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SOCIAL SECURITY: KEEPING THE PROMISE IN THE 21ST CENTURY

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BEFORE THE

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UNITED STATES SENATE

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SOCIAL SECURITY: KEEPING THE PROMISE IN THE 21ST CENTURY

WEDNESDAY, JUNE 17, 2009

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 2:04 p.m. in room SH–216, Hart Senate Office Building, Hon. Herb Kohl (chairman of the committee) presiding.

Present. Senators Kohl [presiding] and Martinez.

OPENING STATEMENT OF SENATOR HERB KOHL, CHAIRMAN

The CHAIRMAN. Good afternoon to everybody, and at this time we'd like to commence our hearing.

We all appreciate your attending this hearing on Social Security. The last time the Senate took a close look at the program, we were responding to the former administration's plan to privatize the program, as you remember, with investment accounts.

Four years later, I think we're all thankful that effort was not successful and Social Security was not exposed to a stock market that has devastated the retirement savings of so many people over the past year. The impact of the financial downturn provides a stark contrast to the dependability of Social Security, and it's also a reason that the program's guaranteed inflation-protected benefits are more vital to Americans, now more than ever.

More than just a retirement program, Social Security is a collective insurance policy, protecting us all from the possibility that we die young and leave a family behind, become disabled and not able to work, or even live into a ripe old age and beyond our savings. Because we all pay into the program, the cost of this insurance is relatively low, given the significant monetary benefits individuals receive in exchange. For example, the survivor benefit is equivalent to a 433,000 life-insurance policy, and disability benefit is equivalent to a $413,000 disability insurance policy for a young family.

Consider this as if a couple wanted to buy the same income protection they would receive from Social Security retirement benefits, they would have to pay over a half a million dollars to buy an inflation-indexed annuity in the private market.

However, as crucial as the program is today, the fact that it was designed in another era—the fact is that it was designed in another era. In 1935, when Franklin Roosevelt signed the Social Security Act into law, women mostly worked in the home and did not generate their own earnings, and so the program was designed to provide benefits for spouses and widows. Today, women make up nearly half the work force, earning their own benefits and contributing to the strength of our economy. Also, people did not live as long back then, the life expectancy back then was 62. Today, someone who retires at age 65 can expect to live to the age of 83. As Social Security nears its 75th anniversary, it's time to take a fresh look at the retirement program to ensure that it will be just as strong in another 75 years.

The changes in benefits that have taken place in our society should be mirrored in the types of benefits Social Security provides and in the way we raise revenues. Today, we'll place a particular focus on making sure that the most vulnerable in our society are not left behind as we examine ways to strengthen benefits.

When Social Security began in 1935, 50 percent of seniors lived in poverty. Today that number is below 10 percent. While the program has been incredibly successful at reducing poverty among the elderly as a whole, poverty still remains high for some groups, including those aged 85 and over, older single and widowed women, as well as minorities. Nearly one-quarter of elderly African Americans and more than one-sixth of elderly Hispanics today live in poverty.

As we begin the discussion about making changes to the program, we need to keep in mind that Social Security benefits are not overly generous. While Social Security makes a critical difference in the lives of tens of millions of the American elderly, disabled, and survivors, the average retirement benefit is only $1153 a month. Yet, despite these modest payments, Social Security is still a vital lifetime, because, over 40 percent of all older Americans, Social Security is what provides nearly all of their income.

We all know that healthcare reform is the No. 1 priority of the administration and of my colleagues here in the Senate and across the Capitol. But with an urgent need to contain the Federal deficit, there's no doubt that, sometime soon, all eyes will turn to Social Security. When that time comes, this committee wants to be prepared to act as a repository of ideas for reform proposals. As our witnesses will confirm today, Social Security can be strengthened, benefits for those who need them most can be increased, and long-term solvency can be ensured, with just a few relatively small, relatively commonsense changes.

So, we'd like to thank our witnesses today for their willingness to participate. We look forward to their testimony. Before we get to them, we turn to the ranking member on this committee, Senator Mel Martinez.

OPENING STATEMENT OF SENATOR MEL MARTINEZ, RANKING MEMBER

Senator MARTINEZ. Thank you very much, Chairman Kohl.

I appreciate you calling this hearing today on this very important issue to so many Americans, those who are, today, receiving their Social Security benefit, and those of us who anticipate that in the future. Preparing to live on a fixed income can often be worrisome, which is why Americans deserve to know that they will receive their fair share of Social Security upon their retirement. Social Security has been a primary source of income for retirees and disabled Americans for many decades.

For one-third of Americans 65 years and older, Social Security benefits constitute 90 percent of their total income. Social Security is safe today for seniors, but unfortunately it's in serious danger for our children and grandchildren. That's why Social Security reform remains a top priority for our nation.

For states like Florida, the home to 3.4 million beneficiaries, it is essential. At risk is the Social Security trust fund, which has helped to ensure generations of Americans receive what they have been promised.

As the number of baby boomers retiring increases, and more Americans begin to receive their share, it's clear the financial foundation of Social Security is weak. There won't be enough money to meet its future obligations, and fixing the system is long overdue. In 1950, there were about 16 workers to pay every beneficiary, but today there are about 3 workers to support each person collecting Social Security. Without some sort of change, by 2016, the government will begin to pay out more in Social Security benefits than it collects in payroll taxes. By 2034, the Social Security Administration expects we'll have almost twice as many people 65 and over than there are today, and that will be 74 million seniors. If we don't act now, by 2037, when today's workers who are in their mid-20's begin to retire, the program will only have enough revenues to pay about 75 percent of benefits.

Under current law, Social Security has a total unfunded obligation of more than $10 trillion. A 2001 White House report on Social Security stated, and I quote, "As time goes by, the size of the Social Security problem grows, and the choices available to fix it become more limited."

Eight years later, the problem remains unsolved. There are a variety of plans and ideas that have been proposed to fix Social Security, but unfortunately we've not reached a consensus on how best to do this.

We need to work together, here in Congress and with the President, to determine the best elements of the proposals that have been put forward. I look forward to hearing from our witnesses today, and I'm certain they will underscore what we already know, that the longer we wait to take action, the more difficult and expensive the changes will be.

Thank you, Mr. Chairman.

The CHAIRMAN. Thanks very much, Senator Martinez.

Our first witness today will be Leon Burzynski, the President of the Wisconsin Alliance for Retired Americans.

Mr. Burzynski is also a member of the IBEW and Executive Board Member of the Wisconsin AFL–CIO.

Our next witness will be Kenneth Apfel, Professor at the University of Maryland School of Public Policy. Mr. Apfel served as commissioner of the Social Security Administration under the Clinton administration from 1997 until 2001. He also served at the Office of Management and Budget at the U.S. Department of Health and Human Services, and also as the Legislative Director for Senator Bill Bradley. Today, he's known for his research in public management and leadership, with a particular focus on aging, healthcare, and retirement issues.

Next, we'll be hearing from Joan Entmacher. She's the Vice President for family economic security at the National Women's Law Center. Prior to this time, Ms. Entmacher worked for the National Partnership for Women and Families, the Massachusetts Attorney General's office, and also the U.S. Department of Labor. She's also taught political science at Wellesley College.

Next, we'll be hearing from Dr. Melissa Favreault. Dr. Favreault is a Senior Research Associate at the Urban Institute's Income and Benefits Policy Center. Her primary research interests include aging, social policy, and the life course, and is one of the most—one of the foremost experts at modeling how Social Security reform will affect different populations.

Next, we'll be hearing from Dr. John Irons, from the Economic Policy Institute. He's previously served as the Director of tax and budget policy at the Center for American Progress, and also as an Assistant Professor of economics at Amherst College. Additionally, Dr. Irons has worked for the Brookings Institution, as well as the Federal Reserve Board of Governors.

Senator Martinez, would you like to introduce the final witness?

Senator MARTINEZ. Thank you, Mr. Chairman.

I would like to introduce Mr. Andrew Biggs. Mr. Biggs is currently a Resident Scholar at the American Enterprise Institute. Previously, he was the Principal Deputy Commissioner of the Social Security Administration, where he oversaw SSA's policy research efforts, and led the agency's participation in the Social Security Trustees Working Group.

Thank you.

The CHAIRMAN. Thank you so much.

As you can see, we have a very distinguished group of panelists, and we're looking forward to hearing your 5-minute comments before we engage in conversation.

We'll start with you, Leon.

STATEMENT OF LEON BURZYNSKI, PRESIDENT, WISCONSIN ALLIANCE FOR RETIRED AMERICANS, PEWAUKEE, WI

Mr. BURZYNSKI. Thank you, Chairman Kohl.

Mr. Chairman and members of the Special Committee on Aging, my name is Leon Burzynski. I'm the president of the Wisconsin Alliance for Retired Americans, representing more than 89,000 Wisconsin retirees, and part of the National Alliance for Retired Americans, representing more than 4 million retirees across the nation. We are dedicated to the economic and health security for current and future retirees. I greatly appreciate this opportunity to testify on the importance of strengthening Social Security.

Senator Kohl, I especially want to thank you for all your efforts on behalf of Wisconsin retirees and seniors.

The theme today, "Social Security: Keeping the Promise in the 21st Century," is as relevant now as any time in the history of the program. The recent economic downturn clearly demonstrates that the guaranteed benefits of Social Security are the foundation of retirement security. We in the Alliance for Retired Americans believe Social Security is vitally important for current retirees, our children, and our grandchildren.

Please consider. Social Security is America's family insurance policy. Retirees, workers, surviving spouses, and children all benefit from the program. Two, two-thirds of retirees receive more than one-half of their income from Social Security. If Social Security did not exist today, about 40 percent of retirees over 65 would have incomes below the poverty level. Finally, it provides a steady stream of income, with built-in protections against excessive inflation, that you cannot outlive.

I'd like to share four personal stories from members of the Alliance for Retired Americans of how Social Security has helped them and their families.

Let's start with Michael Ott, from Hilbert, WI, who ran the family farm until it became impossible to compete with large corporate farms. Michael ended up with a part-time job, at just over the minimum wage. At age 62, he began collecting Social Security, and was getting by. Michael had been sick, but was hoping to make it to 65 and have Medicare. Unfortunately, he ended up in the emergency room, where he was diagnosed with congestive heart failure. As a result, he had to stop working. I ask you, what would Michael have done without the guaranteed $600 a month he received from Social Security?

Without Social Security, Jed Jennings, a cancer patient from Bow, NH, would be unable to pay for her chemotherapy and medications. The Social Security she receives also helps pay for her food and regular household expenses. These benefits play an important role in her life, and she can state confidently that if Social Security did not exist, her income would be inadequate to cover her expenses.

Finally, Art Palian, from Cedarburg, WI, is a retired teacher. When he was 17 years old, his father died, and during this difficult and challenging time, Art's mom received survivor benefits that helped in raising her six children. Art has stated, on a number of occasions, that Social Security benefits kept his family intact after the passing of his dad.

Bob Kirkner of King, NC, is 70 years old, a proud father and grandfather. He retired with a good pension after 34 years as a mechanic for U.S. Airways. When U.S. Air first declared bankruptcy, Bob's health insurance payment went from $40 to $600 a month, until he received his Medicare and VA benefits. After the second bankruptcy filing, Bob's pension was cut drastically, and his Social Security check, that was a supplement, is now half his income. Even with Medicare and VA benefits, his healthcare costs are almost $400 a month.

With all due respect to those claiming the program's in financial crisis, we strongly disagree. According to Social Security trustees, the program will have enough funds to pay full benefits through 2037, and about 78 percent thereafter. In consideration of our children and our grandchildren, we're not suggesting Congress do nothing. However, the time is approaching when Congress will need to take action to extend the solvency of Social Security. One simple solution is to restore the earning caps to the historical level of 90 percent of all wages earned. The erosion to the current level of 82 percent has derived the Social Security Trust Fund of income to insure payments for future beneficiaries.

In conclusion, Mr. Chairman, Social Security has been the underpinning of our country's safety net. We believe President Obama and Congress should be able to restore its solvency without making radical changes to this fiscally responsible Federal program that's essential for our security.

Thank you for listening to me and giving me this opportunity to speak.

[The prepared statement of Mr. Burzynski follows:]

Wisconsin Alliance for Retired Americans®

6333 W. Bluemound Road
Milwaukee, WI. 53213

Testimony
United States Senate
Special Committee on Aging
June 17, 2009
Leon Burzynski, President
Wisconsin Alliance for Retired Americans

Mr. Chairman and Members of the Special Committee on Aging:

My name is Leon Burzynski. I am the president of the Wisconsin Alliance for Retired Americans (WIARA), representing more than 89,000 Wisconsin retirees, and part of the national Alliance for Retired Americans, representing more than 4 million retirees across the nation. We are dedicated to the economic and health security for current and future retirees.

I greatly appreciate the opportunity to testify today on the importance of strengthening Social Security. Senator Kohl, I especially want to thank you for all your efforts on behalf of Wisconsin retirees and working families.

The theme of this hearing, "Social Security: Keeping the Promise in the 21st Century," is as relevant now as any time in the history of the program. The recent economic downturn clearly demonstrates that the guaranteed benefits of Social Security are the foundation of retirement security. We in the Alliance for Retired Americans believe Social Security is vitally important for current retirees, our children and our grandchildren. Please consider:

- Social Security is America's family insurance policy. Retirees, workers, surviving spouses, and children all benefit from the program.
- Two-thirds of retirees receive more than one-half of their income from Social Security.
- If Social Security did not exist today, about forty percent of retirees over 65 would have incomes below the poverty level.
- It provides a steady stream of income, with built in protection against excessive inflation, that you cannot outlive.

I would like to share four personal stories from members of the Alliance for Retired Americans about how Social Security helped them and their families.

- Michael Ott from Hilbert, Wisconsin, ran the family farm until it became impossible to compete with large corporate farms. Michael ended up with a part-time job paying just over the minimum wage. At age 62, he began collecting Social Security, and was getting by. Michael had been sick, but was hoping to make it to 65 and have Medicare. Unfortunately, he ended up in the emergency room where he was diagnosed with congestive heart failure. As a result, he had to stop working. What would Michael have done without the guaranteed $600.00 monthly he received from Social Security?

- Without Social Security, Jet Jennings, a cancer patient from Bow, New Hampshire, would be unable to pay for her chemotherapy and other medications. The Social Security she receives also helps pay for her food and regular household expenses. These benefits play an important role in her life, and she can state confidently that if Social Security did not exist, her income would be inadequate to cover her expenses.
- Art Palleon from Cedarburg, Wisconsin, is a retired teacher. When he was seventeen years old, his father died. During this difficult and challenging time, Art's mom received survivor benefits that helped in raising her six children. Art has stated on a number of occasions that Social Security benefits "kept his family intact" after the passing of his dad.
- Bob Kirkner of King, North Carolina, is seventy years old, a proud father and grandfather. He retired with a good pension and optimistic future after 34 years as a mechanic for US Airways. When US Air first declared bankruptcy, Bob's health insurance payment went from $40 to $600 per month, until he received his Medicare and VA benefits. After the second bankruptcy filing, Bob's pension was cut drastically, and his Social Security check that was a supplement is now half his income. Even with Medicare and VA benefits, Kirkner's health care costs him almost $400 per month.

With all due respect to those claiming the program is in a financial crisis, we strongly disagree. According to the Social Security trustees, the program will have enough funds to pay full benefits through 2037 and about 78% thereafter. In consideration of our children and grandchildren, we are not suggesting Congress do nothing. However, the time is approaching when Congress will need to take action to extend the solvency of Social Security. One simple solution is to restore the earnings cap to the historical level of 90% of all wages earned. The erosion to the current level of approximately 82% of wages has deprived the Social Security Trust Fund of income to ensure payments for future beneficiaries.

In conclusion, Mr. Chairman, Social Security has been the underpinning of our country's safety net. We believe President Obama and Congress should be able to ensure it's solvency without making radical changes to this fiscally responsible federal program that is essential for retirement security and peace of mind.

In closing, Mr. Chairman and Members of the Committee, thank you for giving me this opportunity to speak about the importance of Social Security.

The CHAIRMAN. Well, that's a remarkable statement, for many reasons, one of which is it's exactly 5 minutes. [Laughter.]

Exactly. Thank you, Leon.

Mr. Apfel.

STATEMENT OF KENNETH APFEL, PROFESSOR OF THE PRACTICE, SCHOOL OF PUBLIC POLICY, UNIVERSITY OF MARYLAND, COLLEGE PARK, MD

Mr. APFEL. You established quite a standard that I'll try to live by.

Senators, it's an honor to be back in the Hart Senate Office Building to testify on Social Security in the 21st century.

Our Social Security system has been the bedrock of support for millions of Americans for 75 years now. Social Security's core framework has essentially remained the same as instituted in the 1930's. The program, however, has evolved considerably over the years to meet changing demographic, human, and economic needs.

Social Security provides a foundation of support for about one in six Americans. While benefits are modest, for most Americans the value of Social Security is the biggest accumulation of dollars they will take into retirement. According to a recent National Academy of Social Insurance study—NASI study—a 65-year-old with average benefits would need to pay an insurance company almost a quarter-million dollars for that level of protection.

Social Security is without a doubt the crown jewel of American antipoverty policy. Social Security lifts 13 million elders out of poverty. Without those monthly benefit payments, about half of all seniors would be living in poverty.

Social Security is also America's family protection plan. About one-third of beneficiaries are severely disabled workers, their spouses and children, or they're surviving family members of workers who have died. Social Security is the equivalent of about a $400,000 disability insurance policy, and the Social Security survivor benefit is the equivalent of almost a $450,000 life-insurance policy for a young family. About 6 and a half million children under 18, nearly 9 percent of all U.S. children, received part of their family income from Social Security in 2005. About 1.3 million of these children were lifted out of poverty by Social Security benefits.

Social Security is particularly important to retirees in communities of color. According to the NASI study, among all beneficiaries 65 and older, 42 percent of singles and 22 percent of married couples rely on Social Security for almost all of their income. Among African Americans, the figures were 54 percent for single persons, 33 percent for married couples. Among Latinos, the figures were 62 percent for singles, 37 percent for married couples.

Social Security is the majority source of income for more than three-quarters of nonmarried aged-women beneficiaries, and almost all income for more than two out of every five nonmarried aged women.

The chart in my testimony that's before the committee here today, highlights the importance of Social Security as a source of income for older Americans. I don't need to go through all these numbers. But, we're all painfully aware of the strains that we're now experiencing in the other legs of the elderly income stool. Retirement savings accounts have shrunk by 40 percent over the past year. Private defined benefits are shrinking and are under unremitting stress. The unemployment rate for older Americans is increasing significantly. These changes, coupled with the erosion of employer-provided retiree health plans, the increases in Medicare premiums, and the cost of healthcare, all place growing importance on Social Security as a source of income that can be counted on.

Now, while it's true that Social Security provides essential protections for Americans, it's also true that millions of beneficiaries still live on the edge. According to NASI studies, those 65 and older who are poor or near poor—family incomes below 125 percent of the poverty level—25 percent of unmarried women, 26 percent of black men, 36 percent of black women, 27 percent of Hispanic women, 31 percent—of Hispanic men—31 percent of Hispanic women, 18 percent of Asian men and women. Among persons age 80 and older, those with income below 125 percent of the poverty line include 28 percent of unmarried women, 46 percent of black women, 37 percent of Hispanic women.

Our Social Security system needs to continue to evolve, as it has for the past 75 years, to meet the nation's needs. We need to be clear that we face two challenges, twin challenges, and that both need to be addressed: the solvency challenge and the benefit-adequacy challenge.

The National Academy of Social Insurance has been examining in depth these benefit-adequacy issues. Indeed, three of the panel members appearing before this committee today have been researching these activities for the National Academy of Social Insurance. Today, as chairman of the board of the National Academy of Social Insurance, I'm providing to the committee the first of several NASI reports to be published in the months ahead on the topic of benefit adequacy for vulnerable populations. This report focuses on the benefits of targeted groups, such as widowed spouses, low-paid workers, people who have spent part of their time out of the workforce because of childcare or eldercare responsibilities, beneficiaries who have lived to advanced ages, older workers with occupational disabilities. Any discussion on modifying Social Security should consider, not just solvency, but benefit adequacy, particularly for vulnerable groups.

Thank you, Mr. Chairman. I completed my testimony.

[The prepared statement of Mr. Apfel follows:]

Statement of Kenneth S. Apfel
Professor of the Practice
Maryland School of Public Policy
The University of Maryland

Testimony to the US Senate Special Committee on Aging
"Social Security: Keeping the Promise in the 21st Century"
June 17, 2009

Mr. Chairman and Members of the Committee, it is an honor to be asked to testify today on Social Security in the 21st Century. It is a particular delight to be back in the Hart Senate Office Building for this hearing. I worked in this building for more than a decade, including in 1983 -- the last time Congress made major modifications to our Social Security system. I was also in this building many, many times during my years as Commissioner of the Social Security Administration. I know how hard you all work for the American people. It is my sincere hope that we will all be part of the next chapter in strengthening the Social Security program for current and future generations.

There are three issues I would like to address today. First, I'd like to discuss how Social Security has evolved over the past three generations. Second, I'll discuss how the program provides essential protections for millions, but that many people still face major economic challenges. Lastly, I'll discuss the need for Social Security to continue to evolve in the future to meet these challenges in light of changing demographic and economic conditions.

1. Social Security Evolution

Our Social Security system has been the bedrock of financial support for millions of Americans for nearly 75 years. Past Presidents and Congresses have worked together time and again over the years to help build our current system. I remember Senator Bill Bradley's statement made during the 1983 Social Security reform debate that Social Security is the best expression of community that we have in America. This is still true today, and I believe will be true long into the future.

Social Security's core framework has essentially remained the same as instituted three generations ago. The program, however, has evolved considerably over the years to meet changing demographic, human and economic needs.

What Franklin Roosevelt helped to create - to use his words - was "some measure of security" in old age. The signing of the Social Security Act in 1935 represented a dramatic departure in the role of government in providing a foundation of economic support for older Americans. The key elements of the social security system that were adopted in the 1930s and 1940s have remained largely intact - intergenerational financing through payroll taxes paid by workers, a relatively modest and progressive benefit structure paid to workers and their dependents, with excess tax revenues placed in a trust fund to pay future benefits.

While the core framework of Social Security remains basically the same as three generations ago, the program has evolved to meet changing human needs. In terms of the scope of benefit protections, the original act in 1935 provided only very modest retirement coverage for workers. By 1939 survivor benefits were added, and in the 1950s during the Eisenhower Administration and under the congressional leadership of Lyndon Johnson, disability benefits were added. During the Nixon Administration, cost of living adjustments were added so that benefit payments would grow with inflation, so that people could count on the purchasing power of their benefits staying constant over a lifetime. During the Eisenhower and Kennedy Administrations, early retirement was permitted, so that workers could start receiving benefits at age 62 rather than 65.

In the late 1970s, there was a growing understanding that demographic and economic changes were taking place in the United States that placed strains on the system. In 1977, benefit growth was slowed and in 1983, a series of changes were enacted to stabilize the system. Taxes were raised, the retirement age was increased, cost of living adjustments were delayed and benefits were modestly curtailed. Lastly, during the Clinton Administration, the Social Security retirement earnings test was repealed for most of the elderly population to help encourage older persons to work later in life.

It s clear that Social Security has evolved over time to meet the needs of the American people. Even with all the expansions and restraints adopted over the past three quarters of a century, the system still remains remarkably successful in addressing FDR's goal of providing "some measure of security".

2. Social Security Impact

Social Security provides the foundation of support for about one in six Americans—with benefit protections available over a lifetime, no matter how long one lives.

Average Social Security benefits only provide basic security. The benefit level for the average single worker is currently about $14,000 a year. The poverty level is now about $11,000 a year. According to the Economic Security Standard developed by the Wider Opportunities for Women, minimal living costs for a single older American living alone in rental housing is about $20,000 a year. It is clear that our current Social Security benefit protections provide only a very modest foundation of support in retirement.

While benefits are modest, for most Americans the value of Social Security is the biggest accumulation of dollars they will take into retirement. According to a recent National Academy of Social Insurance study, a 65-year old with Social Security benefits of about $1,100 a month who wanted to buy a guaranteed income of that size - with payments that go up with the cost of living and to continue for a widowed spouse - would need to pay an insurance company about $225,000 for that level of protection.

Social Security is without a doubt the crown jewel of American anti-poverty policy, and it is hard to overstate its importance. Social Security lifts 13 million elders out of poverty. Without those monthly benefit payments, about half of all seniors in America would be living in poverty.

Social Security is also America's Family Protection Plan. About one third of beneficiaries are severely disabled workers, their spouses and children, or the surviving family members of workers who have died. Over a quarter of today's 20 year olds are estimated to become disabled before retirement. According to the NASI study, Social Security is the equivalent of a $400,000 disability insurance policy, and the Social Security survivor benefit is the equivalent of a $450,000 life insurance policy for a young family.

About 6.5 million children under 18 – or nearly 9 percent of all U.S. children – received part of their family income from Social Security in 2005. About 1.3 million of these children were lifted out of poverty by Social Security benefits.

Social Security is particularly important to retirees in communities of color. According to the National Academy of Social Insurance study:

- Among all beneficiaries 65 and older, 42% of single persons and 22% of married couples relied on Social Security for almost all (90% or more) of their income in 2006.
- Among African-Americans, the figures were 54% for single persons and 33% for married couples.
- Among Latinos, the figures were 62% for single persons and 37% for married couples.
- Among Asian Americans and Pacific Islanders, the figures were 55% for single persons and 27% for married couples.
- Among Indians and Alaskan Natives, the figures were 61% for single persons and 25% for married couples.

Social Security is the majority source of income for more than three quarters of non-married aged women beneficiaries, and is almost all income for more than two of every five non-married aged women.

The table attached to my testimony developed by the Social Security Administration and the National Academy of Social Insurance highlights the importance of Social Security as a source of income for older Americans. Social Security is the main source of income for about two thirds of older Americans, and nearly the only source for a third of older Americans.

We know that many individuals are increasingly relying on individual savings for retirement security, given the shift of our private pension system away from defined benefits. Given the continued shift of retirement risks away from employers and toward individuals, the importance of that monthly inflation-protected Social Security benefit – something that can be counted on over a lifetime -- becomes all the more important, particularly in these troubling economic times.

We all are painfully aware of the strains that we are now experiencing in the other "legs" of the elderly income stool. Retirement savings accounts have shrunk by 40% over the past year, private defined pensions are shrinking and are under unremitting stress, and the unemployment rate of older workers has increased significantly. These changes, coupled with the erosion of employer provided retiree health plans, the increases in Medicare premiums and the cost of health care all place growing importance on Social Security as a source of income that can be counted on.

While it is true that Social Security provides essential protections for Americans, it is also true that millions of beneficiaries still live life on the edge. According to NASI studies, those age 65 and older who are poor or near poor - with family incomes below 125% of the poverty line - include 25% of unmarried women, 26% of black men and 36% of black women, 27% of Hispanic men and 31% of Hispanic women, and 18% of Asian men and women. Among persons age 80 and older, those with income below 125% of the poverty line include 28% of unmarried women, and 46% of black women and 37% of Hispanic women. While we can and should applaud our prior Social Security accomplishments as a nation, we need to be very clear that we still face real challenges in providing an adequate benefit structure for vulnerable populations. We still have a ways to go. Our Social Security system needs to continue to evolve, as it has for the past 75 years, to meet the nation's needs.

3. Social Security in the 21st Century

The last point I would like to address is this -- the need for Social Security to continue to evolve to meet changing human needs in light of changing demographic and economic conditions. Almost all the discussion over the past 16 years has been focused on financing Social Security. We need to be clear that we face twin challenges that both need to be addressed: the solvency challenge and the benefit adequacy challenge.

On the solvency challenge, I've said for years that Social Security clearly faces a long-term and manageable problem, and that it's a challenge that we should face up to sooner rather than later. The Social Security financing shortfall is manageable without drastic changes. A doubling of the senior population will certainly place strains on financing Social Security, but it's certainly not Armageddon. According to projections by the Social Security Trustees and the Congressional Budget Office, the Social Security trust fund will not be exhausted for decades, and the system will not be "bankrupt" after that time. Social Security revenues will still be sufficient to pay between 70 percent and 80 percent of today's benefit commitments. Social Security will be there in the future.

A package of tax increases and modest reductions in the growth of benefits phased in over the next half century is what is needed to resolve the solvency challenge.

A related solvency question is whether the privatization of Social Security will help to solve the long-term Social Security shortfall. Absolutely not. Taking payroll tax revenues out of Social Security to create private accounts makes the long-term financing problem bigger, not smaller. Unless future benefits are drastically curtailed, privatization only makes the financing problem worse. Future benefit commitments will most likely have to be sharply curtailed if we privatize parts of Social Security.

With privatization, a growing share of retirement income will be based on the returns of the market. Certainly stock market investments can lead to high returns over time. We all know from personal experience, however, that what goes up also sometimes comes down. Retirement savings has declined by about 40% over the past year. With privatization, trying to retire in a time of down market conditions can be a very risky proposition. And trying to live in retirement on your retirement savings in a time of down market conditions can also be very risky.

There has been much debate over how many people will end up winners and how many will end up losers under a privatization scheme. Yale economist Robert Shiller predicts that about one third to two thirds of workers may be losers under privatization plans. I am not an expert in this area, but it is clear to me that there will be losers, and we won't know for sure how many would end up losers for decades to come, after we see how the markets actually perform.

It is difficult to come to terms with the real life implications of these policies. Let me provide an example. During my years as Commissioner, I met the head of Chile's privatized system during a time of steep interest rate reductions in Chile. At the time, he was publicly urging older workers to delay retiring until the economic conditions improved so workers would not be forced into receiving inadequate annuities in retirement. This senior government official was urging older people to keep working until the markets came back.

Do markets bounce back quickly? Sometimes they do. And sometimes it takes many, many years for markets to come back. The problem, of course, is that we can't predict future market conditions. If we privatize a part of our Social Security system, we would find ourselves some day in the same situation as Chile. Frankly, I would hate to see future U.S. Social Security Commissioners urging America's older workers to "just keep working until the markets come back." Social Security ought to represent a foundation of support that can be counted on in retirement no matter what happens to the markets.

I would hope that the President and Congress could come together soon on a package of changes to ensure the long term solvency of Social Security. That package should not include private accounts. But it is likely that it will have to include changes to slow the growth of benefits for future generations. Benefits will likely be affected by any bipartisan effort to restore long term solvency. And that takes us to our second Social Security challenge: benefit adequacy, particularly for vulnerable populations. Any solvency action should be accompanied by proposals to address the current weaknesses in our benefit structure.

A series of issues need attention in the months ahead. I would like to provide four quick examples. Should we explore ways to enhance benefits for the oldest old, whose sources of non-Social Security income support often erodes over time? Should benefits for widows be enhanced, and, if so, how? Should we provide more adequate benefits to those with low lifetime earnings, given the near absence of other substantial sources of retirement support for these workers? Lastly, since low-paid workers experience greater risk of becoming disabled before becoming old enough to retire, should the disability benefit safety net be adjusted for those unable to work, particularly if increases are made to the eligibility age for Social Security retirement benefits?

These are all very important income adequacy issues, and all should be examined within the context of any solvency debate.

The National Academy of Social Insurance has been examining in depth these benefit adequacy issues. Indeed, three panel members appearing before this Committee today have been researching these activities for NASI. Today, as Chair of the Board of the National Academy of Social Insurance, I am providing to the Committee the first of several NASI reports to be published on the topic of benefit adequacy for vulnerable populations. This report focuses on the benefits of targeted groups, such as widowed spouses, low-paid workers, people who have spent time out of the workforce because of childcare or eldercare responsibilities, beneficiaries who live to advanced ages, and older workers with occupational disabilities. Any discussion on modifying Social Security should consider benefit adequacy for vulnerable groups.

In closing, I would like to address how I believe we should proceed in the months ahead. I believe the path that we should follow is as follows:

- First, I would urge President Obama and the Congress to set a goal of addressing by the end of 2010 the dual challenges of Social Security solvency and Social Security benefit adequacy. Social Security has evolved for the past 75 years to meet changing needs, and it must continue to evolve. Any solvency proposal needs to address the adequacy of benefits for vulnerable populations.

- Second, Congress and the Administration need to come to agreement on the overall proportional mix of benefit and revenue changes needed to strengthen the system. Given the importance of Social Security as a source of income, I personally would lean more towards revenue enhancements. And rather than trying to solve a potential problem that may exist in the year 2100, I urge you to establish a more realistic goal. Frankly, no one knows what our fertility rates or our economic growth rates will be 100 years from now.

- Third, I do not believe that progress will take place on the Social Security issue until there is agreement to drop consideration of privatizing part of Social Security. A privatized system represents a dramatic departure from the framework that has guided Social Security for generations. If added retirement savings is desired – and it should be – it should come not at the expense of Social Security. I suggest that the Committee consider 401-k and IRA changes to help low and moderate income workers save through changes in default rules and added retirement savings tax incentives targeted at low and moderate income families.

I would like to conclude my testimony today with a quote from my testimony before this very same Committee ten years ago, during my tenure as Commissioner of Social Security. As we consider changes to Social Security, we need to ask a series of questions: "...whether Social Security continues to be a benefit people can count on; whether the elderly, disabled and survivors of workers are protected from financial hardship; whether the program is efficient, universal and fair; and whether the program is maintained as a basic public trust." I believe that these questions all still apply today. Social Security should continue to evolve, as it has in the past. We certainly need to find solutions to deal with the solvency challenge that we face, but we also need to find solutions than ensure that Social Security's essential framework stay strong and that we ensure the basic adequacy of benefits, particularly for our most vulnerable populations. I thank the Committee for continuing to focus on both of these very important topics.

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The CHAIRMAN. I owe ya. Great statement, thank you so much.

Now we hear from Joan Entmacher from the National Women's Law Center.

Thank you for being here.

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

Ms. ENTMACHER. Chairman Kohl, Senator Martinez, thank you for holding this hearing and for giving me the opportunity to testify on behalf of the National Women's Law Center.

Too often, discussions of Social Security portray it as a problem that needs to be brought under control. But, as you both and other witnesses on this panel have emphasized, it's the largest and most secure piece of Americans' retirement income, and strengthening and improving it has never been a more important topic.

My written testimony explains the challenges that women, in particular, face in achieving a secure retirement, and why those challenges persist despite the growth in women's work and earnings in recent decades. So, with my limited time, I'll discuss reforms, focusing on a proposal to improve the benefit for surviving spouses.

That's one important element of a reform package, because over half of all poor, elderly women, 55 percent, are widows. Even with the changes in marriage and divorce patterns in recent decades, widows will remain the largest group of poor, elderly women for decades to come. However, I emphasize, along with Ken and Melissa, that reforms need to be developed as a package, including consideration of the important nonretirement benefits that are also part of Social Security.

Additional reforms beyond the widows' benefit are needed, because more women, especially black women, will enter retirement never having been married, or having been married for less than 10 years in a—in one marriage, and not qualify for benefits as a divorced spouse. They would not be helped by improvements in the widows' benefits. So, the proposals that Melissa will talk about, to improve benefits for lifetime low earners and caregivers, are also essential. But, a change in benefits for surviving spouses could improve both the adequacy of benefits for poor widows and the equity of benefits for surviving spouses in low-earner, dual-earner couples.

Before I describe the reform proposal, I'll give a brief explanation of how current benefits for surviving spouses work.

A surviving spouse is entitled to receive up to 100 percent of the deceased spouse's benefit, to the extent it exceeds his or her own worker benefit, assuming no reductions for early retirement. This helps provide basic income security for a surviving spouse, but there are some issues with the current benefit structure.

It means that household Social Security benefits drop at widowhood by 33 to 50 percent. The cost of maintaining a household for one person is less than for two, but it doesn't drop that much.

Second, households in which spouses' earnings were more equal experience a greater decline at widowhood; and with more women contributing more to household income, the number of households in this situation is increasing.

Third, the survivor of a dual-earner couple can end up with a lower benefit than the survivor of a single-earner couple that contributed less over their working lives to Social Security.

So, as Ken has said, as part of a project by NASI that was funded by the Rockefeller Foundation, several of us analyzed options for improving benefits, including one that I looked at for reforming the widow(er)'s benefit. Under this proposal, which is a variant on earlier reform ideas, a surviving spouse would receive the higher of his or her current benefit or an alternative benefit, which would be equal to 75 percent of the couple's combined benefits that they had earned as retired workers. This feature would help reduce the disparity in benefits that currently exists between single- and dual-earner couples.

Second, the value of the deceased spouse's benefit used in the calculation would not be reduced because the deceased spouse had claimed benefits before full retirement age. This would increase the adequacy of benefits for lower-income survivors.

Finally, the size of the increase would be capped to target the improvement to those most in need and to control the cost.

The Social Security actuaries recently provided a rough estimate of the cost of this proposal, using two different caps. With a cap based on the average benefit for all retired workers, the cost would increase the long-term deficit by just 4 percent. Setting the cap at a higher rate, the benefit of a maximum earner, would add 20 percent to the current deficit. Of course, there are possibilities in between.

My written testimony, and that of Melissa and Ken, describe other possible reforms.

So, in my remaining seconds——

The CHAIRMAN. Go ahead.

Ms. ENTMACHER [continuing]. I will simply remind the committee that it's important to look not only at Social Security but also at Supplemental Security Income, which provides a means-tested support for the lowest-income beneficiaries.

There are ways to modernize that program to ensure that all beneficiaries can truly benefit from the improvements in Social Security that we're talking about.

Thank you.

[The prepared statement of Ms. Entmacher follows:]

NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

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

Senate Special Committee on Aging
Social Security: Keeping the Promise in the 21st Century
June 17, 2009

Chairman Kohl, Ranking Member Martinez, and members of the Committee, thank you for giving me the opportunity to testify on behalf of the National Women's Law Center. There has been much discussion about the future of Social Security in recent years, but too often that discussion has portrayed Social Security as a problem that needs to be brought under control, rather than a source of economic security for nearly 52 million Americans and their families. Thank you for holding this hearing on ways to strengthen and improve Social Security.

The importance of the secure benefits that Social Security provides was highlighted by the hearing this Committee held in February, "Boomer Bust? Securing Retirement in a Volatile Economy." Sources of income in retirement other than Social Security are shrinking, and their risk is being more apparent. Traditional pensions are disappearing at an accelerated rate. Employers are cutting back or eliminating contributions to defined contribution plans. Both 401(k)s and housing prices have plummeted, and may not recover in time for those at or near retirement. Many older Americans report that they would like to stay in the workforce longer than they had planned or return to work – but have found that the jobs just aren't there.

The truth is, for most Americans – even before this recession -- Social Security has been the foundation of economic security in retirement. The three-legged stool isn't a reality for most Americans: the Social Security leg is much taller and stronger than the others.

Social Security accounts for more than half of the total income of two out of three Americans 65 and older. This is true even though the benefits that Social Security provides are modest; the average retired-worker benefit was $13,900 a year in May 2009.[1] For one in three beneficiaries age 65 and older – and nearly half of single (widowed, divorced and never-married) women 65 and older -- Social Security provides nearly all (90%) of their income.[2]

Social Security is the foundation of the retirement security pyramid – and building up that base is the most effective way to increase retirement security for Americans in an environment of increased economic risk. Fortunately, it will not take an extreme makeover of Social Security to keep the promise in the 21st century.

[1] Office of the Chief Actuary, Social Security Administration, Online Beneficiary Data, available at http://www.ssa.gov/cgi-bin/currentpay.cgi ["Online Beneficiary Data"].
[2] Social Security Administration, Income of the Population 55 and Older, 2006 (2009), available at http://www.ssa.gov/policy/docs/statcomps/income_pop55/2006/index.html.

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Social Security already has many of the features of an ideal pension system. It's virtually universal; fully portable between jobs; covers low-paid, part-time and temporary workers and the self-employed; provides secure, predictable, life-long retirement benefits not subject to the ups and downs of the market or the risk of depletion prior to reaching retirement; keeps up with increases in the cost of living; provides benefits to spouses, surviving spouses, and divorced spouses, and dependent children; includes disability and life insurance benefits as well as retirement benefits; imposes few responsibilities on employers; and is highly efficient, spending less than 1% of the funds collected each year on administrative costs.[3] And, while Social Security faces a long-term shortfall, it has sufficient resources to pay 100% of promised benefits for three decades, and 76% of promised benefits after that, according to the latest estimate of the Social Security Trustees.[4] With some adjustments, Social Security can continue to make progress in helping older Americans, and others, avoid poverty and maintain a decent standard of living.

My testimony will discuss why it is important to improve Social Security benefits and some ways that Social Security can be improved for economically vulnerable older Americans, such as improving widow(er)'s benefits, benefits for low lifetime earners and caregivers, and modernizing Supplemental Security Income. But, Social Security isn't just a retirement program. It's a family insurance program that provides disability and life insurance benefits to workers and their families, including children – one million of whom are lifted out of poverty by Social Security.[5] When Congress considers Social Security reforms, it should also consider ways to improve Social Security for vulnerable beneficiaries who rely on Social Security's non-retirement benefits.

The Need to Improve Social Security

Social Security has dramatically reduced elderly poverty. Yet, despite Social Security, 2.5 million women and 1 million men 65 and older are still living in poverty; 12% of older women, and 6.6% of older men, are poor.[6] More than one in four older Black women (27.3%) and one in five Hispanic women (20%) are poor.

Single older women – widowed, divorced and separated, and never-married – are far more likely to be poor than are married women. The poverty rate for married women is 5.2%, compared to 15.1% for widows, 18.4% for divorced women, and 26.1% for never-married women.[7]

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[3] Virginia Reno and Joni Lavery, National Academy of Social Insurance, "Social Security and Retirement Income Adequacy," Social Security Brief No. 25 (May 2007) available at http://www.nasi.org/publications2763/publications_show.htm?doc_id=482679.
[4] *See* Joni Lavery, National Academy of Social Insurance, "Social Security Finances: Findings of the 2009 Trustees Report," Social Security Brief No. 30 (2009), available at http://www.nasi.org/publications2763/publications_show.htm?doc_id=910750.
[5] *See* Arloc Sherman, Center on Budget and Policy Priorities, "Social Security Lifts One Million Children Above the Poverty Line" (2005), available at http://www.cbpp.org/5-2-05socsec.htm.
[6] U.S. Census Bureau, March Supplement to the 2008 Current Population Survey ("2008 Current Population Survey").
[7] *Ibid.*

There are multiple reasons for women's greater economic vulnerability in retirement.[8] Women earn lower wages than men and spend more time out of the labor force for caregiving, sometimes by choice and sometimes because they cannot afford the high cost of child or elder care. These combine to produce lower lifetime earnings. Lower lifetime earnings, in turn, mean workers have lower retirement income from pensions, savings and Social Security. In addition, women generally live longer than men; over a longer lifespan, assets are depleted, income other than Social Security is eroded by inflation, and medical needs and costs increase. And, women spend more years in retirement without the support of a spouse.

Women have greatly increased their participation in the paid labor force in recent decades, and the gap between men's and women's earnings has narrowed. Future cohorts of women will receive higher Social Security benefits as workers, and are more likely to have other work-related retirement benefits than today's female retirees. Yet substantial gaps remain, and women remain at higher risk of poverty in old age than men.

The wage gap for women working full time, year round, is smaller than in the past but persistent; overall, women earn 78% of what men earn, and the earnings gap is particularly large for women of color. Black women earn 38% less and Hispanic women earn 47% less, on average, than White, non-Hispanic men.[9] Women are still more likely than men to work part time or take time out of the labor force for family caregiving,[10] making the lifetime earnings gap between women and men far greater than the annual earnings gap.[11]

Trends in the labor market in recent decades present increased challenges to the economic security of low-wage workers, both men and women. Declining wages and reduced job opportunities for low-skilled, low-wage workers put such workers at even greater risk of poverty.[12]

Finally, scheduled changes in Social Security benefits disproportionately affect low-income beneficiaries. The increase in the full retirement age, which is gradually being raised from 65 to 67, is the equivalent of an across-the-board benefit cut. The size of this cut is equal, in percentage terms, for those with low and high Social Security benefits. But for those with low benefits, who are also more likely to rely on Social Security for most or all of their income, the reduction in Social Security benefits will have a greater impact on their total income. Also, those

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[8] *See* Government Accountability Office, "Women Face Challenges in Ensuring Financial Security in Retirement," GAO-08-105 (October 2007) ["GAO 2007"], available at http://www.gao.gov/products/GAO-08-105, and Tori Finkle, et al., Institute for Women's Policy Research, "The Economic Security of Older Women and Men in the United States" (December 2007).
[9] 2008 Current Population Survey, *supra*.
[10] GAO 2007, *supra*.
[11] Stephen J. Rose and Heidi I. Hartmann, Institute for Women's Policy Research, *Still a Man's Labor Market: the Long-Term Earnings Gap* (2004).
[12] Laura Sullivan et al., Institute on Assets and Social Policy, Heller School, Brandeis University, "Enhancing Social Security for Low-Income Workers: Coordinating an Enhanced Minimum Benefit with Social Safety Net Provisions for Seniors," available at http://www.nasi.org/publications2763/publications_show.htm?doc_id=819522 (2008) ["Sullivan et al. 2008"].

with lower lifetime earnings will be more likely to experience these reductions because they tend to file for Social Security retirement benefits at younger ages than those with higher earnings.[13]

Ways to Improve Social Security for the 21st Century

Improve widow(er)'s benefits

Widows are a majority, 55%, of all poor elderly women, although poverty rates are higher for never-married and divorced women.[14] And, widows are projected to remain the largest group of poor elderly women by marital status for decades to come.[15] This makes improvement of the widow(er)'s benefit an important element of Social Security reform. However, it should be considered as just one part of a package.

In the future, while widows will remain the largest group of poor elderly women, changes in marriage and divorce patterns mean that a larger proportion of poor women will be never-married or divorced. More women, especially Black women, will enter retirement never having been married, or having been divorced after a marriage that lasted fewer than ten years.[16] They will be ineligible to receive Social Security benefits as a spouse or widow, and would not be helped by improvements in the widow(er)'s benefit. Other reforms, such as improvements to benefits for lifetime low earners and caregivers, should be part of a package of reforms to ensure adequacy and equity of benefits.

The current widow(er)'s benefit

Before describing the reform proposal, I'll briefly describe the retirement benefits Social Security provides for the spouses, surviving spouses, and divorced spouses of retired workers. A spouse is eligible for a retirement benefit equal to 50% of the worker's benefit; a surviving spouse, to a benefit equal to 100% of the worker's benefit, assuming no early retirement reductions apply. Divorced spouses and divorced surviving spouses, if married to the worker for at least ten years, are entitled to the same benefits as current spouses. These spousal benefits are equally available to men and women, husbands and wives, widows and widowers, but virtually all (98.6%) of the recipients of benefits as a surviving spouse are women.[17]

Social Security spousal benefits are designed to ensure basic income security for spouses and surviving spouses when a worker retires or dies. A beneficiary can receive the higher of her or his own worker benefit or the benefit to which she or he is entitled as a spouse or surviving

[13] *See* Karen E. Smith et al., Urban Institute, *Final Report: Modeling Income in the Near Term* (2007), available at http://www.urban.org/publications/411571.html.
[14] 2008 Current Population Survey, *supra*.
[15] Karen E. Smith, Urban Institute, "How Will Recent Patterns of Earnings Inequality Affect Future Retirement Incomes?" (2003) ["Smith 2003"], available at http://www.urban.org/publications/411164.html.
[16] One study found that among women born in the 1960s, 82% of White women, 85% of Latina women, and 50% of Black women will reach retirement with a qualifying marriage. Madonna Harrington Meyer et al., Center for Policy Research, Maxwell School, Syracuse University, "How Will Declining Rates of Marriage Reshape Eligibility for Social Security?" (2006), available at http://econpapers.repec.org/paper/maxcprpbr/33.htm.
[17] Online Beneficiary Data, *supra*.

spouse, but not both, a policy referred to as the "dual entitlement" rule. A couple of examples, which assume that both spouses claim at full retirement age, illustrate how it works:

> (1)George receives a monthly Social Security benefit of $1,000 per month. His wife Martha does not have sufficient credits to qualify for Social Security and receives a spousal benefit of $500, giving the household combined benefits of $1,500 per month. At widowhood, Martha receives a benefit of $1,000, 67% of their combined benefits.
>
> (2)John and Abigail have equal lifetime earnings and equal monthly benefits of $750, for combined benefits of $1,500. At widowhood, Abigail receives a $750 benefit, because her benefit as a worker offsets her benefit as a widow dollar for dollar. The benefit she receives as a widow is 50% of their combined benefits.

The examples above illustrate a few important points about the current widow(er)'s retirement benefit. First, household Social Security benefits drop at widowhood by 33% to 50%. While the cost of maintaining a household declines when there is only one person to support, it does not fall by half, or even by a third. Using the Census Bureau's poverty thresholds as a guide, a one-person elderly household needs 79% of the income of a two-person household to maintain the same standard of living. Second, the decline in Social Security benefits at widowhood is largest for households in which the spouses' earnings were more equal. Third, the survivor of a dual-earner couple who contributed more to Social Security over their working lives can end up with a lower benefit than the survivor of a single-earner couple that contributed less. The increase in labor force participation by married women, and the increased share of household income contributed by wives, ironically means that more widows in the future will experience a drop in household Social Security benefits that approaches 50%.

Claiming benefits before full retirement age can further reduce the benefit received by a surviving spouse. The widow(er)'s benefit is the *smaller* of: the benefit received by the deceased spouse, including any reduction for claiming benefits prior to full retirement age, subject to a floor of 82.5%; or, the benefit the deceased spouse would have received at full retirement age, reduced for the number of months the surviving spouse claims widow(er)'s benefits prior to the survivor's full retirement age.[18] (On the other hand, a surviving spouse will benefit from the delayed retirement credits earned by a higher-earning spouse who waits beyond full retirement age to claim benefits.) Lower-income workers are more likely to need and claim their Social Security benefits early, reducing potential benefits for a surviving spouse as well as themselves.[19]

The drop in Social Security income at widowhood is a significant factor in widows' poverty. And, it is often accompanied by a drop in pension income, loss of earnings from a spouse who

[18] For a further discussion, *see* Joan Entmacher, National Women's Law Center, "Strengthening Social Security Benefits for Widow(er)s: The 75% Combined Worker Benefit Alternative" (2008), available at http://www.nasi.org/publications2763/publications_show.htm?doc_id=819521 ["Entmacher 2008"].
[19] Smith 2003, *supra*.

was still employed, or depletion of assets due to medical and other expenses associated with the death of a spouse.[20]

Proposals for improving widow(er)'s benefits

One approach to improving widow(er)'s benefits is to calculate it as a larger fraction of the couple's combined benefits. This concept has been part of Social Security reform discussions for more than a decade, including the 1994-96 Advisory Council on Social Security, the 2001 report of the President's Commission to Strengthen Social Security, various bills introduced in Congress, and analyses by researchers and advocates.[21]

As part of a project to develop proposals to improve Social Security for vulnerable groups, conducted by the National Academy of Social Insurance with the support of the Rockefeller Foundation's Campaign for American Workers Initiative,[22] I was able to develop and analyze a variant of this concept.

The goals of the proposal are to improve the adequacy of benefits for surviving spouses and the equity of benefits for dual- and single-earner couples. It would allow surviving spouses, including divorced spouses eligible for survivor benefits, to receive the higher of the current law widow(er)'s benefit or a benefit calculated under a new, alternative formula.

The alternative benefit would be equal to 75% of the couple's combined retired-worker benefits. This feature of the proposal would increase its effectiveness in reducing the disparity in benefits between single- and dual-earner couples. Second, the value of the deceased spouse's benefit used in the calculation would not be reduced because of that spouse's decision to claim benefits before full retirement age. Finally, the size of increase available under the proposal would be capped – for example, at the level of the benefit for a career average earner – to target increased benefits to those who are economically vulnerable and reduce the cost of the proposal. Individuals whose current law benefits exceed the cap would continue to receive the current law benefit.

The proposal would improve the adequacy and equity of benefits for the surviving spouse when both spouses worked for modest pay. It would be easy to implement, because Social Security already collects all the information needed to calculate benefits under the proposal, and beneficiaries would automatically receive the higher of their benefit under current law or the

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[20] Kathleen McGarry and Robert F. Schoeni, "Medicare Gaps and Widow Poverty," Social Security Bulletin, Vol. 66, No. 1 (2005), available at http://www.ssa.gov/policy/docs/ssb/v66n1/v66n1p58.pdf. In addition, those most likely to be widowed tend to have lower income before widowhood than intact couples, reflecting poorer health and less education. Nadia Karamcheva and Alicia Munnell, Center for Retirement Research at Boston College, "Why Are Widows So Poor?" (July 2007), available at http://crr.bc.edu/briefs/why_are_widows_so_poor_.html.
[21] *See* Entmacher 2008, *supra*.
[22] The National Academy of Social Insurance published a report summarizing the twelve papers, *Strengthening Social Security for Vulnerable Groups* (2009); links to the report and the 12 papers are available at http://www.nasi.org/publications2763/publications_show.htm?doc_id=805665 ["*Strengthening Social Security for Vulnerable Groups*"].

alternative calculation. The level of the cap could be adjusted to determine the potential benefits – and cost – of the proposal.[23]

Disabled widows and widowers are a small but particularly vulnerable group that could be assisted by other changes to Social Security eligibility rules. These individuals are unable to work because of disability, have lost the income of a spouse, and do not qualify for disabled worker benefits. But some are denied benefits as disabled widow(er)s under rules that require that a disabled widow(er) be at least 50 years old and that disability occur within seven years of the spouse's death or last eligibility for benefits as a caretaking parent. The limitations serve little purpose for a group that is, by definition, unable to work; the cost of removing these restrictions would be minimal and would help individuals at high risk of poverty.

A different approach to changing the way Social Security benefits are calculated for married individuals than basing the survivor benefit on 75% of combined benefits is "earnings sharing." With earnings sharing, the earnings records of a husband and wife during the period of the marriage are combined, and then divided, for the purpose of computing Social Security benefits. The concept embodies the appealing concept of marriage as an economic partnership, and was the subject of debate and detailed analyses in the late 1970s and 1980s.[24] However, these early studies identified difficult implementation and transition issues and unexpected distributional consequences.[25] With the significant changes in women's work and marital histories in the last few decades, researchers have given earnings sharing another look.[26]

A just-published analysis by researchers in the Social Security Administration examined how three options for earnings sharing would affect benefits for retirees in 2030. It found that they would *reduce* benefits compared to current law for about six in ten affected individuals, and increase benefits for fewer than three in ten.[27] The decreases in benefits under the earnings sharing options were particularly severe for widows and widowers. More than eight in ten widows and widowers would see a benefit decrease; the average decline in benefits would be 16% to 27% for widows, 15% to 19% for widowers, depending on the option. These results led the researchers to explore another option that deviated from earnings-sharing principles: allowing spouses to inherit the unshared portion of a spouse's earning record for the years of marriage. This improved the outcomes; still, a third of widows would see their benefits reduced by an average of 10%. It appears that some of the earlier concerns about earning sharing remain; recently analyzed options for earning sharing continue to present difficult transition and implementation issues and unexpected distributional consequences.

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[23] For a range of cost estimates for similar proposals, *see* Entmacher 2008, *supra*.

[24] For a review of the literature, *see* Melissa Favreault and C. Eugene Steuerle, Urban Institute, "Social Security spouse and survivor benefits for the modern family" (2007), available at http://www.urban.org/publications/311436.html ["Favreault and Steuerle 2007"].

[25] Ibid.; see also Edith Fierst and Nancy Duff Campbell, *Earnings Sharing in Social Security: A Model for Reform*, Report of the Technical Committee on Earnings Sharing (1988).

[26] Favreault and Steuerle 2007, *supra*, analyzed several earnings sharing options in conjunction with other benefit changes.

[27] Howard M. Iams, et al., Social Security Administration, "Earnings Sharing in Social Security: Projected Impacts of Alternative Proposals Using the MINT Model," *Social Security Bulletin*, Vol. 69 No. 1 (May 2009), available at http://www.ssa.gov/policy/docs/ssb/v69n1/v69n1p1.html.

Improve Social Security Benefits for Low Lifetime Earners and Caregivers

This part of my testimony will be brief, because Melissa Favreault, one of today's witnesses, has developed a proposal for a new minimum benefit to assist workers with low lifetime earnings, including those whose work histories have been interrupted by caregiving, unemployment, or poor health.[28] However, I do want to emphasize the importance of reforming benefits for low lifetime earners and call the Committee's attention to other reform options.

The regular Social Security benefit formula is progressive. It provides workers with low lifetime earnings benefits that represent a higher percentage of their pre-retirement income than higher-income workers. However, benefits are proportional to average lifetime earnings, and for workers with very low lifetime earnings, benefits calculated under the regular formula will still be very low. For example, under the regular formula, a worker who retires at age 62 after 40 years of work at the minimum wage would receive a benefit equal to about 82% of poverty.[29] Many retired workers, especially women, receive benefits that provide less than a poverty-level income: 45% of female workers and 19% of male workers received below-poverty benefits in 2006.[30]

Social Security has an alternative benefit formula, the Special Minimum Benefit (SMB), intended to "provide long-term workers with an income that would free them from dependency on welfare."[31] Workers receive the higher of a benefit calculated under the SMB or any other benefit to which they are entitled, under the regular formula as a worker or as a spouse, surviving spouse, or divorced spouse of a higher earner.

However, the current SMB does little to help workers with low benefits. In December 2007, fewer than 100,000 beneficiaries – less than two-tenths of one percent of all beneficiaries – received benefits under the SMB.[32] Largely because the SMB is price-indexed, while the regular formula is wage indexed, the number will continue to drop. After 2013, no newly retiring workers are expected to benefit from the SMB.[33]

While the SMB is disappearing, the problem the SMB was supposed to address has not. In fact, falling wages and growing instability in the low-wage labor market are making the problem worse.[34]

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[28] Melissa Favreault, Urban Institute, "A New Minimum Benefit for Low Lifetime Earners" (2008), available at http://www.nasi.org/publications2763/publications_show.htm?doc_id=819525 ["Favreault 2008"].
[29] *Ibid.*
[30] *Ibid.*
[31] *See* Kelly Olsen and Don Hoffmeyer, "Social Security's Special Minimum Benefit," Social Security Bulletin 64(2) (2001-2002), available at http://www.ssa.gov/policy/docs/ssb/v64n2/v64n2p1.pdf [Olsen and Hoffmeyer 2001).
[32] Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin, 2008,* Table 5.A8 (2009).
[33] Olsen and Hoffmeyer 2001, *supra.*
[34] Sullivan et al. 2008, *supra.*

There are several options for reform. In addition to the proposals developed by Ms. Favreault, Mr. Biggs, and myself, other ideas for improving benefits for low-income workers, providing credits for caregiving, and assisting vulnerable groups were recently developed and analyzed as part of the NASI project funded by the Rockefeller Foundation.[35]

Improve Supplemental Security Income

Social Security is not the only program that provides economic security to older Americans. Supplemental Security Income (SSI) is a means-tested program that provides income to poor people age 65 and older, and to poor blind or disabled people.

Ironically, because of the rules governing SSI and other means-tested benefit programs, a modest increase in Social Security benefits – for example, in the widow(er)'s benefit or minimum benefit – could make some beneficiaries worse off. A small increase that put a beneficiary over the SSI eligibility threshold could mean the loss of Medicaid, Supplemental Nutrition Assistance Program Benefits (formerly Food Stamps) or Low-Income Home Energy Assistance Program benefits.

By coordinating policy changes to Social Security, SSI, and other benefit programs, Congress could ensure that beneficiaries are protected from unintended consequences if Social Security benefits are improved.[36] And – even without changing Social Security – Congress could modernize SSI, as described below, to increase economic security for low-income older Americans.

<u>Update SSI rules for disregarding Social Security benefits and asset limits</u>

A majority of SSI recipients receive Social Security benefits as well. However, under SSI rules, with the exception of a $20 per month disregard, every $1 of Social Security income reduces SSI income by $1. So, low earners with a substantial work history, but whose Social Security benefits are still below SSI eligibility levels, receive just $20 per month more than individuals with no history of Social Security contributions. This amount has not been changed since 1974.[37]

Indexing the disregard for inflation since 1974 would raise it to about $89 per month ($105 per month if it had been indexed to wages); these adjustments would boost the income, and reduce the poverty gap, for older Americans.[38] (If Congress also increased Social Security benefits, raising the disregard for Social Security income in SSI would reduce, but not entirely eliminate, the impact of that increase on eligibility for other assistance programs.)

[35] *Strengthening Social Security for Vulnerable Groups, supra.*
[36] Sullivan et al. 2008.
[37] Kilolo Kijakazi, Center on Budget and Policy Priorities, "Women's Retirement Income: The Case for Improving Supplemental Security Income" (June 2001)
[38] Sullivan et al. 2008, *supra.*

The SSI program also has a restrictive asset limit: $2,000 for an individual, $3,000 for a couple, amounts that have not increased since 1989. An adjustment for inflation would bring them to about $3,500 for an individual, $5,300 for a couple; a further increase would better reduce the disincentive to save and allow elders to maintain more of a reserve in case of emergency.[39] In addition, while a traditional defined benefit pension is not considered an asset for purposes of SSI (the income is counted for determining income eligibility), the accumulation in a defined contribution plan, now the most common form of retirement plan, counts against the SSI asset limit. To equalize the treatment of different forms of retirement plans, retirement accounts could be treated as annuitized income.[40]

By modernizing SSI rules, Congress could enable low-income older Americans to derive greater benefits from their own Social Security benefits and savings. These changes would not affect the solvency of the Social Security Trust Funds, although they would affect the cost of SSI, which is funded with general revenues.

Conclusion

For generations, Social Security has, in the words of President Franklin Roosevelt, provided some measure of protection to workers and their families against the "hazards and vicissitudes of life" and a "poverty-ridden old age." I thank the Committee again for holding this hearing on ways to keep that promise in the 21st century, and for giving me this opportunity to testify.

[39] *Ibid.*

[40] Zoe Neuberger et al., Retirement Security Project, "Protecting Low-Income Families' Retirement Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Savings" (2005), available at http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Retirement_security/RSPAssetTestReport0605.pdf.

The CHAIRMAN. Thank you very much, very fine statement.
Dr. Melissa Favreault.

STATEMENT OF MELISSA FAVREAULT, SENIOR RESEARCH ASSOCIATE, INCOME AND BENEFITS POLICY CENTER, URBAN INSTITUTE, WASHINGTON, DC

Dr. FAVREAULT. Thank you, Senators, for this opportunity to testify. I'm going to focus on four key points.

First, Social Security benefits for long-term, low-wage workers are modest, and need to be increased. Second, there are many ways to bolster benefits for low-income retirees. The technical details of each proposal will determine its effectiveness. Third, any Social Security reform package will include multiple provisions that interact with each other. So, certain provisions to help low earners may be more or less desirable, depending on other components of the package. Finally, some low-income older and disabled Americans are beyond the reach of Social Security. To help them, Congress should consider expanding SSI, the Supplemental Security Income program, as Joan Entmacher just described.

On to my first point, about the need to reduce poverty risk by shoring up Social Security for long-term low-wage workers. About 10 percent of Americans age 65 and older live in poverty, and many have incomes that leave them just barely above the poverty line. Low-wage workers' Social Security benefits are modest, both compared to benefits in other developed countries and compared to basic needs. For example, someone who spent 35 years working full time at the minimum wage, who retired at age 62, would receive a Social Security benefit equal to only about 83 percent of the poverty level. Many low-lifetime earners don't even get that much; many drop out of the labor force for a time or only work part time, often to care for children, disabled family members, and frail parents. Also, recessions hit them especially hard, and they are more likely than others to become disabled.

This leads to my second point. We can bolster benefits for these vulnerable earners in different ways, with various strengths and weaknesses. Let me start with minimum benefits, because of their prominence in reform packages. They are highly cost effective, and directly address the problem of wage stagnation that has hurt less-educated workers in recent decades. Our models show that within 5 to 10 years of enactment certain minimums could lift tens of thousands of Social Security beneficiaries out of poverty. By mid-century, they could help almost a million people every year.

Minimum benefits with stricter work-years definitions would have smaller effects, but would cost less and maintain Social Security benefits' strong ties to time in the labor force.

That is the challenge in designing a minimum benefit. The better it is at alleviating poverty, the worse it sometimes is at rewarding work. Really large minimum benefits could weaken the relationship between taxes paid and benefits received. Given the fiscal challenges ahead, Social Security must continue to reward long-term workers.

Another interesting Social Security adequacy proposal would increase benefits at older ages, say when folks are in their 80's and older, through a longevity insurance bonus or index. This addresses the risk that people might outlive their assets. Such benefits would be targeted toward a time of life when work ability is most limited, and would ensure that older seniors' incomes kept up with standards of living for workers in the economy. But some of these benefits may go to well-off seniors who don't need extra help. Without caps, then, longevity benefits may be less effective at reducing poverty than other equally costly approaches.

Proposed spouse and survivor benefits, as Joan Entmacher has described, often try to increase a program's fairness, for example, making benefits more equal for single- and dual-earner married couples. A challenge for these proposals is that trying to make benefits fair for some couples often makes benefits less fair for unmarried workers who paid the same payroll tax. Some of these proposals are also fairly costly, and caps can help, as Joan pointed out already.

Caregiver credit options try to deal with most of the limitations of spouse and survivor benefits. They could effectively serve many single parents, who now often fall through the cracks. Like minimum benefits, they also tend to be quite cost effective, and very progressive. But they're not always fair for caregivers who earn more than the credit level, and they're hard to administer.

So, details matter. Without careful design, large vulnerable groups could be left out, diversity within groups may be overlooked, and benefit improvements could become less effective over time.

My third point is that, in any Social Security reform package, provisions are going to interact. Sometimes people say that solving Social Security's financing needs is just an arithmetic problem. We just need to raise some taxes and cut some benefits.

But, different tax increases and benefit cuts affect workers and beneficiaries very differently. For example, reductions to cost-of-living adjustments would affect the oldest old more than other beneficiaries. I've simulated many Social Security packages in which the impact of an adequacy adjustment that appeared to be highly effective in isolation has been largely wiped out by other elements in the package. That's why it's critical to look at packages in totality, as—again, as Joan pointed out, the whole is often quite different from the sum of its parts.

My final point, echoing Joan again, is that Social Security can't do it all. SSI was designed to aid those with limited work histories. It has languished over the last 35 years, and needs to be updated if it's to play more of a role in reducing need among rapidly aging baby boomers. For example, increasing SSI's asset test would be an especially cost effective way to alleviate poverty among older women. Given the increasing share of defined contribution employer-provided pensions, Congress could reconsider the way SSI treats these types of pensions.

So, that's the end of my statement. Thank you, and welcome the opportunity to have a discussion of these issues and to answer any questions you may have for me.

[The prepared statement of Dr. Favreault follows:]

Revitalizing Social Security:
Effectively Targeting Benefit Enhancements for Low Lifetime Earners and the Oldest Old

Statement of
Melissa M. Favreault
Senior Research Associate
The Urban Institute

Before the
U.S. Congress
Senate Special Committee on Aging
Sen. Herb Kohl, Chairman

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The Urban Institute is non-profit, non-partisan organization that conducts social and economic research and policy analyses to foster sound public policy and effective government.

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Mr. Chairman and members of the committee: Thank you for the opportunity to testify today about ways to shore up Social Security for lower-wage workers. My name is Melissa Favreault, and I am a Senior Research Associate at the Urban Institute.

As policymakers think about bolstering the Social Security system's finances, it would also make sense to think about benefits for lower-income workers. Let me lay out the relative merits of several alternative, potentially complementary strategies for improving Social Security benefits for long-term low-wage workers and the oldest old retirees. These include minimum benefits, formula adjustments, special longevity insurance benefits, and enhanced non-contributory (spouse, child, survivor) benefits. Each approach has strengths and weaknesses, and each targets a different group of beneficiaries. Some benefit changes are highly skewed, with a small number of beneficiaries experiencing huge changes; others offer smaller benefit changes for more people. The Urban Institute research findings that I will outline highlight these disparate effects.

Social Security has been Tremendously Successful

Social Security plays a vital role for aged and disabled Americans and their dependents and survivors. As the program approaches its 75th birthday (next August), there is much to celebrate. Poverty rates for adults age 65 and older have declined markedly over the past half century, falling from 35.2 percent in 1959 to 9.7 percent in 2007 (DeNavas-Walt, Proctor, and Smith 2008).[1] Reductions in poverty among the oldest old have been particularly impressive.

Social Security is near universal, with over 90 percent of those 65 and older receiving benefits from the program, and it remains the bedrock of the retirement system for most older Americans. On average, households with Social Security beneficiaries age 65 and older received about 64 percent of their income from the program in 2006 (Social Security Administration 2009b: Table 9.A1). About 60 percent of the households in the lowest fifth of the income distribution receive all of their income from Social Security (Ibid. Table 9.A4). Even in the middle fifth of the income distribution, more than three quarters of households receive at least half their income from Social Security.

The program is also highly efficient, with overall administrative expenses of less than one percent of benefits paid (Social Security Administration 2009a: Tables 4.A1-4.A3).[2]

Social Security Should Better Reflect Americans' Current Home and Work Lives

However, these successes should not foster complacency. Aged poverty of almost 10 percent is worrisome, and substantial fractions of the aged have resources that place them just

[1] Research by Englehardt and Gruber (2004) suggests that the decline in elderly poverty is in part directly attributable to Social Security.

[2] Administrative expenses are about 0.63 percent of benefit payments for Old-Age and Survivor Insurance benefits, and about 2.57 percent of payments for Disability Insurance benefits, which require more careful screening and evaluation. Combined, expenses are about 0.95 percent of payments.

barely above the poverty line, so they are still economically vulnerable even if not poor by official standards. Moreover, aged poverty levels are substantially higher under alternative poverty measures, like those developed by the National Academy of Sciences that better reflect older adults' health care spending (Zedlewski 2009).

Arguably, several aspects of the Social Security program have failed to keep up with changes in our economy and society. As Congress aims to shore up the program's finances, it is an excellent time to consider modernizing other aspects of the program. As important as Social Security has been and continues to be for older Americans, it should better fit with the ways that Americans live and work today. Notable changes include:

- Stagnating wages, especially for less educated earners, that make it difficult for some workers to save for retirement or even to keep up with basic living expenses;
- Increased life spans, plus increased healthy life spans for many, that improve opportunities for long and productive careers but also raise the risk of outliving one's assets without careful planning;
- Rapid changes in family structure that increase the odds of entering retirement without a partner, and thus without an important form of financial protection;
- Related changes in women's work that highlight questions about how to equitably treat workers—including unmarried parents—who have taken time out of the labor force to raise children or care for frail parents;
- Changing employer-provided benefits, including the shift from defined benefit to defined contribution employer pensions that reduce the share of retirement income received as predictable, monthly payments; and
- Relatively high levels of immigration and a rapidly changing immigrant population, with special needs and risks.

Low Lifetime Earners Remain Economically Vulnerable in Retirement

Social Security benefits for long-term, low-wage workers are relatively modest under current law, both compared to workers' basic needs and compared to benefits in comparably wealthy countries (Aaron 2009; OECD 2007; Thompson and Carasso 2002). Thus the case for shoring up Social Security benefits for vulnerable populations is strong.

With 40 full-time work years at the minimum wage, a worker claiming benefits at age 62 could expect to receive a Social Security benefit equal to about 83 percent of the federal poverty level (FPL). [In 2007, the FPL corresponded to about $829 per month, or about $9,994 per year for a person age 65 or over and living alone. For those younger than age 65, the corresponding figures are $898 and $10,787.] With 30 years of full-time work, the same worker could expect a benefit about 78 percent of FPL, again assuming Social Security claiming at age 62.

Outcomes are even worse for the many workers who are not able to work a full 35 to 40 years and who are often forced to work part-time. For numerous reasons, the work histories of most low-lifetime earners include years out of the labor force (Favreault and Steuerle 2008). Caregiving responsibilities are a big part of the story, with some workers, especially women, forced to interrupt their careers to care for children, disabled family members, and frail parents. Additionally, recessions tend to hit certain groups harder than others, with younger workers and people of color, especially men, more likely to become unemployed and spend more time out of work. The incomes of lower-wage families tend to take longer to recover from a recession (see, for example, Acs 2008). Further, disability is more prevalent among low-wage workers with limited education. Recent estimates of the experiences of Americans ages 51 to 61 from the Health and Retirement Study (HRS) show that just more than 40 percent of respondents develop a serious medical condition over a 10-year period, about a third experience work limitations, and about one fifth are laid off (Johnson, Mermin, and Uccello 2005). Racial and ethnic minorities and those with less education are more likely than others to experience these shocks (Ibid, Table 4). Research suggests that labor market discrimination based on age and race has declined, but has not yet disappeared (Favreault 2008).

Partly because of career interruptions and reduced wages, about a third of retired workers in recent years received Social Security benefits of less than the poverty threshold for a single aged person including about 18 percent of men and 45 percent of women (author's calculations from Social Security Administration 2009a).[3] After taking all income sources and living arrangements into effect, Social Security beneficiary poverty rates at ages 55 and older in 2006 were about 9.9 percent for women and 4.2 percent for men (Social Security Administration 2009b).[4] But, again, near poverty rates reveal that many non-poor beneficiaries face considerable risk: 17.1 percent of women and 9.1 percent of men receiving Social Security have incomes of less than 125 percent of the poverty level.

Minimum Benefits are One Prominent Approach to Shoring up Social Security

These economic challenges faced by many low-income beneficiaries have prompted analysts and policymakers from both parties to propose adding minimum benefits to Social Security. (Technically, the program already includes a minimum benefit, called the Special Minimum Primary Insurance Amount, but it now covers so few people that it is essentially ineffective.[5])

Several proposals would enhance minimum benefits. These proposals vary widely in their goals, their larger contexts (some appear as part of packages that would integrate personal accounts, others do not), and in the ways they would enhance benefits for long-term low-wage workers and other vulnerable populations. While some would shore up Social Security' existing

[3] Estimates should be interpreted conservatively, as they are sensitive to a number of issues, including whether one uses an aged or non-aged poverty threshold, the number of months one assumes that benefits are received, and other factors.
[4] These are lower than the overall aged poverty numbers cited above, since many of the most vulnerable do not receive Social Security benefits. I discuss the SSI program, which reaches some of the aged and disabled who do not qualify for Social Security benefits, below.
[5] In December 2007 about 95,500 persons (less than 0.2 percent of the OASDI caseload) received benefits based on the special minimum PIA (Social Security Administration 2009a: Tables 5.A1 and 5.A8). Olsen and Hoffmeyer (2001/2002) and Fitzpatrick, Hill, and Muller (2003) provide detail on the special minimum. Analyses suggest the special minimum will be irrelevant for new beneficiaries by 2013 (Feinstein 2000). Special minimum coverage has declined largely because its parameters are indexed to prices rather than wages.

special minimum PIA benefit (for example, Sullivan, Meschede, and Shapiro 2008, Reno 2009, Rep. Ryan 2008), others would create a new minimum benefit (for example, Reps. Kolbe-Stenholm 2002, Rep. Kolbe-Boyd 2005, National Commission on Retirement Policy 1998), and still other approaches would fall somewhere between the two (for example, Diamond and Orszag 2003, Sen. Graham 2003, President Bush's Social Security Commission 2001). The broad support for minimum benefits indicates both the perceived importance of these types of enhancements and the potential for reaching common ground on improving the adequacy of Social Security benefits.

Urban Institute Projections Suggest that Minimum Benefits Could Remove Hundreds of Thousands of Beneficiaries from Poverty at Relatively Modest Cost

The Urban Institute has developed a detailed projection model to forecast Social Security benefits into the distant future and to assess the effects of alternative proposals. We have used this model to simulate a wide range of Social Security policy options including a substantial number of alternative types of minimum benefits.

Our analyses using this model show that minimum benefits can reduce poverty among Social Security beneficiaries in a cost-effective way.[6] For example, one simulation measures the impact of instituting a generous version of the minimum benefit that was incorporated in the National Commission on Retirement Policy plan (and later included in Kolbe-Boyd and Kolbe-Stenholm). It would pay benefits equal to 60 percent of the poverty threshold to retirees with 20 years of work, and the minimum would increase to 120 percent of the poverty threshold for those with 40 years of work.[7] Assuming that the benefit grows with average wages, we conclude that within 5 years of inception (2015 for a plan implemented next year) the benefit would lift 125,000 Social Security beneficiaries out of poverty. This figure would grow to about 700,000 by 2030 and would approach one million (930,000) by 2050.[8]

Enhancing the existing special minimum PIA benefit, which defines a work year more stringently (see Figure 1), so that it provides a maximum benefit (for those with 30 or more work years) equal to 125 percent of the poverty threshold, would have lesser effects on poverty. But while it would remove fewer beneficiaries from poverty—about 120,000 in 2050, for example, assuming the special minimum benefit grows with average wages—it would also cost far less. It would have another appealing feature too: it maintains a virtually identical pattern of Social Security benefits by number of years worked as current law.

[6] Given the complexity of each of the proposals (starting period, phase-ins, treatment of those receiving benefits from DI, design and implementation of caps, and other considerations), I do not provide precise projections of the simulated effects of various proposals but instead focus on qualitative assessments of some of the relative effects, strengths, and weaknesses. More detailed analyses that include benefit projections with more detailed descriptions about assumptions are cited in the text where possible.

[7] A work year would be defined as earnings of at least four covered quarters, with partial years countable.

[8] These projections rely on assumptions of the 2008 Trustees report, so do not incorporate the effects of the current recession. Projections also assume minimal behavioral response. Details of the minimum benefit are highly stylized, rather than ideal. All projections should be interpreted cautiously given these limits and the tremendous uncertainty associated with long-run modeling.

In both of these cases, our models indicate that most of the new benefits would go to those in the bottom fifth of the lifetime earnings distribution. So money is well spent. Also, some of these resources go to individuals whose incomes remain just below poverty. So the projections of the number of individuals removed from poverty understate the degree to which severe need would be alleviated.

These projections are from simulations that add minimum benefits to Social Security as scheduled under current law without any other changes, so they would increase costs. We have examined minimum benefits in many other circumstances, for example while holding total program expenses constant. We find that minimum benefits could markedly reduce projected poverty and near poverty among Social Security beneficiaries in these types of packages (Favreault 2008). We have also simulated packages that included minimum benefits that would reduce overall Social Security expenditures to help close the program's fiscal shortfall while at the same time still reducing beneficiary need (Favreault, Mermin, and Steuerle 2007).

A Minimum Benefit's Effectiveness at Reducing Need Depends on Technical Features

Our results show that in designing benefit enhancements like these, the details matter (see, for example, Favreault, Mermin, and Steuerle 2006, 2007 for further discussion). The specific type of minimum benefit—whether it's an extension of the existing special minimum PIA or a new element altogether—shape its costs, effectiveness at alleviating poverty and near poverty, and the distribution of winners and losers within and across generations. Some key features include the following:

- The benefit level, for example how quickly in rises with work;
- The choice of whether and how (by growth in wages or growth in prices) to adjust the benefit level after initially setting it;
- The benefit's eligibility criteria (often expressed in terms of work or service years);
- The definition of a work year;
    - Does it consider provision of care as creditable toward benefits?
    - Are partial years permissible?
- Whether it confers rights to spouse and/or survivor benefits;
- The treatment of time in employment not covered by Social Security because of, for example, employment in uncovered government work or time outside of the United States (for example in cases of relatively late-career immigration).

This latter point is important because of Social Security's progressive benefit formula. Some workers may appear relatively vulnerable when considering only their earnings covered by Social Security, but actually have considerable resources derived from other sources (Brown and Weisbrenner 2008, General Accounting Office 1979, Gustman and Steinmeier 1998). Social Security includes provisions that prevent treating workers with pensions from uncovered employment as low lifetime earners. Designers of minimum benefits (and other benefit enhancements) should be able to similarly insure that adequacy benefits are well-targeted toward those who need them by including analogous features.

There are Tradeoffs between Keeping Costs Low, Reaching the Most Vulnerable, and Maintaining Work Incentives and Equity for Workers with Long Careers

Undoubtedly, part of the strong political support that Social Security has enjoyed results from the close relationship that exists between payroll taxes paid and benefits received in retirement and disability.[9] While the program has a number of redistributive elements (for example, a progressive benefit formula, partial taxation of benefits through the personal income tax system, and non-contributory benefits for dependent children, spouses, and survivors), consensus appears to be broad that Social Security currently incorporates an acceptable level of redistribution.

Minimum benefits, and many of the other enhancements I discuss next, could alter this relationship if they were substantial in size. This could be problematic for several reasons: There are important tradeoffs between efficiently targeting the most vulnerable and maintaining work incentives and equity for other workers. When workers who work for long periods get lower "returns" to their Social Security contributions, they may ultimately elect to work less. Workers who pay a lot more in payroll taxes may withdraw their political support from the program. Careful design can help to mitigate these concerns. None of the minimum benefits discussed here increase adult benefits by more than two percent at any point over the 75-year horizon.[10]

Social Security Adequacy Adjustments other than Minimum Benefits Can Also Reduce Poverty, Often with Different Strengths and Weaknesses

While minimum benefits have received a lot of attention, they are not the only means for targeting vulnerable Social Security beneficiaries.

Formula adjustments: Social Security's benefit formula for workers is based on the highest 35 years of a worker's earnings, and replaces higher shares of earnings at lower lifetime earnings levels [Figure 2]. Some have proposed changing the Social Security benefit formula, for example by adding a new bend point or increasing the replacement rates for the lowest lifetime earners (for example, Hartmann and Hill 1999).

In previous research, we have found that benefit formula adjustments can be about as effective at reducing poverty and near poverty in a reduced Social Security system as minimum benefits, but that the latter tend to keep benefits more closely tied to time in the labor force (Favreault, Mermin and Steuerle 2007). Policymakers should consider this difference if choosing between these alternatives.

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[9] Franklin Delano Roosevelt famously said that payroll taxes would keep other politicians from scrapping his Social Security program (DeWitt 2005, citing Gullick).

[10] We defer to the Office of the Chief Actuary of the Social Security Administration for detailed costs estimates on these options.

Increased benefits at older ages: Some have proposed adding a longevity insurance benefit enhancement to Social Security for the oldest old (Turner 2008, Reno 2009; see also appendix in Social Security Advisory Council 1994-1996). This could take the form of a benefit boost at some point in later life (say, age 85). It could be granted to all who survive until that age (for example as a flat sum or a percentage increase in benefits), or it could be targeted toward those with relatively low benefits (for example, an enhanced benefit capped at the benefit for an average wage worker).

One rationale for providing some form of longevity bonus is that the oldest old are typically far less able to work than younger beneficiaries. A second rationale is that at older ages, other sources of income besides Social Security may have eroded in value. For example, many households will find that they are less able to meet expenses because their employer-provided pensions are not, like Social Security, indexed for inflation. Other reasons a longevity benefit might make sense is that some Americans lack financial knowledge and sophistication and may plan poorly for a long retirement. Specifically, they may fail to properly estimate how long they are likely to live and how high necessary expenditures, like health care costs, may be in their retirement. Factors like these contribute to the fact that the poverty rate in 2006 was about 2.5 percentage points higher for those beneficiaries ages 80 and older than for those between ages 65 through 69 (10.7 versus 8.2 percent) (Social Security Administration 2009b, Table 11.2). Insuring against longer than average life expectancy would be one way to help those who find themselves strapped by health or long-term costs late in life.

On the other hand, longevity-based adjustments could end up subsidizing relatively well-off beneficiaries. Mortality rates are much lower among those with higher lifetime earnings and in wealthier communities, and this gap may be increasing (Singh and Siahpush 2006). So, within gender, the oldest old are disproportionately high-earners. While, as just noted, the oldest old have markedly higher poverty rates than other Social Security beneficiaries, this gap has narrowed considerably over the last few decades and may continue to decline. Social Security's increased maturity (and coverage of an increased share of the workforce) and protections in legislation like the Retirement Equity Act (under ERISA), which requires spouses to sign off on decisions about survivor benefits in defined benefit pension plans, have no doubt played a role in reducing poverty among the oldest old.

To prevent unintended redistribution toward well-off workers, longevity enhancements could target lower lifetime earners. Given that there is no clear age when other retirement income sources drop off (and for many workers, they never do), a continuous rather than sudden increase in benefits, for example gradually increasing benefits from ages 85 to 90 rather than instituting a sharp benefit increase at a single age, would likely make for a stronger policy. Developers of this type of benefit might consider indexing it for life expectancy increases—with changes estimated well in advance—rather than permanently setting ages in the legislation.

The costs and distributional effects of any longevity enhancements would of course depend on these choices.

Spouse and survivor benefit adjustments: An extensive literature addresses how Social Security spouse and survivor benefits shape program adequacy and equity by gender, marital status, and family earnings patterns and how changes to these benefits might increase beneficiary adequacy and reduce poverty. These alternatives have been prominent in adequacy debates, though often their primary aim is to improve fairness (for example, between married people and single people, between spouses when a marriage ends in divorce, between married couples with the same total earnings but different shares earned by each spouse). Proposals range from major structural changes like earnings sharing to more incremental extensions or modifications of existing benefits. Urban Institute research on these types of alternatives has been extensive (for example, Favreault, and Sammartino 2002, Favreault, Sammartino, and Steuerle 2002, Favreault and Steuerle 2007).

Earnings sharing received a great deal of attention in the 1980s, but discussion of the option remained relatively dormant because of complications revealed then (see Ross and Upp 1993) until fairly recently. The more recent research on this topic suggests that transitioning to an earnings sharing approach would still pose great challenges (Favreault and Steuerle 2007, Iams, Reznick, and Tamborini 2009). The effects of an earnings sharing proposal would depend greatly on the details of the policy. Broadly speaking, while equity may increase on many dimensions under earnings sharing, maintaining adequacy would require very careful design, perhaps with significantly increased costs.

Caregiver credits could be awarded independently of other changes to Social Security's spouse and survivor benefits, or they could be part of a shift toward greater marriage neutrality to make the program fairer for parents who never married (see, for example, Favreault 2008, Herd 2005). Legislators have expressed some interest in proposals that include caregiver credits (Lowey 2009). Distributional estimates typically reveal such adjustments to be very progressive.

One particularly prominent benefit increase proposal would increase survivor benefit to two thirds to three quarters of the combined worker benefits of the two spouses, sometimes with a corresponding reduction in spouse benefits to finance the higher widow(er)s benefits, and sometimes with a cap on the benefit increase (for discussion, see, for example, Burkhauser and Smeeding 1994, Entmacher 2008, Graham 2003, Hurd and Wise 1991, Iams and Sandell 1998, Reno 2009, Sandell and Iams 1997, Social Security Advisory Council 1994-1996). Such increases are geared at preventing standards of living from falling rapidly upon widowhood and aim to address inequities such as the preferential treatment single-earner couples receive relative to dual-earner couples who pay the same amount in payroll taxes. Other proposed increases in non-contributory benefits could include extending coverage for certain benefit types that exist under existing rules to address cliffs in benefit eligibility. Examples include reducing the minimum marriage duration for spouse and survivor benefits from 10 years to 7 years[11] (for example, Hartmann and Hill 1999) or allowing students to continue to receive children's benefits after age 19 (Reno 2009). Distributional estimates of both types of options reveal that they would reduce poverty.

However, many will fall through the cracks if spouse and/or survivor benefit enhancements are the primary mechanism for addressing needs among long-term, low-wage

[11] Given that approximately 63 percent of marriages that end in divorce do so before the 10 year eligibility threshold for Social Security, this would provide a way to compensate a spouse who may have taken many years of the labor force to raise children but who is not entitled to a spouse or survivor benefit.

retirees. Marriage rates are down, marriage is often delayed, nearly half of marriages end in divorce, and nearly 40 percent of births occur outside of marriage, so many caregivers do not qualify for these types of benefits. Without other adjustments, shoring up spouse or survivor benefits also increases the gap between the returns that married and single people receive from the program. At present, poverty rates among never married older women are higher than those of widows (Social Security Administration 2009b).

Given these important demographic and economic patterns, targeting is an especially important issue for auxiliary benefit adjustments. Cost and distributional estimates suggest that enhanced survivor benefits would be more costly than the most generous minimum benefits we simulate, but less effective at reducing poverty. Caps on the survivor benefits—for example at the benefit an average wage history would generate—reduce the costs markedly with virtually no change in poverty reduction, and they would also lead to more evenly distributed benefit increases by race/ethnicity. Increasing eligibility for divorced spouse and widow(er) benefits would be less costly than a survivor benefit increase, but not as effective as marriage-neutral adjustments, like a minimum benefit or caregiver credit, of comparable cost at reducing poverty.

Supplemental Security Income is an Additional (or Alternative) Lever

Social Security is not the only possible mechanism for bolstering retirement incomes of lower lifetime earners. The Supplemental Security Income (SSI) program, sometimes referred to as the program of last resort, was designed to aid those with less significant work histories. As such, it may be an appropriate vehicle for improving the economic well-being of a subset of the vulnerable. SSI has, however, languished over the last 35 years, and will not be able to play a more significant role in reducing need among the rapidly aging baby boomers without updating that will incur costs.

For example, SSI's asset test has not been updated in 20 years, since 1989. (SSI's asset test excludes a home, a vehicle if used for employment or medical appointments, household goods and personal effects, plus modest burial funds, but includes virtually all financial assets, including the balances of retirement accounts.) Had these figures merely kept up with inflation since 1989, they would be set at $3,450 for an individual and $5,145 for a couple (rather than the present levels of $2,000 and $3,000 for singles and couples, respectively). The amount of earnings that an SSI beneficiary can keep without a reduction in his or her benefit (the "earned income exclusion") and the amount of other income he/she can keep from any other source (the "general income exclusion"), including Social Security benefits, are still set at the level established when the program began in 1974. Had they kept up with inflation, they would now be more than quadruple their current monthly levels of $65 and $20, respectively.

Cost and distributional research suggests that increases in SSI's asset test would be an especially cost-effective approach for alleviating poverty among older women (Rupp, Strand, and Davies 2003). Increasing the exclusions would also help, but they are somewhat less cost-effective. Given the increasing share of employer-provided pensions that are defined contribution pensions, SSI's treatment of workers' resources could be changed so that holdings in defined contribution pension plans could be evaluated based on the income streams they could generate, rather than strictly as assets (Parent 2006). SSI's complex regulations on in-kind support and maintenance (ISM) for those who live in another's home also deserve reconsideration (Balkus et al. 2008).[12]

There are tradeoffs between using Social Security and SSI to reduce need among the aged and disabled eligible for relatively low Social Security benefits. Means tested assistance programs like SSI may carry stigma, and they are often not well understood. As a result, SSI participation rates are much lower than participation rates in social insurance programs like Social Security (for example, Davies et al 2002). Means tested programs can also be quite costly to administer and frustrating to beneficiaries and administrators alike. In contrast, Social Security has low administrative costs and provides easy access to benefits.

The choice between increasing Social Security benefits for low-income individuals and SSI improvements also has important implications for Medicaid eligibility (for discussion, see, for example, Sullivan, Meschede, and Shapiro 2008, Smeeding and Weaver 2001). Policymakers may need to avoid the potential loss of Medicaid benefits from higher Social Security benefits. On the other hand, spillover costs to Medicaid programs could be significant with SSI expansion.[13]

Groups with Relatively High Proportions of Vulnerable Beneficiaries are often Very Diverse

Because certain groups, for example unmarried women, African-Americans and Latinos, those who live alone, and the oldest old, tend to have much higher rates of aged poverty than the aged as a whole and the general Social Security beneficiary population, there may be some temptation to target new resources toward these populations. This can sometimes lead one to overlook the tremendous diversity within these groups.

When weighing the merits of alternative approaches to shoring up Social Security (or SSI) adequacy, it may thus be helpful to ask a few important questions. First, if a proposal does target a narrow group, does it appropriately take diversity into account? When developing benefit enhancements, design elements like caps and tests for need or work history can help to insure that resources are well-targeted so that those who are not needy do not receive a large share of new benefits unless there is some compelling other reason (like fairness) to target them. Second, does the supplement (or package of changes) leave out any large vulnerable group? Third, are there any differences in life-course patterns across groups that may lead the proposal to have disparate effects? While in the past Social Security had some regulations that were different for men than for women, today the rules are all gender neutral, though gender still indirectly shapes how the program treats men and women. This occurs, for example, because of

[12] While the intention of these regulations is to insure that those who do not need support do not receive SSI, they serve to deter individuals from giving to (or seeking support from) friends and family, are often poorly targeted, plus difficult and expensive to administer.

[13] See, for example, Congressional Budget Office 2003, for a case in which increased Medicaid costs would dwarf the costs in added cash payments from SSI for an SSI expansion through a liberalized approach to counting certain resources toward program eligibility and benefits.

the way it pays benefits in the form of life annuities. Social Security rules are not, however, marriage neutral, so it is valuable to consider potential disparities that could arise because of differences in marriage patterns by race and lifetime earnings.

Given Social Security's long-term imbalance, it is important to target adequacy enhancements carefully. There is no right answer on which of the adjustments that would improve adequacy for lower lifetime earners is the best. Best depends on how one weights various criteria. Legislators need to weigh these difficult tradeoffs between poverty reduction and work incentives, between universality and simplicity in administration and keeping costs low, and between recognizing the work efforts of those who worked continuously and protecting those who become unable to work because of a lay-off or disability, to name just a few.

The Broader Context: Financing Adequacy Adjustments

Because of the focus of today's hearing, I have stressed Social Security design issues rather than financing. It's worth briefly pointing out, as noted earlier, that our previous research, and the literature more broadly, both indicate that many of the adequacy adjustments that we have discussed could be partially or fully self-financed. For example, benefit increases in later life could be financed by modest reductions earlier in retirement, when other sources of income are higher and work ability is greater. Similarly, survivor benefit increases could be financed by reductions in spousal benefits earlier in life. Minimum benefit costs could be offset by caps on or reductions in non-contributory benefits that are not currently need-based.

Of course, additional revenues, either from new payroll taxes, expansion of the contribution and benefit base (the "taxable maximum"), expansion of the personal income taxation of OASDI benefits, or new sources not previously earmarked for Social Security could also be used to make Social Security more adequate. (SSI costs have historically been funded through general revenues rather than Social Security taxes, so it seems likely that any SSI enhancements would continue to be funded this way.)

The Broader Context: Adequacy Adjustments Could Interact with Solvency Adjustments

Social Security's long-term financing issues are well-known, documented each year in the Report of the program's Trustees. This year's Trustees Report indicates a 75-year deficit equivalent to just about 2 percent of payroll (Board of Trustees 2009). If action were taken today, this would translate into a permanent payroll tax increase of 2.01 percent, an across-the-board benefit reduction of 13.3 percent, general revenue transfers of $5.3 trillion in present value, or some equivalent combination of tax increases, benefit reductions, and financial transfers. This may appear to be a relatively manageable sum, albeit one that would call for considerable sacrifice. But it's worth emphasizing that the longer we defer action on correcting this imbalance, the larger sacrifices would become and the more limited our ability to share the sacrifices across generations. Delays in addressing current long-run imbalances also could mean that retirees, near-retirees, and other workers would have less opportunity to adjust their expectations and plans.

Legislators should bear in mind the larger context of Social Security adjustments to bring the system into long-term balance when designing ways to improve Social Security for the vulnerable. Some of these adjustments may be more desirable or pressing than others, depending on what form solvency adjustments to Social Security take, as different tax increases and benefit cuts affect workers and beneficiaries differently. For example, the case for increased longevity insurance may be more compelling if another change has disparate impacts by age, like research has shown a reduction to the cost-of-living adjustment would.

So, again, attention to design details and interactions is critical for Social Security reform and the prospects of the millions who depend on this program.

Conclusions

Because Social Security is a near-universal and highly efficient program, it has tremendous potential for even further reducing need among workers and their dependents in old age and disability. Our research suggests that there are ways to beef up benefits for long-term, low-wage workers and reduce poverty and near poverty at relatively modest cost while maintaining the strong connection between Social Security benefits and work. While balancing competing goals will be a huge challenge for policymakers, the opportunities for improving the program are too valuable to bypass.

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Figure 1. Comparing Alternative Work Years Thresholds for Potential Minimum Benefits (as a percent of the Average Wage Index)

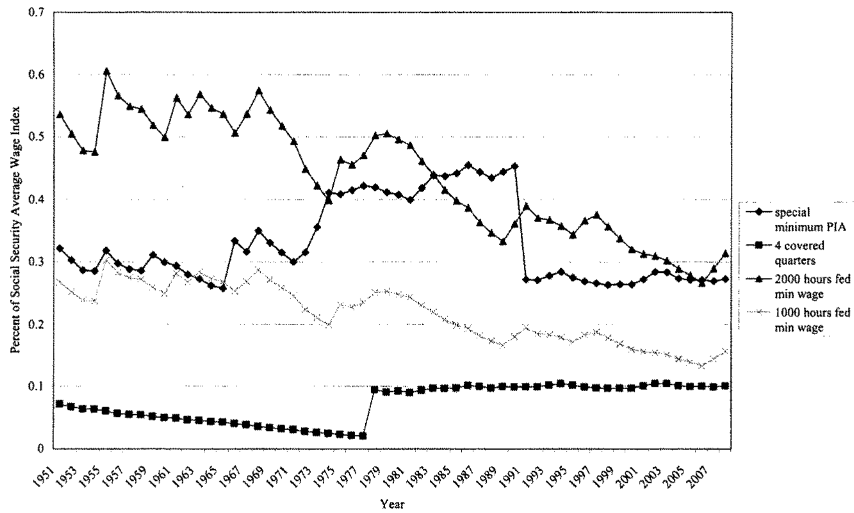
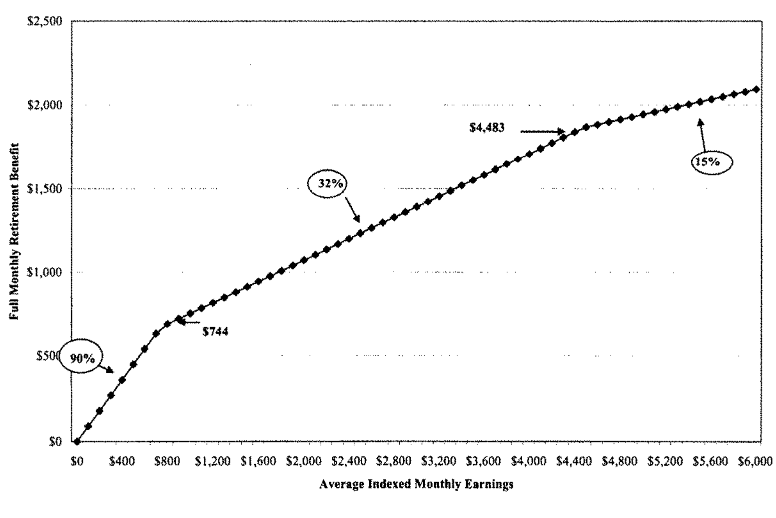


Figure 2. Social Security Benefit Formula, 2009 (with Replacement Percentages (in circles) and Bend Points)



The CHAIRMAN. Thank you very much, Dr. Favreault.
Dr. Irons.

STATEMENT OF JOHN IRONS, RESEARCH AND POLICY DIRECTOR, ECONOMIC POLICY INSTITUTE, WASHINGTON, DC

Dr. IRONS. Well, thank you, Chairman Kohl and Ranking Member Martinez, for inviting me here today.

As has been already said, the Social Security system has been the bedrock of retirement security.

Sorry, I hope you can hear me better now.

The Social Security system has been the bedrock, as was mentioned earlier, of retirement security for over half a century. Over the years, the system has evolved in response to changing conditions, and, as is well known, program outlays are expected to exceed revenue. So, the system faces a shortfall over the next 75 years.

Responsible stewardship of the program would again necessitate making feasible adjustments to move us toward sustainability. Long-run balance within the system can be achieved in one or a combination of three ways: by reducing total benefits, by increasing payroll tax revenue, or by transferring general revenues to Social Security. My testimony today will focus on the second of these options, that is increasing the payroll tax revenue.

Specifically I want to suggest that any policy to increase overall revenue through the payroll tax should include an increase in the cap on earnings subject to the tax. As you know, Social Security taxes are levied on earnings up to a maximum level that is adjusted each year to keep pace with average wages. In 2009, the payroll tax cap is set at $106,800, and roughly 6 percent of the population has earnings above that cap.

Due to growing income inequality, the share of earnings above that cap has risen from 10 percent in 1982, when the system was last in balance, to over 16 percent in 2006. This is because incomes have grown strongly at the top, while incomes in the middle have stagnated. This trend is expected to continue, meaning that the growing share of earnings remain outside of the payroll tax base.

The cap also means that higher-income individuals pay a smaller share of their income in Social Security taxes than middle-class employees. Including the employee and employer share of Social Security, together with the Medicare tax, earners in the middle fifth of the income distribution pay an average effective payroll tax of about 11 percent. In contrast, the top 1 percent of earners pay just 1.5 percent of their earnings, on average.

Let me turn now to two different options for making adjustments to that cap. According to the Social Security Administration, fully eliminating the cap on taxable earnings would be sufficient to fully close the projected shortfall in Social Security. If newly taxed earnings above the taxable maximum were credited toward the benefits, eliminating the cap would close most, but not all, of the gap. Short of that, raising and indexing the cap to capture 90 percent of earnings, as it did when the system was last in balance, would reduce the shortfall by slightly less than half, assuming benefit adjustments as well.

A third option, which I want to focus on a little bit more today, would be to split the difference, to eliminate the cap on earnings for employer contributions, and raise the cap to cover 90 percent of earnings on the employee side. With earnings up to the employee cap credited for benefit purposes, this change would reduce the long-term shortfall by about three-fourths.

There are several advantages to this last approach. It would eliminate most of the long-term shortfall while maintaining a link between contributions and benefits, which I think is very important. It would not lead to extremely large benefits for millionaires, which could be a concern if all earnings were credited for benefit purposes. Finally, self-employment—self-employed taxpayers, who are responsible for both the employee and the employer share, would not face as large an increase in payroll taxes as if you had a full elimination of the gap.

Further, this option would have, at most, a modest impact on the standard of living of upper-income taxpayers. On the employee side this would mean an increase in tax payments of, at most, 2.6 percent of income. If income growth for the top 5 percent of the households continues as it has for the past 20 years, and assuming that the full 6.2 percent of the employer tax were passed on to their employees in the form of lower wages, the additional tax obligation would be recouped by these individuals in less than 4 years. Affected taxpayers would also recoup some of the higher taxes in the form of higher benefits.

Some would argue that an increase in the cap would create inefficiencies and cost jobs. Indeed, all else equal, I too would prefer to live in a world without taxes. But, all else is not equal. If revenue is not generated by lifting the cap, it must be raised from other sources or benefits must be cut. Those choices have costs, as well.

While no one likes to raise taxes, raising the cap on taxable earnings would, in my opinion, be a better option than raising tax rates across the board. Thus, any policy to increase overall revenue through the payroll tax should have a higher cap as part of the equation. In particular, raising the cap to cover the 90 percent of all earnings, and eliminating the cap on employer side, would close about three-fourths of the projected 75-year shortfall, and the higher cap would affect just 6 percent of employees. By contrast, an across-the-board rate hike would affect everyone, with a disproportional impact on low- and moderate-income workers.

For most of those who would face a higher tax obligation, the impact would be minimal relative to their incomes, and would likely be more than offset by wage growth in just a few years.

So, thank you for the opportunity to speak with you today, and I look forward to answering questions.

[The prepared statement of Dr. Irons follows:]

Testimony of

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Before the United States Senate
Special Committee on Aging
Hearing on:

"Social Security: Keeping the Promise in the 21st Century"

Wednesday June 17, 2009; 2:00 am
Room 216 Hart Senate Office Building
Washington DC

Introduction
The Social Security system has been the bedrock of retirement security for Americans for over a half century. Over the years, the system has undergone numerous changes, both large and small, in response to changing conditions.

As is well known, under current law, program outlays are expected to outpace revenue so that, in aggregate, the system faces a shortfall over the next 75 years. Some of this shortfall is due to well-known demographic changes, but some is due to policy choices that have let the system continue as is without making adjustments. For example, changes in trend income growth or productivity growth will impact taxable payrolls and thus Social Security revenue and outlays; hence policy changes may be needed if the goal is to restore balance.

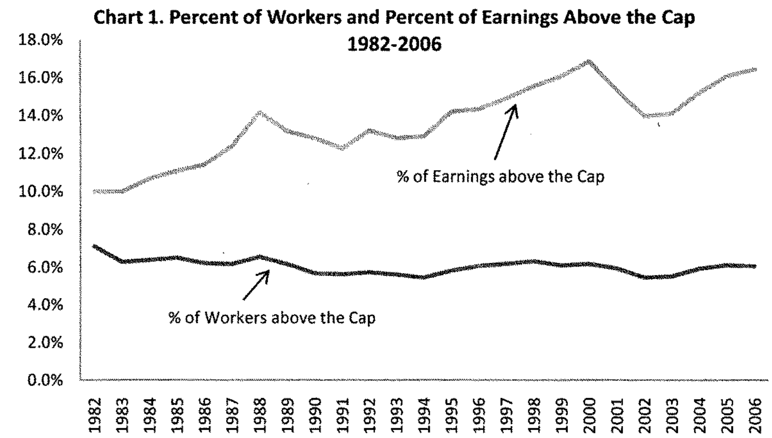
Restoring balance
Over the 75-year horizon used by the Social Security actuaries, outlays for benefits will exceed payroll tax revenue by about 2 percent of taxable payroll. Long-run balance within the system can be achieved in one or a combination of three ways: by reducing total benefits, by increasing revenue currently dedicated to Social Security, or by transferring general revenue (or linking new revenue sources) to Social Security.

My testimony today will focus on the second of these two options – that is, I will focus on options to increase revenue from the currently existing payroll tax that would bring the overall system closer to long-run balance.

I say "closer to balance" because I do not believe that it is necessary to make changes today to fully close the projected gap. Current projections show a 75-year imbalance, but such estimates are inherently uncertain – and it is not unreasonable to assume that we may do better than the baseline forecast. A system of triggers could be implemented to create automatic adjustments if needed (see, for example, Diamond and Orszag, 2004).

However, having said that, acting sooner rather than later means that the final adjustment will be milder than if we delay. Responsible stewardship of the program would necessitate making feasible adjustments to move us in the right direction whenever warranted. Thus, proposals should not be dismissed just because they do not fully close the gap: incremental progress is still progress.

Payroll tax and income distribution: overview
Social Security taxes are levied on payroll earning up to a maximum level that is adjusted each year to keep pace with average wages. In 2009, this payroll tax cap was set at $106,800, and roughly 6 percent of the population has earnings above the cap, a share which has remained relatively stable over time (see Chart 1.)



Source: Author's calculations based on data from Social Security Administration, Annual Statistical Supplement, 2008.

The chart also shows that the percent of earnings above the cap has increased. This is a result of growing inequalities in incomes – those with incomes above the cap have seen a faster pace of growth than those with incomes below.

Unlike the income tax, the payroll tax is levied at a flat rate beginning with the first dollar earned and, above the cap, the marginal tax rate is zero. As a result of the design, lower-income taxpayers end up paying a greater percentage of their income when compared to upper-income individuals (see Chart 2). With a flat rate of 6.2 percent paid by employees and employers on their behalf, that means that earners in the second quintile (20-40%) and third quintile (40-60%) pay an average effective payroll taxes (including the Medicare portion) of 10.4 and 10.9 percent, respectively.[1] In contrast, the top 1 and 0.1 percent of earners pay respective average payroll taxes of 1.5 and 0.7 percent. The income tax, by contrast, contains personal exemptions and standard deductions, which lead to lower tax rates on the first dollar earned, and multiple tax brackets that lead higher income taxpayers to pay a greater percentage for higher income levels.

More concretely, workers making $106,800 or less pay a flat 6.2 percent for Social Security on their earnings, as do their employers. Since the most employees and employers can each owe is $6,622 (6.2

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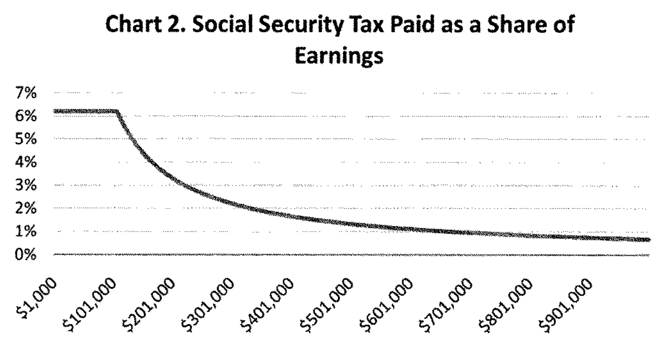
[1] The effective payroll tax rate includes both the employer and employee share of the tax, as well as the Medicare portion of the payroll tax.

percent x $106,800), the tax rate for someone earning a million dollars per year and their employer is just 0.66 percent ($6,622/$1,000,000), roughly one tenth the rate paid by most workers.



Also, since upper-income individuals receive more of their total income in the form of non-payroll income—such as capital gains—they see a total Social Security liability that can be much lower than average taxpayers. In 2005, those with income in the top 5 percent received 13.2 percent of their income in the form of capital gains. Those in the top 1 percent and 0.1 percent received 17.3 percent and 19.1 percent of their income from capital gains, respectively (Piketty and Saez, 2007). Since this income is not subject to payroll tax and is also subject to a lower federal income tax rate than earned income, many wealthy families owe a lower share of their overall income in taxes than many middle-class families.

Due to growing income inequality, the share of payroll income above the payroll tax cap has risen from 10.0 percent in 1982—after Congress instituted changes to put the system in balance—to approximately 16.4 percent in 2006.[2] This is because incomes have grown strongly at the top—28.5 percent real income growth over the past 20 years for the top quintile—while middle incomes have stagnated.[3]

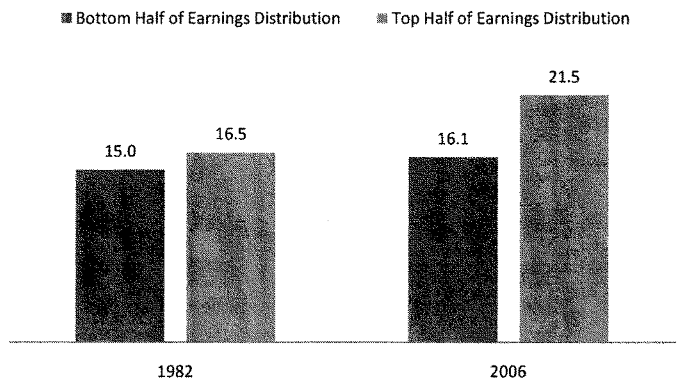
[2] The *total* share of earnings of workers who earn above the cap is almost twice as high (31.6 percent).

[3] In nominal terms, the average pay of workers earnings above the cap grew 281 percent from 1982 to 2006 (from $51,482 to $195,928), while the average pay of workers earning below the cap grew only 156 percent (from $10,671 to $27,266). If the cap had been eliminated in 1982, this would have had only a modest impact in the growth in after-tax pay for affected workers (pay would still have increased by 270 percent) (author's calculations based on SSA 2008).

This trend is expected to continue, meaning that a growing share of payroll income will remain outside the tax base. This is happening at a time when federal income taxes have become less progressive as a result of tax cuts passed under the Bush Administration, which exacerbated the increase in income inequality.

Meanwhile, high earners are also capturing a growing share of Social Security retirement *benefits*, as life expectancy in retirement is growing faster among high-income than low-income earners (see Chart 3).

Chart 3. Male life expectancy at age 65



Source: Waldron, 2007

Options for additional payroll tax revenue

An increase in revenue would forestall Social Security benefit cuts at a time when other sources of retirement income and savings have eroded due to a shift from traditional pensions to defined contribution plans and a plunge in home and stock prices. Federal Reserve data show that households have lost over $12 trillion dollars since 2007, and are now below 2004 levels (Federal Reserve, 2009).

There are several options for increasing revenue through the current payroll tax. They include: increasing rates across the board, raising or eliminating the cap on taxable payroll incomes, and expanding the taxable base beyond payrolls to include other forms of income.

An increase in revenue would also allow *expanded* Social Security benefits, as discussed by some of my co-panelists, in response to this unprecedented decline in retirement security.

This committee has no doubt already explored these and other options already. While all these options should be explored in connection with closing the gap and improving benefits, I will suggest that a high priority should be put on changes to the cap on earnings subject to the payroll tax.

According to the Social Security Administration, fully eliminating the cap on taxable earnings would be sufficient to close the projected Social Security shortfall over the next 75 years. This assumes benefits for high earners remain unchanged. If, instead, newly-taxed earnings above the taxable maximum were credited toward benefits, eliminating the cap would reduce the shortfall by 1.8 percent of taxable payroll, slightly less than the long-term shortfall projected by the Social Security trustees.[4]

Short of that, raising and indexing the cap to capture 90 percent of covered earnings, as it did when the system was last in long-term balance, would reduce the shortfall by about 0.8 percent of taxable payroll, or slightly less than half of the projected shortfall according to the Social Security trustees, if earnings above the cap were credited for benefit purposes.[5]

A third option would be to split the difference: eliminate the cap on earnings for employer contributions, and raise the cap to cover 90 percent of earnings for employee contributions. With earnings up to the employee cap credited for benefit purposes, this change would reduce the long-term shortfall by about 1.5 percentage points, or three-fourths of the gap as projected by the Social Security trustees, and more than enough to eliminate the gap as projected by the Congressional Budget Office.

There are several advantages to this last approach. It would eliminate most, and potentially all, of the shortfall, while maintaining a link between higher employee contributions and higher benefits. It would not lead to extremely large benefits for millionaires, which could be a concern if the cap were eliminated altogether and all earnings were credited for benefit calculations. Finally, self-employed taxpayers, who are responsible for both employer and employee contributions, would not face as large an increase in payroll taxes.

Further the tax would have at worst, a modest impact on the standard of living of upper-income taxpayers. The Joint Committee on Taxation estimated that a cap of $186,000 would have captured 90 percent of covered earnings in 2008 (Roenig and Mulvaney 2009). On the employees side of the tax,

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[4] However, the program would still be considered to be in long-term actuarial balance by many experts—more than sufficient, for example, to close the projected shortfall estimated by the Congressional Budget Office, which is less than 1.1 percent of taxable payroll (author's calculations based on Roenig and Mulvey 2009, SSA 2009, and CBO 2008).

[5] This would close roughly three-fourths of the gap according to CBO. In 2005, EPI economist Josh Bivens estimated that nearly half of the projected long-term shortfall (0.9 percent of taxable payroll) could be attributed to the growing share of earnings above the cap. That is, he estimated that if the cap had continued to cover 90 percent of earnings from 1983-2005, as it did in 1982, the $330 billion in additional revenues would cut 0.15 percent of taxable payroll from the 75-year deficit. If the cap was then indexed to cover 90 percent of earnings, this would have cut the deficit further by 0.75 percent of taxable payroll (Bivens 2005).

this would mean an increase in tax payments of, at most, 2.6 percent of income for those impacted. If current income growth for the top 5% of households continues to grow as it has for the past twenty years, and assuming that all 6.2 percent of the tax is passed on to employees, this additional tax obligation will be recouped by these households in less than 4 years.[6]

Even eliminating the cap altogether—as was done for Medicare in 1993—would have a fairly modest impact on affected taxpayers, who are at the very top of the earnings distribution. The Congressional Research Service has projected that fewer than 8 percent of taxpayers would face higher taxes in any given year. A higher share (21 percent) would face higher taxes at some point by 2035, but the median increase in lifetime tax payments would be only 3 percent. The majority (16 percent of beneficiaries, or three-fourths of those affected) would see their lifetime tax payments increase by less than 10 percent. (Roenig and Mulvey 2009).[7]

Some will argue that an increase in the cap will create inefficiencies and cost jobs. Indeed, all else equal, I too would prefer to live in a world without taxes, but all else is not equal. If revenue is not generated by lifting the cap, it must be raised from other sources or benefits must be cut to bring the system into balance. The alternative is not "do nothing" but rather a comparison of alternatives. In particular, the revenue generated by lifting the cap is equivalent to increasing revenue by 2.2 percent of taxable payroll.

Affected taxpayers could also recoup some of these higher taxes in the form of higher benefits. Social Security retirement benefits are calculated using a formula based on average indexed monthly earnings (AIME).[8] For example, for someone with career earnings equal to twice the cap, annual benefits would increase from around $30,000 to around $45,000. In the aggregate, affected taxpayers would recoup around 17 percent of their higher taxes in the form of higher benefits if earnings above the current cap are included in benefit calculations (author's calculations based on Roenig and Mulvey 2009).

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[6] President Obama has suggested allowing the Bush tax cuts to expire for households earning $250,000 or more, which along with the repeal of the cap on earnings subject to payroll taxes would increase the tax rate of these households by 10.8%. If current income growth for the top 5% of households continues to grow as it has for the past twenty years, and assuming that all of the tax is passed on to employees, this additional tax obligations will be recouped by these households in just 6.2 years.

[7] The impact on self-employed workers would be larger than the impact on wage and salary workers, because they are responsible for both the employer and employee contribution. This is one argument for retaining the cap (but indexing to cover 90 percent of earnings) for employer contributions. Regardless, most self-employed workers would not be affected, since only 5 percent had earnings above the cap in 2004, slightly lower than the share of wage and salary workers with earnings above the cap (6 percent). All told, just one in ten workers with earnings above the cap was self-employed (Roenig and Mulvey 2009).

[8] For every $100 in AIME above a certain threshold, monthly benefits increase by $15.

Conclusion

As policymakers, you have several options to bring the Social Security system into balance. If benefits are not reduced, then you must look at the revenue side of the ledger. While no one likes to raise taxes, raising the cap on the earnings subject to the payroll tax would, in my opinion, be a better option than raising tax rates across the board; thus, any policy to increase overall revenue through the payroll tax should have a higher cap as part of the equation.

In particular, raising the cap to cover 90 percent of all earnings and eliminating the cap on the employer side of the tax would close about 3/4 of the projected 75-year shortfall. This higher cap would impact just 6% of all employees—in contrast, an across the board hike which would impact everyone, with a disproportional impact on low- and moderate-income workers. For most of those that would face a higher rate with a higher cap, the impact would be minimal relative to their incomes, and would likely be more than offset by wage growth in just a few years.

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The CHAIRMAN. Thank you very much Dr. Irons.

Dr. Biggs.

STATEMENT OF ANDREW BIGGS, RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, DC

Dr. BIGGS. Chairman Kohl, Ranking Member Martinez.

Social Security is the largest Federal spending program, the largest tax paid by most workers, and the largest source of income for most retirees. It also faces a significant long-term funding challenge. For these reasons, I am glad you chose to hold this hearing today, and I'm thankful for the opportunity to testify.

In my testimony, I wish to highlight three main points. First, Social Security's long-term shortfalls increased significantly in the latest trustees report, and will worsen further if reform is delayed. Second, population aging, not rising per-capita healthcare costs, is the principal driver of rising entitlement spending. Even if current health reforms are successful, we may still face a budget crisis if aging-associated costs are ignored. Third, Social Security reform should encourage longer work lives and simplify the benefit formula.

The 2009 Social Security Trustees Report showed worsening program finances due to lower payroll tax revenues, increased life-expectancies, and the simple passage of time. While many people focus on the date of trust-fund exhaustion, which moved from 2041 to 2037, the more important finding is that the projected long-term deficit rose by almost one-fifth. Moreover, each year we delay reform, this deficit increases around 5 percent. Time is money, as they say.

More broadly, I wish to place Social Security in a context of overall increases in entitlement spending. Rising entitlement costs spring from population aging, which increases the number of beneficiaries, and per-capita healthcare price increases, which raise costs even if the beneficiary population does not change. The administration has argued that per-capita healthcare inflation is, in OMB Director Peter Orszag's terms, the real deficit threat, and that Social Security and population aging in general are small issues. Yet, both CBO and OMB projections clearly show that population aging, not rising per-capita health costs, will be the largest entitlement-cost driver through around 2050. A chart in my testimony illustrates these trends.

Policies to address aging include specific Social Security reforms, such as those we'll talk about here today, plus macrolevel policies such as increasing labor- force participation, boosting saving rates, and raising skilled immigration levels.

My final comments propose two improvements to Social Security's benefit structure aimed, in particular, at low earners. First, we need to improve Social Security's incentives to delay retirement. Second, we must simplify the benefit formula to better target benefits, and to make benefits more understandable. While longer work lives enhance retirement security, due to quirks in the Social Security benefit formula, a person who delays retirement and continues to pay into Social Security typically receives almost no benefits in return. On average, a person who works an additional year receives only around 9 cents in extra retirement benefits for each extra dollar of taxes they pay. Policymakers should consider lowering the Social Security payroll tax for older workers, which would encourage delayed retirement.

Second, the Social Security benefit formula is remarkably complex—basing benefits on average wages, the number of years worked, length of marriage, relative earnings between husbands and wives, and other factors. As a result, many workers have no idea what their Social Security benefit will be until the first check arrives. By this time, of course, it is too late to plan their other savings or to consider working longer. Almost one in four individuals near retirement cannot even guess what their future Social Security benefit will be. Of those making predictions, one-quarter of near-retirees over estimated their benefits by more than 28 percent. This predictability risk is every bit as damaging as having your 401(k) account decline on the verge of retirement.

Moreover, the benefit formula's complexity means that retirees with the same lifetime earnings often end up with very different benefits. Figure 3 in my testimony illustrates how large these disparities can be. The poor targeting of Social Security's progressivity means that for many low earners Social Security is a social insurance policy that fails to pay off when they need it the most.

Fixing this problem, though, does not require higher average benefits or greater progressivity. Instead, benefits must merely be targeted more effectively. One solution, which resembles the pension program in New Zealand, combines a flat dollar benefit paid to each retiree, with automatic enrollment in individual retirement accounts. As a chart in my testimony shows, this alternative, while much simpler than current-law Social Security, actually targets low earners much more effectively.

To conclude, rising entitlement costs, especially those caused by population aging, pose significant challenges. Reforming Social Security in the near future can reduce the long-term fiscal gap while enhancing the welfare of retirees.

Thank you again for your consideration. I'd be happy to take any questions.

[The prepared statement of Dr. Biggs follows:]

American Enterprise Institute
for Public Policy Research

Statement before the Special Committee on Aging
United States Senate

Social Security: Keeping the Promise for the 21st Century

Andrew G. Biggs, Ph.D.

Resident Scholar

American Enterprise Institute

June 17, 2009

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

Chairman Kohl, Ranking Member Martinez, and members of the Committee. Social Security is the largest spending program of the federal government, the largest tax paid by most workers and the largest source of income for most retirees. It also faces a significant long-term funding challenge. For these reasons, I am glad you chose to hold this hearing and am thankful for the opportunity to testify here today.

In my testimony I wish to highlight three points.

- First, Social Security's long-term shortfalls worsened significantly in the latest Trustees Report, and is expected to continue to worsen if reform is delayed.
- Second, population aging, not rising per capita health care costs, is the principal driver of overall entitlement costs and the largest threat to the budget; and
- Third, Social Security policy should encourage longer work lives and simplify the program's complex benefit formula.

I will address these points in turn.

The 2009 Social Security Trustees Report

As you are probably aware, the Social Security Trustees Report, released in May, showed a worsening of the program's finances. There were three principal causes:

- The recession reduced payroll tax receipts and lowered interest rates (accounting for around 50 percent of the decline in the actuarial balance);
- Higher-than-expected improvements in life expectancies, which increases the number of beneficiaries (35 percent); and
- The simple passage of time, which adds an additional year of deficits to the 75-year period over which solvency is measured. (16 percent).

Worsening of the deficit due to increased life spans will remain even if the economy rebounds faster than the Trustees project.

Increases in the shortfall due to the passage of time, moreover, will continue for as long as Social Security reform is delayed. If we wait four years to enact reform, for instance, we can expect the problem needing to be resolved to be around 10 percent larger than today's.

Most focus is on changes in the date of initial cash deficits, which shifted from 2017 to 2016, and the date of trust fund exhaustion, which moved from 2041 to 2037. These dates are volatile and not too much emphasis should be placed on these changes.

More ominous, however, is that the program's total long-term deficit rose from 1.7 percent to 2.0 percent of payroll. This is an increase of almost one-fifth in the program's total shortfalls.

It is tempting to downplay the size of the Social Security shortfall. But as noted as the outset, Social Security is the largest single spending program of the federal budget and its costs are projected to grow by one third over the next two decades. Social Security's problems are "small" relative only to those of Medicare and Medicaid, but reforms to Social Security are better understood and easier to implement. As President Obama recently said, "Social Security, we can solve."[1] By contrast, we don't truly yet know how to fix Medicare and Medicaid.

Social Security, Population Aging, and Health Care Inflation

Which brings me to my second topic, which is to place Social Security and population aging in the context of overall increases in entitlement spending. There are two ways in which entitlement costs can increase: first, population aging, which increases the number of beneficiaries, and second, per capita benefit increases, which raises costs even if the beneficiary population does not rise.

It has become accepted that per capita health care inflation is the largest driver of entitlement costs -- in OMB director Peter Orszag's terms, "the real deficit threat."[2] Since rising health prices are common to both government programs and private sector health provision, the administration argues that only by exerting greater federal control over private sector health care can Medicare and Medicaid spending be curbed. "Health care reform is entitlement reform," as the President has said.[3]

Costs associated with population aging, by contrast, are largely concentrated in government programs, since Social Security and Medicare dominate income and health care provision for seniors. Social Security costs are entirely driven by aging, while Medicare and Medicaid costs so include aging and per capital price growth.

Most importantly, both Congressional Budget Office and Office of Management and Budget projections clearly show that population aging, *not* rising per capita health costs, will be the largest driver of budget deficits and accumulated debt over the next several decades.

Figure 1

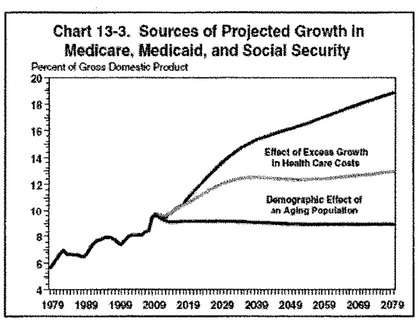

Figure 1 is reprinted from the administration's Fiscal Year 2010 budget.[4] It shows the relative contributions of population aging and health care cost growth to the increase in overall entitlement costs. It is not until around 2050 that health care inflation becomes the largest driver of annual entitlement costs.

Figure 2 shows the accumulated debt that would be associated with financing these entitlement cost increases by borrowing. Even over 75 years, total entitlement costs attributable to population aging exceed those from per capita health care cost growth.

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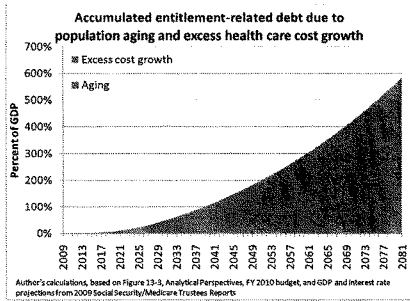
[1] "Obama Pledges Entitlement Reform." *Washington Post.* January 19, 2009.

[2] Peter R. Orszag. "Health Costs Are the Real Deficit Threat." *The Wall Street Journal*, May 15, 2009.

[3] Remarks by the President on the Economy, Georgetown University, Washington, DC, April 14, 2009. Available at http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-Economy-at-Georgetown-University/

[4] *Budget of the United States Government for Fiscal Year 2010*, Analytical Perspectives, p. 191

Figure 2



Unfortunately, we don't have 75 years to wait to fix these problems. Bond rating agencies warn that U.S. Treasury debt could be downgraded as early as 2017.[5] This fiscal crisis, if it comes, will be driven predominantly by aging, not health care inflation.

In short, even if the administration's efforts to rein in health care cost growth were wholly successful, we could nevertheless face a budget crisis driven by the costs of a graying population.

Policies to at least soften the effects of population aging deserve the consideration of Congress. These can be policies specific to programs like Social Security, such as increasing the retirement age, or they can macro policies such as raising skilled immigration or increasing the labor force participation of working age Americans. In particular, despite recent upticks, male labor force participation remains well below 1950 levels. Returning to those rates would produce significant increases in GDP, improvements in Social Security and Medicare financing, and – most of all – benefits to the individuals involved.

Policy Options

I now turn to my third area, which is policy. There are many areas of Social Security reform deserving attention, and I touch on some of them in my written testimony. I will here focus on two that may be less familiar to the Committee. First, the need to improve Social Security's incentives to delay retirement; and second, the costs imposed on retirees by the complexity of the Social Security benefit formula.

Longer Work Lives: Despite longer life expectancies and less physically taxing work conditions, workers are retiring earlier. Today the average worker retires at age 62 or 63, compared to 68 in the 1950s. To the degree that Social Security's funding shortfalls are exacerbated by rising life spans, it makes sense for individuals to respond by working longer. But Social Security's benefit formula does not encourage longer work lives.

While the Social Security benefit formula is roughly neutral with regard to the age of benefit claiming, it is not at all neutral with regard to additional years of work and payroll tax contributions. The Social Security benefit program only counts the highest thirty-five years of a retirees' career. For most workers, additional work late in life adds little to this calculation. In addition, individuals who receive spousal benefits rarely increase their benefits by additional work.

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[5] For instance, see Kraemer, Moritz. "In The Long Run, We Are All Debt: Aging Societies And Sovereign Ratings." Standard & Poor's, June 28, 2005. Available at http://www2.standardandpoors.com/portal/site/sp/en/eu/page.article/2,1,1,2,1112292523641.html

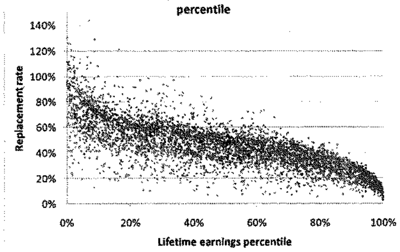
I and my -coauthors found that the typical near-retiree who works an additional year receives only around nine cents in additional lifetime benefits for each dollar of additional taxes they paid. This amounts to a marginal rate of return of negative 50 percent.[6]

To encourage delayed retirement, policymakers should consider lowering the Social Security payroll tax for older workers. A lower payroll tax would encourage these individuals to remain in the workforce and would make them more attractive to employers.

Benefit Simplification: While most discussion of Social Security reform understandably focuses on solvency issues, it is very important that this program be kept current with the needs of the population it serves. The Social Security benefit formula is remarkably complex, basing benefits on average wages, the number of years worked, whether the person is married or, if divorced, on the length of the marriage, on the relative earnings levels of husbands and wives, and other factors.

This has two significant negative effects: first, many working age individuals have little knowledge of what their future retirement benefits will be, making it more difficult to plan their other savings. Using the Health and Retirement Study, I found that almost one in four individuals on the verge of retirement cannot even guess as to their Social Security benefit level.[7] Of those who could make a prediction, one-third of near-retirees overestimated their benefits by at least 10 percent, while one quarter overestimated them by more than 28 percent. One in ten retirees received a benefit less than half as much as they expected. This "predictability risk" is every bit as damaging as having your 401(k) account decline on the verge of retirement.

Figure 3: Household replacement rates by lifetime earnings percentile



Source: Author's calculations, GEMINI model, 1940 birth cohort. Data points represent replacement rates received by individual households in GEMINI model sample.

A second effect of the benefit formula's complexity is that retiree households with the same lifetime earnings can end up with very different benefit levels. Social Security generally replaces a greater share of pre-retirement income for low-earners than for high-earners. But while the program is progressive on average, at any given earnings level benefits can differ significantly, particularly for low earners. As Figure 3 shows, many low earning households receive low replacement rates and many high earning households receive high replacement rates.[8]

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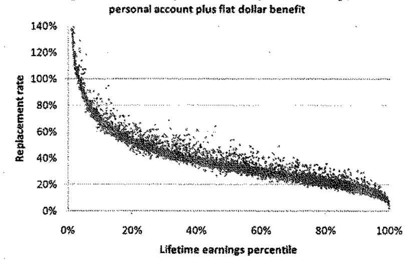
[6] See Reznik, Gayle L. , David A. Weaver, and Andrew G. Biggs. "Social Security and Marginal Returns to Work Near Retirement." Social Security Administration, Issue Brief No. 2009-02, April 2009; Biggs, Andrew G. "Does It Pay to Work? The Case for Cutting the Social Security Tax for Workers near Retirement." *AEI Retirement Policy Outlook* No. 3, April 2009.

[7] Biggs, Andrew G. "Answer Quickly: How Much Do You Think You'll Get from Social Security? The predictability risk of Social Security retirement benefits." *AEI Retirement Policy Outlook* No. 4, June 2009. Forthcoming.

[8] Figures 3 and 4 are reprinted from Biggs, Andrew G. "Will Your Social Insurance Pay Off?" *AEI Retirement Policy Outlook* No. 1, January 2009.

For example, the average household at the 20th percentile of the earnings distribution receives benefits equal to 59 percent of their pre-retirement earnings. But this is only on average: 10 percent of those households receive replacement rates below 37 percent while another 10 percent receive replacement rates above 74 percent. Put another way, despite identical earnings over their lifetimes, some households receive benefits literally twice as high as others. This is like having a home insurance policy that may or may not pay off if your house burns down. It is not enough that Social Security be progressive on average; it must be *consistently* progressive.

Figure 4: Household replacement rate by lifetime earnings; personal account plus flat dollar benefit



Source: Author's calculations, GEMINI model, 1950 birth cohort. Data points represent replacement rates received by individual households in GEMINI model sample.

New Zealand's pensions system might have lessons for the U.S. in this regard. New Zealand combines a flat dollar benefit paid to all retirees with auto-enrollment in personal accounts saving up to 8 percent of earnings. The U.K. has also made moves in this direction. Figure 4 simulates a stylized plan combining a flat defined benefit with a personal account. This stylized plan pays the same average benefits as Social Security and has the same overall progressivity. The difference is that this model reform targets its benefits far more precisely: low earners *consistently* receive higher replacement rates than high earners, enhancing the social insurance value of the program. In addition, this stylized plan would be far easier to understand than the current benefit formula. While any reform must be tailored to the needs and values of the United States, I believe these approaches deserve greater study and consideration.

In conclusion, rising entitlement costs, especially those caused by population aging, pose significant challenges to the country's financial future. While there are many problems in the Medicare and Medicaid systems that should be addressed, changes to Social Security provide a sure means to reducing the long-term fiscal gap. Congress should seriously consider reforms that encourage longer working lives and simplifies the program for the average American.

Thank you for your consideration. I will be glad to take any questions.

Addendum

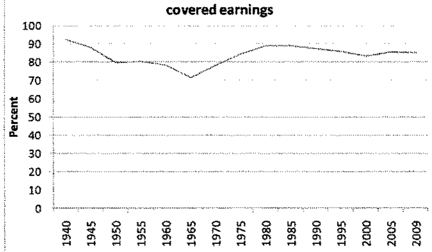
Taxes

A not unreasonable argument can be made for achieving solvency by increasing taxes rather than reducing benefits: Social Security will provide the only defined benefit pension income for most future retirees, and as life spans increase it is not rational to pay more to support the increased lifetime benefits the system must provide.

However, unlike Medicare or Medicaid benefits, it is relatively easy to substitute increased personal saving for reduced traditional benefits. As tax increases are damaging economically, they should be limited to cases where individual action is least effective. For that reason, I generally oppose increasing Social Security taxes.

It is often argued that Social Security solvency should be addressed by increasing the maximum taxable wage, which is currently $106,800 and rises with average wage growth each year. Any reform plan that is enacted is likely to be a series of compromises, and so I would not be surprised if the wage cap were increased as part of any reform legislation. Nevertheless, we should be wary of doing so, for three reasons.

Figure 5: Taxable earnings as percentage of total covered earnings



Sources: Social Security Administration, 2008 Statistical Supplement; 2009 Social Security Trustees Report

First, as Figure 5 shows, the current wage cap is not particularly low relative to historical norms. For 2009, the Social Security Trustees project that 85.2 percent of total wages will be subject to payroll taxes, a figure that is slightly above the average level since the program's inception. While many advocate increasing the cap to cover 90 percent of total wages, there were only two relatively short periods in Social Security's history in which taxes were this high.

Second, raising the taxable maximum constitutes a significant tax increase at the margin for affected individuals. While only around 6 percent of individuals have earnings above the cap in any given year, these are not the same individuals each year. Around 22 percent of workers have earnings above the cap at some point during their working lives, and increasing the cap would amount to an increase of almost 12 percentage points in their marginal tax rates. A total marginal tax rate exceeding 50 percent is easy to imagine, presenting significant disincentives to work and significant incentives to avoid taxes where possible, such as through increased use of so-called Chapter S corporations.

Finally, President Roosevelt established Social Security with a tax cap so the program would more closely resemble a private sector pension rather than a "welfare" plan that might cause a stigma to those who collect benefits and resentment from those who pay taxes. Social Security has remained popular in part because it is progressive, but not *too* progressive. Congress should bear this in mind as it considers reform options.[9]

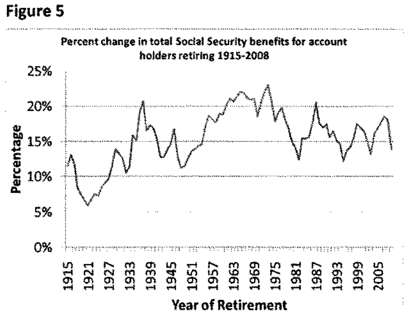
If taxes are to be increased, a case can be made that simply increasing the 12.4 percent payroll tax rate is the option that is fairest, most economically efficient, and most in keeping with Social Security's history. The payroll tax is portrayed as regressive, but this is true only when viewed in isolation from the benefits the tax "purchases." In fact, the "net Social Security tax" - that is, Social Security taxes minus the benefits they generate - is progressive and, for many low earning households, highly negative.[10] The net tax rate determines economic incentives and the overall progressivity of the program. Whether individuals would prefer to pay additional taxes to the Social Security program, versus saving more on their own, is a question policymakers should bear in mind.

Market Risk and Individual Investment

As members of the Committee know, the introduction of personal retirement accounts inside of the Social Security program was a central part of President Bush's reform proposal in 2005. For a variety of reasons, no doubt including the public's mixed views regarding the introduction of market volatility to Social Security benefits, that proposal was not accepted.

The recent market downturn provides an opportunity to "stress test" market investment.[11] To do so, I simulated a reform plan similar to that proposed by President Bush: individuals could invest 4 percentage points of the Social Security payroll tax in a personal account, which would hold a "life cycle fund" that automatically shifted from stocks to bonds as the worker aged. In return for diverting a portion of their taxes, workers would give up traditional benefits equal to their account contributions compounded at the interest rate earned by the Social Security trust funds. Had such a plan been in place, how would workers retiring in late 2008 have fared? Using historical stocks and bond data, I attempted to answer this question.

Figure 5



A worker who held a personal account his entire life and retired in October of 2008 would have increased his total Social Security benefits by around 15 percent, despite truly terrible stock market returns in the years approaching retirement.[12] This highlights the fact that long-term returns are

[9] See Biggs, Andrew G. "Obama vs. FDR." *The American Magazine*, February 2, 2009. Available at http://american.com/archive/2009/obama-vs-fdr

[10] This issue is discussed at greater length and net payroll taxes are calculated at Biggs, Andrew G. "Is the Social Security tax regressive once you account for benefits?" *Notes on Social Security Reform*, December 29, 2008. Available at http://andrewgbiggs.blogspot.com/2008/12/is-social-security-tax-regressive-once.html

[11] The following discussion draws on Biggs, Andrew G. "Social Insecurity?" *AEI Retirement Policy Outlook* No. 1, November 2008.

important and that shifting from stocks to bonds over time, as a life cycle fund does, can reduce volatility as retirement nears. I went further, simulating 95 cohorts of retirees using stock and bond data from 1871 through 2008. As Figure 5 shows, all 95 cohorts would have increased their total Social Security benefits by holding an account. The average increase was 15 percent, with the smallest being 6 percent and the largest 23 percent.

I am under no illusion that accounts funded out of the payroll tax will be on the policy menu again anytime soon. However, as policymakers consider reform options, they may wish to think about so-called "add-on" personal accounts built on top of Social Security as an alternative to explicit tax increases. The simulations I performed regarding carve-out accounts imply that we should not overstate the risks from market investment as we consider whether to establish universal retirement saving accounts. Market downturns in any given year can be significant, but retirement saving is about the long-term and so a long-term focus is more appropriate.

[12] Workers who held a personal account for only part of their lives would have experienced smaller gains and, in the case of workers who established accounts at older ages, small losses. Maximum losses would have equaled 0.7 percent of total benefits.

The CHAIRMAN. Thank you very much, Dr. Biggs.

Senator Martinez.

Senator MARTINEZ. Well, thank you Mr. Chairman.

It is apparent that we all acknowledge there's a problem, and that there are no easy, simple, or painless solutions to the problem. I guess the beginning question I would have for Mr. Irons is—you indicated and some would say that your proposal would cost jobs if you increase the payroll taxes of employers, and you answer that by saying that the world would be a nicer place if none of us paid taxes, or something like that. I realize that that's not an option. The question really is, Would it, in fact—at a time when we have unemployment reaching double digits, would it in fact be something that would threaten job loss?

Dr. IRONS. I think if you were to do it all today, then that would probably not have a good impact on the broader macroeconomy, or it very well might cost jobs. I think the magnitude of the job loss would be relatively minor, for various reasons, but I think if you were to actually try to implement this, I would suggest phasing it over time to allow people in businesses to plan for it, to push off some of the tax increases until, hopefully, after we've recovered. So, it'd be a phase-in over time, it'd be more predictable, it would happen after we've, largely, recovered.

But, having said that, I think even with—if this were in place, you'd have a relatively mild job loss, if any. Because I think——

Senator MARTINEZ. Why would that be, can you kind of——

Dr. IRONS. I can't necessarily quantify it, it's a—I'm an economist, so it's an on-the-one-hand/on-the-other-hand kind of thing, here, so I can't give you an exact number.

Senator MARTINEZ. No, I realize that, but——

Dr. IRONS. Yeah, but I think the right comparison here, again, is not to compare this with doing nothing, it's to compare this with the alternatives. So, I think this would have a smaller impact on the broader macroeconomy, and on jobs, than if you raised rates across the board, or if you made some other changes by impacting benefits. I think a benefit cut would have a larger impact on jobs. I think cutting benefits would have a larger impact on individuals, especially in a recession. So, again, when you look at all these options, in order to bring the system into balance, I don't want to say there's no cost, but I say this is probably the least cost of the options that are before you.

Senator MARTINEZ. Now, I think there's a pretty good consensus that impacting benefits is not a desirable option. But, I wonder if means-testing of benefits is something that has any merit or should be considered?

I'd throw that open to anyone who might——

Ms. ENTMACHER. I think the concern is that—as several witnesses, and as the chart indicates—benefits are so important for people, really quite high up the income scale, that means-testing would mean, potentially, cutbacks for average Americans who rely on Social Security for the majority of their income. It also would undercut a lot of the strength and support for the program, which is precisely that this is something that everyone contributes to, and it's there when they need it, and benefits are related to the contributions that people make during their working lives, even though Social Security also has progressive features that help those in need. So, I think it would fundamentally change the character of the program if we were to go to something like means-testing benefits.

That's not to say—and several of us had suggested—have suggested—that if you're going to make improvements, you want to target those improvements to those most in need. I think that's, you know, a different way of thinking about the problem, that if we're going to make it better, if we're going to put additional improvements and benefits, make sure they go to people who need them most.

Senator MARTINEZ. Well, shouldn't we first right—get ourselves somewhere out of the hole before we talk about improving benefits? I mean I——

Go ahead, Mr. Apfel.

Mr. APFEL. I believe——

The CHAIRMAN. Microphone.

Mr. APFEL. I believe these two issues must be enjoined. The last time we really dealt with Social Security in a major way was 1983. Since that time we did make changes to the retirements earnings test, which I thought was a very important change. But, we don't deal with these issues very frequently.

It's an excellent—most of the——

Senator MARTINEZ. Know why?

Mr. APFEL. Well, for all the different political reasons, it's very——

Senator MARTINEZ. Right.

Mr. APFEL [continuing]. Very hard—it seems to me that marrying together the issue of long-term solvency of the system, which will take changes, and it will——

Senator MARTINEZ. Not without pain, probably, in some direction or another.

Mr. APFEL. It's—there's going to be pain involved in that package. But, coupling that with a hard look at so many of the people on that chart, particularly in that bottom half—it's critically important that we think about marrying the issue of adequacy of benefits for our vulnerable populations, for low- and moderate-income people, with any efforts at restoring solvency.

Now, I have been one who's argued, for years, that there will have to be some benefit restraints, and I would think that some of those benefit restraints slow the growth rate of benefits for future generations will primarily have to be near the higher end of the income scale. We're going to clearly need tax increases for the system, but we also then have to take a look at what we've done to the system and how the changes that are being talked about today, the adequacy piece, fits into that overall package.

If we do the former, the solvency piece, without the latter, the adequacy piece, we're digging a deeper hole for many of the lower income people on that chart.

If we do the latter, the benefit adequacy changes, without the former, we are digging a deeper hole in terms of solvency. So, I think it's a good chance to build the two together——

Senator MARTINEZ. Improve benefits while at the same time fixing solvency, all in the same package——

Mr. APFEL. I think it's critically——

Senator MARTINEZ [continuing]. Something that we don't do that frequently.

Mr. APFEL [continuing]. Critically important.

Senator MARTINEZ. What about the—and again I'll throw this open to the whole panel. I mean, all of you are so knowledgeable on this, and I would appreciate hearing from any of you on this—the idea of deferring or delaying retirement, given the fact that we live longer, given the fact that we're healthier, given the fact that many of us, particularly after the recent debacle of the market, probably want to work a little longer, things of that nature—how does that——

Go ahead, Mr. Burzynski.

Mr. BURZYNSKI. If I could address that. I think that there are some occupations and careers where that would not be necessarily a problem. Personally, I come out of construction, and construction workers, by the time they're 60, 65, have pretty much beat themselves to death. People that have worked in a factory their whole life, stood on concrete, people that work in stores, clerks, those sorts of jobs, again, by the time they reach what we now consider the retirement age, the idea of working longer years is not necessarily something they're looking forward to.

Senator MARTINEZ. Not really an option, physically speaking, for——

Mr. BURZYNSKI. It's not, physically. In my own case, I begin to—it would take me 5 minutes to tell you all the physical things that I have worked through in the 40-some years I was an electrician in construction, so——

Senator MARTINEZ. The Senate can be a tough place, too, I can——

Mr. BURZYNSKI. Right. [Laughter.]

Senator MARTINEZ. No, I hear you. Any other thoughts on this?

Dr. IRONS. I would just——

Senator MARTINEZ. OK.

Dr. IRONS [continuing]. Concur with that notion, that it is a—Social Security gives people the option. You know, I think preserving that option by maintaining, you know, the current retirement age, I think is critically important. The other piece of this is, because you have the option of early retirement, and your benefits adjust, delaying the normal retirement age is equivalent to just a raw benefit cut.

So, and I think, you know, the way I kind of think about this is twofold. One, you have to maintain the option, and two, if you want to cut benefits, cut benefits; don't do it through changing the retirement age.

Dr. BIGGS. If I might just briefly touch on this, Senator.

Senator MARTINEZ. OK.

Dr. BIGGS. Without minimizing the problems faced by people who work in physically demanding jobs, if we go back to the 1950's, the typical person first claimed Social Security benefits at age 68. Today, life expectancies are longer, work is much less demanding than it was back in the 1950's, when people would work in mines and steel mills and the like; yet people tend to claim benefits at

62 or 63. So we have better work conditions, probably an extra 5 years of longevity, but we're claiming benefits 5 years earlier.

That's great if you can afford to do it, if you have the savings set aside to do it. I don't know if we want to be heavy handed about this, but of the points I made in my testimony is, we want to give people the incentives to work longer. So, I think something like lowering the payroll tax, or doing various other things could that tell people, "We want you to work longer. It's to your benefit, we're going to try to make it a little bit easier for you."

Senator MARTINEZ. I think, too, it may allow for those who really are unable to continue to work, for whatever physical conditions not to, while maybe the others, who could, have an incentive to remain longer in the workforce——

Mr. Biggs. Exactly.

Senator MARTINEZ [continuing]. Might be a good thing.

Mr. Apfel? The demographics are not working in our favor when we look at the numbers, in terms of what they look like in the future. So, maybe allowing people to work longer, and giving them a bit of an incentive to do it, might be a good thing for the whole system.

Yes, sir?

Mr. APFEL. I, for one, have not ruled out supporting any of the things that are being talked about here. Again, it's an issue of marrying together the need for long-term solvency and benefit adequacy.

In this case, if there were efforts made to create encouragements to keep people in the workforce longer, or to change the retirement age, and a whole package of things that have been talked about, if those are coupled with looking at how to provide a stronger set of benefits for low- and moderate-income workers, for blue-collar workers, a way to liberalize the disability program, so that people who are beat up by the time they're 60, who are clearly not going to be eligible for Social Security disability today—these are the kind of issues, again, whether we could couple together a package of changes for solvency, that would have some things that none of us would particularly like, with the notion that we are providing more assurances on adequacy. So, again, this is another example where marrying the two issues of solvency and adequacy could lead to good steps for the future.

Senator MARTINEZ. Well, I guess what you're saying is, that we put everything on the table, and then work at it and come up with something that seems fair and adequate for the future, and for the long term, of the system.

Yes, ma'am?

Ms. ENTMACHER. Senator, if I might, the other piece of encouraging people to work longer is making sure that jobs are available, that employers want to hire them. That, of course, is a problem that many people, particularly lower-skilled workers, but, actually older workers at all education levels are encountering in this current recession. The jobs are not there, and older workers who lose jobs are having an even harder time getting back to work when they're trying to do it.

Discrimination persists, particularly against older women, so staying in the workforce is not always an option, even if you——

Senator MARTINEZ. Sure.

Ms. ENTMACHER [continuing]. Want to do it. A proposal, that actually would not increase costs at all, and might encourage people to work longer, is something that Virginia Reno, at NASI, has suggested, which is, let's rename—re-label Social Security benefits and encourage people to retire at the "best benefit age," and describe that as age 70. It's with maximum delayed retirement credits. Keep the benefit structure below that as it is, but maybe let people know that if they can stay into the workforce, they'll get an even better benefit. Instead of focusing on the "full retirement age," think about the possibilities of increased benefits if they work longer—which our current system does provide—without penalizing people.

Senator MARTINEZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thanks, Senator Martinez.

Dr. Irons, your thought that we might raise the cap—however we do that, at whatever level, and whatever assessment we make—in a sense, that is means-testing, isn't it? Because you're trying to raise money to balance the deficit in Social Security by asking the more affluent to pay in more. So, it is—and I'm not criticizing it—but, it is really a means test in a different kind of a cloak, isn't it?

Dr. IRONS. You can call it whatever you want. It's asking, you're right, the people at the top end of the income distribution to pay more. That's the bottom line of it. I mean, I think the means test—often times talked about in terms of the benefit structure, not so much on the revenue. I concur with the other panelists, to think about this as a package, probably makes sense.

But, it does ask more of upper-income individuals to pay more their tax obligation than the current system currently does. But, it would also change the benefit structure, as well, to allow them to recoup some of that in terms of higher benefits.

The CHAIRMAN. Yes, you could work it into——

Dr. IRONS. But the overall system, as you know, is progressive. People at the low end tend to get a greater share of their tax payments back, at the end of the day. So, this would make the system you know more of what it was designed to do. I think it would return us back to having 90 percent of all earnings covered, and that's—you're right, it's going to impact people with higher incomes more.

The CHAIRMAN. Yes. Although we're not feeling it acutely now, because of the downturn in the economy, all the demographics indicate that in the future we are going to need those people who are aging and healthy to stay in the workforce. There will be a shortage of skilled workers in the decades to come, so that it does behoove us, not only to improve Social Security in terms of its financial structure, but also for our economy. It behooves us to do everything we can to encourage people to stay in the workforce.

I have a bill that would provide benefits to companies who are wanting to keep their people in the workforce, but looking for some benefit. But, in every way, I think we all agree that keeping people in the workforce is a very, very good thing to do, not least of which is that they also stay alive and healthy and active and challenging themselves just as long as they can, you know, be productive in our society. That's a good thing for everybody, and it also helps Social Security, isn't that true? I think we all agree with that.

Now, Mr. Apfel, you were working in the Senate, weren't you, back in the 1983 period, when we reformed Social Security? You probably have some recollection as to how we were able to get it done, even under political duress. Could you give us some recollections of what it was back then?

Mr. APFEL. Well, I do have recollections, Senator. I worked them for Senator Bill Bradley, who was a member of the Senate Finance Committee. A commission was established during that time—with President Reagan and administration officials, senior Democratic leadership, senior Republican leadership, to try to come up with a package that would move the system forward for the long term.

What's interesting about that 1983 package is that, 2 and 3 years before that, some of the things that ended up in that package were considered to be impossible, unacceptable. Still, people came together for what I believe was the greater good. The greater good is the long-term economic security of future generations. A number of things were done that no one thought were possible before that, and everyone came together to support those efforts. That—some of the things that I, personally, would have liked to have seen included didn't get included in that package. Indeed, the increase in the retirement age didn't include liberalizations to the disability program to help people who had trouble working. So even to this moment today, I'm still testifying on behalf of taking another look at that, because I think it's important to do so.

No one supported everything that was in that package; but, for the greater good, and for the greater sense of economic security for future generations, it was a critically important step that everybody came together and supported.

It is one of the—one of my favorite moments of working in the U.S. Senate, seeing people come together for the greater good. I think that is very possible. I would hope that, next year, that this body, working with President Obama, would be in the position to do that again, to—and again, not just make changes for solvency, but for adequacy, as well. To come together, marrying these two issues, and moving the system forward for the greater good.

Because this is the program that is the most important Senator Bill Bradley, at the time, said that it was the best expression of community that he knew, the Social Security system; that was back in 1983. I believe that is true today. It's going to take working together to make that happen. Not just about solvency, but about assuring that the people particularly in the bottom half of those charts, have some assurances that they have an adequate system for retirement.

The CHAIRMAN. So, you are very supportive of the idea of resurrecting that sort of a group and seeing what we can come up with to move forward on Social Security for the next 75 years. You think it would work.

Mr. APFEL. I think it would work. Whether that is a commission, whether that is the leadership from the respective committees, I don't know what the right model would be. Right now, Congress is very heavily involved with healthcare, so trying to deal with the Social Security issue for the next 75 years in——

The CHAIRMAN. It's not going to happen this month or next month——

Mr. APFEL. No, no.

The CHAIRMAN. Next year, I think——

Mr. APFEL. But, I would love to see there be an effort next year to come together for the sake of the American people and for the sake of future generations.

The CHAIRMAN. Have you talked to Senator Bradley recently?

Mr. APFEL. I did recently, within about the last couple of weeks.

The CHAIRMAN. Did you?

Mr. APFEL. Yes, I did.

The CHAIRMAN. How's he doing?

Mr. APFEL. He's doing just fine, and—well, I'll share a couple of private stories with you after the hearing, if you'd like, but I won't for the record.

The CHAIRMAN. Just by coincidence, I'm going to be talking to him next week, but I'll remind him about you.

Mr. APFEL. Ask how Betty Sue is.

The CHAIRMAN. OK. Betty Sue. OK.

Who else wants to make comment? I think this is really a good panel.

Yes, sir, Leon, go—say what's on your——

Mr. BURZYNSKI. If I could add one more concern, and that's a rather recent phenomenon about the garnish from bank accounts. What we're hearing is that—normally, under the Federal law, Social Security and veteran benefits and some other sorts of military disability benefits, are not allowed to be garnisheed or put a hold on or taken from beneficiaries. But, what's happened recently is, because, under the new programs, all of our benefits go into a bank account electronically, and then the creditor will put a hold on the bank account, and the bank freezes it. So, now all the money that the person has for the month—and in many cases that's their Social Security benefits, and maybe a few bucks—gets frozen. On top of it, the banks add fees and—late fees and overdraft fees and all sorts of things, and, in some cases, the fees amount to more than the amount that's in the account.

I think that's drastically wrong that that can happen, and I would hope that there's—that's something that needs to be addressed right away, and especially—you know, one of the big banks—we just gave Bank of America a ton of bailout money—us taxpayers—and Bank of America is one of the banks that's freezing accounts and freezing Social Security funds for beneficiaries.

So, I would hope that that—that's not necessarily going to fix Social Security, but it certainly would fix the income for some of the folks that are dealing with that today.

The CHAIRMAN. That's a very good comment, very appropriate, and we will look into that very carefully.

Yes, sir, Kenneth?

Mr. APFEL. The report that we provided to you today, one of the proposals that's in there is to examine whether specific changes could be made in this area. The Social Security Act does protect benefits from garnishment or attachment by creditors, but this is a real problem. So, we have—this report does include some suggestions to look at for fixing this problem.

The CHAIRMAN. Very good.

Who else would like to make comment?

Mr. Biggs. If I might——

The CHAIRMAN. Yes Dr. Biggs.

Mr. Biggs [continuing]. Touch briefly on the tax issue. I think, as the representative on my end of the spectrum, I would feel remiss if I didn't talk a little bit about taxes.

Understanding that Social Security reform will necessarily be a compromise between the different positions, different parties, certainly I wouldn't say that people on my end of things should simply oppose any plan that includes a tax increase. We need to come to fix this program, and, at the end of the day, compromises are going to have to be made.

At the same time, I think—when we think about raising the wage cap, the $107,000 that we currently levy taxes on, I think we want to be a little bit wary of what's going to happen with that. If we—I guess, to touch, first, there's the argument that the payroll tax currently covers 85 percent of total wages, which is a decline from 90 percent in the early 80's. If you look throughout Social Security's history, the average coverage has been right around 84 percent. So, the current level is not out of line with where Social Security has been, historically.

If we raise it back up to 90 percent, that raises the tax max from $107,000 to around $180,000. A person making $180,000 is in the 28-percent income tax bracket. They probably pay 6 or 7 percent for State income taxes. If they are going to pay the Social Security tax of 12.4 percent on top of that they're looking at a 47-percent marginal tax rate. If they're married it could be higher than that.

I am wary of—$180,000 is good money, no doubt. If you're living in a place like New York City, it's—you know, you're—not private jets, or even private schools, with that kind of salary—I'm wary of having a nearly 50-percent tax rate on somebody at that income level, given that we haven't even started to address Medicare or Medicaid, both issues which also might require tax increases.

So, I think we want to be careful. Social Security is one area where personal savings can fairly easily substitute for Social Security benefits. If I save more in my IRA or 401(k), that can reduce the burden on Social Security. With something like Medicare or health insurance, it's harder to do that through personal substitution. So, I just think it's something we should be wary of.

The CHAIRMAN. I think it's a good point, and, you know, one thought on that is that we could have a moratorium on any increase beyond its current level, until a person's income stretches to $200,000 or $250,000 and then come back and take a look at assessing some kind of a—of a fee, beyond that.

Mr. Biggs. I think, in terms of when we want to say, why has this coverage fallen from 90 percent to 85 percent, the solution is to levy a higher tax on people making $180,000. The real cause of the decline in the coverage has been people at the very, very top end of the earning spectrum making $1 million, $5 million, a year. So, raising taxes on the person making $180,000, I don't—there's a fairness issue there, as well. He didn't cause the problem, so I'm not sure whether he should have to pay for it.

So, I think a wide range of solutions should be looked——

The CHAIRMAN. Sure.

Dr. BIGGS [continuing]. In this regard.

Ms. ENTMACHER. Senator?

The CHAIRMAN. Who also wants to make comment?

Ms. ENTMACHER. I'd actually like to follow up on the point that Andrew made, which I think is a very good one, because I was going to suggest that, in addition to looking at ways of increasing the base of payroll taxes for Social Security, we should be looking at taxes on those very high-income people. I don't think that's, maybe, entirely where Andrew was going to take his argument. But, I don't think it's necessary that financing for Social Security come entirely from the payroll tax. That was the focus of Mr. Irons' testimony. But, I think there are other options and reasons to look at them.

Part of the reason there is a long-term shortfall in Social Security is that, soon after the program was created, we allowed people to claim benefits so that they could get out of poverty, so that those people in—you know, coming out of the Depression, could benefit from Social Security even though they hadn't paid into it long, and we could quickly start addressing the problem of elderly poverty.

That's known as the legacy problem that—Social Security inherited this long-term debt. Recognizing that, I think it would be appropriate to look at some highly progressive taxes, some other forms of revenues that might help shore up Social Security.

The CHAIRMAN. I agree.

Dr. IRONS. If I could just piggyback on—

The CHAIRMAN. Dr. Irons.

Dr. IRONS [continuing]. The prior two comments. I do think—I agree, to some extent, with both comments. I do think that looking at other taxes is very much merited. I didn't focus on that in my testimony, but it's worth exploring, certainly.

With regard to the cap, I think I come down as an economist, thinking about the design of the tax code. Right now, as I said in my testimony, if you are in the middle of the income distribution, you pay around 11 percent of your income, in terms of the payroll tax. If you're in the top 5 percent, you pay one and a half percent. So, from—on a basis of fairness and just basic economics, there's an imbalance there that needs to be rectified. Whether you do it in the way you suggest, about raising taxes on people above 250,000 or something, that's certainly one way to go. Raising the cap, or some combination of the two, might be warranted.

But, I think there is something, which is a focus on making the overall payroll tax more fair, and to do so in a way that raises revenue, in a way that does not allow people at the very top end to avoid their obligation, which is largely the way the system is now.

The CHAIRMAN. Very good.

Mr. Apfel.

Mr. APFEL. I don't know whether we're almost done, Mr. Chairman, but I wanted to thank you, personally, for a focus of a hearing on benefit adequacy. We've spent hearing after hearing after hearing looking at the issue of solvency. What you have asked us to look at is critically important, which is, "How adequate is that benefit structure, particularly for vulnerable populations?" This is a big contribution, and I would hope that your committee will continue to look at these issues and dig in, in depth, so that, whenever we do resolve this issue for the long term, that the issues that you've asked us to address on adequacy become part of that package. So I want to thank you——

The CHAIRMAN. Thank you.

Mr. APFEL [continuing]. Personally for what you've done.

The CHAIRMAN. Thank you so much.

Who else? [No response.]

The CHAIRMAN. Well I have just one request. If we put together a commission, are you all willing to work on it? I think you'd be great. [Laughter.]

You do a wonderful job, and you did a great job here today. We thank you all for coming, and we'll see you soon.

[Whereupon, at 3:14 p.m., the hearing was adjourned.]

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