are based on publicly available data that can be verified or challenged by anyone interested in the issues we raise. In some regards, this sort of work is as relevant as that coming out of the Research Consortia and other grant research that the Social Security Administration spends millions of dollars sponsoring each year. If such data are made available each year and a wider group of researchers become familiar with their potential use, there is considerable prospect that the public understanding and discourse about the program's operations would be widened significantly at almost no public cost.

If you have additional questions or I can be of any further assistance, please let me know.

Sincerely,

Sylvester J. Schieber

Sylvester J. Schieber

C. Eugene Steuerle, Ph.D.

Questions for the Record
What Every Worker Needs to Know About an Unreformed Social Security System

C. Eugene Steuerle

1. Recent legislative proposals have focused on expanding Social Security benefits and dramatically increasing taxes, but would do little to address the program's financing challenges over the long-term. As we work to strengthen Social Security, should Congress look to expand benefits across the board, or should increases be targeted to help those poorly served by the current system?

2. Research like yours provides important insights into the Social Security program. Does Social Security make needed data available to researchers to enhance their ability to further examine the impacts of the program? What should change?

3. You note in your testimony how Social Security benefits grow automatically, regardless of actual changes in the needs of the public. What impact will leaving this program on autopilot have on future generations?

Recent legislative proposals have focused on expanding Social Security benefits and dramatically increasing taxes, but would do little to address the program's financing challenges over the long-term. As we work to strengthen Social Security, should Congress look to expand benefits across the board, or should increases be targeted to help those poorly served by the current system?

1. Social Security has always tried to maintain a balance between providing adequate levels of support for all workers and giving each participant some return on his or her contributions. The former appeals to a principle of progressivity and the latter to a principle of individual equity. In the first case, government usually tries to provide more for those with greater needs, in the second, people are mandated to participate in the retirement system so that they do not unfairly act as free riders (not contributing when working, then later spending down their money so that others have to support them).

   Because of the latter principle, I do not think that progressivity should be extended so far that Social Security becomes means-tested, by which I refer to cutting benefits to zero when income reaches some level. If people are mandated to contribute to their retirement, then they should get some retirement benefits back from that mandate. In addition, means testing on the basis of annual income works very poorly when people can decide to work or not or can shift their assets to children. However, Social Security does provide a type of lifetime "means testing" in that it attempts to provide greater returns to lower-wage workers.

   The complication is that despite the progressive rate formula for allocating benefits according to lifetime earnings, the old age part of the system (excluding disability) does not turn out to be very progressive, if at all. The system contains a number of regressive or unfairly distributed benefits, and the higher mortality rates of lower-wage workers. Forced annuitization, though appropriate for a retirement system, offsets much of the intended progressivity.

Now take a system out of balance, such as Social Security in its current condition. Either tax increases or benefit cuts must be enacted to bring the system back into balance. On the benefit side, benefits have expanded significantly over the decades, in no small part because more and more years of benefits have been provided as people's life expectancies have increased. The primary beneficiaries of these years of expansions have been higher-wage workers, so that, say, an extra six years of benefits at $50,000 a couple add up to $300,000 of additional lifetime benefits for those higher income groups.

My conclusion is that the system should start moving toward establishing a higher level of progressivity among the truly old, doing better by those at the lower-end of the spectrum by raising minimum and other benefits but reducing the rate of growth of real lifetime benefits at the top. Note that I would do this regardless of the overall eventual size of the system. I would also reform the system in ways that encourage employment, as we are moving to a system that will be providing benefits to close to one-third of the adult population, encouraging them to retire in what might be considered late middle age. Regardless of Social Security balances, this reduces personal income and GDP and income and other tax collections, and it threatens the well-being of many elderly who approach old age in decent financial shape in their early 60s but are not prepared for retirement in their late 80s or 90s.

Research like yours provides important insights into the Social Security program. Does Social Security make needed data available to researchers to enhance their ability to further examine the impacts of the program? What should change?

2. Yes. Data are crucial for performing analysis of Social Security. Confidentiality issues can be handled by engaging Social Security or other government researchers in collaborative nonpartisan research with outsiders, ensuring that confidential data are not revealed. The Social Security Administration (SSA) has made headway in the recent past, e.g., establishing the Retirement Research Consortium (RRC), but funding for research has been cut in recent years. The research staff at SSA, for instance, has cut back staff significantly, and RRC funding has declined.

   High on the list where progress has been very slow is in the area of merging Social Security records with other sources (income tax records, surveys, Medicare records) in ways that would allow us to answer all sorts of questions not just on Social Security, but economic mobility (Social Security is the only agency with lifetime earnings histories), health by lifetime income, combined progressivity and benefits provided by Social Security and Medicare (and, for that matter, Medicaid), and much else.

   Keep in mind that with administrative records or with surveys already conducted, the public has already paid for most of the cost of gathering the basic information. Yet much of that information is not assembled or presented in ways that could answer many questions.

As I see it, there are at least three levels of problems in getting adequate levels of Social Security research performed.

The first is that no one is held responsible for insuring that at least some minimum level of good research is done. SSA has turned more and more to administrative matters, partly because research, even simple factual information, may be disliked by some portion of the population or political community.

The second is ensuring adequate resources, and this includes the ability of SSA to hire enough top-notch staff who understand the issues and the assignment of enough people to partake in collaborative research.

The third is adequate guidance, sometimes by Congress, as to what is allowed. Otherwise, legal advisors will almost always be tempted to take the easy way out of simply blocking the research or making it hard for very many to undertake it. For instance, researchers must have a government grant or contract to be able to use Health and Retirement administrative data at their own site under careful conditions. This leaves out many potential research projects that could be done with data for which Congress has already paid the cost.

You note in your testimony how Social Security benefits grow automatically, regardless of actual changes in the needs of the public. What impact will leaving this program on autopilot have on future generations?

3. As I discuss in more detail in a book, *Dead Men Ruling*, the complication with fore-ordaining where most future spending will go is not that it is ill-intended. It is simply that we do not know the future and therefore simply cannot direct it efficiently or fairly. No business would sign contracts for all the plant and equipment it is going to buy 50 or 100 years from now even if it expected to have a lot to spend on such items. One consequence of so many attempts to control the future is that the budget for children and infrastructure and other major functions of government are in significant decline even as health and retirement spending keep ratcheting upward. Along with interest costs, they now absorb just about all projected growth in direct spending as the economy grows. This spending is also designed in a way that discourages work in late middle age and maintains a late-19th century view of an industrial order where education, work, and retirement occur in three distinct periods of life, rather than in more of a continuum over a lifetime. To be clear, tax cuts that are not financed by spending cuts add to interest costs and also attempt to foreordain a future that has not arrived, as do many tax subsidies (e.g., housing subsidies that grow as ever larger McMansions are built).

   Congress was given the power of appropriations for a reason. I do not believe the founders of this nation intended for past Congresses essentially to take that power away from current and future Congresses.

Andrew G. Biggs, Ph.D.

Response to Questions for the Record. Social Security Subcommittee, Committee on Ways and Means. Hearing on "What Workers Need to Know About Social Security as They Plan for Retirement." July 29, 2014.

Andrew G. Biggs, Ph.D. Resident Scholar, American Enterprise Institute

1. A number of recent proposals from Members of the House and Senate and independent think tanks would significantly expand Social Security benefits. In my view, an overall expansion of Social Security benefits – that is, an increase in the *total benefits* the program has promised to pay – would be costly and largely ineffective. The program is already underfunded by $10-$15 trillion over 75 years (based on Trustees or CBO projections). Raising benefits makes the system's funding problems more difficult to solve. Just as importantly, most expansion plans would not effectively target benefit increases on individuals who are currently poorly served by the program, such as those who retire after only short attachment to the labor market. Raising benefits across the board would not help these individuals very much. There *are* reforms that would help improve the social insurance protections provided by Social Security. For instance, I have proposed a universal benefit paid to all retirees regardless of work experience that would effectively eliminate poverty in old age. But once such reforms are implemented, there is little need to increase the size of the program. Thus, policymakers should focus on making Social Security work better rather than simply assuming that "more is better."
2. There are two ways to consider targeted reforms for Social Security. One is to focus on individuals who have low lifetime earnings but do not receive adequate benefits from the program. For instance, low-income individuals with little attachment to the labor force may not even qualify for a Social Security benefit. Likewise, a couple with long careers at low wages will receive benefits, but may not receive as much (relative to their earnings or contributions) as a high-income household with a single earner and a spouse who does not work. Targeted reforms can helps these classes of beneficiaries. A second approach is to consider individuals who might receive decent treatment by Social Security, but are unlikely to be able to save enough outside of Social Security to provide of a decent retirement income. These may include those who are not offered pension plans through work. In addition, some research points to single women as being likely to fall short in retirement. For these individuals, however, the Social Security benefit formula may not be able to target benefits adequately. Thus, efforts to expand retirement saving outside of Social Security – such as through automatic enrollment in employer pension plans or the provision of savings accounts for workers who are not offered a retirement plan on the job – may be the best option to increase retirement security.
3. The Retirement Earnings Test has two parts: first, for early retirees who continue to work, monthly benefits are reduced by 50 cents for each dollar of earnings over a given threshold (currently around $15,000). Second, once the individual reaches the full retirement age his benefits are recalculated to make up for anything benefits earlier lost to the RET. Over the course of an average lifetime, total benefits are about the same with or without the RET. However, many individuals are aware of only the first element of the RET and view it as a 50 percent "tax" on their benefits, over and above the other taxes they pay. As a result, many early

retirees work up to the earnings threshold but then stop, unaware that any benefits lost to the RET are "repaid" later. SSA has in the past not been very good at informing the public about both sides of the RET equation; the agency was very good at describing how benefits were reduced, but often would not tell the public about the benefit recalculation at the normal retirement age. During my time at SSA we redesigned the agency's educational material to more accurately describe the full effects of the RET so that the public would no longer view the RET as a "tax." This information has begun to be absorbed by financial advisors and newspaper columnists, which is a very helpful change. I am less sure whether the updated information is being consistently conveyed through SSA field offices.

4. In my testimony I noted that many individuals have a hard time predicting what their ultimate Social Security benefit will be, which makes it more difficult for them to decide how much to save for retirement and when to claim benefits. The basic reason for this "predictability risk" is simply that the Social Security benefit formula is extremely complex. To understand, first consider how a typical private sector defined benefit pension is calculated: workers simply multiply a percentage of their final salary by the number of years of employment. This allows for relatively easy estimates of future retirement benefits that can be updated "on the fly." But now consider how Social Security benefits are calculated. First, the worker's past earnings are indexed to the growth of average national wages. This involves multiplying the ratio of earnings in a past year to average wages economy wide in that year by the average wage in the year the worker turned sixty. Earnings past age sixty are not indexed. Next, Social Security averages the highest thirty-five years of indexed earnings. These average earnings are then run through a progressive benefit formula to produce the Primary Insurance Amount payable at the full retirement age, currently sixty-six. However, if this benefit is less than half of the benefit received by the higher earning spouse in a married couple, the lower earning spouse is eligible to receive a spousal benefit instead. Spousal benefits may be collected off the earnings record of former spouse, but only if the marriage lasted at least ten years. Whatever benefit is received is then reduced or increased based on whether benefits are claimed before or after the full retirement age, which is itself increasing for those born between 1954 and 1959 . Finally, the retirement earnings test may reduce benefits for early claimants who continue working. Few Americans are aware, however, that at the full retirement age benefits are increased to account for reductions due to the earnings test. In short, these are simply not the sorts of calculations most individuals can do on their own. My own research appears to show that the increasing distribution of the Social Security Statement has not improved near-retirees' abilities to predict their benefits.
5. SSA's field office employees and those who man telephone lines are given an extremely difficult job: the system itself is terribly complex, and more frequently today individuals are looking to exploit the technicalities of the system as part of "claiming strategies" to maximize benefits. In reality, it is difficult to expect SSA employees to know every aspect of the benefit formula, though in my experience SSA staff often know a great deal that even a policy analyst (such as myself) does not. Efforts to improve SSA's communications with the public should continue; I believe SSA's educational materials have improved and now the main issue is getting these messages to the public. But much of the problem is inherent to the program itself: if Social

Security is complex there is only so much that SSA staff can do to make it simple for participants. Congressional reforms should push for simplicity along with solvency. At the very least, reforms should not make the system more complex: for instance, some proposed “minimum” or “enhanced” benefits would require that individuals make a separate calculation of their benefits, on top of calculating benefits based upon their own earnings and comparing these to those they might be eligible for based on a spouse’s earnings. Thus, an individual would need to make three separate benefit calculations, which would produce almost hopeless complexity for many Americans.

Public Submission For The Record

Financial Planning Association

Financial Planning Association Hearing Statement:
What Workers Need to Know About as They Plan for Their Retirement
House Ways and Means Committee on Social Security
Tuesday, July 29, 2014 at 11:00 a.m.

Financial Planning Association
7535 E. Hampden Ave.
Suite 600
Denver, CO 80231
(303) 867-7194
knystrom@onefpa.org

Submitted on July 28, 2014 by:
Evelyn Zohlen, CFP®
Frederick Miller, Ph. D., CFP®
Sharon Lacy, CFP®

FINANCIAL PLANNING ASSOCIATION STATEMENT:

Thank you for asking us to testify about this very important subject.

As Financial Planners, we advise almost every client who is considering retirement about the essential role that Social Security will play in providing a stable and reliable source of retirement income. Social Security is the cornerstone of retirement income planning, regardless of whether it represents 20% or 80% of your retirement income. Many seniors do not understand that the timing of claiming their Social Security benefits can make a significant difference to the success or failure of their retirement income plan. Providing seniors with the information and the tools needed to evaluate this decision is critical.

Planning for retirement is difficult. Prospective retirees must decide when to retire, where they will live, and how they will fund living expenses. They must also deal with enormous uncertainty about how their health will develop, how long they will live, and for those with investments, how their investments will perform. As a lifetime inflation-protected income annuity, the Social Security retirement benefit is a reliable base upon which to build a retirement plan, and helps retirees manage the risk of outliving their assets.

Despite its importance, the complexity of Social Security Retirement Benefits means that many prospective retirees are uncertain and often confused about which approach to claiming benefits will be most beneficial to them. In particular, we advise our clients about when to file, when to claim benefits, and which earnings record to rely on. Decisions in each of these areas can have a significant impact on the timing and size of their lifetime benefit.

Before they can even begin the process of deciding when to take their benefits, seniors want to have unambiguous answers to some basic questions, including:

- Is Social Security going to be there for me, and is it more likely to be there if I take my benefit early?
- If means testing is adopted, will I be better off taking my benefit early?
- What are the considerations for taking my benefit at 62 vs. 66 or 70?

- What is a spousal benefit and do I qualify for that benefit?
- What is a survivor's benefit and do I qualify for that benefit?
- How do my filing decisions affect my spouse and how do his/her filing decisions affect me?
- What is meant by "longevity insurance?"
- Where can I find unbiased information on when to file for Social Security?

For many prospective retirees, when to claim their benefit is the most important Social Security decision they must make. Many people underestimate how long they may live, and do not fully appreciate that their life expectancy is just an average. In fact, longevity risk is one of the largest risks that retirees will face. Approximately half of retirees will live longer than their life expectancy. As Social Security is income they cannot outlive, these retirees will have many years to celebrate or to rue their timing decision. Social Security is a better annuity than anything available on the commercial market and provides excellent "longevity insurance."

Under any circumstances, people find it difficult to make good decisions about events that will occur far in the future, especially when uncertainty is involved.[1] To compound the problem, the Social Security claiming decision is very complex. The benefit increases if a retiree is willing to wait to claim. Taxes on benefits vary with age and income. A couple must consider the values of both Retirement and Survivor benefits. Retirees who have certain kinds of pensions, or whose spouses do, face additional complexity, as do those who are widowed and divorced.

The question of when to claim Social Security benefits can only be answered definitively after evaluating the relative ages and relative benefits (for a couple), life expectancies and circumstances of the worker. In general, we recommend that individuals wait as long as they can before filing for benefits. The only good reasons for a retiree to file for benefits early are (1) they need the cash flow or (2) they are single and have good reason to believe they will not live to their life expectancy.

Financial planners have found it necessary to build analytical tools to help us advise our clients (one of us, Sharon Lacy, has developed such a tool – an optimizing calculator). We can begin with Social Security Administration (SSA) tools and statements, but they are usually insufficient by themselves. Using an optimization calculator provides a worker with the universe of available filing strategies. We can then fine-tune the strategy for their specific circumstances. Prospective retirees may be considering employment alternatives that the statements do not allow for. SSA online tools can be cumbersome to use, requiring considerable time for data entry, and may not support a straightforward comparison of the alternatives retirees are considering.

Retirees without financial planning support may find it difficult to make the claiming decision that is best for them. The best decision must account for a combination of many factors and preferences unique to each retiree or retiree couple. As a result, the advice readily available from television or radio commentators or from books or websites is unlikely to produce the best result for all or even most retirees who may use them. At worst, financial advisors who are motivated to keep clients from withdrawing managed assets may recommend early claiming, which is unlikely to be best.

---

[1] See Daniel Kahneman, **Thinking Fast and Slow**.

Other retirees may seek advice from their local Social Security office. Unfortunately, SSA office staffers do not have the financial planning training necessary to provide good benefit claiming advice. They also lack the time and tools they would need to analyze prospective retirees' situations, and retirees usually do not bring with them sufficient information about their circumstances to support the appropriate analysis in any event. We are concerned that neither SSA staffers nor the retirees who may seek their advice fully appreciate these issues, and that some retirees end up with claiming decisions that are not in their best interest.

Access to "file and suspend" and "restricted application" have the primary benefit of encouraging workers to delay their benefit past their full retirement age by providing an incentive (in the form of current income) to delay. Whether or not these strategies are eventually eliminated, we, as fiduciaries, are responsible for making our clients aware that they are currently available. Any advantage to those with financial planners accrues because their financial planners make them aware of these strategies which are little known to the general public. Publicizing these strategies would redress this imbalance, and also likely have the salutary effect of encouraging more retirees to delay claiming their retirement benefits. More broadly, providing more accurate and useful Social Security planning to the average worker would "level the playing field" and help more people make better claiming decisions and have access to better retirements.

Despite all of its complexity and the difficulties involved in making good claiming decisions, Social Security is an enormously important component of almost every retiree's retirement income plan. The most important possible improvement to the system is to credibly address the solvency issue. Many of our clients approaching retirement are uncertain about how large their benefits will be, and how long they will last. These clients are motivated to claim early to "get what they can." Many of our younger clients do not believe that they will receive any Social Security benefits at all.

Everyone knows that some sort of change to the system is coming. The public sees the shortfall in the Disability Income fund as a harbinger of future problems. However, no one knows what the change(s) will be. As financial planners, we believe that the best Social Security system is predictable and dependable. Transparency is important, too, as it goes to the credibility of the system. Finally, it is important that most people perceive the system as fair – the system will not be able to adapt and adjust well to future demographic and economic changes without broad and deep political support.