Statement of Stanford G. Ross

Before Senate Committee on Finance

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Chairman Grassley, Senator Baucus, and Members of the Committee, I thank you for the opportunity to testify on achieving sustainable solvency in Social Security. This is an important subject and I commend the Committee for trying to pursue this goal at this time. I hope I can be helpful by presenting a viewpoint informed by many years of experience working within the system.

I am a former Commissioner of Social Security under President Jimmy Carter, Public Trustee of the Social Security and Medicare Trust Funds under Presidents George H.W. Bush and William Clinton, and Chairman of the Social Security Advisory Board under Presidents William Clinton and George W. Bush. I was confirmed to all these posts by the Senate after being approved by this Committee. I have been intimately involved with the Social Security system in these capacities for more than 25 years and have appeared before this Committee many times.

I care deeply about the Social Security system and believe that it is important to resolve the current financing issues in a way in which the system can maintain the broad public support it needs and restore confidence that its goals of providing reliable income replacement for the elderly, disabled and their dependents and survivors can be sustained.

Social Security Institutions

One of the most disturbing parts of the discussion of Social Security reform to date has been the undermining of confidence in institutional arrangements such as the integrity of the Trust Funds. I think it is important for the public to understand that the Treasury obligations held by the Social Security Trust Funds are backed by the full faith and credit of the United States like any other obligation of the Treasury. In fact, the bonds held by the Trust Funds receive a preferred rate of interest and are entirely equivalent in value and security to those held by the public.

The institutions surrounding Social Security have evolved over a long period. The independence of the actuaries, the annual reporting, and other governance arrangements such as an independent Social Security Advisory Board and the presence of independent public trustees, are all important protections for the public.

The rancor in the present discussion of Social Security is unprecedented. For nearly 70 years since its enactment, the Social Security system has been broadly supported by Republican presidents and administrations as well as Democratic presidents and administrations. Bipartisan approaches supporting Social Security were taken under Presidents Eisenhower, Nixon, Ford, Reagan and George H.W. Bush. The present

Administration is the first Administration that has suggested that the concepts underlying the system are inherently flawed. In fact, the concepts underlying the system are sound and the values they reflect of providing income protection for the elderly, the disabled, and their spouses and dependents on a universal, contributory basis are widely shared by Americans.

Moreover, the institutions that have evolved to implement these concepts work well. That is why we know the amount of deficits and what must be done to remedy them. The Congress has received early warning on an annual basis of the problems for many years and there is no reason to distrust the long-term viability of the system if the Congress takes appropriate and timely legislative action. Up until now, the Congress over 70 years has always done what was necessary to protect the American public's interests in a sound Social Security system, and there is no reason to doubt that it will do so once again.

Proceed on a Bipartisan Basis

To my mind, there is only one effective way to address Social Security solvency issues – develop a legislative package on a broadly bipartisan basis. This will inevitably involve compromise and a willingness to give respect and recognition to a variety of viewpoints. There is no better place for work on bipartisan approaches to begin than in this Committee with its tradition of cooperation and comity among members.

Agree on the Size of the Deficit

The first task is to reach a consensus, if possible, on the dimensions of the problem. The Social Security Actuaries' 75-year projection is of a deficit equal to 1.92% of payroll. The Congressional Budget Office's comparable figures on a 75-year projection are that there is a deficit of 1.05% of payroll. It would be helpful if these two projections could be reconciled and, if possible, there was a common projection or at least a clear explanation of the differences. Projections vary based on assumptions and methodologies and it is quite possible that there could be reasonable differences based on varying views on these matters. But clarification is needed as the process moves forward to help policymakers reach agreement on the size of the deficit.

While the SSA-CBO difference is relatively large, even accepting the Social Security Actuaries' projection, the problems of the Social Security system, while serious, can be addressed in a considered manner and do not, to my mind, present a crisis. We have solved problems of this dimension before. The deficit situation present in 1983 could be viewed as a more difficult challenge because of the imminence of the lack of funds to pay benefits. In the present situation, it will be several decades before a point of disruption in benefit payments is reached. Nonetheless, it would be better to address the financing issues sooner rather than later because the changes that are needed can be less drastic and the transitions for changes can be implemented in a more measured manner. Hopefully, this Congress, responding to the priority given to this issue by the President, will address the subject and resolve it on a basis that lasts for the indefinite future.

Before leaving this first issue of establishing the dimension of the problem, I should note that some in the Administration have suggested that the solvency problem should be resolved based on projections based on an infinite horizon. This would be a new departure since in the past the 75-year projections of the Social Security Actuaries have always been used. Importantly, it would appear to make the problem that must be addressed considerably larger and more difficult to resolve. The infinite horizon projection of SSA shows a deficit of about 3.6% of payroll. This projection, while perhaps useful for some purposes, is not to my mind useful from the standpoint of developing a legislative package. It is not the traditional approach of the Office of the Actuary and is not generally accepted by the actuarial profession for use in this context.

Since I think the important goal of the Congress ought to be to resolve the solvency issue of Social Security, I will approach the problem assuming there is to be no diversion of revenue from the traditional Social Security system to establish individual accounts. As discussed below, the individual account system suggested by the Administration would appear to worsen the deficit by about 0.6% of payroll and make achieving sustainable solvency considerably more difficult. I will also assume the target should be the 1.92% of payroll deficit based on the Social Security Actuaries 2005 Report, although the Committee may well decide a smaller figure is appropriate based on the CBO projections. I also assume the need to meet the SSA Actuaries' tests that sustainable solvency is indicated if the trust fund ratio is projected to be (1) positive throughout the 75-year projection period and (2) either stable or raising at the end of the 75-year period.

Construct a Balanced Package of Changes

Historically, a bipartisan approach in this type of situation has developed a balanced package of revenue enhancements and benefit adjustments. This is the approach that was taken by the Congress in 1983 when the most recent solvency legislation was enacted. It was also the approach taken in 1977 and, indeed, in 1972 when benefits were indexed for inflation and the attempt was made, unsuccessfully, to place the system on a basis that would be sustainable automatically for the indefinite future without the need for periodic legislation to adjust the system.

Some would say that a balanced package of incremental changes that would allow compromises on a bipartisan basis is mere "tinkering" with the system. I suggest, however, that this a misunderstanding of what is inevitably involved in changing a large system like Social Security. Every change affects many people over very long periods and relatively small, incremental changes that are well designed and carefully implemented are the best way to change a big system. This is true not only in the United States, but across countries. Large changes often produce unintended consequences and harsh results that can undermine public support. Therefore, based on the history of this system and its critical importance to all Americans, I would strongly recommend the same approach that has been taken in the past – a balanced package of incremental changes.

Possible Revenue Enhancements

On the revenue enhancement side, there is one obvious possibility for change. The 1983 changes were based on about 90% of earnings being covered by the system. In recent years, coverage has been reduced to about 83%. This is partly because of the greater dispersion of income in recent years in the United States, and partly because of the increasing amounts of non-cash income, such as in-kind benefits, but 90% is still a useful standard to reestablish for the system. According to the Social Security actuaries, restoring the maximum earnings base over a ten-year transition period would produce about 0.75% of payroll, roughly 40% of the projected deficit.

Another possible revenue enhancement would be to increase the administrative resources of IRS to close the part of the so-called annual tax gap of $350 billion attributable to Social Security taxes, perhaps $55 to $65 billion per year. While in the context of tax reform legislation, improved administration has generally not been scored as a revenue producing item, we should examine whether in the context of long-term Social Security projections that it might be treated as a revenue enhancement in the same way as adding non-cash benefits into the earnings base is credited.

Another possibility is to tax Social Security benefits in a manner similar to private pension income. The lower income thresholds would be phased out over a ten-year period. Such a change would produce about 0.33% of payroll. Because the income tax is structured to not tax lower income workers, they would not be affected. In this regard, it should be noted that when taxation of Social Security benefits was last changed, the increased funds were directed to the Medicare Trust Fund. However, it should be recognized that it would be more appropriate to have this money from taxing Social Security benefits recycled into the Social Security Trust Fund to be available for payment of Social Security benefits. Changes in the taxation of benefits would be controversial and might be hard to reach bipartisan agreement on, but as a matter of policy, taxation is a far better approach to reducing benefits for upper income earners than other suggestions that have been made such as progressive indexing, which lack a policy rationale, as discussed below.

Thus, there are a variety of possible changes that could provide revenue enhancements of about 0.96% of payroll, roughly one-half of the projected deficit.

Possible Benefit Adjustments

The second part of any bipartisan package will involve benefit adjustments. I use the word adjustments, rather than benefit cuts, in this context advisedly. I think any changes in the structure of benefits ought to be done in a way that makes them more efficient and improves fairness.

From this standpoint, I would not make major changes to indexing. The indexing system that has been arrived at historically, which is basically wage indexing up to the time of setting the initial benefit and price indexing thereafter, is sound. This system evolved after much study. The reason for wage indexing of initial benefits is to make

sure the benefit is in line with economic conditions at the time that a person moves from worker status to retired status. The reason for price indexing of benefits after someone is in retirement is that the purchasing power of their benefits should be kept up to date.

It would be particularly inappropriate to change the indexing in calculating the initial benefit from wages to prices. This would deprive workers of improvements in the economy over the period of their working lives. So-called "progressive indexing" would be even worse because it would discriminate among various workers and result in long-term distortions in the structure of benefits. Thus, too many middle and upper income workers would ultimately receive a flat benefit and the universality of the program would be lost. It would be far better if there were to be an attempt to introduce more progressivity into the system to tax more of the benefits in the same manner as with private pensions, as discussed above.

There may be ways to improve the accuracy of Social Security cost of living adjustments. There is a new CPI that takes additional account of consumer behavior and is viewed by many as a superior measure of purchasing power. Although it would be controversial since there are other viewpoints, this change would reduce the deficit by 0.35% of payroll and would be entirely in accord with the income replacement goals of the program.

Another possibility for adjusting the benefit structure would be to change the formulas for calculating initial benefits. Thus, the number of years used to calculate benefits could be increased from 35, the present number, to 38 or 40 and phased in over an appropriate period of five to eight years. These kinds of changes would save from 0.26% to 0.42% of payroll and would be entirely in accord with the goals of existing formulas to produce an appropriate replacement for earnings over the entire working life. In this regard, a credit for years spent outside the paid workforce doing childcare would be in order. Further changes in the benefit structure to reduce the bend points and replacement factors are also possible but hopefully would not be needed to achieve solvency.

One change in the benefit structure that would not be in order at this time would be a major change in the retirement age, which was raised from 65 to 67 in 1983 with a protracted phase-in. Until the labor markets adapt to show that older workers will be able to work longer, further changes in the retirement age are simply a way to cut benefits. The benefits cut would likely affect the more vulnerable, those less able to work in older age. As discussed above, there are better ways to adjust benefits. However, eliminating the existing hiatus in the normal retirement age by speeding up the transition to the increase to age 67 which was enacted in 1983 would be in order and could save approximately 0.14% of payroll.

It could be that further increases in the retirement age would be necessary and appropriate in the longer run to maintain solvency. The actuarial test for solvency requires stable or rising trust fund rates at the end of the 75-year projection period. People are living longer and the system may need to be adapted to those circumstances in the future.

When approaching the benefit adjustments, the present structure of spousal benefits should be reviewed and appropriate changes should be made. At present, spouses get an automatic 50% of the higher earner's benefit. This can be seen as discriminatory vis a vis working spouses and lower income spouses. While benefits can be viewed on a family basis, something like earnings sharing or other methods of dividing benefits could be developed to achieve greater fairness.

Another change that would increase costs but would be desirable would be to develop a minimum benefit that protects low-income workers. A worker with a full lifetime of work should receive a benefit that provides sufficient income to avoid poverty.

It would also be helpful if service delivery issues at the Social Security Administration, particularly with the disability program, could be more forcefully addressed. At present, there are often long waiting lines at Social Security offices and inadequate telephone service. Processing of disability claims can take years. The independent Social Security Advisory Board, while I was Chairman, documented the presence of these issues and they need to be corrected as promptly as possible. The public deserves better service. Thus, more resources should be furnished to SSA to improve benefit delivery structures as part of the implementation of the legislative package that is constructed.

To summarize, once a figure is reached for remedying the deficit, a package of incremental changes involving revenue enhancements and benefit adjustments should be constructed that increases the efficiency and fairness of the system. An illustrative legislative package is attached to this statement.

Individual Accounts

If individual accounts were set up on a carve-out basis that would divert revenues from the traditional Social Security system, and would make the deficit in Social Security finances more difficult to solve. Although a complete actuarial analysis has not yet been provided, the plan for individual accounts suggested by the Administration would appear to increase the deficit by a considerable amount, around 0.6% of payroll. It would also greatly increase public debt, around five trillion dollars over the first twenty years. And it would make fundamental social security benefits inordinately subject to market risk.

If at the point that a solvency package is achieved, the Congress were to decide to introduce an individual account system into the legislative package, it could be done on a fully financed and fiscally sound add-on basis. The best approach here could be along the lines that the late Senator Moynihan, a former Chairman of this Committee, once suggested, which would be simple 2% add-on accounts, 1% contributed on a voluntary or mandatory basis by the worker with a matching 1% by the government, with subsidization of lower income workers. Of course, if there was a general budget surplus, this approach would be more feasible than at a time when large deficits are being run and there are no government funds available for a matching contribution to provide workers with an incentive to enter the new system.

An additional set of considerations that has largely been absent from the debate to date about Social Security individual accounts involves administrative issues and implementation of any changes. Countries that have introduced an individual account system have usually needed to change and adjust it very rapidly. Just as this country had difficulty when it introduced the indexing of benefits in 1972 and correcting it required the Congress to return to the subject fairly promptly because of the inadequacies of the first approach, this need to revise is almost inevitable with a complicated subject like individual accounts. Some countries have done it so badly, such as the United Kingdom, that they have both damaged their fundamental income replacement protection and, after several attempts at reform, not produced an individual account system that adequately makes up for the erosion of the basic coverage of their state pension system. Even a small country such as Sweden, which took a great deal of time and introduced the system on a nonpartisan basis, in the sense that all political parties agreed to the changes, had difficulty with various aspects of implementation.

Given the general fund deficits and the difficulties that would inevitably be involved in implementation of a new system, it might be better for the time being to improve the treatment of 401(k)'s and IRA's as a way of encouraging additional savings for retirement. Thus, automatic 401(k) accounts, which would reduce some of the complexity for individuals to participate might well increase private savings. Similarly, there could be improvements in the structure of IRA's to make them more useful. While none of this is necessary to include with a Social Security reform package that is designed solely to return long-term sustainable solvency to the system, it would be a useful addition if it were fully financed, for example, by being part of a fiscally balanced set of tax changes.

Conclusion

I strongly urge embracing a broadly bipartisan approach to construct a legislative package of incremental changes to restore financial solvency. If, in the current political environment, it is difficult for the Congress to achieve this directly, it might consider appointing a commission along the lines of the 1983 Social Security Commission, which included Members of Congress, or the recent 9/11 Commission. The President's Commission to Strengthen Social Security was constrained by its mandate to make recommendations that included, among other guidelines, individual accounts, and its membership reflected a limited number of viewpoints. In contrast, a broadly bipartisan commission with a clear mandate to achieve sustainable solvency and a membership that was reflective of a broad spectrum of viewpoints could usefully produce an agreed set of facts and recommendations for the Congress to consider. If such a commission were set up in the near future, it could be given a year to report and then the Congress would have a basis for legislation next summer. If the Congress were unable to reach agreement on the basis of such a broadly bipartisan report, the elections in the fall of 2006 could provide a public referendum on the issues addressed.

I will be happy to help the Committee and its members in any way I can and, once again, I thank you for the opportunity to be here today.

Illustrative Legislative Package to
Eliminate SSA Deficit Projection of 1.92%*

Possible revenue enhancements

Restore covered earnings to 90%	0.75
Tax social security benefits in a manner similar to private pensions; or enhanced collection of payroll taxes	0.21
	0.96

Possible benefit adjustments

Make CPI formula more accurate	0.35
Increase number of years to calculate benefits from 35 to 40	0.42
Eliminate hiatus in reaching normal retirement age of 67 and increase retirement age in future as necessary	0.14
Revamp spousal benefits, add minimum benefit, and other changes in benefit formulas	0.05
	0.96

* If the targeted deficit is 1.05% (CBO), fewer of the changes listed above would be needed. It is important to note that calculating the effects of possible changes are complex and are only an approximation until an actual package is prepared. These calculations are for illustrative purposes and based on the 2004 SSA Trust Fund Reports and a February 7, 2005 memorandum of the SSA Office of the Actuaries that scores possible individual changes without taking into account their interactions.

Stanford G. Ross is a lawyer/consultant based in Washington, D.C. He has served (1997-2002) as Chairman of the Social Security Advisory Board, an independent bipartisan agency of the U.S. government that advises the President, the Congress, and the Social Security Administration on pension and income protection issues. He has previously served as Commissioner of Social Security (1978-79), and as Public Trustee of the Social Security and Medicare Trust Funds (1990-95). He has dealt extensively with public policy issues while serving in the U.S. Treasury Department, on the White House domestic policy staff, and as General Counsel of the Department of Transportation.

Mr. Ross has provided technical assistance on social security and tax issues under the auspices of the International Monetary Fund, World Bank and U.S. Treasury Department to various foreign countries. He has taught courses on social security and taxation under the auspices of the OECD for officials from Central and Eastern European countries. He has participated in programs on social protection systems for developing countries sponsored by the International Social Security Association and APEC/Asian Development Bank.

Mr. Ross is co-author of a recent IMF Working Paper (December 2004) entitled: "Integrating a Unified Revenue Administration for Tax and Social Contribution Collections: Experiences of Central and Eastern European Countries." He is the author of "Doctrine and practice in social security pension reforms," in International Social Security Review, Vol. 53, No. 2 (2000) and "Political and social aspects of international tax policy in the new millennium," in Brooklyn Journal of International Law, Vol. XXVI, No. 4 (2001).

Mr. Ross is an Honorary Advisor and Founding Member, and a former Director and President, of the National Academy of Social Insurance.

Mr. Ross has taught at the law schools of Georgetown University, Harvard University, New York University, and the University of Virginia, and has been a Visiting Fellow at the Hoover Institution, Stanford University. He has served as Chairman of American Bar Association Tax Section committees and on the Advisory Committee for the federal income tax laws of the American Law Institute. He received his J.D. from Harvard Law School and his B.A. from Washington University (St. Louis).