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2003 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD AGE AND SURVIVORS INSURANCE AND DISABILITY TRUST FUNDS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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2003 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD AGE AND SURVIVORS INSURANCE AND DISABILITY TRUST FUNDS

WEDNESDAY, APRIL 9, 2003

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:15 a.m., in room 215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Santorum and Baucus.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. Thank you for your patience while Senator Baucus and I, on other subjects, had very important business to discuss. So, that is why we are 15 minutes late.

The purpose of today's hearing is to review the latest report of our Social Security Board of Trustees. Our first and only witness is Mr. Stephen Goss, Chief Actuary of Social Security. I am very pleased that you could be here with us today.

As anyone involved in the Social Security debate can tell you, and we all know of Mr. Goss' very outstanding reputation. He is widely respected by members on both sides of the aisle, not only of this committee, but of several members of the U.S. Senate.

Although the Social Security trustees' report was issued last month, I believe today's hearing is very important. According to this year's report, annual benefits will exceed payroll taxes until the year 2018, and the trust fund will be depleted by the year 2042.

I think it would be better to say "depleted," meaning that there would be IOUs, not to continue benefits at 100 percent of claim based on present law. As a result, benefits will probably, as far as I know, be paid in the 70 to 75 percent of claim range.

Despite looming financial crisis, Congress remains reluctant, I am sorry to say, to enact meaningful reform. I believe that this political inertia is largely the result of fear. Beneficiaries are afraid their benefits will be cut. Workers are afraid their taxes will go up, and Congress is afraid of taking blame.

I would suggest that one of these fear is entirely unfounded. As far as I can tell, no one in elected office will ever again seriously

propose to reduce benefits of current recipients. It is simply not going to happen. I hope that that issue is off the table.

Of course, there is a price to be paid for protecting those who are currently eligible. As we are going to learn today, I believe, taking current benefits off the table means tougher choices for everyone else, but that is the price that is going to have to be paid.

There is, however, another price that we do not have to pay, and that is the cost of delay. It is often said that the longer it takes to improve Social Security, the harder it gets. This is an expression that may sound cliched, but it is true.

As the trustees' report shows, the Social Security shortfall is $10.5 trillion. This number remains the same whether we enact reform this year, next year, or any year thereafter. The only thing that changes from one year to the next is who is going to pay our burden.

The longer it takes to enact reform, then the greater the burden will be on younger workers. Assuming Congress fully protects those who are currently eligible, eliminating Social Security shortfall would require a 25 percent reduction in future benefits, or a 30-percent increase in future taxes.

Every year that we delay, these numbers go up roughly 1.5 percent for those who are not yet eligible to collect benefits. Despite this rising burden on the young, many people in Washington continue to question the political viability of bringing about changes. Members on both sides of the aisle are concerned that the other party would rather have a political issue than a practical solution.

So the question we face today, is how to build bipartisan consensus on changes. To begin the process, I believe that we, first, agree on what the problem is. The report we will hear today clearly identifies the size and scope.

The testimony we hear today translates the problem into specific benefit reductions or tax increases. We may not like those numbers, but we should at least be able to agree that those are the numbers to be dealt with.

Let me be clear on another point. Accepting the validity of these numbers does not imply an endorsement of specific tax or benefit changes. These changes are illustrative. We have plenty of time at future hearings to consider policy options, and I hope that this committee can lead in that discussion.

Changing Social Security will require an honest and open discussion about some politically difficult choices, but this discussion can only occur if we first agree on the size and scope.

Today's hearing on the latest Social Security trustees' report is designed to get everyone on the same page. Hopefully, we can accomplish that goal. After all, if we cannot agree on the problem, we are obviously never going to agree on a solution.

I now call on my counterpart, Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Mr. Chairman, for holding today's hearing. There are not a lot of people attending this hearing. However, it is extremely important. Often, I think in our society we pay too little attention to matters that are important, but not urgent.

This is one of those that is very important. I guess the lack of attendance is due to the lack of urgency at this point. But, as we all know, things happen sometimes more quickly than we anticipate.

I am reminded, Mr. Chairman, of a Japanese poem that goes somewhat to the effect of, I always knew 1 day I would travel down this road, only I did not know it would be so soon. Frankly, the problems we are facing with Social Security are going to be upon us a little more quickly than I think some people realize.

This report, like the reports before it, is a good one. It has been completed with attention to quality and not to politics. So I want to thank all of the trustees. I want to thank Secretaries Snow, Thompson, Chao, and also Commissioner Barnhart and the two public trustees, John Palmer and Thomas Savin. Is it Savin or Saving?

Mr. GOSS. Saving.

Senator BAUCUS. Saving. Thank you.

Mr. Stephen Goss, our witness today, is the Chief Actuary of the Social Security Administration. I want to take this opportunity to thank you, Mr. Goss, and all of your other highly skilled actuaries at Social Security. It is not an easy job. It is a difficult job. I personally think that you all do it exceedingly well.

This year's report provides some good news as well as some bad news, and I think we should pay careful attention to both.

First, the good news. Social Security will be able to pay full benefits until the year 2042. In last year's report, the date was 2041, so that is a slight improvement.

But there is also some bad news. After 2042, the Social Security trust fund will be empty. However, Social Security will still be able to pay a significant portion of benefits out of the payroll taxes that are collected each year.

But Social Security cannot pay full benefits. For example, in 2043, Social Security will be able to pay 73 percent of the benefits that are scheduled. We need to fix the problems that will occur after 2042. Fixing these problems will require some heavy lifting. We cannot wait until 2042.

The trustees state very clearly that we must begin to close this financial gap soon. Otherwise, solutions will be far more painful and workers will not have enough time while they are in their working years to make the required adjustments for changes to their retirement benefits.

There is another figure in the report that tells the same story. This figure is called the "Actuarial Imbalance Over the Next 75 Years." The report indicates that, over 75 years, there is an imbalance of 1.92 percent of the amount of wages and salaries and payroll subject to the Social Security payroll tax.

This means that the trust funds would be put back into balance for 75 years if Social Security payroll taxes were immediately raised by 1.92 percentage points. That would mean that the current total rate that employers and employees are taxed would increase from 12.4 percent to 14.32 percent.

Of course, there are other alternatives for eliminating the 75-year actuarial imbalance besides raising the payroll taxes. Benefits could be cut by 13 percent, or we could direct general revenues into

the trust fund in an amount equivalent to $3.5 trillion in today's dollars, taking into account the time value of money, or we could have some combination of these changes.

None of these solutions is easy. Each would require very painful choices. But the numbers involved are within somewhat reasonable bounds if we take steps soon.

But that is not the end of the story. For the first time, this year's trustees' report tells us what we would need to do to achieve actuarial balance over an infinite horizon, not just over 75 years. In other words, it tells us what we need to do to achieve permanent actuarial balance.

How difficult would it be to reach this goal? The answer is, if we want to achieve actuarial balance permanently, the size of the problem doubles. We would have to raise payroll taxes immediately by 3.8 percentage points, not 1.9 percent.

The amount of general revenues needed would triple, from $3.5 trillion to $10.5 trillion. Obviously, huge numbers that will require much more heavy lifting than is needed to achieve the 75-year balance.

These numbers tell us that whatever combination of solutions we come up with, general revenues are almost assuredly going to have to play a big part. Without general revenues, the other solutions are just too draconian.

How hard will it be to find massive amounts of general revenues to transfer? General revenues, by definition, must come from surpluses in the non-Social Security budget. In other words, from all of the budget except the benefits and revenues from Social Security.

Unfortunately, in this regard we are moving in the wrong direction as we continue to run up bigger and bigger deficits in the non-Social Security budget.

In fact, the Congressional Budget Office projects that if all of the proposals in the President's budget were enacted, the non-Social Security budget would still have an annual deficit of over $400 billion 10 years from now.

Suppose, however, that we decide not to enact the President's entire $725 billion economic growth package. For example, Peter Orszag of Brookings has calculated that if we do not enact the dividend proposal, we would save an amount over an infinite horizon that is equal to $2.4 trillion today, taking into account the time value of money.

If this amount were instead diverted into the Social Security trust fund, it would reduce the permanent actuarial imbalance by 25 percent. That is a lot of money.

Now, looking at a measure for achieving actuarial balance has a disadvantage, too. It has a lot more uncertainty than the 75-year measure. It means that making small changes in economic or demographic assumptions could create extremely large changes in outcomes.

Fortunately, for trust funds that do not exhaust during the 75 years, there is a proxy method for analyzing whether they are in permanent actuarial balance. This method does not involve making any projections beyond 75 years. Here it is.

For each of the last few years of the 75-year period, look at the ratio of assets in the trust fund at the end of the year to the size of next year's expenditures. If the ratio is declining, then the trust funds are likely to be in permanent actuarial imbalance.

However, to get a better idea for the size of the imbalance, we can, and should, look at the projections over an infinite horizon as it has done in this year's trustees' report for the first time.

We found that Social Security can pay full benefits until 2042, but we must fix the system in order to pay full benefits beyond 2042, and we need to do it soon.

Moreover, to put the Social Security system into balance on a permanent basis is going to require substantially more resources than we have been thinking about up until now. This means it will have to impose some very serious fiscal discipline in the rest of the budget if we are going to succeed.

Mr. Goss, I look forward to hearing your testimony.

The CHAIRMAN. Proceed, Mr. Goss.

STATEMENT OF STEPHEN C. GOSS, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, BALTIMORE, MD

Mr. GOSS. Thank you very much, Mr. Chairman and Ranking Member. It is truly a pleasure to be able to come and talk with you today about Social Security, about its financial status, and about the contents of the latest trustees' report.

I will apologize in advance for talking to you on some points that you all have very effectively covered already, but there are some additional details that I would like to be able to pass on to you.

The Social Security program currently provides monthly benefits to over 46 million individuals, and the primary source of financing is, of course, the payroll tax, which applies to more than 150 million workers in covered employment.

Regarding the latest trustees' report that has just come out, the overall financial status of the Old Age and Survivors and Disability Insurance program was little changed from last year's report.

Under the intermediate assumptions, as you have both indicated, the long-range actuarial deficit is now estimated at 1.92 percent of payroll over the 75-year projection period. This long-range deficit is 0.04 percent of payroll larger than was reported in last year's 2002 report. That is not a very large change.

However, changing the valuation period alone by going from the 2002 to 2003 report, moving 1 year forward at the point at which we start our valuation, would, all by itself, change the estimate for the actuarial deficit by increasing it by 0.07 percent of payroll.

The fact that the actual deficit increased by only 0.04 percent of payroll is a bit of good news. It means that, on balance, the changes in assumptions, methods, and the starting data that went into the trustees' report were a slight positive, offsetting about a third of the effect of changing the valuation date itself.

Assets of the OASI and DI trust funds are invested in special obligations of the U.S. Treasury, as we are all well familiar. These combined assets increased by $165 billion during calendar year 2002, reaching a level of almost $1.4 trillion at the beginning of 2003.

At that point, these assets represented almost 300 percent, almost three times, or moer precisely 288 percent, of the estimated annual expenditures for the year.

These values are virtually identical to the estimates that were included in the 2002 trustees' report, so for that far in the future we are usually pretty certain about the projections we are making.

Both the OASI and DI programs are, again, in this year's trustees report, projected to meet the short-range test of financial adequacy, which basically requires that over the course of the next 10 years, the trust funds are projected to be equal to at least 100 percent of annual outgo of the system.

Tax revenue exceeded the cost of the program by $85 billion in 2002. The balance of the $165 billion was due to interest earnings during the year. However, based on the intermediate assumptions of the 2003 trustees' report, the cost of the OASDI program is projected to begin growing faster than the program's tax income in the year 2009.

In fact, the cost of the program is projected to exceed the income beginning in 2018. This is 1 year later than was estimated in last year's report, as you both noted.

The combined OASI and DI trust funds are projected to grow to nearly five times the annual cost of the program in 2016. However, after that point they are projected to be declining and become exhausted in the year 2042, which again is 1 year later than in last year's trustees' report.

At the point of the trust fund exhaustion, the continued revenue coming into the system is estimated to be sufficient to pay 73 percent of the cost of the program.

This percentage would be declining as we move through the balance of the 75-year projection period to the point of having financing sufficient to cover 65 percent of the cost of the program under current law by 2077.

As in last year's report, the OASI and DI programs are both separately, and on a combined basis, in a position where they do not meet the trustees' long-range test of close actuarial balance.

This means basically that the projected income and assets of the program represent less than 95 percent of the amount that would be needed to fully pay scheduled costs throughout the upcoming 75-year period.

A combination of changes in assumptions and starting data coming into this year's trustees' report had relatively small net effects on the annual pattern of the costs of the program over the 75-year projection period.

These changes are described in some detail in the written testimony that I have submitted, and if you all desire, we could talk about it more in the question period.

The OASDI program cost is projected to rise from 10.9 percent of taxable payroll in 2003 to almost 20 percent, to 19.9 percent of payroll, in the year 2077. At that point in 2077, the cost is projected to be 6.5 percent of taxable payroll higher than the revenue coming into the system.

This means that if payroll taxes were to be raised in that year 2077 so as to permit full payment of benefits scheduled in that

year, an increase of more than half in the level of the current payroll tax rate of 12.4 would be needed.

Expressed as a percentage of the gross domestic product of the country, the cost of the OASDI program is projected to rise from 4.4 percent this year, 2003, to a level of 7 percent in the year 2077. That 2077 projected level is the same as was projected in last year's trustees' report.

Several additional measures of OASDI unfunded obligations have been added to this year's trustees' report, as you both have well noted. The open group unfunded obligation of the program, under the intermediate assumptions, is estimated in present value dollar terms at $3.5 trillion for the 75-year period, 2003 through 2077.

This unfunded obligation is conceptually very similar to the actuarial deficit for the 75-year period, which is now estimated at 1.92 percent. It is important to remember that both of these measures indicate the magnitude of the financial shortfall for the upcoming 75-period as a whole.

The actuarial deficit of 1.92 percent expresses this 75-year shortfall relative to the tax base or the taxable payroll for the program over this 75-year period as a whole, and therefore represents an average level of tax rate increase that would be needed to address this shortfall.

The $3.5 trillion unfunded obligation expresses a 75-year shortfall in a single aggregate value and we must keep in mind that this is a total amount which must be addressed over the course of the next 75 years.

The 2003 trustees' report also includes an estimate of $10.5 trillion, again in present value terms, for the open group unfunded obligation over the infinite future period.

This means that beyond the $3.5 trillion that we have already noted as the shortfall that must be addressed over the next 75 years, there is an additional $7 trillion of shortfall in present value that will need to be addressed over the infinite period that extends beyond the 75-year period, i.e., beyond the year 2077.

The equivalent actuarial deficit for the infinite period, as again you have already noted, is estimated to be about 3.8 percent of taxable payroll, which is about double the deficit if we were to address only the next 75 years.

It should be noted that, like the actuarial deficit measure, the 1.92 percent, these present value measures of unfunded obligations will also tend to increase from one trustees' report to the next, even if no changes in data or assumptions are made.

The increase is simply due to the changing valuation date. For example, the 75-year open group unfunded obligation was increased from $3.3 trillion on the basis of last year's estimates, to $3.5 trillion based on this year's valuation, even though the updated assumptions and experience were, on balance, slightly positive.

However, to the extent that these measures of unfunded obligations grow faster than Social Security taxable payroll, they represent a real increase in the cost of meeting shortfalls for future years as these years get closer.

The 2003 trustees' report also provides two components of the $10.5 trillion estimated infinite future unfunded obligation. The

first of these two components, or decompositional pieces of the infinite unfunded obligation, is something we refer to as the unfunded obligation that the program would have if participation in the program were closed off to individuals who are now under age 15 or not yet born.

The value of this closed group unfunded obligation is estimated, somewhat coincidentally, also at $10.5 trillion in present value. As a result, the second component which adds up to the entire infinite horizon open group unfunded obligation, is the net present value of the cost of future scheduled benefits to new entrants to the program for all future years over the infinite period, less their scheduled taxes.

This second component representats people who are under 15 now or not yet born, including the entire net effect of their future taxes and their future benefits that are anticipated under the program. The net discounted present value for such individuals is zero, indicating that the taxes for future generations could finance the benefits that would be payable to them under current law on a fully advance-funded basis.

While these two values are important for evaluating a program that is fully advance funded, we should look at them with some caution in terms of the current Social Security program. The current Social Security program is financed on a basically pay-as-you-go basis.

Under a pay-as-you-go program, the taxes for each generation are, of course, used to pay benefits of prior generations and are not saved to pay for their own benefits.

Thus, the fact that taxes for future generations are about equal to the present value of the cost of their own scheduled benefits is, in fact, not really relevant to the actuarial status of the program which is financed on the pay-as-you-go basis.

Similarly, the closed group unfunded obligation, which is entirely appropriate as a measure for programs that are intended to be financed on an advance-funded basis, is not relevant to the actual status of the pay-as-you-go-financed program of Social Security.

The actuarial deficit and the unfunded obligation for a period indicate the financial status of the program for the period as a whole, and one additional item. They also indicate whether the program will be financially solvent at the ending date of the period in question.

It is also important, however, to consider whether solvency will be achieved, or is expected to be achieved, for the program at all times within the valuation period and beyond the period.

For this purpose, we consider the level of the trust fund at each point in time, which, if positive, indicates that the program is solvent. If the program is solvent throughout the 75-year period, for example, and the trust fund expressed as a percentage of annual program cost, is stable or rising at the end of the period, then solvency can be expected to be sustained well beyond the end of the 75-year period.

This year's trustees' report shows, again, that under current law, scheduled benefits are not sustainable in the long run with current law tax rates.

The Appendix E added to this year's trustees' report presents the results of a new, first generation model using stochastic modeling techniques. These results are an important addition, we believe, to the sensitivity analysis and to the presentation of alternative scenarios that have been included in the report for many years.

We are pleased with the prospects of expanding our understanding of uncertainty through this model and look forward to further development, which we are very much engaged in.

Availability of this model for inclusion in the 2003 trustees' report was only possible through the advice and counsel of the trustees, along with the extraordinary effort by Alice Wade, our Deputy Chief Actuary for long range actuarial estimates, and the extremely talented group of members of our office that worked very hard on this effort.

Plus, one other citation we must make is the invaluable consultation from other pioneers in this area, particularly the staff at the Congressional Budget Office who have been working on these models also.

However, we note that the results of this model should be viewed with some care. More work is absolutely needed on this, and similar models to bring them to the point where they will fully represent the range of uncertainty associated with the future costs of Social Security.

Even at this stage of development, however, these models do confirm that outcomes as good as the trustees' low-cost project alternative, or as bad or worse than the high-cost projections, are relatively unlikely in the long run.

Finally, Mr. Chairman, your staff requested that I present an analysis of the effect of delaying the implementation of Social Security reform, and the size of the benefit reductions and tax rate increases that would be needed.

The table I have submitted titled, "Immediate Benefit Reductions and Tax Rate Increases That Would Eliminate Long-Range Social Security Actuarial Deficits," provides the effects of delaying the start of changes for the next several years.

The 2003 report indicates that eliminating the 75-year actuarial balance for the period 2003 through 2077 could be achieved with an immediate 13 percent reduction in benefit levels for all recipients in years 2003 and later.

The report also indicates that an immediate reduction of about 23 percent—more precisely 22.7 percent—could put the program in balance for the infinite future period. If the start of the benefit reductions were delayed 7 years, for example, to the year 2010, then reductions needed to eliminate these deficits would increase by about 1.5 percentage points, to about 14.5 percent and 24.3 percent, respectively.

We may also consider such hypothetical benefit reductions if they were only to apply to individuals who newly become eligible for benefits in year 2003 or in some later year. On this basis a 15.1 percent reduction for all individuals newly eligible for benefits in 2003 and later could eliminate the 75-year actual deficit.

A 25.1 percent reduction for those newly eligible for benefits at age 62—for example, for retirement benefits—in 2003 and later could eliminate the infinite future deficit.

However, if such reductions were delayed by seven years to affect those newly eligible for benefits in year 2010 and later, the benefit reductions would need to be increased by about 2.5 percentage points to levels of 17.6 and 27.6 percent, respectively.

Similarly, the payroll tax increases that could eliminate the long-range deficits would increase if action were delayed. As indicated in the 2003 trustees' report, an increase in the combined payroll tax rate of 1.92 percent of taxable earnings starting in 2003 could eliminate the 75-year deficit, and an increase of about 3.8 percent—or more precisely, 3.77 percent—could eliminate the infinite future deficit.

If the starting date, again, were delayed by seven years to the year 2010, these levels would increase to about 2.25 percent and 4.21 percent increases in the payroll tax rates, respectively.

I want to emphasize that these estimates are intended absolutely to be illustrative and hypothetical examples which are only a few of the infinite variety of possible ways to address the financial shortfalls, as you have both noted.

Finally, it is important to note that the total savings or additional revenue for the OASDI program is exactly the same in present value for each of the illustrations provided that could eliminate the deficit for the 75-year period, 2003 through 2077. The same is true for illustrations provided that could eliminate the infinite future deficit.

Thus, the effect of delaying action so that there would be no change for the next few years in the program would be to require a larger change for the subsequent years that would follow. Whether the delayed change is larger or smaller for any individual depends on when that individual would stop working and/or become eligible for benefits.

I would be happy to answer any questions and engage in any discussion that would be useful. Again, thank you very much for the opportunity to come before you today.

[The prepared statement of Mr. Goss appears in the appendix.]

The CHAIRMAN. We thank you very much for your report, and also what it does to emphasize the importance of Congress taking action.

I would be glad to defer to Senator Santorum. If you have to be on the floor early to manage the CARE Act, you could ask your questions right now.

Senator SANTORUM. I am good.

The CHAIRMAN. All right. We will take five-minute rounds.

The Social Security trustees' report has traditionally made these 75-year projections that you are reporting on. Some people have questioned whether or not anyone can make accurate projections that far into the future.

I recently came across a memo that one of your predecessors, Mr. Robert J. Myers, had written. The memo compares the Social Security projections made in 1935 with the actual results. These were fairly accurate.

I do not expect you to be able to see this, and I do not know whether you are aware of this. He actually made this historical reminder to all of us in a report to Congress, I think, way back in the early 1980's.

Anyway, have you had a chance to see Mr. Myers' article?

Mr. GOSS. Yes.

The CHAIRMAN. Have you done any comparisons of other Social Security projections made in the past that might build on this or confirm this, or bring it up to date?

Mr. GOSS. Mr. Chairman, I remember well when analysis of this type was being done back some years ago, and doing some calculations along these lines. We also were very pleasantly surprised with the fact of the projections many years later, projections made back in 1935 and 1940, had, on a relative basis, been effectively realized through about 1980.

It is important to note that if you look at the projected levels of cost, or the levels of revenue to the Social Security program that many years downstream from when projections have been made, in dollar amounts, you are very unlikely to find a good match because the rates of inflation vary over time and are very unpredictable.

However, fortunately for us at Social Security when we are making these projections, the nature of the program is such that relative changes in the income of the program versus the benefits is what really matter.

That is why Bob Myers found, and we found in other calculations that we have done, that if you look at the cost of the program expressed as a percentage of the payroll, that in fact, these numbers tend to be rather well-realized for even many decades into the future.

This results from the fact that the cost of the program is basically a reflection, to a large degree, of the number of individuals in the population who are over age 65, and the contributions to the program accrue largely from the number of people who are between ages 20 and 64, our working age population.

We actually have been very good in making projections of the total population and of the relative size of the population in these two age groups over the historical period.

An advantage we have in making a 75-year projection is that basically all of the people who will even be receiving benefits towards the end of that period have already been born at the beginning of the period, so we have a good starting point to work from.

We have also been very fortunate in having trustees over the years who have worked together and have come up with very good long-term assumptions.

We will get back to you after looking further at how some of the projections made back in earlier years look relatively to around the year 2000.

We have been very encouraged over the years that these numbers turned out to be fairly close. This is also due to the inherent nature of the program, which does have a wage indexed system, so that the benefit levels tend to rise roughly in synch with the level of the average contributions into the system which also were very directly tied to the wage levels.

The CHAIRMAN. Well, then right now you cannot say that if this had been extended out for another 23 years, that it might show the same for the last 23 years as it did for those first 40 years.

Mr. GOSS. I cannot say that with any certainty, but I would expect that we would have been fairly close. For example, we know

that in the 1990's the economy operated better than everyone expected. In fact, the program did fairly well.

The fact, however, that the higher levels of revenue, because of faster wage growth during that period, were also accompanied by higher rates of growth in benefits. This tends to provide compensating of offsetting effects on the cost as a percentage of payroll. So, even through periods of extremely good times or extremely bad times, we tend to have some compensating factors in terms of the projection of cost rates.

The CHAIRMAN. You made comments just now, as well as in your report, about rising projections showing what would happen if current law continued forever. Some people obviously might find it strange that anyone would attempt to project taxes and benefits forever. However, if I understand your methodology correctly, going from the traditional 75 years to infinity is not as difficult as it seems.

As I understand your testimony, this estimate is based on two groups of people, those age 15 and over, which you have already noted in your testimony, and everyone else, including the unborn.

However, since you assume that the net cost for everyone else is zero, the infinite future unfunded obligation is based solely on those 15 and above.

In other words, the infinite horizon does not really go to infinity, but covers the lifetime of those 15 and above, or roughly the next 100 years. Would that be accurate, the way I have described it?

Mr. GOSS. Mr. Chairman, I wish, in fact, it were quite that simple. In fact, the way we did these calculations, was to explicitly project out, going centuries into the future, what the annual costs and the revenue of the program would be.

Our finding that for people who have not yet entered the program, the net present value of their contributions and their benefits essentially match in the infinite future, is something that we discovered in making these projections. It was, in fact, not an assumption.

So, we really did do it the old-fashioned and the hard way, actually making the projections many years into the future. We had a suspicion that something like this might come out for the future years because we do generate estimates of the entry-age normal cost of the program. This is a pension concept, which simply answers, for each generation, what is the cost of the program relative to the earnings that will be paid to that generation.

When we do that, we see that there is roughly a match between the present value of expected benefits and taxes, for people entering the program right now. In fact, they are slightly over-financed on an advance-funded basis with the 12.4 percent payroll tax rate.

As we project much, much further into the very distant future, eventually people are expected to be living to higher and higher ages, raising the level of their cost as compared with the years in which they would be paying into the system. So eventually future generations far down the line would be contributing less than the present value of their benefits.

We are simply projecting that, for the totality of all future generations coming in, that there would be a net wash. However, I want to come back to the notion of extending from the $3.5 trillion

75-year deficit to the additional $7 trillion deficit beyond the 75-year period.

Those estimates were done explicitly by continuing our projections into the future, which, technically speaking, is not a major effort. We were able to simply extrapolate our populations and our beneficiaries and our revenues beyond the 75-year period.

The real question on those extrapolations, is coming up with appropriate assumptions that make sense, going out not only 75 years, but for many years beyond that. Working with the trustees, we think we have developed reasonable assumptions for that purpose.

The only other caveat I think that I would put on those numbers, is related to uncertainty. While 75 years is a long time, we feel some confidence, as you pointed out from Bob Myers' note, that we have done fairly well on these estimates over even a period of decades. However, going beyond 75 years is even a longer period.

The level of uncertainty associated with projections that go out beyond 75 years is undoubtedly greater than even for the first 75-year projection.

The one very final point that I want to make about the infinite projections is that this is the first time in a very long time that we have had numbers that have gone out beyond 75 years. For a period prior to the mid-1960's, we did have some estimates that, at that time, went into perpetuity, actually, while Bob Myers was the Chief Actuary.

I would mention, though, that the way in which the perpetuity estimates were done at the time and the way that the discounting was done made the numbers actually not very much different from projections for the 75-year period.

So in the sense of having really meaningful numbers that are projected into perpetuity, the numbers that we have in this year's trustees' report are in effect the first.

The CHAIRMAN. Thank you.

Senator Baucus?

Senator BAUCUS. Mr. Goss, so what explains the one-year improvement?

Mr. GOSS. A very good question. Thank you.

The CHAIRMAN. I read in the newspaper, immigrants coming into the country. We are going to have more open immigration. Is that right?

Mr. GOSS. On balance, it is probably fair to characterize the net effect that improved the annual cash flows of the program over the first 40 years, as the net effect of immigration. There were, in fact, a number of things that all work together, as is always true with trustees' reports, many of which tend to net each other out. We had a rather substantial change in the estimated starting level of wages as a result of a revision by the Bureau of Economic Analysis.

Fortunately for the Social Security program, as we were talking about before, there tend to be a lot of offsets. This was true when the BEA revised downwards the level of wages for 2001 and 2002.

Those revised levels of wages give us lower levels of revenue in future years which tend to be offset naturally by lower projected levels of benefits in future years.

We also made some methodological changes and some assumption changes relating to the ages at which people would be expected to be retiring under Social Security as the new normal retirement age is phasing in and is increasing in the future.

But to the largest degree, you are exactly right; the change that made the biggest difference is in immigration related to the new 2000 Census. The Bureau of the Census learned and surmised that there was a very much greater level of immigration coming into the country during the 1990's. The trustees extended that increase in the level of immigration to a significant degree over the next 20 years of the projection.

Senator BAUCUS. Thank you.

What is the importance of the analysis over an infinite period? In addition to the 75, why do we get involved in numbers beyond 75 years, which, after all, is a few years away?

Mr. GOSS. It is, indeed, a very long period. Conceptually, people have oftentimes commented on the 75-year period as being sort of an arbitrary end point.

Senator BAUCUS. Right. Yes.

Mr. GOSS. Oftentimes, people said maybe it should be shorter, some say maybe it should be longer. Conceptually, the infinite open group unfunded obligation is really very much the same as the 75-year, but goes even beyond.

The infinite horizon is an additional way that we can use to try to look at the full picture of the Social Security cost. It might potentially help in providing a full picture of the implications of possible reform plans. Many reform plans may not have their entire impact seen within the 75-year period.

Fortunately, we do have other, more practical, ways of looking at the entire impact of reform plans, even with only 75-year projections. We will continue to be looking at the impact of reform plans through 75 years, with emphasis on the trend in trust fund assets at the end as a proxy for perpetuity, as the Chairman described.

Senator BAUCUS. Well, I think it is a great benefit, frankly, for the reason you indicated. A lot of times we do have reform plans and it is helpful to know what this really means down the road.

We have gone a little bit over the tax increases, the benefit cuts, and the general revenue transfers that will be needed to close the actuarial imbalance over an infinite horizon.

As I mentioned in my statement, Peter Orszag at Brookings has estimated that the cost of the dividend tax proposal in the President's budget is at $2.4 trillion in present value over an infinite horizon.

I know you did not do that calculation, that is his. But if that is accurate, is it true that that would amount to about 25 percent of the Social Security actuarial imbalance over the same time horizon? Would that be about 25 percent?

Mr. GOSS. It absolutely would. As you indicated, we have not looked at that calculation or attempted to replicate it. But $2.4 trillion would, indeed, be approximately one-fourth of the shortfall of the infinite horizon, no question.

Senator BAUCUS. And it is his calculation, anyway, excluding that dividend proposal in current dollars would be about $2.4 trillion over the infinite time horizon.

Another interesting question. We have some charts here. That is, the trends in the defined benefits of Social Security on the one hand over time, compared with the benefits in the President's privatization plan. There are two charts. This is one over 75 years, and then I will give you one over the infinite time horizon.

But the red line is the personal account benefit. It starts down about 10 percent. As I recall the personal account benefit, the latest plan is 4 percent of the 12.4 percentage points of payroll tax that could be set aside for a personal account.

Mr. GOSS. Four percent, up to, I believe, $1,000.

Senator BAUCUS. Up to $1,000. That is correct. Four percent up to $1,000.

The black line is the defined benefits under Social Security today. So it starts out and you can see that the defined benefits, as a percent, have declined. Actually, by 2075, they are significantly less than the personal account benefits, at least as projected.

The next chart. We will take the same phenomenon, but extend it over the infinite time horizon. What is shown here, is that essentially Social Security, if this plan were to be enacted, granted over a long period of time—a very long period of time here—that gradually it becomes, in essence, a 401(k) account. That is, the red line is almost all the benefits.

The defined benefits of Social Security are virtually nothing. It gets to your point of, what is the value of having these infinite analyses? It seems to me that one value is to show that if the President's personal account were enacted, that over time we are virtually eliminating Social Security as we know it, that is, defined benefits, and replacing it with essentially a 401(k) plan. People know that there are advantages and disadvantages to 401(k)s, particularly lately in the news.

Any comment about this?

Mr. GOSS. I guess, just one, Senator Baucus, if I might. In the context of developing the proposals for the Commission, they were, in fact, at that time looking at the 75-year projection period. That was clearly their focus. That was the world we were working within.

It is not entirely clear to me that they had really made a formal decision about what they would do with respect to the nature of their plan and going beyond the 75-year period.

At the end of the 75-year period, projections for their number-two option plan indicated that the Social Security system was, running at rather substantial surpluses.

Arguably, if they were to consider going beyond 75 years in their vision of what their plan would be, they could have had the benefit for the defined benefit not continuing to decline relative to wage increase in the future, and probably still have a sustainable projection.

I think that, in the context of a perpetuity projection now, it would be necessary for the Commission to go back and look further at what they would want to do. If, indeed, their plan did follow through with the price indexing forever, this appears to be accurate.

Senator BAUCUS. I just think this kind of analysis is important.

Mr. GOSS. Absolutely.

Senator BAUCUS. Of course, we work on the estimates and so forth, and the assumptions, but with respect to any plan, any variation of the plans. But it is a tool that I believe very strongly that we should utilize as we are, here in the Congress, contemplating changes to the Social Security that is particularly adding in personal accounts if we do so.

Frankly, I have strong reservations about it. But it is, nevertheless, I think, useful. I commend you very much for starting to go down this road, because it is going to be helpful for all proposals to be a little more clear in what they are projecting or the actual effects are down the road.

Because once you start a plan like this, like I say, the personal accounts, it is pretty hard to stop it. One can, of course. But if you start down a road that has very significant consequences, I think it is important to note what those consequences are.

Senator Santorum?

Senator SANTORUM. Thank you.

Good to see you again, Mr. Goss. Just a comment on that chart. I think you brought the point up, which was the President's plan only did a 75-year projection. Within that time, the President expected us to reach a balance.

Beyond that, I do not think the President—I mean, correct me if I am wrong—would want to build up Social Security surpluses and continue to reduce benefits. At some point, we would turn off the benefit reductions once we achieve actuarial balance over the long term and those benefit reductions would not continue.

I think to suggest that somehow or another we are going to continue to reduce benefits when we are building up surpluses and that we have a long term surplus in the system, does not give much credit to future Congress' political sense, much less concern for seniors and their benefits upon their retirement.

So, I think you made the point, and maybe it is something, now that you have come out with long-term projections, the President needs to go back and look at those long-term projections and see how he would adjust his plan accordingly to make sure that what Senator Baucus has suggested does not become a reality.

One other follow-up on one of the things that was asked on the issue of why the change. You said immigration was a big part. Are you talking principally about H1Bs, folks who are coming here, working, contributing, and then not staying here to collect benefits? Is that the windfall we are getting from this, or is it something else?

Mr. GOSS. On the immigration, what we are really talking about is what we sometimes refer to as the "other than legal immigration." The reason for the larger number presumed for the 1990's is the new 2000 census. Every 10 years when a new national Census is developed by the Bureau of the Census they learn the reality of how large the population really is, this time for the year 2000.

Between 1990 and 2000, they made interim estimates by adding up the total number of births, the total number of deaths, the total number of legal immigrants coming into the country. They can do that fairly directly, and they therefore are able to make a prediction of the level of the population in the year 2000.

The 2000 Census population turned out to be several million people more than had been expected, and we are left only to infer that that is a result largely of people who are other than legal entering the country.

Senator SANTORUM. And they are paying Social Security?

Mr. GOSS. Some of them are, some of them are not. We assume that half to three-fourths of the individuals who are residing in the country in an other-than-legal status and are working will, one way or another, be contributing to Social Security and that many of them will potentially, be able to receive a benefit under the system.

As a result of the contributions by a portion of these individuals, the system does, indeed, enjoy a positive effect on its actuarial balance.

The other important thing to keep in mind though, is that the biggest long-term effect when people enter the country, whether they are here legally or not, is that if they have children while they are in the country, those children will be legal and they will be citizens of the United States.

Senator SANTORUM. Right.

Mr. GOSS. In the course of the 75-year projection, that is a very significant factor.

Senator SANTORUM. That is a plus.

Mr. GOSS. Absolutely.

Senator SANTORUM. I will say, I am doing my part. We are expecting our eighth child, so I am doing my part to help the Social Security system long term. I just want everybody here to know that I am not just doing it on a policy front, I am doing it on a personal front.

A couple of questions on what Senator Grassley talked about, which has to do with the longer we wait to solve this problem. You talk about the shortfall is 1.92 percent over the 7-year period. But that is an average, is it not?

So the fact that we are in all these surplus years and we have these very big surpluses right now, every year we wait and every year of surplus we put behind us, that number grows and grows and grows. Is that not correct, that the problem grows?

Mr. GOSS. It depends. There are a couple of different perspectives here. This particular chart was done on the basis of considering the 75-year period. It was done on the basis of considering a fixed 75-year period so that the total amount of money that we need to generate within that period is the same regardless of when we start. It is true that if we start later, the size of the increase from a later point in time would have to be larger.

But there is another consideration that I think you might be referring to, Senator Santorum, which is that with respect to the 75-year deficit in this year's trustees' report of 1.92, if we do nothing and next year we come back to the same discussion and a new trustees' report has come out, we would expect that for the new 75-year period that we would be looking at that point we would have a deficit of almost 2.0 percent of payroll.

It would increase by about 0.07 percent of payroll. That is largely because of the addition of one additional year onto the end of the period, and the fact that all the years of deficit would be 1 year closer at that point.

Senator SANTORUM. That is right.

Mr. GOSS. So, delay is important.

Senator SANTORUM. If we are looking at the total cost of the program today versus what the total cost of the program is as a percentage of taxable payroll, we are looking at about 11 percent, is what the cost of the program is today as far as taxable payroll.

One of the years I have here is 2033, which is 17.3 percent; in 2063, 19 percent. So the point I guess I am trying to make, is as the baby boomers retire and other factors go in, this delay is really going to cost us some serious dollars and is requiring us to more dramatically increase taxes or cut benefits to solve the problem. Those have been the options we have used in the past, which is either reduction of benefit or increase in taxes.

One other question, very quickly. Everyone talks about, the problem date is 2042, but when we reach 2018, we are not going to have enough money to pay benefits at that point, or 2019. We are going to have to do what? How is Social Security going to pay these benefits? What are they going to do?

Mr. GOSS. Well, in 2018, we would reach the point where the tax income coming into the system would first fall, a little bit short of the total cost of benefits.

What that would mean is, in net, we would have to use all the taxes coming in towards the benefits. In addition, we would have to redeem some of the trust fund assets that are held in the fund. At that point in time, of course, trust fund assets, these special issue bonds that the trust funds hold would be rather large.

Senator SANTORUM. And they would be redeemed from?

Mr. GOSS. They would be redeemed by the general fund of the Treasury, which of course would have budget implications which are significant. Not to make this point too strongly, but the impact of having to redeem bonds at that point is significant.

It is also true that, we have an $85 billion surplus right now in the year 2002, that is, excess of taxes coming in over the cost of the program currently and those monies are being invested in the general fund of the Treasury. Those numbers will be declining after about the year 2009.

So, even before the point that we reach 2018 in which we actually cross over to have a net redemption of bonds, the amount by which we will be having excess taxes going into the general fund will be declining after the year 2009.

Senator SANTORUM. Thank you.

The CHAIRMAN. Thank you. Obviously, you might get some questions for answer in writing from those of us who were here, as well as people that are not here. We would appreciate, maybe in two or 3 weeks, to have those answers back in writing.

Senator BAUCUS. Mr. Chairman, I have a question.

The CHAIRMAN. Well, if Senator Baucus has a question, we will continue.

Senator BAUCUS. The question gets to replacing wage indexing with price indexing. It is my understanding—I am just getting up to speed on this—that we are making projections, the present Commission's Option 2, really, is based on replacing wage indexing with price indexing, which has the effect of lowering benefits. Am I correct? Because wages generally rise faster than prices.

Mr. GOSS. Absolutely. The trustees are assuming that wages will rise at about 1.1 percent faster than prices in the future, on average. And, under those circumstances, most definitely benefits would rise at a slower rate if they are rising with prices.

Senator BAUCUS. All right. That means that somewhere out beyond the 75-year window, the traditional benefit will be, I was going to say, almost entirely gone. I guess the point I am just trying to figure out, is the degree to which that is a factor, particularly over a longer period of time. Is there any way of projecting?

Mr. GOSS. Well, some have argued that sort of the purchasing power of the benefit would be maintained by price indexing. Of course, the standard of living that we all enjoy with new things coming out of the marketplace would not be captured by simply maintaining purchasing power.

I think you have very accurately portrayed, through at least the 75-year period, and we are a little bit in question as to what exactly the Commission would intend beyond it, the sort of shift between a defined benefit and a defined contribution component of the Social Security plan.

There is no question but that the Commission proposals would move Social Security away from being a purely defined benefit plan to partially, and increasingly through 75 years, moving towards having a defined contribution component of the plan. Many of the proposals that we have seen have had that nature.

Senator BAUCUS. What is the argument for wage indexing as opposed to price indexing?

Mr. GOSS. I think traditionally when people have looked at a wage indexed system, they have looked at the system from the point of view of devising a benefit formula that would provide benefits that would maintain a somewhat constant relationship to the wage levels that the individual had over their career.

So what we refer to as the replacement rate would be similar in the future for the Social Security program across generations. I would hesitate to try to characterize precisely the thinking of the members of the Commission, but I do believe that they had largely that aim in mind for the totality of the benefit structure that would be provided under their plans, and they were, in effect, devising a plan that would have the defined benefit portion, the traditional Social Security benefit shrinking as a percentage of one's career wages with the idea that the expected defined contribution or the individual account benefit would be rising relative to that, exactly as your chart showed.

Senator BAUCUS. Do you have a view on the COLA issue, how accurate it is, how inaccurate it might be, when the Bureau of Labor Statistics calculates this figure.

Mr. GOSS. A very good question. In fact, I am glad you mentioned that, if we have just another moment. This relates to one of the small changes that we had in this year's trustees' report. We all recall back to the Boskin Commission, appointed by this Committee to analyze the accuracy of the CPI.

At this point, we believe, and from what we understand from the people at the Bureau of Labor Statistics, that the remaining principal shortcoming of the Consumer Price Index is that there is something that we refer to as upper level substitution bias.

This upper level substitution bias derives from the fact that, across broad categories of goods and services, the CPI is not automatically reweighted in the way that the index is done when people shift from one type of good to another, and people do shift over time.

So, this is not captured in the current Consumer Price Index. This kind of shifting is captured in the gross domestic product price index, sometimes called the deflator.

As a result, we project in the future that we will have about a three-tenths of 1 percent difference between the rate of growth in the Consumer Price Index, at a faster rate than the gross domestic product price index.

This has actually increased from last year's projections, from two-tenths up to three-tenths. We did this on the basis of consultation with the people at Bureau of Labor Statistics who have done more careful analysis in conjunction with their development of a new index, that they refer to as the chained CPIU.

They have actually developed one of their price indices now that takes into account this inaccuracy and is adjusted for it. As we stand in the current law, though, our Consumer Price Index is based on the CPIW and it does not have a correction for upper level substitution bias. It is something that could be considered for the future, though.

Senator BAUCUS. So do you recommend making those changes? That is, that more accurately reflect, I guess, seniors' standards and buying power or whatnot?

Mr. GOSS. Well, we fortunately, at the Office of the Actuary, never recommend any proposal one way or the other.

Senator BAUCUS. You are the numbers guys.

Mr. GOSS. But we are extremely happy to talk in terms of what the implications of doing something one way or the other would accomplish. The Consumer Price Index, as it stands now, arguably, does result in price increases that are somewhat faster than for the overall market basket of goods and services that people actually tend to purchase.

To the degree that that is a fact, then the Consumer Price Index would tend to give a slightly faster rate of growth in benefits than in the price of the pure purchased market basket, but to a fairly small degree.

The CHAIRMAN. Senator Santorum?

Senator SANTORUM. Yes. I just would like to pursue that, because I think it is an important question. It is one of the things I think we are going to have to deal with here, is what assumptions we are going to make going forward as to the growth in the program.

I have seen a past Social Security Advisory Council report talking about this back in 1979. I know the late Senator Moynihan was a strong advocate of making this change.

Let me understand. Basically what we want to do, is to maintain the purchasing power of the beneficiary today for all future beneficiaries. The problem that we have today, is actually the purchasing power of Social Security benefits is increasing as a result of the form that we use today, which is leading, in part, to some of the solvency problems that we have. Is that an accurate depiction?

Mr. GOSS. I think that would be accurate. I believe our estimate is that if we were to modify the cost of living adjustment within the current system and adjust it downward to have a chained CPI approach, then we would have around a 0.25 to 0.3 percent of payroll reduction in the 75-year actuarial deficit.

Senator SANTORUM. You say adjusted down. But that is where others would say, well, what we are doing here is reducing benefits. But you worry less about hard dollars than you do about sort of percentages of how things grow and how things look as far as the percentage of things, because these dollars are very hard to estimate. You made that comment with respect to Senator Grassley's question.

If what we are trying to do here is accurately maintain the same purchasing power of the senior today, and when we are looking at these huge problems confronting us, huge unfunded liabilities that have grown every year, I mean, we talk about the last time we made the major fix to Social Security we were going to solve the problem for the next 75 years, and that lasted, I think, 2 years until we started to go out of balance.

From 1985, when we were at $268 billion, to now, where we are at $3.5 trillion, every single year after that the deficit or the debt has grown.

When we have these huge problems, we want to be responsible in trying to deal with this. We do not want to have future generations of seniors be worse off than the current generation of seniors. But when you are faced with this difficult problem, you do not want them necessarily to be better off, either.

I mean, you do not want to exacerbate the problem by making future generations pay even more—and that is what we are talking about here, we are talking about increases in payroll taxes—to have a richer benefit than should be the case.

So I understand you are making a factual statement saying, we would reduce the rate of growth. But in a sense, all we are doing is trying to better accurately project what the purchasing power is of the dollars that are being given to Social Security recipients today and project that out into the future. Is that a fair assessment?

Mr. GOSS. I think it is.

Senator SANTORUM. I appreciate that.

I do not have any more questions.

Senator BAUCUS. Just one more question, a little offbeat here. Have you ever read the book, Against the Gods by Jeremy Bernstein?

Mr. GOSS. No, I confess I have not.

Senator BAUCUS. Have you heard of it?

Mr. GOSS. I have heard of it, but I have not read it.

Senator BAUCUS. I highly recommend it. It is a great book. As an actuary, I think you would love it.

Mr. GOSS. Great.

Senator BAUCUS. It is really a history of the development of the concept of risk in western thought. It is very interesting. I think any numbers person would love it.

Mr. GOSS. Wonderful. Thank you very much.

Senator BAUCUS. Thank you.

Mr. GOSS. I learned even more than I expected today.
Senator BAUCUS. Thank you.
Mr. GOSS. Thank you.
Senator BAUCUS. The hearing is adjourned.
[Whereupon, at 11:23 a.m., the hearing was concluded.]

APPENDIX

PREPARED STATEMENT OF STEPHEN C. GOSS

Mr. Chairman, ranking member, and members of the committee, thank you for the opportunity to talk with you about the financial status of the Social Security program, and the results presented in the 2003 Annual Report of the Board of Trustees.

Current Financial Status of the Social Security Program

The Social Security program currently provides monthly benefits to about 46 million individuals. The primary source of financing is a payroll tax on the over 150 million workers in covered employment.

Overall, the financial status of the Old-Age, Survivors, and Disability Insurance (OASDI) program is little changed from last year. Under the intermediate assumptions of the 2003 Report, the long-range actuarial deficit of the OASDI program is estimated to be 1.92 percent of taxable payroll. This long-range deficit is 0.04 percent of payroll larger than it was in the 2002 Report. Changing the valuation period alone, by adding the high deficit year 2077 to the long-range period, increased the actuarial deficit by 0.07 percent of payroll. The fact that the actuarial deficit is only 0.04 percent of payroll larger for this report therefore indicates that, on balance, changes in assumptions, methods, and experience have slightly improved the financial outlook through 2076, offsetting about one third of the effect of adding the year 2077.

Assets of the OASI and DI Trust Funds are invested in special obligations of the United States Treasury. Their combined assets increased by $165 billion during 2002, reaching $1.378 trillion at the beginning of 2003 and representing 288 percent of estimated annual expenditures for the year. These values are virtually identical to the estimates for 2002 in last year's report. Both the OASI and DI programs meet the "short-range test of financial adequacy", because the trust funds are projected to maintain assets at levels in excess of one year's cost throughout the short-range (10-year) period.

Tax revenue exceeded the cost of the program by $85 billion in 2002. However, based on the intermediate assumptions of the 2003 Trustees Report, OASDI program cost is projected to begin growing faster than the program's tax income in 2009, and to exceed tax income beginning in 2018, one year later than projected in last year's report. The combined OASI and DI trust funds are projected to grow to nearly five times the annual cost of the program in 2016, and to decline thereafter, becoming exhausted in 2042, also one year later than in last year's report. At the point of trust fund exhaustion in 2042, continuing tax income is expected to be equal to 73 percent of the cost of the program. By the end of the 75-year period, tax income is projected to equal only 65 percent of the cost of the program.

As in last year's report, the OASI and DI programs, both separately and combined, do not meet the test of "long-range close actuarial balance". This means basically that the projected income and assets of the programs are less than 95 percent of the level needed to fully pay scheduled costs throughout the 75-year period.

Projected annual balances between tax income and the scheduled cost of the program for the next few years deteriorated somewhat from last year's projections as a result of downward revisions by the Bureau of Economic Analysis (Department of Commerce) in estimates of wages for 2001 and 2002. The negative effects of lower wage levels are offset after a few years by corresponding reductions in average benefit levels and by an increase in the delayed-retirement assumption associated with the increasing Normal Retirement Age. These factors, combined with higher immigration between 1990 and 2022, based on the 2000 Census and new assumptions, result in higher annual balances in this report than in the 2002 report from 2010 through 2040. The higher levels of immigration for 1990 through 2022 result in ad-

ditional beneficiaries which cause a reduction in the annual balances from about 2040 to 2075.

OASDI program cost is projected to rise from 10.9 percent of taxable payroll in 2003 to 19.9 percent of payroll in 2077. In 2077 the cost of the program is projected to exceed income by 6.5 percent of taxable payroll. This means that if payroll taxes were to be raised in 2077 to permit full payment of benefits scheduled for the year, an increase of more than 50 percent would be needed. Expressed as a percent of GDP, the cost of the OASDI program is projected to rise from 4.4 percent in 2003 to 7 percent for 2077, the same level as in last year's report for 2076.

New Measures in the 2003 Report

Several additional measures of OASDI unfunded obligations have been added to this year's Social Security Trustees Report. The open-group unfunded obligation of the program under the intermediate assumptions is estimated at $3.5 trillion, in discounted present value, for the 75-year period 2003 through 2077. This unfunded obligation is conceptually similar to the actuarial deficit for the 75-year period. It is important to remember that both of these measures indicate the magnitude of the financial shortfall for the next 75-years as a whole. The actuarial deficit of 1.92 percent of payroll expresses this 75-year shortfall relative to the tax base, or taxable payroll, for the program over the same 75-year period. The $3.5-trillion unfunded obligation expresses the 75-year shortfall as an aggregate value which must be addressed over the course of the next 75 years.

The 2003 Trustees Report also includes an estimate of $10.5 trillion, in present value, for the open-group unfunded obligation of the OASDI program for the infinite future period. The equivalent actuarial deficit for the infinite future is estimated at about 3.8 percent of taxable payroll. As with these measures for the 75-year period, the values reflect the projected shortfalls for the period as a whole, or the infinite future in this case. Thus, these values indicate that the shortfall for the infinite future represents about 3.8 percent of the taxable payroll for the infinite future, and that the $10.5 trillion present value unfunded obligation will need to be met over this infinite period.

It should be noted that like the actuarial deficit measure, these present-value measures of unfunded obligations will tend to increase from one Trustees Report to the next even if no changes in the data or assumptions are made. The increase is simply due to the changing valuation date. For example, the 75-year open-group unfunded obligation is increased from $3.3 trillion to $3.5 trillion based on this year's valuation, even though the updated assumptions and experience were, on balance, positive. However, to the extent that these measures of unfunded obligations grow faster than the Social Security taxable payroll, they represent a real increase in the cost of meeting shortfalls for future years, as these years get closer.

The 2003 Trustees Report also provides two "components" of the $10.5 trillion infinite future unfunded obligation. The first is the unfunded obligation the program would have if participation in the program were closed off to individuals under age 15 in 2003. The value for this "closed-group" unfunded obligation is estimated at $10.5 trillion. The second component is the net present value of scheduled taxes and cost for new entrants to the program for the infinite future. This value is zero, indicating that taxes for future generations could finance their benefits on a fully-advance-funded basis. These two values are important, for evaluating a program that is designed to be "fully advance funded".

However, it is important to recognize that the Social Security program is financed on a basically pay-as-you-go basis. Under a pay-as-you-go program the taxes of each generation are used to pay the benefits of prior generations and are not saved to pay for their own benefits. Thus, the fact that taxes for future generations are about equal to the present value of the cost of their own scheduled benefits is not relevant to the actuarial status of the program. Similarly, the closed-group unfunded obligation of the program is not relevant to the actuarial status of the program, because benefits of current program participants will be paid largely by the taxes of future generations, which are not reflected in this value.

Sustainable Solvency

The actuarial deficit and the unfunded obligation for a period indicate the financial status of the program for the period as a whole, and whether the program will be financially solvent at the end of the period. It is also important to consider whether solvency is achieved for the program at all times within the valuation period, and beyond. For this purpose we consider the level of the trust fund at each point in time, which if positive indicates that the program is solvent. If the program is solvent throughout the 75-year period, and the trust fund, expressed as a percent of annual program cost, is stable or rising at the end of the period, then solvency

can be expected to be sustained well beyond the end of the period. This year's report again shows that under current law, scheduled benefits are not sustainable in the long run with current tax rates.

Stochastic Projections and Uncertainty

Appendix E of the 2003 Trustees Report presents the results of a new, first generation model using stochastic modeling techniques. These results are an important addition to the sensitivity analysis and presentation of alternative scenarios in the report. We are pleased with the prospects of expanding our understanding of uncertainty through this model and look forward to further development. Availability of this model for inclusion in the 2003 report was only possible through extraordinary effort by Alice Wade, Deputy Chief Actuary for Long-Range Actuarial Estimates, the highly talented team she led in the effort, and consultation with other pioneers in this field, like the staff at CBO. However, we note that the results of this model should be viewed with care. More work is needed on this and similar models to bring them to the point where they will fully represent the range of uncertainty associated with the future cost of Social Security. However, even at this stage of development, these models confirm that outcomes as good or better than the Trustees' low-cost projection, or as bad or worse than the high-cost projections, are relatively unlikely in the long run.

Effects of Deferring Reform

Finally, Mr. Chairman, your staff requested that I present an analysis of the effect of deferring action for reforming Social Security on the size of benefit reductions and tax rate increases that would be needed. The table I have submitted titled "Immediate Benefit Reductions and Tax-Rate Increases that Would Eliminate Long-Range Social Security Actuarial Deficits" provides the effects of delaying the start of changes for the next several years.

The 2003 Trustees Report indicates that eliminating the 75-year actuarial deficit (for 2003 through 2077) could be achieved with an immediate 13-percent reduction in benefit levels for all recipients in 2003 and later. The report also indicates that an immediate reduction of about 23 percent (more precisely about 22.7 percent) could put the program in balance for the infinite future. If the start of such benefit reductions were delayed 7 years to the year 2010, the reductions needed to eliminate these deficits would increase to 14.5 percent and 24.3 percent, respectively.

We may also consider such hypothetical benefit reductions if they were only to be applied to individuals who become newly eligible in 2003, or some later year.

On this basis, a 15.1-percent reduction for all individuals newly eligible in 2003 and later could eliminate the 75-year actuarial deficit. A 25.1-percent reduction for those newly eligible in 2003 and later could eliminate the infinite-future deficit. However, if such reductions were delayed 7 years, to affect those newly eligible for benefits in 2010 and later, then the benefit reductions would need to be 17.6 percent and 27.6 percent, respectively.

Similarly, the payroll-tax-rate increases that could eliminate long-range deficits would increase if action were deferred. As indicated in the 2003 Trustees Report, an increase in the combined payroll tax rate of 1.92 percent of taxable earnings starting 2003 could eliminate the 75-year deficit, and an increase of about 3.8 percent (more precisely about 3.77 percent) could eliminate the infinite-future deficit. If the starting date were delayed 7 years to 2010, then the tax-rate increases needed would rise to 2.25 percent and 4.21 percent, respectively.

It is important to note that the total savings, or additional revenue, for the OASDI program is exactly the same in present value for each illustration that could eliminate the deficit for the 75-year period 2003 through 2077. The same is true for all illustrations that could eliminate the infinite-future deficit. Thus, the effect of delaying action so that there would be no change for the next few years is to require a larger change after the next few years. Whether the delayed change is larger or smaller for any individual depends on when he/she will stop working and become eligible for benefits.

I would be happy to answer any questions that you may have about the OASDI projections for this year.

Immediate Benefit Reductions and Tax-Rate Increases that Would Eliminate Long-Range Social Security Actuarial Deficits

	Percentage Reduction in OASDI Benefits		Increase in Payroll Tax Rate	
Year	Apply to all benefits payable in the year and later	Apply only to beneficiaries who become eligible in the year and later	Increase in combined payroll tax rate starting in the year	Percentage increase in payroll taxes paid starting in the year
	change required for 75-year balance 1/		*change required for 75-year balance 1/*	
2003	13.0%	15.1%	1.92	15.5%
2004	13.2%	15.6%	1.96	15.8%
2005	13.4%	15.9%	2.00	16.1%
2006	13.6%	16.2%	2.05	16.5%
2007	13.8%	16.5%	2.10	16.9%
2008	14.0%	16.9%	2.15	17.3%
2009	14.2%	17.3%	2.20	17.7%
2010	14.5%	17.6%	2.25	18.1%
	change required for infinite-future balance		*change required for infinite-future balance*	
2003	22.7%	25.1%	3.77	30.4%
2004	23.0%	25.7%	3.83	30.9%
2005	23.2%	26.0%	3.89	31.4%
2006	23.3%	26.2%	3.95	31.9%
2007	23.6%	26.6%	4.01	32.4%
2008	23.9%	26.9%	4.08	32.9%
2009	24.1%	27.2%	4.14	33.4%
2010	24.3%	27.6%	4.21	34.0%

1/ For the valuation period 2003 through 2077.

Source: Office of the Chief Actuary, Social Security Administration
Based on the intermediate assumptions of the 2003 OASDI Trustees Report
April 9, 2003

Current and Projected Status of the
Social Security Trust Funds Under Intermediate Assumptions
2003 Trustees Report

	Calendar year 2002	Calendar year 2001
	(billions)	
• Operations of the Combined OASI and DI Trust Funds		
• Assets at beginning of calendar year	$1,212.5	$1,049.4
Excess of tax income over cost	$85.0	$90.2
Interest income	$80.4	$72.9
• Assets at end of calendar year	$1,378.0	$1,212.5

	2003 Report	2002 Report
• Long-range summarized values over the next 75 years:		
• Actuarial balance (percentage of taxable payroll)	-1.92%	-1.87%
Income rate	13.78%	13.72%
Cost rate	15.70%	15.59%
• Open-group unfunded obligation	$3.5 trillion	3.3 trillion
• Long-range estimates over the next 75 year:		
• 75th year	2077	2076
• Cost rate in 75th year	19.92%	19.84%
• OASDI balance in 75th year	-6.50%	-6.42%
• Year of exhaustion		
OASI and DI, combined	2042	2041
OASI	2044	2043
DI	2028	2028
• Percentage of annual cost that can be met from annual tax income:		
In year of exhaustion	73%	73%
In 75th year	65%	66%
• First year in which cost exceeds tax income	2018	2017
• First year in which cost exceeds total income	2028	2027
• Maximum trust fund ratio	471%	471%
year reached	2016	2015
• Summarized values for the infinite future		
• Actuarial balance	3.8%	NA
• Open-group unfunded obligation	$10.5 trillion	NA

March 17, 2003

PREPARED STATEMENT OF HON. CHARLES E. GRASSLEY

The purpose of today's hearing is to review the latest report of the Social Security Board of Trustees. Our first and only witness is Mr. Stephen Goss, the Chief actuary of the Social Security Administration. I'm very pleased Mr. Goss could be here today. As anyone involved in the Social Security debate can tell you, Mr. Goss has an outstanding reputation. He is widely respected by members on both sides of the aisle for his experience and expertise. I look forward to his testimony. Although the Social Security Trustees Report was issued last month, I believe today's hearing is both timely and important. According to this year's report, annual benefits will exceed payroll taxes by 2018 and the trust fund will be depleted by 2042. As a result, Social Security will be unable to pay benefits in full, or on time, forever thereafter. Despite this looming financial crisis, Congress remains reluctant to enact meaning-

ful reform. I believe this political inertia is largely the result of fear—beneficiaries are afraid their benefits will be cut, workers are afraid their taxes will go up, and Congress is afraid of taking the blame. I would suggest that one of these fears is entirely unfounded. As far as I can tell, no one in elected office will ever again seriously propose to reduce benefits for current recipients. It's simply not going to happen. So, we can take that issue off the table.

Of course, there is a price to be paid for protecting those who are currently eligible. As we will learn from today's testimony, taking current benefits off the table means tougher choices for everyone else. But, that's a price we should be willing to pay. There is, however, another price we don't have to pay. That's the cost of delay. It's often said that the longer it takes to reform Social Security, the harder it gets. This expression may sound clichéd, but it is true, although not in the way most people think. As the trustees' report shows, the Social Security shortfall is $10.5 trillion. This number remains the same whether we enact reform this year, or next year, or any year thereafter. The only thing that changes from one year to the next is who must bear this burden. The longer it takes to enact reform, the greater the burden on younger workers.

Assuming Congress fully protects those who are currently eligible, eliminating the Social Security shortfall would require a 25 percent reduction in future benefits or a 30 percent increase in future payroll taxes. Every year we delay, these numbers go up roughly 1.5 percent for those who are not yet eligible to collect benefits. Despite this rising burden on the young, many people in Washington continue to question the political viability of Social Security reform. Members on both sides of the aisle are concerned the other party would rather have a political issue than a practical solution. So, the question we face today is how do we build a Social Security Trustees' Report clearly identifies the size and scope of the problem. The testimony we will hear today translates the problem into specific benefit reductions or tax increases. We may not li9ke these numbers, but we should at least be able to agree that these are the numbers we've been dealt. Let me be clear, accepting the validity of these numbers does not imply an endorsement of these specific tax or benefit changes. These changes are merely illustrative. We will have plenty of time at future hearings to consider all of our policy options. Reforming Social Security will require an open and honest discussion about some politically difficult choices. But, this discussion can occur only if we first agree on the size and scope of the problem. Today's hearing on the latest Social Security Trustees' Report is designed to get everyone on the same page. Hopefully, we can accomplish that goal. After all, if we can't agree on the problem, we will never agree on the solution.