National Committee to
Preserve Social Security
and Medicare

Presented to:
Commission to Save Social Security

Regarding

Social Security Reform

September 6, 2001

The Social Security system contributes to the well being of American families by providing a foundation of retirement income that permits seniors to live in dignity and relieves younger family members of much of the financial pressures of ensuring their parents' financial well-being. Social Security, however, does not only provide benefits for retired workers. Social Security benefits Americans of all ages. Thirty-eight percent of all Social Security benefit dollars are paid to disabled individuals, spouses of retired and disabled workers, dependent children and survivors. We have received many, many stories from individuals detailing how Social Security payments provided an economic lifeline to their families when they lost a spouse or became disabled.

Without Social Security, approximately half of all seniors would be living in poverty. Social Security is perhaps the most effective anti-poverty program this nation has ever enacted. The reason that it is so effective is that it is not a need based welfare program. Benefits are paid as a matter of right in return for contributions throughout an individual's working years.

Social Security provides benefits in a manner that is progressive and fair: lower-income workers get back a higher percentage of their earnings as Social Security benefits, but the more someone has paid in the more they get back. No other wage replacement program, public or private, offers the protection of the Social Security Old Age, Survivors, and Disability Insurance program.

Although Social Security is currently running sizeable annual surpluses, the Trustees anticipate that changing demographics will lead to shortfalls over the long term. While addressing this projected shortfall presents challenges, Social Security in not in crisis, as was suggested by the Commission's Interim Report. There is no need to alter the programs fundamental structure.

We should work together as a nation to strengthen and protect this vital program upon which so many depend. Adjustments in financing and benefits can preserve the long-range solvency of the Social Security program for generations to come. The sooner changes are made, the less onerous they are likely to be. On the other hand, early consideration without adequate forethought poses the risk of precipitous action that could be financially damaging to the most vulnerable Americans.

The National Committee to Preserve Social Security and Medicare remains committed to maintaining Social Security as a system of social insurance that pools risk among all workers, rather than forcing each worker to individually bear the risk that his or her retirement benefits may perform poorly. If we believe, as I think most of us do, that society has an interest in ensuring that workers and their families have a foundation of retirement income, than we must guarantee that foundation is dependable, regardless of economic cycles.

Social Security Solvency

There is considerable exaggeration about an impending Social Security crisis, and claims that the program is in imminent danger of bankruptcy are inaccurate. Over the next 75 years, the Social Security Trustees project a shortfall of about 1.86 percent of taxable payroll, or about 12 percent of projected expenditures. The long term fiscal health of Social Security is manageable. In fact, Social Security has a remarkable and proven history of durability.

Social Security will continue to run an annual surplus for the next 15 years. In the year 2016, Social Security will begin relying on interest payments from the trust funds in addition to the FICA tax revenues. Although the Commission's Interim Report portrays this date as the beginning of a funding crisis, the reality is that if Congress follows the President's principle that Social Security funds should be "locked up" and only spent for Social Security purposes or to pay down the debt, meeting benefit obligations in 2016 will not be burdensome.

In Fiscal Year 2000, $283 billion was spent paying interest on total outstanding federal debt. If Social Security surpluses are used to pay down the debt, the amount of debt held by the public will decrease, while the amount of debt held by the Trust Funds increases. Total debt will remain fairly constant, as will interest payments on the debt. The only difference will be that more (and indeed eventually all) of these interest payments will be going to the Trust Funds as the publicly held debt is paid down. Thus, the contention that new sources of revenue will be needed and we will have to raise taxes or cut other spending to meet benefit obligations beginning in 2016 is misleading.

Beginning in the year 2025, interest and tax revenues combined will be insufficient to meet benefit demands and the program will need to redeem some of the bonds held by the Trust Funds. Then, in the year 2038, if no changes are made to ensure long-term solvency, the trust fund will be exhausted and incoming revenues will only meet about 72 percent of benefit obligations.

However, even at this point Social Security will not be "bankrupt". The program will run a deficit if changes are not made, but payroll tax revenues will still be coming in to the system. There are myriad of moderate adjustments on both the revenue and benefit sides that can be combined in various ways to develop viable and equitable reform options. The Social Security program was not set up to run on auto-pilot. Throughout the history of Social Security regular adjustments have been needed to respond to changing demographics.

Yes, changing demographics and significant increases in longevity will strain Social Security in the future. However, transforming Social Security into a system of individual retirement accounts would do nothing to improve solvency.

Indeed, funneling two percentage points of payroll out of Social Security and into private accounts serves to more than double the long-term shortfall. As Americans are living longer, the inescapable conclusion is that it will cost more to support them in their retirement years. There is, after all, no such thing as a truly "free lunch."

The Importance of Social Insurance

Social Security was never intended to be an investment program. Instead, it is a contributory social insurance program, designed to protect workers and their families from loss of income due to death, disability or retirement. Social Security is not a needs based program. Rather, it is a true entitlement program in which people earn the right to participate by working and contributing.

Unlike private retirement plans, Social Security has broader policy goals than merely providing retirement benefits. Social Security was also established to protect our most vulnerable citizens from falling into poverty, raise the standard of living for lower-income workers, and provide financial security to the spouses and dependent children in the event of a worker's disability or death.

Under Social Security all workers contribute to a universal pool of funds from which benefits are paid. Social Security is financed equally by employer and employee, is portable from job to job, provides inflation-adjusted benefits, and covers all earnings over a working lifetime up to the taxable wage base. The benefit formula is weighted in favor of workers with lower average lifetime earnings.

From the program's beginning, it was intended to be a base of protection, supplemented by private pensions and savings, not an individual's sole source of retirement income. The Social Security program has worked well, providing at least 50 percent of the total income for three out of five older Americans, and keeping millions of Americans, young and old, out of poverty for the last sixty-five years.

In December 2000, Social Security paid benefits to 5 million disabled workers and to 1.6 million dependents of disabled workers, as well as 7 million survivors of deceased workers. The Social Security disability program provides the same value as a $203,000 disability insurance policy for a worker aged 27 with average earnings and with a spouse and two children. The survivors' protections Social Security provides are equivalent to a $295,000 private life insurance policy. Thirty eight percent of Social Security benefits paid go to disabled workers, to families of disabled or retired workers and to survivors of deceased workers.

This disability and survivors' protection is difficult, and even impossible for some workers, to duplicate in the private sector. Currently insurance companies do sell disability insurance, but individuals with a prior history of medical problems or who work in industries with a high rate of injury frequently find it prohibitively expensive or impossible to obtain coverage. It is also important to note that unlike private disability policies and annuities, Social Security benefits are increased annually to keep up with the cost of living. This protection is particularly valuable in times of double digit inflation such as we experienced in the late 1970's and early 1980's.

Obviously, the death and disability protection Social Security provides is extremely important, particularly for young families that have not been able to accumulate adequate savings. Social Security is at heart a family program that benefits and protects people of all ages. Without Social Security, a much greater burden would be placed on families and need based government programs to support those left in financial need due to the unexpected death or disability of a wage earner.

In addition to providing valuable disability and retirement income protection, the Social Security program is very efficient. Since the cost of administering the program is only about one percent of contributions paid, 99 percent of the funds paid in by workers are returned in benefits paid to them or their survivors. These administrative costs are much lower than those of private insurance and investment companies. For example, Chile's private retirement system has administrative costs of about 13 percent of contributions. These costs have increased over the years rather than declined.

It is tempting to look at the high rates of return the stock market has produced over the past fifteen years, and see private investment accounts as a painless solution to Social Security's predicted 75-year shortfall. It would be a mistake to rush into radical changes without careful examination of the many problems those changes present.

Problems With Carve Out Individual Accounts

Perhaps the biggest argument against transforming part of Social Security into a system of individual retirement accounts is the tremendous cost the transition to such a system would entail. Money from workers that is now used to pay current beneficiaries would be transferred into individual retirement accounts for future use. Although individual accounts are often presented as a way to "save" Social Security, diverting money to individual accounts actually worsens Social Security's long-term projected shortfall and requires more revenue.

If two percentage points of FICA are transferred into private accounts, the shortfall will double and about $1 trillion dollars will be needed to meet benefit costs in the first decade. Since writing off the benefits promised to older workers and current retirees is not an option, these funds would have to be replaced. Given the size of the tax cut that has recently been enacted into law, one must ask where will we find a revenue source to fund these individual accounts within Social Security.

In return for paying these transition costs, future retirees would be guaranteed base benefits lower than current law. The base benefit would be supplemented by the proceeds of the individual accounts, which may or may not be adequate to provide reasonable benefit levels throughout that worker's retirement. Indeed, several studies suggest that even with the proceeds of the individual accounts, many workers-- will face retirement with fewer assets.

To the extent that revenues are diverted to individual accounts, investment risks would shift to individual workers, instead of being spread out over the entire workforce as Social Security does. Even relatively safe investments, such as state or local government bonds, are subject to potentially significant risk for an individual investor.

Not every investor earns the market average. Markets can and do stay down for long periods of time. Last month, Japan's Nikkei index hit a 16-year low and has yet to recover the highs it attained in the early 1980's. We are seeing massive turbulence in our own markets, particularly the NASDAQ.

In recent months, the National Committee has begun to receive increasing numbers of letters from its members, detailing how market down turns have impacted their retirement. We received one such letter from a National Committee member who is 63 and newly retired. Her pension and private savings were largely invested in stocks. Although the average purchase cost of her stocks was $39.00 a share, those shares are now worth $0.85 each. Without her Social Security, she would be destitute.

Individual accounts could work well for some workers, particularly upper-income earners and earners without dependents. But they would not work as well for low-income workers, disabled workers or families. Since low-earners would have less to invest than high earners, even a high rate of return would not enable their savings to accrue at the same rate as high earners, and they could be devastated by high administrative fees and bad or overly cautious investment decisions.

Privatization holds no guarantee that overall national savings will increase. In fact, workers captivated by promises of overly optimistic returns could well reduce other savings. The national savings rate can only rise if overall private savings increases more than government borrowing.

A retirement system based on individual savings accounts also runs the risk that Congress would accede to inevitable worker demands to use part of retirement savings to buy a house, pay for a child’s education, obtain medical care and other such major expenses. After all, workers would own the individual accounts and feel entitled to access them when faced with major financial necessity. How many Members of Congress would be able to tell a constituent with a dying child that he or she could not take money from their account to cover the medical costs?

Suggestions for Solvency

Supplementing payroll taxes with general revenues. An influx of dollars from general revenues would help meet the increased demands of an aging population. This option recognizes the broad popular support Social Security enjoys and the benefits it bestows on Americans of all ages. The recently enacted tax cuts could be repealed at least partially, and resulting surpluses could be used to strengthen Social Security for future generations.

Increasing the maximum wage base. Currently, only the first $80,400 of earned income is subject to the payroll tax. The base should be increased so that 90 percent of covered earnings are taxable and then indexed thereafter. Senator Moynihan, we saluted you for your leadership in introducing legislation to raise the wage base in 1998, and it continues to make good policy sense today. This is one of the most progressive reforms and it would have a substantial impact on closing the long-term gap.

Expanding coverage. Newly hired state and local workers could be brought into the Social Security program. This would increase solvency and also provide these workers with increased retirement security and greater freedom in changing jobs. It would also bring them added protection from the eroding effects of inflation on income and in many cases significantly expand spousal and disability protections.

Government investment of a portion of the trust fund reserves. Private investment of a portion of the reserves, should be seriously considered and debated. Investing some of the reserves in an indexed selection of stocks could allow Social Security to realize a higher return on its investments, without appreciably increasing individual risk. The investments could be chosen and monitored by Social Security's trustees. Various and multiple "firewalls" could be built into such a system to protect investment policy from political manipulation. Although this option is controversial, it deserves to be explored rather than summarily dismissed. This option has been endorsed by Former Social Security Commissioner Robert Ball, and several other members of the Social Security Advisory Council.

Conclusion

Social Security was never intended to be a person's sole source of retirement income. Instead, it is a guaranteed base, which should be supplemented by private pensions and personal savings. Fewer than half of America's workers are covered by pensions. Even those that do have pensions, are increasingly likely to have defined contribution plans, like 401(k)s, which are dependent on market returns rather than defined benefit plans. Also, many people invest the bulk of their personal savings in private markets. In light of this, it does not really make sense to add a component of risk to Social Security benefits by tying them to the stock markets performance.

Although Social Security will face new challenges as the baby-boomer generation moves into retirement, these challenges can be met without dismantling the United States' remarkable and successful system of social insurance. Transforming all or part of Social Security into a system of individual private retirement accounts would champion individual self-interest over community interest and destroy a safety net that is essential to millions of Americans of all ages.

Senator Moynihan, the National Committee commends you for your long and illustrious history of working to protect Social Security. You more than most understand what is at stake-- how much people depend on this program and how far reaching the impact of even minor changes. I hope that you will continue your efforts to strengthen Social Security for all Americans without altering its fundament structure and protections. I would also like to thank the members of the Commission for holding public hearings on this issue.