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THE FUTURE OF SOCIAL SECURITY

HEARING

BEFORE THE

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

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FIRST SESSION

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THE FUTURE OF SOCIAL SECURITY

WEDNESDAY, MARCH 9, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 10:45 a.m., in room 1100 Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
March 09, 2005
FC–4

CONTACT: (202) 225–1721

Thomas Announces Hearing on the Future of Social Security

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on the future of Social Security. **The hearing will take place on Wednesday, March 9, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:30 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include U.S. Comptroller General David M. Walker, and Social Security Trustees Thomas R. Saving and John L. Palmer. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Social Security Trustees reported in their 2004 report that while Social Security is currently running an annual surplus, Social Security's annual costs are projected to exceed its tax income starting in 2018, and the program is expected to become "insolvent (i.e., unable to pay scheduled benefits in full on a timely basis)" when the trust funds' balances are exhausted in 2042. According to the Trustees, Social Security's cash flow deficits and the subsequent depletion of the trust funds are expected to have important economic and public policy implications, as within a little more than a decade, the government must increase taxes, reduce other spending, or borrow to raise cash to honor obligations to the trust funds and pay promised benefits.

In announcing the hearing, Chairman Thomas said, "We stand at a critical crossroads in shaping the retirement security of all Americans, especially since the Baby Boomers begin retiring just three short years from now. To ensure Social Security meets its promise to all, President Bush has challenged Congress to update the program to offer greater prosperity to future generations. As we discuss how to meet the needs of an aging society, we will examine Social Security's financial challenges and also consider ways to protect pensions, enhance personal savings and improve long term care options."

FOCUS OF THE HEARING:

The hearing will focus on Social Security's financial outlook, why Social Security faces problems, and the importance of acting soon to restore the program's solvency in the context of the Federal budget, the economy, and the impact on today's workers and future beneficiaries.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Se-

lect the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record.*" Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You **MUST REPLY** to the email and **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Wednesday, March 23, 2005. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman THOMAS. I want to welcome you all. I am pleased today's panelists, the U.S. government Accountability Office Comptroller General David Walker and two Public Trustees of the Social Security and Medicare Trust Fund, Mr. John Palmer and Thomas Saving, will be at this first hearing on the future of Social Security. This is the Committee that is responsible for dealing with a trust fund, normally referred to as Social Security, and in reviewing the history, I realized that the last time that the Committee handled this with any degree of specificity was 1983. On the Committee on Ways and Means panel in the 98th Congress were three Members who are still on the Committee today, to my left, the gentleman from New York, Mr. Rangel, and to his left, the gentleman from California, Mr. Stark, and the Chairman. Of the three, one of us were on the Subcommittee on Social Security, which in great detail examined options. That Subcommittee on Social Security was

chaired by J.J. "Jake" Pickle of Texas. Jake Pickle had been a driver for Lyndon Baines Johnson and eventually succeeded Lyndon Baines Johnson in the House of Representatives in Lyndon Baines Johnson's old district. The other primary Democrat who had been involved in structuring the debate on the floor of the House was Senator Claude Pepper, who was a Member of the House of Representatives but had served in a long and distinguished career in the U.S. Senate and was a U.S. Senator in 1936.

The point I am clearly making is that this very important fundamental safety net program, not having been reviewed for more than 20 years, is being looked at by a Committee that has not had significant experience in legislating in the area. It seems to me that when you have that kind of a time gap, what you ought to do is to pretty much begin at the beginning, as they say, and talk about what the program is, what the program looked like, what the program looks like, and what the program will look like. Clearly, the current program, because the American population has changed, is not sustainable based upon the old method of financing. President Bush is clearly committed to strengthening Social Security and has agreed to expend significant time and energy with the American people so that there will be a receptive audience when this Committee examines options to change the system. I do want to remind Members as we move forward that retirement security in an aging society does not depend on Social Security alone. Personal savings, pensions, health care, especially long-term and chronic care, each play an essential role in helping seniors meet their needs.

The President's leadership, however, has given us a unique opportunity to assess government institutions that worked and will not work in the near future, and it has given this Committee an opportunity to examine a number of other issues that probably would not be able to be examined in the manner the Chair hopes that we examine them if the President hadn't gone out front on Social Security issues. The Nation's population or the demographic patterns have changed. Labor force, economy, length of employment at particular locations, family structures have all changed over the last five decades and have continued to change over the last two. This reexamination of the government's commitment to an aging society and seniors is essential and the government faces unprecedented challenges in meeting the needs of this new and different society. The Chair looks forward to working with all Members as they present ideas to help us with this daunting task, and the Chair recognizes the gentleman from New York, Mr. Rangel, for any opening statement he may wish to make.

Mr. RANGEL. Thank you, Mr. Chairman. I know the Chairman will agree with me that tackling this very complex legislative and social problem demands and screams out for bipartisanship. It doesn't really make any difference about the sincerity of each side when you are about to pay out more than you are taking in. In order to resolve this problem, you are going to have to cause some political pain. The only way you can ease that pain and accomplish your goal is to get people that worked together in the past working together so the American people will know that it may have been

a difficult political task, but together, in a bipartisan way, we can resolve it.

If, Mr. Walker, you are able to testify in a way that you have done your job in an objective and partisan way, then we will then ask you the question as to why is privatization and the private accounts placed on the table if, in fact, it has little or no relationship to deal with the real problem that we face, and that is solvency. We cannot use these words about crises and bankruptcies and polarizing the young against the old and saying the system will not be there when you know if we do nothing, the system would be there, but it would be the fiscal irresponsible thing to do nothing.

There are two ways to handle this, to come to the table, take off the one thing that doesn't deal with solvency, take it off the table so we can work, or to go around the country to political groups, 60 cities in 60 days, tightening up and separating our ability to work together. I know you don't deal with the politics of it, but I do hope that you can help us to overcome this hurdle we are having since private accounts will not be on the table if you are looking for bipartisanship. I would like, Mr. Chairman, to yield to Mr. Levin, who is the Ranking Member of the Social Security Committee.

Mr. LEVIN. Thank you, Mr. Rangel. The topic, as we know, for today's hearing is "The Future of Social Security." Recently, I had the opportunity to talk with hundreds of my constituents who came to townhall meetings because they felt so strongly about what Social Security has meant to them and their families. For seniors especially, but also disabled workers, widows, and children, Social Security has meant independence to live their own lives. The more they learned about President Bush's Social Security privatization proposals, the more worried they became about the future of Social Security. Private accounts do not address Social Security shortfall. In fact, they would actually make it significantly worse by diverting nearly $5 trillion from the trust fund over the first 20 years of private accounts. If President's private accounts proposal were enacted, Social Security would experience a shortfall 11 years sooner, in 2031.

Social Security's challenges are made more difficult by the fiscally irresponsible policies of the past 4 years, which have turned a $5.6 trillion projected surplus into a nearly $3 trillion projected deficit. This year, the President's budget, like previous ones, proposes to borrow every penny of Social Security's surplus, $169 billion, to pay for other proposals in the budget. Democrats stand ready to address Social Security's long-term challenges and safeguard it for future generations, just as we have in the past. We cannot accept the notion that you safeguard Social Security by undermining it. In recent days, the President has taken to trying to describe his proposal as adding on to Social Security. Addition is the opposite of subtraction. We have before us today three witnesses that have a duty to provide factual, unbiased information about the solvency of Social Security. I hope and trust that all three of them will take that responsibility seriously and will particularly focus on answering two major questions. One, do private accounts that divert money from Social Security address the solvency issue? Two, how do the overall fiscal policies of this govern-

ment affect our ability to meet our obligations to Social Security? Thank you.

Chairman THOMAS. I thank the gentleman. It has been a pleasure——

Mr. MCDERMOTT. Mr. Chairman? Point of information.

Chairman THOMAS. Any additional Members who have written statements can be made a part of the record.

Mr. MCDERMOTT. I just want to ask a question about the new equipment I see here. Where is it run from, who runs it, and what do we expect to see on it, and how is it going to be used so we understand what is going out on the television?

Chairman THOMAS. The Chair's assumption is that any of the witnesses who wish to augment their written testimony, which will be made a part of the record, with visual charts or other information generated either by the General Accounting Office or the Social Security Actuaries will, in fact, do that——

Mr. MCDERMOTT. Will it be shown——

Chairman THOMAS. —in the enhancement of their presentation. Is the Chair's assumption correct?

Mr. WALKER. It is, Mr. Chairman.

Mr. MCDERMOTT. Will the same thing be shown on that screen at the far that is sort of at a tough angle for us as the one that is here? Are those two going to show the same thing?

Chairman THOMAS. When I was growing up, they used to have drive-ins in which they had a different theater at each end, and depending on the way you parked, you could watch each particular movie.

[Laughter.]

My assumption here is that it will be the same show on each screen, and although that is a bigger one down there, the Chair believes this is a higher-resolution quality one for the Members.

Mr. MCDERMOTT. That is the one for television and this is the one for us?

Chairman THOMAS. These are actually both, but it is an assistance to the audience since we got some comments the last time that the angle of this particular screen did not allow the audience full participation in the hearing. We are trying to accommodate that. The Chair is resisting, as you have seen in some other Committee rooms, hanging televisions from various portions of the room.

Mr. MCDERMOTT. Is the system——

Chairman THOMAS. The colonial revival architecture does not lend itself well to plasma TV screens.

[Laughter.]

Mr. MCDERMOTT. May I ask one further question? You said last time that perhaps some day soon the minority might be able to use the PowerPoint operation and slip a disk in and show some things if we wish?

Chairman THOMAS. The Chair is more than willing to allow everyone who wants to make a visual point to make a visual point. This is the second time the gentleman has brought it up in a full Committee hearing meeting. If he really wants to talk about it, he ought to engage the Chair when we can come in and talk about how the machinery works so that he can actually have an oppor-

tunity to do it rather than to bring it up as a discussion issue every time we have a full Committee meeting. The Chair looks forward to the gentleman contacting the Chairman so we can do a walk-through.

Mr. MCDERMOTT. I will do that. Thank you.

Mr. RANGEL. I will tell you how to reach him.

[Laughter.]

Chairman THOMAS. Thank you, Mr. Walker, who is the seventh Comptroller General of the United States. He began his 15-year career when he took his oath of office on November 9, 1998, sworn in under President Clinton. As Comptroller General, Mr. Walker is the Nation's chief accountability officer and head of the U.S. government Accountability Office, and I think he is one of the three very appropriate people that we would have before this Committee to discuss what we look like and what we are going to be looking like. Mr. Walker, as I said, any written testimony you have will be made a part of the record. We will incorporate any visual presentation that you make, as well, and you can address the Committee in any way you see fit.

STATEMENT OF THE HONORABLE DAVID M. WALKER, COMPTROLLER GENERAL, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. WALKER. Thank you, Mr. Chairman, Ranking Member Rangel, all Members of the full Ways and Means Committee. It is a pleasure and a privilege to be back before you to talk about the important topic of Social Security. As you know, Mr. Chairman, in addition to my current capacity, I also served as a Public Trustee of Social Security from 1990 to 1995, as well as Medicare, so I have been involved in this issue for many years. If I can, I am going to use a PowerPoint presentation to help, but we won't go to it immediately. Almost all of the material that will be shown here is in the statement. I will provide all of it for the record. There is only one show, for the record, so we won't be showing two different ones here. In summary, at the outset, Mr. Chairman, Social Security does not face an immediate crisis, but it does have a large and growing financing problem and it would be prudent to address it sooner rather than later.

There are two broader contexts where I believe it is important for the Congress to keep in mind in connection with any related Social Security reform effort. First, Social Security, its financial challenge, is a subset of our Nation's financial and fiscal challenge. Social Security has an estimated unfunded commitment in current dollar terms for the next 75 years of $3.7 trillion, in current dollar terms. That compares with a roughly $43 trillion problem for our country. Secondly, Social Security reform should also be considered in the context of trends and challenges facing the private pension system as well as our personal savings rate, because as you pointed out properly, Mr. Chairman, Social Security is intended to be the foundation of retirement income security, but it is intended to be supplemented by private pensions and personal savings. With regard to private pensions, we have a stagnant private pension coverage rate—we have had for a number of years—and the private pension system is moving to the defined contribution world. Sec-

ondly, we have the lowest personal savings rate of any major industrialized nation on Earth. So, in effect, we have three deficits, a Federal budget deficit, a balance of trade deficit, and a savings deficit, and all are problems that have to be addressed. With regard to Social Security, the first slide, please. This represents the cash flows for Social Security and Medicare, and I will give you the key dates. Social Security is expected to run a negative cash flow starting in 2018. That means in that year, there is not enough money going to be coming in to pay benefits and expenses and what will have to happen is we will have to start cashing in some of these bonds that have accumulated over time. To cash in these bonds, you will either have to increase taxes, cut other spending, or increase the debt held by the public.

In reality, 2008 is a sooner date that you need to be concerned with because in 2008, the surplus in Social Security will start to decline, and since Congress has for a number of years spent every dime of the surplus on other operating expenses, that means it will increasingly put additional pressure on the balance of the Federal budget starting in 2008. I might note that 2008 is the date that the first baby boomer is eligible for early retirement, and so the problem will become worse and accelerate over time. I also note for you here, just to give you a sense not just of Social Security but Medicare, and you can see it has problems, too, but I realize that this is not the purpose of this hearing. To put it into perspective, Social Security's problem is $3.7 trillion in current dollar terms. Medicare is $27.8 trillion in current dollar terms. Next one, please. The key dates, 2008, the Social Security surplus begins to decline. Two thousand eighteen, negative cash flow. Two thousand twenty-eight has a negative income, but frankly, that is not of significance because it is really just paper, adding interest on paper. There is no cash there. There is no economic value. Two thousand forty-two is the date that the Trustees estimate by their best estimate, intermediate assumptions, that the trust fund will become exhausted. In 2042, if their estimate is correct, then benefits will have to be cut precipitously and dramatically across the board by 27 percent and they will have to be cut gradually more as time moves on. The CBO has an alternative date based on different assumptions. The bottom line is, we have got a large and growing problem that it would be prudent to act sooner rather than later. Next, please.

If you look at the numbers over 75 years or the infinite horizon, I have mentioned the $3.7 trillion being the discounted present value dollar number term. That is how much money you would have to have today invested at Treasury rates to close the gap between projected revenues and projected expenditures over the next 75 years. If you wanted to do it in perpetuity, you would have to have $10.4 trillion, and the reason being is because every year we drop off a positive year—for example, last year, we had a $151 billion surplus. Every year we drop off a positive year until 2018 and we add an increasingly negative year because of known demographic trends, primarily. Next, please. It would be prudent to act sooner rather than later for a number of reasons, which I am happy to get into in the Q&A session, but one of the reasons is because time is working against us. The sooner you act, the less dra-

matic the changes have to be made, whether it is on the benefit side, the income side, or a combination thereof.

This chart demonstrates the percentage increase that would have to be made to either benefits, which is the blue or left-hand side of the bar, versus the tax side, or the revenue side, which is the red, right-hand side of the bar, if you were to try to solve the problem totally on the benefits side or totally on the revenue side as of 2004, 2018, or 2042. You can see with delay, the degree of change that is necessary becomes more dramatic. Yet importantly, at the end of the 75-year period, you still have a huge problem, and so I would encourage you not just to look for a solution for 75 years but also to try to look for a solution that at the end of the 75-year period, your position, such that hopefully you can maintain solvency for the long term rather than pre-programmed to have to come back, which was the case in 1983. Next, please. The GAO has done a tremendous amount of work on Social Security reform. We have analyzed various proposals already. I expect we will be asked to analyze others. The three major elements in which we have analyzed them on is how do they do in financing sustainable solvency? How do they do in balancing adequacy and equity? What are the implementation and administrative challenges?

Importantly, under financing sustainable solvency, one of the sub-elements is what do they do to improve our savings rate, either with regard to the government and/or individuals and then in the aggregate? Savings is critically important and we have a serious problem there. Next, please. The last two slides. It is important to understand where the budget has come from and where it is heading. Forty years ago, almost—about 43 percent of the Federal budget was for defense. It is down to 19. Where did the money go? Social Security, Medicare, and Medicaid, almost dollar for dollar. You will note 40 years ago we didn't have Medicare and Medicaid. It came into existence in 1965, and it is growing a lot faster. Secondly, looking forward——

Mr. MCDERMOTT. Mr. Chairman, did you skip slide number seven that you had in the packet, the one that says——

Mr. WALKER. It is next. It is next, Mr. McDermott.

Mr. MCDERMOTT. Oh, that is next?

Mr. WALKER. I apologize. I changed the order.

Mr. MCDERMOTT. Okay.

Mr. WALKER. I apologize for that. It is coming next.

Mr. MCDERMOTT. Thank you.

Mr. WALKER. I think you are talking about the disembodiment chart, is what I call it, which is the—yes, that is it. Next, please.

Chairman THOMAS. The gentleman will continue with his testimony.

Mr. WALKER. Next, please. This shows what our potential fiscal future is. We have got two scenarios included in your testimony. This is the more serious or adverse of the two. This cannot be allowed to happen. Frankly, the first one is not acceptable, either. Under this scenario, we could be doing nothing more than paying interest on Federal debt in 2040 if we don't end up engaging in some fundamental reforms of entitlement programs, mandatory spending, discretionary spending, and tax policy, all three. All three need to be on the table. We have issued this report, gen-

tleman and ladies, which I would respectfully suggest that if you have not read, it is critically important for our country, our children and grandchildren that you do read. It was issued within the last two weeks. It is on our website, www.gao.gov. It is entitled, "21st Century Challenges: Reexamining the Base of the government."

Basically, Mr. Chairman, as you know, and other Members, a significant majority of the Federal Government, both on the spending side and the tax side, is based upon conditions that existed in this country in the 1950s and sixties and has not been subject to fundamental review and reexamination for 21st century realities. It is time that we do that, and we look forward to working with you and other Committees to be able to do that in a professional, objective, fact-based, nonpartisan, and non-ideological manner. Thank you, Mr. Chairman.

[The prepared statement of Mr. Walker follows:]

Statement of The Honorable David M. Walker, Comptroller General, U.S. Government Accountability Office

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the underlying structural problems and long-term challenges facing the Social Security program.[1] Before addressing these matters specifically, I would like to place these challenges in the context of the larger challenges facing the federal government today, which we discuss in our recently issued 21st Century Challenges report.[2] There is a need to bring the federal government and its programs into line with 21st century realities. This challenge has many related pieces: addressing our nation's large and growing long-term fiscal gap; deciding on the appropriate role and size of the federal government—and how to finance that government—and bringing the panoply of federal activities into line with today's world. Continuing on our current unsustainable fiscal path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security. We therefore must fundamentally reexamine major spending and tax policies and priorities in an effort to recapture our fiscal flexibility and ensure that our programs and priorities respond to emerging security, social, economic, and environmental changes and challenges.

Social Security represents the foundation of retirement income for millions of Americans and has helped to prevent many former workers and their families from living their retirement years in poverty. It provides millions of Americans with disability insurance and survivors' benefits, thus, providing benefits that are critical to the current and future well-being of tens of millions of Americans. Fixing Social Security is about more than finances. It is also about maintaining an adequate safety net for American workers against loss of income from retirement, disability, or death.

As I have said in congressional testimonies over the past several years, the Social Security system faces serious solvency and sustainability challenges in the longer term.[3] While the Social Security program does not face an immediate crisis, it does have a $3.7 trillion gap between promised and funded benefits in current dollar terms over the next 75 years. This gap is growing as time passes and, given this and other major fiscal challenges, including expected growth in federal health spending, it would be prudent to act sooner rather than later to reform the Social Security program. Failure to take steps to address our large and structural long-range fiscal imbalance, which is driven in large part by projected increases in Medicare, Medicaid, and Social Security spending, will ultimately have significant ad-

[1] In this statement, Social Security refers to the Old-Age and Survivors Insurance and Disability Insurance (OASDI) program.

[2] GAO, 21st Century Challenges: Reexamining the Base of the Federal Government, GAO–05–325SP (Washington, D.C.: February 2005).

[3] GAO, Budget Issues: Long-Term Fiscal Challenges, GAO–02–467T (Washington, D.C.: Feb. 27, 2002); Social Security: Long-Term Financing Shortfall Drives Need for Reform, GAO–02–845T (Washington, D.C.: June 19, 2002); Social Security: Long-Term Challenges Warrant Early Action, GAO–05–303T (Washington, D.C.: Feb. 3, 2005); and Long-Term Fiscal Issues: The Need for Social Security Reform, GAO–05–318T (Washington, D.C.: Feb. 9, 2005).

verse consequences for our future economy and the quality of life of our children, grandchildren, and future generations of Americans.

Let me begin by highlighting a number of important points concerning the Social Security challenge and our broader fiscal and economic challenge.

- **Solving Social Security's long-term financing problem is more important and complex than simply making the numbers add up.** Social Security is an important and successful social insurance program that affects virtually every American family. It currently pays benefits to more than 47 million people, including retired workers, disabled workers, the spouses and children of retired and disabled workers, and the survivors of deceased workers. The number of individuals receiving benefits is expected to grow to almost 69 million by 2020. The program has been highly effective at helping to reduce the incidence of poverty among the elderly, and the disability and survivor benefits have been critical to the financial well-being of millions of others.
- **Focusing on trust fund solvency alone is not sufficient.** We need to put the program on a path toward sustainable solvency. Trust fund solvency is an important concept, but focusing on trust fund solvency alone can lead to a false sense of security about the overall financial condition of the Social Security program. After all, the Social Security Trust Fund is a subaccount of the federal government rather than a private trust fund. Its assets are not readily marketable nor are they convertible into cash other than through raising revenues, cutting other government expenses, increasing debt held by the public, or some combination of these. Furthermore, the size of the trust fund does not tell us whether the program is sustainable—that is, whether the government will have the capacity to pay future claims or what else will have to be squeezed to pay those claims. Aiming for sustainable solvency would increase the chance that future policymakers would not have to face these difficult questions on a recurring basis. Estimates of what it would take to achieve 75-year trust fund solvency understate the extent of the problem because the program's financial imbalance gets worse in the 76th and subsequent years.
- **Social Security reform is part of a broader fiscal and economic challenge.** If you look ahead in the federal budget, Social Security together with the rapidly growing health programs (Medicare and Medicaid) dominate the federal government's future fiscal outlook. While this hearing is not about the complexities of Medicare, it is important to note that Medicare presents a much greater, more complex, and more urgent fiscal challenge than Social Security. Medicare growth rates reflect not only a burgeoning beneficiary population, but also the escalation of health care costs at rates well exceeding general rates of inflation. Federal and state spending for Medicaid will especially be stressed by anticipated growing demand for long-term care services by the aging baby boom population. Taken together, Social Security, Medicare, and Medicaid represent an unsustainable burden on future generations. Under the 2004 Trustees' intermediate estimates and the Congressional Budget Office's (CBO) long-term Medicaid estimates, spending for Social Security, Medicare, and Medicaid combined will grow from 8.5 percent of GDP today to 15.6 percent in 2030. Absent meaningful changes to these programs, the nation will ultimately have to choose among persistent, escalating federal deficits, huge tax increases, and/or dramatic budget cuts. Furthermore, any changes to Social Security should be considered in the context of the problems currently facing our nation's private pension system. These include the chronically low levels of pension coverage of the private sector workforce, the continued decline in the number of defined benefit plans coupled with the termination of large underfunded plans by bankrupt firms, and the shift by employers to defined contribution plans, where workers face the potential for greater return but also assume greater financial risk. Similarly, the growing demand for long-term care will also likely exacerbate current concerns regarding the provision and financing of these services. These include the potential for families to face the financially catastrophic costs of long-term care. In addition, the heavy reliance on unpaid care from family members and other informal caregivers already has led, in many cases, to severe personal burdens. This strain will likely be exacerbated, with possibly fewer caregivers available in the coming decades.
- **Acting sooner rather than later helps to ease the difficulty of change.** The challenge of facing the imminent and daunting budget pressure from Medicare, Medicaid, and Social Security increases over time. Social Security will begin to constrain the budget long before the trust fund is exhausted in 2042. The Social Security cash surpluses that are now helping to finance the rest of the government's budgetary needs will begin to decline in 2008, and by 2018,

the cash surpluses will turn to deficits. Beginning in 2008, Social Security's declining cash flow will begin to place increasing pressure on the rest of the budget. In addition, starting in 2018, the government will have to either increase revenues, decrease other government spending, or increase debt held by the public to convert the bonds in the trust funds into cash in order to pay full benefits when due. Waiting until Social Security faces an immediate solvency crisis will limit the scope of feasible solutions and could reduce the options to only those choices that are the most difficult. It could also contribute to a further delay of the really tough decisions on Medicare and Medicaid. Acting sooner rather than later would allow changes to be more modest while also being phased in so that future and near-term retirees will have time to adjust their retirement planning. Furthermore, acting sooner rather than later would serve to increase our credibility with the markets and improve the public's confidence in the federal government's ability to deal with our significant long-range fiscal challenges before they reach crisis proportions.

- **Reform proposals should be evaluated as packages.** The elements of any reform proposal interact; every proposal will have pluses and minuses, and no plan will satisfy everyone on all dimensions. Reform elements can take a variety of shapes; examples include benefit reductions, like changing replacement rates, moving from wage to price indexation, or increasing the retirement age, increasing payroll taxes or the taxable wage base, and/or creating individual accounts. If we focus on the pros and cons of each element of reform by itself, we may find it impossible to build the bridges necessary to achieve consensus. However, any analyses of reform proposals should reflect the fact that the program faces a long-term actuarial deficit and that benefit reductions and/or revenue increases will be necessary to restore solvency. Therefore, it is important to establish the appropriate comparisons or benchmarks against which reforms should be measured. This requires looking at proposed reforms from at least two benchmarks—one that raises revenue to fund currently scheduled benefits (promised benefits) and one that adjusts benefits to a level supported by current tax financing (funded benefits). Comparing the benefit impact of reform proposals solely to currently scheduled Social Security benefits is inappropriate since all current scheduled benefits are not funded over the longer term.

Failure to address the Social Security financing problem will, in combination with other entitlement spending, lead to an unsustainable burden on both the federal government and, ultimately, the economy. As the Congress considers proposals to restore the long-term financial stability and viability of the Social Security system, it will also need to consider the impact of the potential changes on the millions of Americans the system serves: specifically, the effects on different types of beneficiaries and the resulting implications for the adequacy and equity of the benefits structure. The fundamental nature of the program's long-term financing challenge means that timely action is needed. I believe it is possible to craft a solution that will protect Social Security benefits for the nation's current and near-term retirees, while ensuring that the system will be solvent, sustainable, and secure for future generations. I also believe that it is possible to exceed the expectations of all generations of Americans. In addition, given our overall fiscal challenge and various trends in the private pension and personal savings areas, I believe it would be prudent to act sooner rather than later to address this large and growing problem.

Social Security's Long-term Financing Problem Is More Urgent Than It May Seem

Today, the Social Security program faces not an immediate crisis but rather a long-range financing problem driven primarily by known demographic trends. While the crisis is not immediate, the challenge is more urgent than it may appear since the program will experience increasing negative cash flow starting in 2018. Acting soon to address these problems reduces the likelihood that Congress will have to choose between imposing severe benefit cuts and unfairly burdening future generations with the program's rising costs. Acting soon would also allow changes to be phased in so that the individuals who are most likely to be affected, namely younger and future workers, will have time to adjust their retirement planning while helping to avoid related "expectation gaps." On the other hand, failure to take remedial action will, in combination with other entitlement spending, lead to a situation unsustainable both for the federal government and, ultimately, the economy.

The Social Security system has required changes in the past to ensure its future solvency. Indeed, the Congress has always taken the actions necessary to do this when faced with an immediate solvency crisis. While such an immediate crisis will not occur for many years, waiting until it is imminent would not be prudent. I

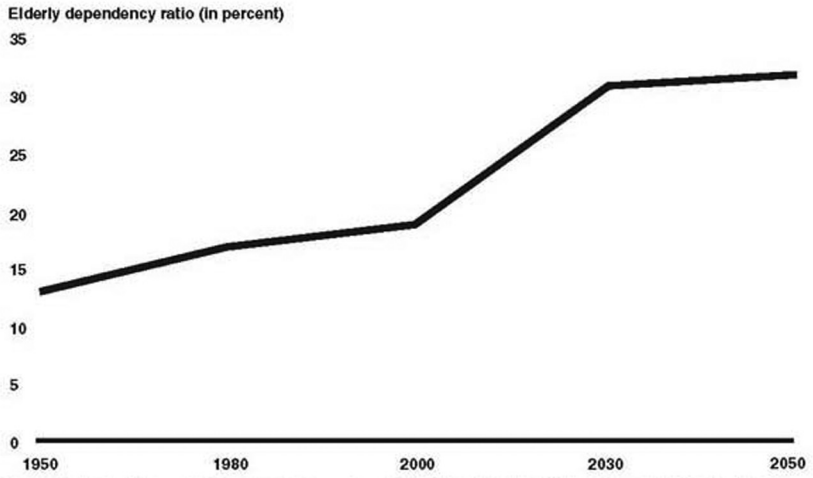
would like to spend some time describing the nature, timing, and extent of Social Security's financing problem.

The Nature of Social Security's Long-Term Financing Problem

As you all know, Social Security has always been a largely pay-as-you-go system. This means that the system's financial condition is directly affected by the relative size of the populations of covered workers and beneficiaries. Historically, this relationship has been favorable to the system's financial condition. Now, however, people are living longer, and spending more time in retirement.

As shown in figure 1, the U.S. elderly dependency ratio is expected to continue to increase.[4] The proportion of the elderly population relative to the working-age population in the U.S. rose from 13 percent in 1950 to 19 percent in 2000. By 2050, there is projected to be almost 1 elderly dependent for every 3 people of working age—a ratio of 32 percent. Additionally, the average life expectancy of males at birth has increased from 66.6 in 1960 to 74.3 in 2000, with females at birth experiencing a rise of 6.6 years from 73.1 to 79.7 over the same period. As general life expectancy has increased in the United States, there has also been an increase in the number of years spent in retirement. Improvements in life expectancy have extended the average amount of time spent by workers in retirement from 11.5 years in 1950 to 18 years for the average male worker as of 2003.

FIGURE 1: U.S. ELDERLY DEPENDENCY RATIO EXPECTED TO CONTINUE TO INCREASE



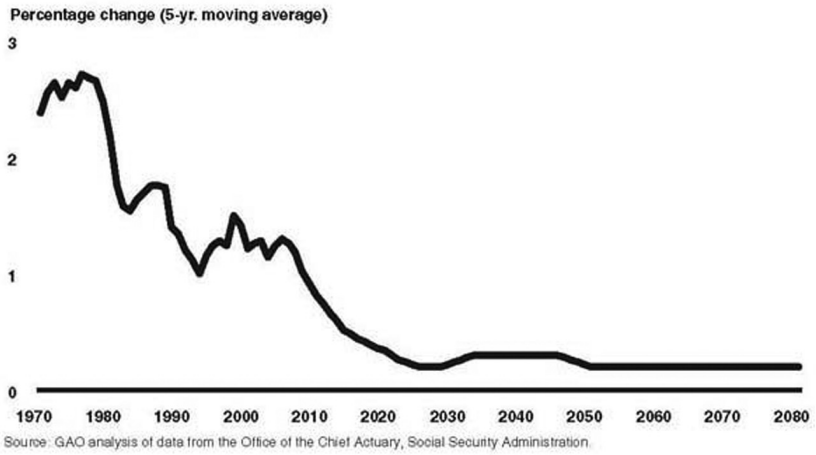
Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2002 Revision, and World Urbanization Prospects: 2001 Revision.

A falling fertility rate is the other principal factor underlying the growth in the elderly's share of the population. In the 1960s, the fertility rate, which is the average number of children that would be born to women during their childbearing years, was an average of 3 children per woman. Today it is a little over 2, and by 2030 it is expected to fall to 1.95—a rate that is below what it takes to maintain a stable population. Taken together, these trends threaten the financial solvency and sustainability of Social Security.

The combination of these trends means that labor force growth will begin to slow after 2010 and by 2025 is expected to be less than a fifth of what it is today, as shown in figure 2. Relatively fewer U.S. workers will be available to produce the goods and services that all will consume. Without a major increase in productivity or immigration, low labor force growth will lead to slower growth in the economy and to slower growth of federal revenues. This in turn will only accentuate the overall pressure on the federal budget.

[4] The elderly dependency ratio is the ratio of the population aged 65 years or over to the population aged 15 to 64.

FIGURE 2: LABOR FORCE GROWTH IS EXPECTED TO SLOW SIGNIFICANTLY



Note: Percentage change is calculated as a centered 5-yr moving average of projections based on the intermediate assumptions of the 2004 Trustees Reports.

This slowing labor force growth has important implications for the Social Security system. Social Security's retirement eligibility dates are often the subject of discussion and debate and can have a direct effect on both labor force growth and the condition of the Social Security retirement program. It is also appropriate to consider whether and how changes in pension and/or other government policies could encourage longer workforce participation. To the extent that people choose to work longer as they live longer, the increase in the amount of time spent in retirement could be diminished. This could improve the finances of Social Security.

The Social Security program's situation is one symptom of this larger demographic trend that will have broad and profound effects on our nation's future in other ways as well. The aging of the labor force and the reduced growth in the number of workers will have important implications for the size and composition of the labor force, as well as the characteristics of many jobs in our increasingly knowledge-based economy, throughout the 21st century. The U.S. workforce of the 21st century will be facing a very different set of opportunities and challenges than that of previous generations. The slowdown in labor force growth can have very negative effects on our nation's economic future, as relatively fewer workers will be producing the goods and services that everyone will consume. If people do choose to work longer this may mitigate the expected slowdown in labor force growth, which could strengthen the nation's economic prospects.

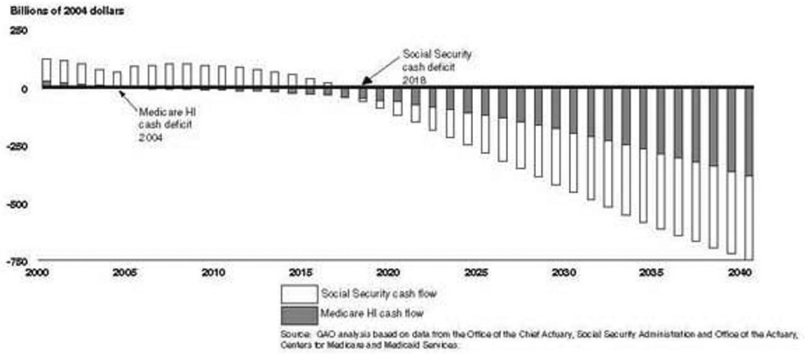
Cash Flow Turns Negative in 2018

Today, the Social Security Trust Funds take in more in taxes than they spend. Largely because of the demographic trends I have described, this situation will change. Although the trustees' 2004 intermediate estimates project that the combined Social Security Trust Funds will be solvent until 2042,[5] within the next few years, Social Security spending will begin to put pressure on the rest of the federal budget. Under the trustees' 2004 intermediate estimates, Social Security's cash surplus—the difference between program tax income and the costs of paying scheduled benefits—will begin a permanent decline in 2008. By 2018, the program's cash flow is projected to turn negative—its tax income will fall below benefit payments. At that time, Social Security will join Medicare's Hospital Insurance Trust Fund, whose

[5] Separately, the Disability Insurance (DI) fund is projected to be exhausted in 2029 and the Old-Age and Survivors' Insurance (OASI) fund in 2044. Using slightly different economic assumptions and model specifications, CBO estimated the combined Social Security trust fund will be solvent until 2052. See Congressional Budget Office, The Outlook for Social Security (Washington, D.C.: June 2004) and Updated Long-Term Projections for Social Security (Washington, D.C.: January 2005).

outlays exceeded cash income in 2004, as a net claimant on the rest of the federal budget. (See figure 3.)

FIGURE 3: SOCIAL SECURITY AND MEDICARE'S HOSPITAL INSURANCE TRUST FUNDS FACE CASH DEFICITS



In 2018, the combined OASDI Trust Funds will begin drawing on its Treasury securities to cover the cash shortfall.[6] At this point, Treasury will need to obtain cash for these redeemed securities either through increased taxes, spending cuts, and/or more borrowing from the public than would have been the case had Social Security's cash flow remained positive. Whatever the means of financing, the shift from positive to negative cash flow will place increased pressure on the federal budget to raise the resources necessary to meet the program's ongoing costs.

Different Measures but Same Challenges and Same Conclusion

There are different ways to describe the magnitude of Social Security's long-term financing challenge, but they all illustrate a need for program reform sooner rather than later. A case can be made for a range of different measures, as well as different time horizons. For instance, the shortfall can be measured in present value, as a percentage of GDP, or as a percentage of taxable payroll. The Social Security Administration (SSA) has made projections of Social Security shortfall using different time horizons. (See table 1.)

Table 1: Different Measures, Same Challenge

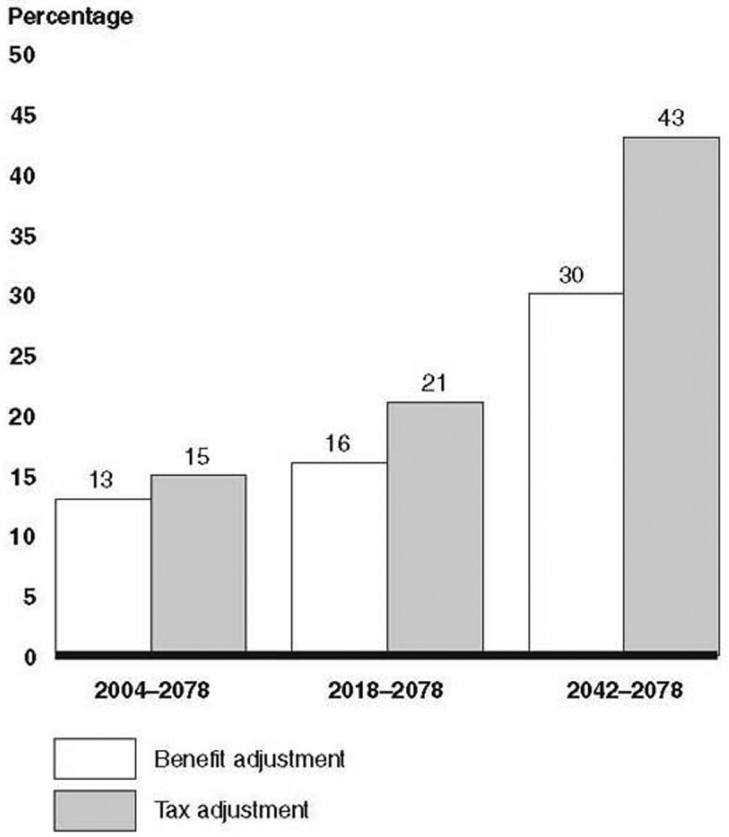
Projection Horizon	SSA's Projections of Unfunded OASDI Obligations		
	Present value	Percent of GDP	Percent of payroll
75 year	$3.7 Trillion	0.7%	1.8%
Infinite horizon	$10.4 Trillion	1.2%	3.5%

Sources: Social Security Administration, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.* Washington, D.C., March 2004.

While the estimates vary due to different horizons, both identify the same long-term challenge: The Social Security system is unsustainable in its present form over the long run. Taking action soon on Social Security would not only make the necessary action less dramatic than if we wait but would also promote increased budgetary flexibility in the future and stronger economic growth. Some of the benefits of early action—and the costs of delay—can be seen in figure 4. This figure compares what it would take to keep Social Security solvent through 2078, if action were taken at three different points in time, by either raising payroll taxes or reducing benefits. If we did nothing until 2042—the year SSA estimates the Trust Funds will be exhausted—achieving actuarial balance would require changes in benefits of 30 percent or changes in taxes of 43 percent for the period 2042–2078. As figure 4 shows, earlier action shrinks the size of the necessary adjustment. However, these changes do not achieve sustainable solvency, they only achieve solvency through 2078.

[6] CBO estimates that OASDI cash flow will turn negative in 2020.

FIGURE 4: SIZE OF ACTION NEEDED TO ACHIEVE SOCIAL SECURITY SOLVENCY



Source: Office of the Chief Actuary, Social Security Administration.

Note: This is based on the intermediate assumptions of the2004 Social Security Trustees Report. The benefit adjustments in this graph represent a one-time, permanent change to all existing and future benefits beginning January 1st of the first year indicated to December 31, 2078.

Social Security Reform is Part of a Broader Fiscal and Economic Challenge

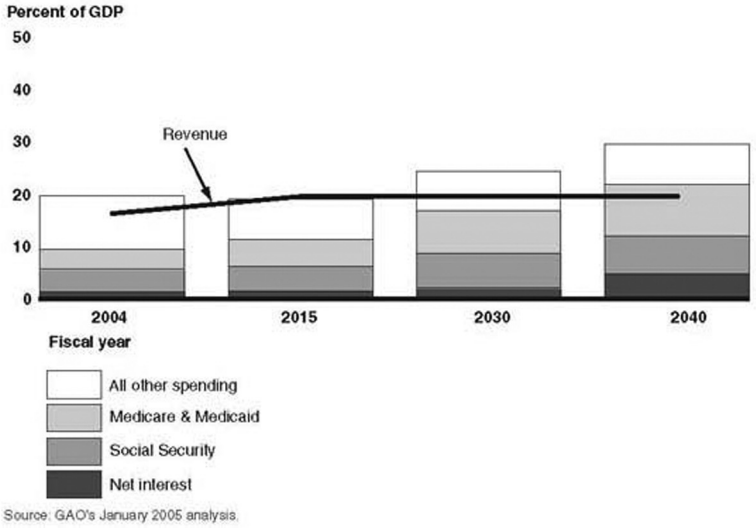
As I have already discussed, reducing the relative future burdens of Social Security and health programs is essential to a sustainable budget policy for the longer term. It is also critical if we are to avoid putting unsupportable financial pressures on Americans in the future. Reforming Social Security and health programs is essential to reclaiming our future fiscal flexibility to address other national priorities.

Changes in the composition of federal spending over the past several decades have reduced budgetary flexibility, and our current fiscal path will reduce it even further. During this time, spending on mandatory programs has consumed an ever-increasing share of the federal budget. In 1964, prior to the creation of the Medicare and Medicaid programs, spending for mandatory programs plus net interest accounted for about 33 percent of total federal spending. By 2004, this share had almost doubled to approximately 61 percent of the budget.

GAO's long-term simulations illustrate the magnitude of the fiscal challenges associated with an aging society and the significance of the related challenges the government will be called upon to address. Figures 5 and 6 present these simulations under two different sets of assumptions. In figure 5, we begin with CBO's January

baseline—constructed according to the statutory requirements for that baseline.[7] Consistent with these requirements, discretionary spending is assumed to grow with inflation for the first 10 years and tax cuts scheduled to expire are assumed to expire. After 2015, discretionary spending is assumed to grow with the economy, and revenue is held constant as a share of GDP at the 2015 level. In figure 6 two assumptions are changed: discretionary spending is assumed to grow with the economy after 2005 rather than merely with inflation and the tax cuts are extended. For both simulations Social Security and Medicare spending is based on the 2004 Trustees' intermediate projections, and we assume that benefits continue to be paid in full after the trust funds are exhausted. Medicaid spending is based on CBO's December 2003 long-term projections under mid-range assumptions.

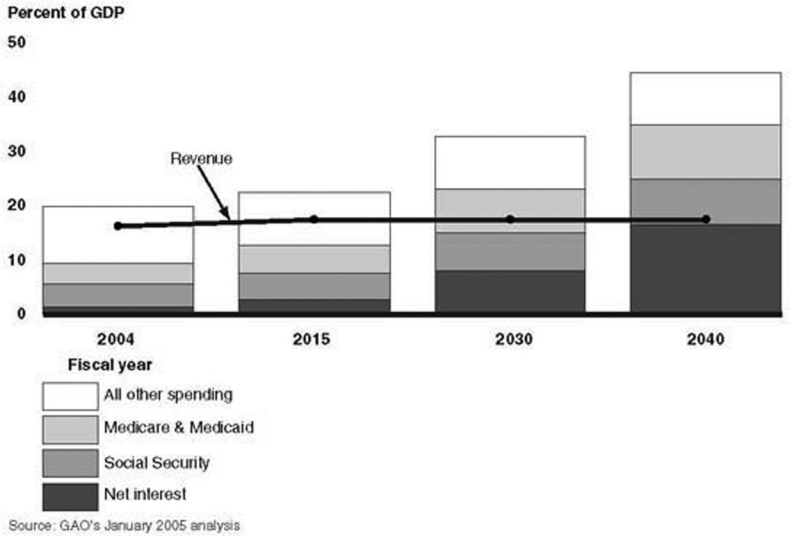
FIGURE 5: COMPOSITION OF SPENDING AS A SHARE OF GROSS DOMESTIC PRODUCT (GDP) ASSUMING DISCRETIONARY SPENDING GROWS WITH GDP AFTER 2005 AND ALL EXISTING TAX CUTS EXPIRE



Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

[7] The Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2006 to 2015, (Washington, D.C.: January 2005).

FIGURE 6: COMPOSITION OF SPENDING AS A SHARE OF GDP ASSUMING DISCRETIONARY SPENDING GROWS WITH GDP AFTER 2005 AND ALL EXPIRING TAX PROVISIONS ARE EXTENDED



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

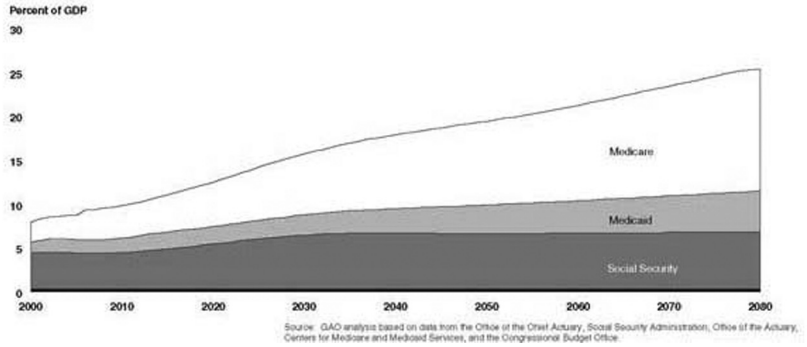
Both these simulations illustrate that, absent policy changes, the growth in spending on federal retirement and health entitlements will encumber an escalating share of the government's resources. Indeed, when we assume that recent tax reductions are made permanent and discretionary spending keeps pace with the economy, our long-term simulations suggest that by 2040 federal revenues may be adequate to pay little more than interest on the federal debt. Neither slowing the growth in discretionary spending nor allowing the tax provisions to expire—nor both together—would eliminate the imbalance. Although revenues will be part of the debate about our fiscal future, the failure to reform Social Security, Medicare, Medicaid, and other drivers of the long term fiscal gap would require at least a doubling of taxes—and that seems implausible. Accordingly, substantive reform of Social Security and our major health programs remains critical to recapturing our future fiscal flexibility.

Alternatively, taking action soon on Social Security would not only promote increased budgetary flexibility in the future and stronger economic growth but would also make the necessary action less dramatic than if we wait. Indeed, long-term budget flexibility is about more than Social Security and Medicare. While these programs dominate the long-term outlook, they are not the only federal programs or activities that bind the future. The federal government undertakes a wide range of programs, responsibilities, and activities that obligate it to future spending or create an expectation for spending. GAO has described the range and measurement of such fiscal exposures—from explicit liabilities such as environmental cleanup requirements to the more implicit obligations presented by life-cycle costs of capital acquisition or disaster assistance.[8] Making government face and address the challenges of the future will require not only dealing with the drivers—entitlements for the elderly—but also looking at the range of federal activities. A fundamental review of what the federal government does, how it does it, and how it finances its operations is both needed and overdue.

[8] GAO, Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties, GAO-03-213 (Washington, D.C.: Jan 24, 2003).

Also, at the same time it is important to look beyond the federal budget to the economy as a whole. Under the 2004 Trustees' intermediate estimates and CBO's long-term Medicaid estimates, spending for Social Security, Medicare, and Medicaid combined will grow to 15.6 percent of GDP in 2030 from today's 8.5 percent. (See figure 7.) Taken together, Social Security, Medicare, and Medicaid represent an unsustainable burden on future generations of Americans.

FIGURE 7: SOCIAL SECURITY, MEDICARE, AND MEDICAID SPENDING AS A PERCENTAGE OF GDP



Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2005 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.

The government can help ease future fiscal burdens through spending or revenue actions that reduce debt held by the public, thereby saving for the future and enhancing the pool of economic resources available for private investment and long-term growth. Economic growth can help, but given the size of our projected fiscal gap we will not be able to simply grow our way out of the problem. Closing the current long-term fiscal gap would require sustained economic growth far beyond that experienced in U.S. economic history since World War II. Tough choices are inevitable, and the sooner we act, the better.

Considerations in Assessing Reform Options

As important as financial stability may be for Social Security, it cannot be the only consideration. As a former public trustee of Social Security and Medicare, I am well aware of the central role these programs play in the lives of millions of Americans. Social Security remains the foundation of the nation's retirement system. It is also much more than just a retirement program; it pays benefits to disabled workers and their dependents, spouses and children of retired workers, and survivors of deceased workers. In 2004, Social Security paid almost $493 billion in benefits to more than 47 million people. Since its inception, the program has successfully reduced poverty among the elderly. In 1959, 35 percent of the elderly were poor. In 2000, about 8 percent of beneficiaries aged 65 or older were poor, and 48 percent would have been poor without Social Security. Because the program is so deeply woven into the fabric of our nation, any proposed reform must consider the program in its entirety, rather than one aspect alone. To assist policymakers, GAO has developed a broad framework for evaluating reform proposals that considers solvency as well as other aspects of the program. Our criteria aim to balance financial and economic considerations with benefit adequacy and equity issues and the administrative challenges associated with various proposals.

GAO Framework For Evaluating Reform Proposals

GAO developed an analytic framework to assess reform proposals using three basic criteria:

- **Financing Sustainable Solvency—**the extent to which a proposal achieves sustainable solvency and how it would affect the economy, the federal budget, and national saving. Our sustainable solvency standard encompasses several different ways of looking at the Social Security program's financing needs. While a 75-year actuarial balance has generally been used in evaluating the

long-term financial outlook of the Social Security program and reform proposals, it is not sufficient in gauging the program's solvency after the 75th year. For example, under the trustees' intermediate assumptions, each year the 75-year actuarial period changes, and a year with a surplus is replaced by a new 75th year that has a significant deficit. As a result, changes made to restore trust fund solvency only for the 75-year period can result in future actuarial imbalances almost immediately. Reform plans that lead to sustainable solvency would be those that consider the broader issues of fiscal sustainability and affordability over the long term. Specifically, a standard of sustainable solvency also involves looking at (1) the balance between program income and costs beyond the 75th year and (2) the share of the budget and economy consumed by Social Security spending.

- **Balancing Adequacy and Equity—**the relative balance struck between the goals of individual equity and income adequacy. The current Social Security system's benefit structure attempts to strike a balance between these two goals. From the beginning, Social Security benefits were set in a way that focused especially on replacing some portion of workers' preretirement earnings. Over time other changes were made that were intended to enhance the program's role in helping ensure adequate incomes. Retirement income adequacy, therefore, is addressed in part through the program's progressive benefit structure, providing proportionately larger benefits to lower earners and certain household types, such as those with dependents. Individual equity refers to the relationship between contributions made and benefits received. This can be thought of as the rate of return on individual contributions. Balancing these seemingly conflicting objectives through the political process has resulted in the design of the current Social Security program and should still be taken into account in any proposed reforms.
- **Implementing and Administering Proposed Reforms—**how readily a proposal could be implemented, administered, and explained to the public. Program complexity makes implementation and administration both more difficult and harder to explain. Some degree of implementation and administrative complexity arises in virtually all proposed changes to Social Security, even those that make incremental changes in the already existing structure. While these issues may seem technical or routine on the surface, they are important. In particular, if these issues are not considered early enough for planning purposes, they could potential delay—if not derail—reform. Moreover, issues such as feasibility and cost can, and should, influence policy choices. Continued public acceptance of and confidence in the Social Security program require that any reforms and their implications for benefits be well understood. This means that the American people must understand why change is necessary, what the reforms are, why they are needed, how they are to be implemented and administered, and how they will affect their own retirement income. All reform proposals will require some additional outreach to the public so that future beneficiaries can adjust their retirement planning accordingly. The more transparent the implementation and administration of reform, and the more carefully such reform is phased in, the more likely it will be understood and accepted by the American people.

The weight that different policymakers place on different criteria will vary, depending on how they value different attributes. For example, if offering individual choice and control is less important than maintaining replacement rates for low-income workers, then a reform proposal emphasizing adequacy considerations might be preferred. As they fashion a comprehensive proposal, however, policymakers will ultimately have to balance the relative importance they place on each of these criteria. As we have noted in the past, a comprehensive evaluation is needed that considers a range of effects together. Focusing on comprehensive packages of reforms will enable us to foster credibility and acceptance. This will help us avoid getting mired in the details and losing sight of important interactive effects. It will help build the bridges necessary to achieve consensus.

One issue that often arises within the Social Security debate concerns the appropriate comparisons or benchmarks to be used when assessing a particular proposal. While this issue may seem to be somewhat abstract, it has critical implications, for depending on the comparisons chosen, a proposal can be made more or less attractive. Some analyses compare proposals to a single benchmark and as a result can lead to incomplete or misleading conclusions. For that reason, GAO has used several

benchmarks in assessing reform proposals.[9] Currently promised benefits are not fully financed, and so any analysis that seeks to fairly evaluate reform proposals should include comparisons to benchmarks that reflect a policy of an adequately financed system. Similarly, it is important to have benchmarks that are consistent with each other. Using one that relies on action relatively soon versus one that posits no action at all are not consistent and could also lead to misleading conclusions. Estimating future effects on Social Security benefits should reflect the fact that the program faces a long-term actuarial deficit and that conscious policies of benefit reduction and/or revenue increases will be necessary to restore solvency and sustain it over time.

Reform's Potential Effects on the Social Security Program

A variety of proposals have been offered to address Social Security's financial problems. Some of these proposals work within the current structure of Social Security and others would restructure the program. For instance, many proposals contain reforms that would alter benefits or revenues within the structure of the current defined benefits system. Also, a number of proposals seek to restructure the program through the creation of individual accounts. The discussion about examples of reform in this section are meant for illustrative purposes, and are by no means intended to be exhaustive of all the reform options proposed or the issues related to these approaches.

Some proposals would reduce benefits relative to scheduled benefits by modifying the benefit formula. For example, increasing the number of years used to calculate benefits or using price-indexing instead of wage-indexing would reduce the benefits individuals receive. Since wages generally grow faster than prices, indexing earnings to prices rather than wages would reduce the measure of average lifetime earnings used in the formula—reducing benefits. Changing the number of working years used to calculate benefits to include more than the highest 35 years of earnings would reduce the average lifetime earnings; thus, reducing benefits as compared to current levels. Other proposals include options to reduce cost-of-living adjustments (COLA) by lowering the COLA to less than the CPI, limiting the COLA to a specified threshold, or delaying the COLA; to raise the normal and/or early retirement ages or to reduce benefits more for workers who retire before the full retirement age; and to revise dependent benefits. Some of the proposals also include measures or benefit changes that seek to strengthen progressivity (e.g., replacement rates) in an effort to mitigate the effect on low-income workers.

Others have proposed options that would provide revenue increases. For example, raising the payroll tax or expanding the Social Security taxable wage base that finances the system would result in more revenue coming into the system. In 2005, earnings above $90,000 are not subject to payroll taxes. If the cap were raised and the benefit formula remained the same, workers with earnings above the old cap would ultimately receive somewhat higher benefits as well as pay more taxes. Other options to increase revenues include increasing the taxation of benefits or covering those few remaining workers not currently required to participate in Social Security, such as some state and local government employees, although such new participants would increase future spending commitments as well. In addition to these proposals, Social Security can obtain revenues from sources outside of the program, such as by increasing the investment returns on Social Security holdings or by earmarking revenue from estate taxes or other sources.

A number of proposals also seek to restructure the program through the creation of individual accounts. Under a system of individual accounts, workers would manage a portion of their own Social Security contributions to varying degrees. This would expose workers to a greater degree of risk in return for both greater individual choice in retirement investments and the possibility of a higher rate of return on contributions than available under current law. There are many different ways that an individual account system could be set up. For example, contributions to individual accounts could be mandatory or they could be voluntary. Proposals also differ in the manner in which accounts would be financed, the extent of choice and flexibility concerning investment options, the way in which benefits are paid out, and the way the accounts would interact with the existing Social Security program—individual accounts could serve either as an addition to or as a replacement for part of the current benefit structure.

In addition, the timing and impact of individual accounts on the solvency, sustainability, adequacy, equity, net savings, and rate of return associated with the Social Security system varies depending on the structure of the total reform package. Indi-

[9] GAO, Social Security Reform: Analysis of Reform Models Developed by the President's Commission to Strengthen Social Security, GAO–03–310 (Washington, D.C.: Jan 15, 2003).

vidual accounts by themselves will not lead the system to sustainable solvency—an increase in revenue, a decrease in benefits, or both will also be necessary. Furthermore, incorporating a system of individual accounts may involve significant transition costs. These costs come about because the Social Security system would have to continue paying out benefits to current and near-term retirees concurrently with establishing new individual accounts.

Individual accounts can contribute to sustainability as they could provide a mechanism to prefund retirement benefits that would be immune to demographic booms and busts. However, if these accounts are financed through borrowing, prefunding will not be achieved until the additional debt has been repaid.[10] An additional important consideration in adopting a reform package that contains individual accounts would be the level of benefit adequacy achieved by the reform. To the extent that benefits are not adequate, it may result in the government eventually providing additional resources to make up the difference.

Some degree of implementation and administrative complexity arises in virtually all proposed changes to Social Security. However, the greatest potential implementation and administrative challenges are associated with proposals that would create individual accounts. These include, for example, issues concerning the management of the information and money flow needed to maintain such a system, the degree of choice and flexibility individuals would have over investment options and access to their accounts, investment education and transitional efforts, and the mechanisms that would be used to pay out benefits upon retirement. The federal Thrift Savings Plan (TSP) could serve as a model for providing a limited amount of options that reduce risk and administrative costs while still providing some degree of choice. However, a system of accounts that spans the entire national workforce and millions of employers would be significantly larger and more complex than TSP or any other system we have in place today.

Harmonizing a system that includes individual accounts with the regulatory framework that governs our nation's private pension system would also be a complicated endeavor. However, the complexity of meshing these systems should be weighed against the potential benefits of extending participation in individual accounts through payroll deductions to millions of workers who currently lack private pension coverage.

Social Security Reform Should be Considered in the Context of Broader Challenges

Other broader concerns for Social Security reform include evaluating a proposal's effect on national saving and a proposal's implications for other sources of retirement income, access to long-term care and retirement security generally. An important economic consideration is assessing a proposal's effect on national saving. Individual account proposals designed as a carve-out that finance accounts through the redirection of payroll taxes or general revenue, do not increase national saving on a first order basis. The redirection of payroll taxes or general revenue reduces government saving by the same amount that the individual accounts increase private saving. Individual accounts that are structured as "add-ons" may increase saving. However, this will depend on how the accounts are financed and how they are structured i.e. do they target low income workers who currently may not have high saving rates. Individual accounts that achieve prefunding without borrowing might increase government and individual saving. The effect of individual accounts on national saving will also be affected by other elements, such as benefit cuts or tax increases, that are part of the overall reform package.

Beyond these first order effects, the actual net effect of a proposal on national saving is difficult to estimate due to uncertainties in predicting changes in future spending and revenue policies of the government as well as changes in the saving behavior of private households and individuals. For example, the higher deficits that result from redirecting payroll taxes to individual accounts could prompt changes in fiscal policy that reduce spending or increase revenue thereby resulting in lower deficits that would otherwise have been the case and increase net national saving. On the other hand, households may respond by reducing their other saving in response to the creation of individual accounts. No expert consensus exists on how Social Security reform proposals would affect the saving behavior of private households and businesses.

Besides the effect on savings, Social Security reform proposals may also have implications for retirement security in general. Economic security in retirement requires both adequate retirement income—Social Security, pensions, personal sav-

[10] After the accounts have been established and the transition costs have been repaid prefunding may be achieved, but this is likely not to happen for many decades.

ings, and earnings from continued employment—and affordable health care—Medicare and retiree health care; and long-term care coverage. In addition to the issues I have discussed regarding the financing challenges that Social Security, Medicare and Medicaid face, the nation also faces serious challenges associated with the private pension system and long-term care financing.

Only about half of the private sector workforce is covered by a pension plan. A number of large underfunded traditional defined benefit plans—plans where the employer bears the risk of investment—have been terminated by bankrupt firms, including household names like Bethlehem Steel, US Airways, and Polaroid. These terminations have resulted in thousands of workers losing promised benefits and have saddled the Pension Benefit Guaranty Corporation, the government corporation that partially insures certain defined benefit pension benefits, with billions of dollars in liabilities that threaten its long-term solvency. Meanwhile, the number of traditional defined benefit pension plans continues to decline as employers increasingly offer workers defined contribution plans like 401(k) plans where, like individual accounts, workers face the potential of both greater return and greater risk. These challenges serve to reinforce the imperative to place Social Security on a sound financial footing which provides a foundation of certain and secure retirement income.

In 2002, GAO reported that the total number of disabled elderly could be as high as 12.1 million, by 2040. Long-term care includes an array of health, personal care, and supportive services provided to persons with physical or mental disabilities. It relies heavily on financing by public payers, especially Medicaid, and has significant implications for state budgets as well as the federal budget.

Current problems with the provision and financing of long-term care could be exacerbated by the swelling numbers of the baby-boom generation needing care. These problems include whether individuals with disabilities receive adequate services, the potential for families to face financially catastrophic long-term care costs, and the burdens that heavy reliance on unpaid care from family members and other informal caregivers create coupled with possibly fewer caregivers available in coming generations.

Given the broader fiscal challenges that our nation faces and the potential future changes to Social Security, Medicare, and Medicaid, as well as the state of private pensions and long-term care trends, it is even more important that individuals are educated about what to expect in retirement. In this respect, regardless of what type of Social Security reform package is adopted, continued confidence in the Social Security program is essential. This means that the American people must understand why change is necessary, what the reforms are, why they are needed, how they are to be implemented and administered, and how they will affect their own retirement income. All reform proposals will require some additional outreach to the public so that future beneficiaries can adjust their retirement planning accordingly. The more transparent the implementation and administration of reform, and the more carefully such reform is phased in, the more likely it will be understood and accepted by the American people.

Conclusions

Social Security does not face an immediate crisis but it does face a large and growing financial problem. In addition, our Social Security challenge is only part of a much broader fiscal challenge that includes, among other things, the need to reform Medicare, Medicaid, and our overall health care system.

Many retirees and near retirees fear cuts that would affect them in the immediate future while young people believe they will get little or no Social Security benefits in the longer term. I believe that it is possible to reform Social Security in a way that will ensure the program's solvency, sustainability, and security while exceeding the expectations of all generations of Americans.

In my view, there is a window of opportunity to reform Social Security; however, this window of opportunity will begin to close as the baby boom generation begins to retire. We have an opportunity to address Social Security as a first step toward improving the nation's long-term fiscal outlook. Furthermore, it would be prudent to move forward to address Social Security now because we have much larger challenges confronting us that will take years to resolve. The fact is, compared to addressing our long-range health care financing problem, reforming Social Security should be easy lifting. As I have said before, the future sustainability of programs is the key issue policy makers should address—i.e., the capacity of the economy and budget to afford the commitment over time. Absent substantive reform, these important federal programs will not be sustainable. Furthermore, absent reform, younger workers will face dramatic benefit reductions or tax increases that will grow over time.

Irrespective of when Social Security reform may occur and what form it may take, other Social Security related issues also need to be explored. These include, but are not limited to, the current accounting/reporting and budget treatment of Social Security and the related trust funds; its current investment options and strategy, and the current composition of the Social Security Board of Trustees.

We at GAO look forward to continuing to work with this Committee and the Congress in addressing this and other important issues facing our nation. In doing so, we will be true to our core values of accountability, integrity, and reliability.

Chairman THOMAS. Thank you very much, Mr. Walker. You indicated in your initial remarks in your testimony that we don't currently face a crisis in dealing with the underfinancing of Social Security. Would you say that in 1983, it would be fair to characterize the last time Congress looked at adjusting Social Security that it could have fairly been called a crisis?

Mr. WALKER. Yes, I would, Mr. Chairman, and the reason being is because in 1983, we were within weeks of the checks not going out on time, and I would respectfully suggest that would have been a crisis.

Chairman THOMAS. We did come to an agreement, and one of the things we are supposed to deal with as humans is to learn from our experience. I think one of the reasons we are here today is that I would hope no Member of this panel would like to wait until we have a crisis before we address it. Clearly, the problem is out there, and as you indicated, every day the solution is delayed, the solution is more costly. In 1983, in large part because there was a crisis in which checks would not go out, as the gentleman from New York indicated, there was a bipartisan agreement. You would like to think that in a crisis when checks are not going out, you could reach a bipartisan agreement. Unfortunately, as far as the Chair is concerned, the bipartisan agreement was what had always been done in previous solutions virtually entirely, and that is from the initial two percent of the payroll tax was to increase the payroll tax, only it wasn't just to increase the payroll tax, because in 1977, Congress had put in an increase in the payroll tax, it was to accelerate the increase in the payroll tax. That was a tax increase. The other half of the bipartisan solution was to cut benefits. The agreement cut benefits in two ways. One, it delayed the cost-of-living adjustment, which was a short-term delay to salvage a cash flow, but it cut benefits by extending the retirement age.

So, I would like to remind Members of this Committee as we begin to look at trying to address the problem, in 1983, under the Democrat leadership, the solution included cutting benefits, and that to the degree we continue to draw a line in the sand that benefits promised that cannot be delivered must be adhered to, I think we are going to have a little bit of difficulty in moving forward. I notice that you looked at a blue and a red line, each of them an extreme example contained only in their particular area, raise the payroll tax up beyond perhaps 16 percent, or cut benefits. Describe the benefit cut, if it were financed only on the benefits side.

Mr. WALKER. Basically, the illustration that we have that is in the testimony would say—it doesn't say how you would achieve that benefit cut. It says that is the percentage, the average percentage of benefit that would have to be cut today or immediately in

order to achieve sustainable solvency and to achieve actuarial balance for 75 years. It would not achieve it beyond 75 years because of known demographic trends.

Chairman THOMAS. The argument that since we have made a promise, however ill-advised the promise may have been in terms of delivering benefits, the damage to the economy in terms of raising taxes to honor an ill-advised commitment versus making adjustments, not completely on the benefit side but prudently on the benefit side, in terms of choices to the Committee, should we continue to honor an ill-advised—this is commonly referred to as a loaded question, in case anybody misses it. I mean, at what point should we, in our process of examining a solution to the problem, begin examining ill-advised promises in terms of benefits versus simply saying we made a promise and we have to honor it and we are going to have to find the revenue to cover it?

Mr. WALKER. Mr. Chairman, I would respectfully suggest that you need to have the benefits side and the revenue side on the table. I would, however, respectfully suggest that, as I mentioned before about our larger fiscal challenge, if you end up dedicating revenues to Social Security, which you may well decide to do, either through increasing the taxable wage base and/or the tax rate, whatever, if you decide to do that, understand those revenues can't be spent twice. So, when you come back here to address Medicare with a gap that is eight times greater than it is Social Security, just keep in mind that whatever you decide to do, to keep it in the broader context that you have got other heavy work that has to be done, as well.

Chairman THOMAS. As we define terms in going forward, we still insist on talking about this as a pay-as-you-go system. One of the concerns I have is that the decisions that were made in 1983 allowed us not to revisit Medicare until 2005, but I think the principal reason we haven't visited it sooner was because in 1983, we began a process that was not pay-as-you-go by virtue of collecting more payroll taxes than was necessary and front-loading the payroll tax side to afford us 20 years of not having to deal with the issue. Yet I see even today, as people write articles, they describe the current system as a pay-as-you-go system. Is it fair to say that we got off significantly of the pay-as-you-go system as we made those decisions in 1983?

Mr. WALKER. Based upon your decisions in 1983, I think it would be fair to say that you have a partially pre-funded system. At the same point in time, as you know, Mr. Chairman, Congress has been spending those surpluses each year on other government expenditures, although at the same point in time, replacing them with government bonds that are non-readily marketable, that are backed by the full faith and credit of the United States government, guaranteed as to principal and interest, so they have legal, political, and moral significance. They will be honored, in my view. But, as I said, when you have to start cashing them in, you are either going to have to raise revenues, cut expenses elsewhere, or increase debt held by the public.

Chairman THOMAS. One of the more difficult problems for all of us as we address problems is that we tend to lapse back into clichés about Social Security. One, it is not pay-as-you-go. Two,

people who say all they want to do is get back what they paid in plus interest get it virtually—well, today it is a little less than it used to be, but they will get that back.

I appreciate your testimony. We look forward to analyses as we look for solutions so that you can begin to give us the short-term and principally the long-term ramifications of decisions, because I agree with you completely. To put blinders on at this stage and attempt to fix Social Security without keeping at least in our peripheral vision the need to deal with Medicare that has the same fundamental problem only multiples of Social Security means we may be able to fix Social Security and we will be jumping out of the frying pan and into the fire. I thank you for your testimony and look forward to working with you. Does the gentleman from New York wish to inquire?

Mr. RANGEL. Thank you, Mr. Chairman. Do you perceive the social contract that we have with the potential beneficiaries as a promise, an ill-advised promise?

Mr. WALKER. I think that we have made a commitment. The current system has made a commitment, but as you know, Mr. Rangel, the Supreme Court has ruled that Congress has the right to change that commitment any time. In fact, Congress has changed that commitment several times.

Mr. RANGEL. Do you think that if we break the commitment, that we can do it in a partisan way, that one party or the other, forgetting this Congress, but any Congress can do that without having the perception of being bipartisan?

Mr. WALKER. My view is, Mr. Rangel, is that you need nonpartisan facts and bipartisan solutions.

Mr. RANGEL. That would mean that if the issue is solvency, then anything that deals with solvency has to be something—we have to have the facts to deal with it in a bipartisan way, is that not so?

Mr. WALKER. You have got to have the facts before you can solve the problem.

Mr. RANGEL. In your opinion, does the question of personal private accounts deal with the question of solvency?

Mr. WALKER. It depends upon how they are structured. If private accounts or individual accounts are a carve-out, then they do not. They would exacerbate the solvency problem. If they are an add-on, they wouldn't affect it. Then, thirdly, it depends upon what other reforms you have, what other type of adjustments would be made in order to deal with the long-term solvency and sustainability problem——

Mr. RANGEL. Can we deal with the short-, medium-, and long-term problems of solvency without having the private accounts on the table, in your opinion?

Mr. WALKER. It is possible to do it, yes.

Mr. RANGEL. If you had a situation where one party or the other was anxious to deal with this issue in an unpolitical way, since it is not a crisis, it is not emotional, bonds of full faith and credit, and it will cause a political problem for both sides, if the one issue did not deal with solvency was private and personal accounts, based on your experience not as a legislator or politician, would you not suggest that that one issue be taken off of the table and the

other issues that could resolve the problem would be what would be before the Congress?

Mr. WALKER. Mr. Rangel, I don't think they are irreconcilable. I mean, it is possible, for example, where you could consider—this is one example—you could consider individual accounts as an add-on rather than as a carve-out. That would be one example where you could get individual accounts and not exacerbate the solvency and sustainability problem.

Mr. RANGEL. Then the answer to my question, then, would have to come from the President, who promised the Congress that he would have a bill that we could determine whether it was a carve-out or whether it was going to be separately. So, before, in this particular case, Democrats could decide whether we can cross the aisle and resolve this problem, in your opinion, would we not have to know first whether it is an add-on or whether it is a carve-out?

Mr. WALKER. You would have to know that and a number of other factors, including what other changes are going to be made in order to try to achieve longer term solvency and sustainability in order to make an informed judgment.

Mr. RANGEL. As long as Democrats, in this particular case, believe that we are talking about dismantling Social Security and not dealing with the solvency problem, is there any way that you can see, based on your past experience in dealing with the Congress, that this issue can be dealt with in a bipartisan way?

Mr. WALKER. Oh, I think it is possible. I think it is critical that it be done that. My personal view, Mr. Rangel, is the step one has to be to convince a majority of the Congress, a significant majority of the Congress because it is going to have to be bipartisan, and a significant majority of the American people, that we have a problem that needs to be solved and it is prudent to solve it sooner rather than later.

Mr. RANGEL. Then do you——

Mr. WALKER. That involves nonpartisan facts. Then to approach solving the problem in a comprehensive, package manner, bipartisan manner——

Mr. RANGEL. Well, let me ask you this. Do you think it would help for us to get together in a bipartisan way, for the President of the United States to visit 60 cities in 60 days dealing with the question of private accounting, which has nothing to do with solvency and it is the one issue that stops us from dealing with this in a bipartisan way, does that make any sense at all to you?

Mr. WALKER. Well, Mr. Rangel, I don't work for the President. I work for the Congress, and I probably——

Mr. RANGEL. That is why I asked you, because——

Mr. WALKER. I would have done it differently. I would have done it differently.

Mr. RANGEL. That is enough for me. I yield back the balance of my time.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Florida, Mr. Shaw, wish to inquire?

Mr. SHAW. Yes, I would. Mr. Walker, it is great to see you back before our Committee. You certainly bring great credibility to this most important debate. In your testimony, you spoke of a $3.7 tril-

lion present value shortfall. Obviously, the Congress isn't going to put up that kind of money, so just push that one off the table and let us talk about what the actual shortfall or the actual deficit is going to be commencing in 2018. For the next 75 years, how much, if Congress goes completely to a borrowing situation and doesn't cut benefits or increase taxes, what would be the cash shortfall over the next 75 years?

Mr. WALKER. I don't have that number readily available, Mr. Shaw, but I will be happy to provide it for the record, if you would like.

Mr. SHAW. The Social Security Administration has used the figure of $26 trillion. Does that sound about right?

Mr. WALKER. It clearly would be over $10 trillion. I don't know what the number would be because this $3.7 is discounted present value. I just have not done the calculation, but I will provide it for the record.

Mr. SHAW. If the Congress does nothing, according to the slide that you have up there, each year gets worse. I notice that 45 years from now, you are looking—at 40 years from now, under your slide, you are looking at an approximately $750 billion shortfall that grows to over a trillion dollars a year as you get beyond 2040 and thereon, is that correct?

Mr. WALKER. Those numbers sound correct, Mr. Shaw.

Mr. SHAW. All right.

Mr. WALKER. I also would note that when you look at my charts, you will see that Social Security is a subset of the broader fiscal challenge, and so we are going to have some heavy lifting to do in other areas, as well.

Mr. SHAW. You also in your testimony stated that the sooner we handle this, the more manageable it is going to be. I have heard the Vice President use the figure of it is going to cost us $600 billion a year the longer we wait. Do you know how he came up with that figure, or do you have a figure that——

Mr. WALKER. I don't know how he came up with that figure. I would imagine that one of the things he could be thinking about is how much the discounted present value number might go up each year, but I have not run the calculation.

Mr. SHAW. You also in your testimony, or in reply to a question from Mr. Rangel, you said that the question of solvency would not be solved with the carve-out, but it would with the add-on. Could you elaborate or expand on that answer?

Mr. WALKER. Well, obviously, to the extent that you have a carve-out, it means that you have to, number one, pay current promised benefits when due as well as fund the individual accounts.

Mr. SHAW. So, if you go with a carve-out, the shortfall that we are projecting in 2018 will actually come earlier?

Mr. WALKER. That is correct. You will end up having—the cash flow—the negative cash flow will happen earlier and the magnitude of the cash flow deficit will increase. Now, over time, that could change depending upon what other types of reforms you have. Undoubtedly, if it is a carve-out, you will exacerbate the negative cash flow and, therefore, solvency and sustainability.

Mr. SHAW. With the carve-out, over 75 years, the cash shortfall would be less than it is under the projections that you have used, or we can go back to the 2040 date which you——

Mr. WALKER. Mr. Shaw, it depends upon what reforms are coupled with the carve-out. In other words, do you have a claw-back provision of the benefit? What other types of changes do you have to the benefit structure otherwise, in order to be able to answer that question.

Mr. SHAW. With the add-on—is this a correct statement, that with the add-on, with personal accounts that are properly funded, that we can solve the solvency problem, we can hold benefits at the same level they are today, and we do not have to increase taxes?

Mr. WALKER. I don't see how you would be able to do all of those things, Mr. Shaw. If you are going to have an add-on, it seems to me that if you are not going to exacerbate the solvency and the sustainability problems, you are going to have to have a revenue source to fund the add-on, which could, for example, be through increasing the taxable wage base or some other way to be able to get at it. Ultimately, even if you do have an add-on, if you want to solve the underlying solvency and sustainability problem for the current program, you are going to have to make other changes. You are going to have to make changes either in replacement rates, retirement ages, indexing formulas, a variety of other factors to make it work.

Mr. SHAW. I would invite you to visit my website to see such a plan that has been scored by the Social Security Administration of not only protecting the solvency of Social Security over 75 years, but creating a $4.6 trillion surplus.

Mr. WALKER. I will be happy to do that.

Mr. SHAW. Thank you, Mr. Walker.

Chairman THOMAS. Does the gentlewoman from Connecticut wish to inquire?

Mrs. JOHNSON. Thank you very, very much, Mr. Walker, for your testimony. You are absolutely right to put this in the context of the problems in the private pension system and the desperate need for reform in that area, public policy reform. Also, it should be put in the context of the crisis that is developing in long-term care, another one that if we address well in advance will cost us a lot less. So, it is important that if the next generation is going to have the retirement security of current retirees, that we address not only Social Security but our underlying pension law as well as long-term care policy and I certainly hope we can work together to do that.

I do think all the ideas have to get on the table because—and those have to come from Democrats as well as Republicans. They can't just wait to see whether they like a total plan we put out. They have to put ideas on the table because this is far bigger than any one individual party. There are systemic problems in Social Security now that create great hardship on people already. The offset issue is working out unfairly. It isn't working out the way we anticipated. The fact that you have to work 10 years to qualify for Social Security, but your benefit is calculated over 35 years, is harsh punishment for women who stay home to raise their children, because for every one of those years, they get a big fat zero in that

calculation. Have you done any thinking or work about how we could improve the equity of this system?

Mr. WALKER. We have, and in fact, there are a number of different proposals that have been put forth in the past that we have done analysis on that include, among other things, looking for a minimum benefit, in other words, strengthening what the minimum benefit would be for low-income, looking at improving progressivity, and looking at some particular populations, if you will, that might be exposed under the current system, and I would be happy to visit with you separately about that if you want.

Mrs. JOHNSON. Thank you. I would like to visit with you about that. I think that is terribly important. I was terribly pleased that, although it has been lost in the discussion, that the President did put on the plate, on our plate, the possibility of having no benefit below the poverty line. There are seniors now getting benefits that are significantly below poverty income, and part of reform ought to be increasing that level. There is something else that I just want to talk about and ask you in general. If you have personal accounts, no matter how they are structured and governed by the government, then you have hard cash in those accounts so when they come due, you are not having to cut spending or increase public debt or increase taxes to get the money to pay them. Now, that seems to be a substantial difference.

Also, those on the other side of the aisle and President Clinton advocated investing Social Security surplus dollars into the private market. In fact, President Clinton suggested putting all of the surplus money in. Now, that would cost a lot more than letting people put a small percentage into personal investment accounts, but all of these are areas—ways in which to get tangle assets underneath the system, are they not, and isn't that in the long range going to make a difference, if we could either structure the government investment or structure the diversion of private contributions so we have tangible money there to help pay the benefits as opposed to just IOUs?

Mr. WALKER. Clearly, one of the things you ought to consider, whether it is through individual accounts or whether it is not through individual accounts, because it can work either way——

Mrs. JOHNSON. Right.

Mr. WALKER. —is to consider how you might change the current investment strategy to obtain some hard assets, if you will. In that regard, Mrs. Johnson, I think one of the things that Congress needs to consider, especially as Social Security gets closer to having negative cash flows, is whether or not any bonds that are going into the Social Security Trust Fund should be readily marketable, such that the Social Security Trustees could sell those bonds and raise cash and not be subject to a situation where, because of the debt limit or otherwise, you might not be able to pay benefits when due.

Mrs. JOHNSON. Thank you very much, Mr. Walker.

Chairman THOMAS. Does the gentleman from California, Mr. Stark, wish to inquire?

Mr. STARK. Thank you, Mr. Chairman. Thank you, General Walker, for your testimony. You mentioned that, I think you said that if you reduce Social Security taxes for private accounts, it

would exacerbate the problem. Isn't it correct that the only way that add-on accounts would help is if they are used to reduce Social Security benefits?

Mr. WALKER. Not necessarily. You could have additional revenues. You, for example, could decide that you are going to increase additional revenues either through payroll taxes or through increasing the taxable wage base or whatever else.

Mr. STARK. Taken by themselves, add-on accounts keep taxes as they—the only way they could help the problem is by reducing benefits, is that not correct?

Mr. WALKER. Well, if you wanted to fund the add-ons, you would have to make changes in the benefit structure in order to make the numbers come out. In my——

Mr. STARK. Those changes would reduce the benefits——

Mr. WALKER. Absolutely.

Mr. STARK. Okay.

Mr. WALKER. My view is, when I say "add-on," Mr. Stark, and maybe it is my terminology rather than yours, I normally assume that when you have an add-on, that there is going to be additional money coming in. You are correct. If there is not additional money coming in, then it is not much different than a carve-out, quite frankly.

Mr. STARK. Last February, you said on the News Hour that it would be inaccurate to say that the Social Security Trust Fund would be bankrupt in 2042. Do you stand by that statement?

Mr. WALKER. I do. I like to go by Webster's Dictionary, and based on Webster's Dictionary, I would say an accurate description of Social Security is it is not in crisis, but in 2042, it would be insolvent because it would not be able to pay full benefits when due, but the system would not be bankrupt because bankrupt means total failure. It would still be able to pay 73 cents on the dollar, gradually declining over time.

Mr. STARK. Now, in your charts, you showed in 2040 this problem of interest using up most of our revenue. I believe it is correct that in 2018, the Social Security cash shortfall will be about $23 billion a year and the interest on the Bush tax cuts will be about $400 billion a year. This is in 2018. You can suggest that those figures aren't accurate, but I suspect they are about in the ballpark. If that is correct, in 2040, where you show this huge amount of revenue being eaten up by interest, can you give me a comparable estimate, comparing the 2040 Social Security cash flow shortage with the interest that we would be paying on the current Bush tax cuts?

Mr. WALKER. I could try to provide you something for the record, but I think I could do something that will help you right now, and the other Members. If you look on page 12 of my testimony and then compare that graphic to the one on page 13, the difference between page 12 and page 13 is page 12 assumes that discretionary spending grows by the rate of inflation and that all tax cuts sunset. Page 13 assumes that discretionary spending grows by the rate of the economy and all tax cuts are made permanent.

Mr. STARK. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from California, Mr. Herger, wish to inquire?

Mr. HERGER. Thank you, Mr. Chairman. Mr. Walker, in your testimony, you lay out the nature of Social Security's problems as one driven by demographics. Americans are living longer. Families are having fewer children. Consequently, there will be fewer workers supporting each retiree in the future. For example, in 1945, when I was born, there were 42, approximately, paying in for every one receiving it. Today, it is just a little more than three paying in for every one retiree receiving it. Would you agree that while the exact date Social Security will start running cash flow deficits and the trust funds will be exhausted can only be estimated, all the signs are that the program's problems are here to stay and will only grow worse unless we act?

Mr. WALKER. The problem is—the program is unsustainable in its present form. You will have to act. It is only a matter of when you act, how you act. You will have to act.

Mr. HERGER. Would you agree that the longer we wait to act, every year we put off acting, that the problem becomes worse and it takes more to be able to correct it?

Mr. WALKER. Because of known demographic trends, primarily, the longer you wait, the bigger the changes will have to be and the less time you may have to transition those changes, the less time individuals will have to be able to adapt to those changes.

Mr. HERGER. So, therefore, while technically it is right we are not in crisis now, in reality, the longer we wait, every year we wait, to put it off, saying it is okay, the more difficult it is for us to solve this problem and the more challenging it is for our children and our grandchildren and their retirement and Social Security?

Mr. WALKER. That is true, and I think one has to keep in mind that in the case of Social Security reform, not only is time working against us, but it is a subset of this bigger challenge. The fact of the matter is that with Social Security reform, you, the Congress, have an opportunity to exceed the expectations of every generation of Americans, with or without individual accounts. Every generation can get more than they think they are going to get—not more than they are promised, more than they think they are going to get if you go about this in the right manner, and I think that is a win and I would encourage you to hit a single or a double in the form of Social Security reform because you have got a lot bigger problems you are going to have to deal with—Medicare, Medicaid, overall health care reform, and a variety of other issues.

Mr. HERGER. From hearing your testimony, it would sound that you would be somewhat encouraged that we have a President Bush with the courage to stand up and say, let us solve this problem today. Let us not wait until tomorrow or next year or ten or 20 years from now.

Mr. WALKER. I think the President is right in saying we should solve it now. The process, I don't think, has been a very good process, but hopefully that will improve going forward.

Mr. HERGER. Ultimately, hopefully, if we can get our friends on the Democrat side to work with us and not try to stop us on everything we do, hopefully we can begin today and do that. Mr. Walker, let me address another issue. There is a great deal of confusion among the American people about the Social Security Trust Funds and how they work. To clarify, all Social Security surpluses are in-

vested into Treasury bonds held by the trust funds and these Treasury bonds are backed by the full faith and credit of the government and will be honored, isn't that correct?

Mr. WALKER. That is correct, but as I said before, I go by Webster's on words. These aren't trust funds. These are accounting devices. Trust funds give you some significance that there is a fiduciary responsibility and that they are treated as separate and distinct legal entities. If you look at the financial statements of the U.S. Government, you won't even find a liability of the U.S. Government for the bonds held in the trust funds, and the reason you won't is because the left hand owes the right hand. Now, don't get me wrong. The government is going to deliver on its promise. It is not going to default on those bonds. We need to fundamentally review how we are treating Social Security from a variety of perspectives.

Mr. HERGER. Mr. Walker, that is the exact point I wanted to make and I appreciate you pointing it out. Many Americans, if not almost all, think this trust fund is something out there, it is an investment, it is an asset. The fact is, that is not the case. All it is is an IOU, and, therefore, we——

Mr. WALKER. Well, right.

Mr. HERGER. —critically important we begin dealing with this.

Mr. WALKER. Right, but we have to be careful about IOU because all bonds are IOUs. The difference is this is not a readily marketable bond, and the other thing that is different is when the government has to start cashing in this bond to turn it to cash, it is either going to have to raise revenues, decrease other spending, or increase debt held by the public, one or the other.

Mr. HERGER. Thank you very much. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Michigan, the Ranking Member on the Subcommittee on Social Security, wish to inquire?

Mr. LEVIN. Thank you, Mr. Walker. I hope everybody in this hall today, in this room, and in the country will very much take note of what you said, that a carve-out does not address solvency. Indeed, it exacerbates it by itself. I just hope the world hears that, and I hope the world will also go back and read the State of the Union Address of President Bush. What he proposed was a carve-out, four cents of the 6.2, about a third of the payroll tax being carved out and put in private accounts. Over the weekend, the President talked about his approach more or less as an add-on. Subtraction isn't addition—and that is in Webster's, too. At least, it was in my fourth grade math, or third grade.

Mr. WALKER. It is Accounting 101, I think.

Mr. LEVIN. I hope I learned it before that. So, this is the problem. This is the gist of the approach of the President, and all that goes into these private accounts and what they mean for benefit cuts and for borrowing, and this is not acceptable to the American people or to Democrats in this institution, but most importantly to the American people. Once that issue is clarified, we are more willing to go on from there. I mean, this is a solution that makes a problem worse and I don't think we want to congratulate anybody for proposing a solution that makes a problem worse. Now, let me just ask you about another aspect, and I think your charts are use-

ful in terms of the overall debt of this country as it is projected. Social Security is less than 10 percent, right?

Mr. WALKER. That is correct.

Mr. LEVIN. It is about eight or 9 percent. I also learned that in fourth grade, I guess. Now, let me just ask you in terms of facing up to the issue, do you favor putting revenue issues on a pay-as-you-go basis?

Mr. WALKER. Are you talking about in the budgetary process?

Mr. LEVIN. Yes.

Mr. WALKER. I have testified before, Mr. Levin, that if you are trying to control the bottom line, if you are trying to make sure that we are fiscally responsible on the bottom line, that you need to look at both the revenue side and the spending side.

Mr. LEVIN. Okay. I just find it mind-boggling that policies that have helped lead to this fiscal irresponsibility, that the advocates of those policies are now using fiscal irresponsibility—irresponsibility—as a reason to dismantle Social Security. Those on this side have taken steps to try to keep the $5.6 trillion projected surplus from being dissipated, but it has been worse than dissipated. It has been reversed. So, to Mr. Herger and everybody else, we are more than willing, as was true 20 years ago, to sit down and talk about approaches that will address solvency and that will be fair. We are not willing to accept policies that do not address solvency and that would dismantle the Social Security system of this country that has meant so much for the independence of people retiring, of the disabled and family members. So, I think your testimony, the gist of your testimony needs to be heard in this institution, in the White House, and around this country. Thank you.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Louisiana, the Chairman of the Subcommittee on Social Security, wish to inquire?

Mr. MCCRERY. Yes. Thank you, Mr. Chairman. Mr. Walker, the Social Security Actuaries don't agree with your conclusion that personal accounts funded through a carve-account cannot contribute to the solvency of the system. So, I don't—and I know you are aware of that. I don't think you meant to say that under no circumstances can personal accounts funded by a carve-out contribute to the solvency of the system. I believe you said earlier in your response to a question that it depends on how those accounts are structured and how they are tied to the ultimate benefit payout of the Social Security system. Would you like to amend your——

Mr. WALKER. Let me—I think I was pretty clear, but let me make it clear now if I wasn't. First, carve-outs by themselves, with no other reforms, will exacerbate the solvency and sustainability.

Mr. MCCRERY. Absolutely.

Mr. WALKER. Depending upon what other reforms you have with a carve-out, they may or may not cause a—contribute positively or negatively over the long term, depending upon what the other reforms are. However, irrespective of what the other reforms are, they will accelerate negative cash flows because most of the reforms——

Mr. MCCRERY. In the short term.

Mr. WALKER. Correct. Correct.

Mr. MCCRERY. Well, let us be clear about it.

Mr. WALKER. Most of the reforms—it is important. Most of the reforms will end up leaving—that I have seen—will leave current retirees and near-term retirees alone, which therefore means to the extent that you are going to have offsets, it is going to be for people who retire in future years, and I think when you look at Social Security reform, you have to consider it two ways, the cash flow impact and the discounted present value dollar impact, because there will be timing differences. So, you need to look at solvency, sustainability, short-term and long-term.

Mr. MCCRERY. The question of short-term impact on the unified budget is a separate question, separate from solvency of the system. Mr. Levin, in his questioning, characterized your earlier remarks as saying unequivocally that carve-out personal accounts don't contribute to solvency, and that is incorrect if you couple that with a claw-back, as you put it, from the ultimate benefit payout from the system, and in fact, Mr. Archer and Mr. Shaw had a plan that the Actuaries have scored as solving the entire insolvency of the system. It will make it permanently solvent. So, that is just dead wrong and we ought—the American people, you are right, ought to know what the facts are, and the facts are that if you do it correctly, if you do it properly, if you structure it right, the personal accounts funded through a carve-out can, in fact, solve the problem of Social Security.

Mr. WALKER. As you point out, Mr. McCrery, if they are coupled with other reforms, and I believe the question I answered was standing alone, and so, therefore——

Mr. MCCRERY. Standing alone——

Mr. WALKER. Therefore, there is a difference. There is a difference.

Mr. MCCRERY. Absolutely.

Mr. WALKER. There is a difference and it is important that that be clear.

Mr. MCCRERY. As part of the solution, personal accounts can contribute to the solvency of the system because of the compound interest those funds that are put—real cash in a real account in a real market will grow over time faster than this imaginary trust fund does.

Mr. WALKER. As you know, part of it is what is the assumption for the offset or the claw-back or whatever you want to call it, and then what other changes occur. So, again, I think it is very, very important for people hopefully to agree that we have a problem. It is prudent to solve it now. It is also important that entire packages of proposals get on the table because there will be pluses and minuses to any package. It is also very important that you look at Social Security reform not just based on promised benefits, but based on funded benefits because not all promised benefits are funded.

Mr. MCCRERY. Right. The bottom line is, for anyone to take anything off the table right now is counterproductive to the process, and if you want to be serious players, then you will stop this nonsense of saying we won't take personal accounts. If it is structured properly, it can be a very constructive reform of the system, and coupled with guaranteed benefits, it can still be a very

strong—in fact, stronger—safety net than it is today. So, I hope that we will all calm down and say everything is on the table.

Mr. NEAL. Will the gentleman yield?

Mr. MCCRERY. I would be glad to yield.

Mr. NEAL. Mr. McCrery, is it your position that the trust fund is an imaginary account?

Chairman THOMAS. The gentleman's time has expired. The gentleman will have the opportunity to ask the question on his own time.

Mr. MCCRERY. Thank you, Mr. Walker.

Chairman THOMAS. Does the gentleman from Michigan——

Mr. NEAL. Mr. Chairman——

Chairman THOMAS. The gentleman from Michigan, Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman. Mr. Walker, I appreciate your testimony today and your written statement here that says early action would be prudent and your comments that Social Security faces serious solvency and sustainability challenges and challenges facing Social Security is more urgent—the challenge is more urgent than it may appear. Those comments are in your written testimony. There has been considerable discussion about the shortage of funding facing the program, and in your testimony, you said that it would be about $3.7 trillion to cover the shortfall over the next 75 years. My question is, how much more will it cost taxpayers each year if we do nothing to address this shortfall that is coming?

Mr. WALKER. I don't have the number off the top of my head, Mr. Camp. I am happy to provide it for the record. By definition, it will go up each year, and the reason it will go up each year is twofold. Each year, we drop a good year with a surplus and we add an increasingly bad year, plus we have one yet less year to discount. Therefore, by definition, it is going up every year.

Mr. CAMP. Senator Lieberman on one of the shows over the weekend said that it was $600 billion more if we fail to address this issue. Is that a number that you——

Mr. WALKER. That is the number I want to verify. That is the one that I think the Vice President has also referred to, and I just want to see how they calculated it. It is an unaudited number. I would like to be able to get behind it a little bit.

Mr. CAMP. If you could get that to me——

Mr. WALKER. I would be happy to.

Mr. CAMP. —I would very much appreciate that. Also, as we have heard, this personal account could be very helpful to solving this problem. The personal account that I have heard discussed would be modeled very much after the Thrift Savings Plan, which is the plan that Federal employees and most Members of Congress contribute. I wondered if you know what percentage of Federal employees take advantage of that plan, and what the administrative costs associated with that plan are.

Mr. WALKER. It is a significant majority. I don't have the percentage. I will provide it for the record. The administrative costs on a relative basis are low. As you may know, Mr. Camp, I used to be Assistant Secretary of Labor for Pensions and Health and so I am very familiar with the Federal Thrift Savings Plan. In fact, I think it is important to note that with regard to if the Congress

decides to have an individual account proposal, whether it be an add-on or a carve-out or whatever, if you decide to do that, two things to keep in mind. The Federal Thrift Savings Plan model has worked and it is one that you may want to look to as a possible example. Secondly, less than 50 percent of the private sector work force has a pension plan, and if the Federal Government decided that it wants to have an individual account plan, either as a carve-out or an add-on, then that could provide a mechanism by which Americans who do not have a private pension plan could save on a payroll deduction basis, gain economies of scale, gain limited investment options like the Federal Thrift Savings Plan, and some investment education to help them plan and save and investment for retirement.

Mr. CAMP. I saw an article in the Washington Post that said that 3.4 million Federal employees belong to the TSP. Does that sound about right to you?

Mr. WALKER. It is over three million. I just don't recall the exact number.

Mr. CAMP. That is more than $151 billion invested, with administrative costs of about 57 cents per $1,000 invested. Does that sound similar?

Mr. WALKER. It sounds reasonable.

Mr. CAMP. All right. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Maryland, Mr. Cardin, wish to inquire?

Mr. CARDIN. I do, Mr. Chairman. First, let me thank you for bringing Mr. Walker before our Committee because I find your testimony very helpful and I thank you for the detailed information that you have supplied us. In response to Mr. Camp's point and your reply, I do want to see Americans have the same type of opportunities that Federal workers have. We have Social Security, which provides about one-third of their replacement for their income, a guaranteed core benefit, inflation-proof and lifetime. We have an employer-sponsored pension plan which adds to that defined benefit. I would like to see American workers have that protection. We have a Thrift Savings Account so I can put money, matched by government, into an account which I can use to supplement my retirement. All three are provided to Federal workers, and that is what I want to see continued. So, let me try to get to Mr. McCrery's point first, just so I can clarify this issue. If you take what the President suggested in his State of the Union Address, 4 percent of the payroll tax, or about one-third, that in and of itself out of Social Security—Mr. Levin suggests, pointed out in his opening comment, that in and of itself would accelerate the insolvency by about 11 years, using the Actuaries' assumptions. I assume that you agree with that, is that correct?

Mr. WALKER. That by itself——

Mr. CARDIN. By itself——

Mr. WALKER. —but I don't think even the President is talking about doing that by itself.

Mr. CARDIN. I am trying to isolate the point. I will come right back to it. That, by itself, accelerates the insolvency by 11 years, by itself.

Mr. WALKER. It would accelerate it. I don't know about the 11 years, but it would accelerate it.

Mr. CARDIN. That change then makes it more complicated and difficult and more changes are going to be needed in order to deal with the insolvency issue if we just dealt with it directly.

Mr. WALKER. It will mean that the sense of urgency—well, not only will the negative cash flow increase, but it also means that potentially the insolvency date would get closer, depending upon what other reforms there are.

Mr. CARDIN. I understand that. Other reforms mean more revenue coming into the system or benefit cuts.

Mr. WALKER. Or some combination thereof.

Mr. CARDIN. Or some combination thereof. Thank you. I appreciate also the fact that we do have a trust account that you agree is there, and, therefore, there is enough assets in those accounts to pay full benefits for 37 years, using the Actuaries' numbers.

Mr. WALKER. I guess the way that I would put it, Mr. Cardin, is I believe that the government will not default on its obligations for those bonds, but this is not a real trust fund. Let us don't kid ourselves.

Mr. CARDIN. Well, it is——

Mr. WALKER. I used to be a fiduciary for private pension plans.

Mr. CARDIN. I agree with you, and that is one of the steps that we should be doing in Congress, is make it a true trust fund.

Mr. WALKER. Yes.

Mr. CARDIN. Let the trustees take the responsibility for the funds and get a fair return. The other point I want to bring out, and I think it is extremely helpful, the fact that on a 75-year basis, we have a serious budget problem in this Nation and Social Security represents about 10 percent—less than 10 percent of that problem. I think in response to Mr. Levin, you pointed that out, and that is a very good point. The two charts, one that you put up that shows—which is pretty frightening, I hope sobering—that if we continue the tax cuts and if discretionary spending moves at the growth of our economy and we don't change entitlement spending, that we will be spending virtually 100 percent of our revenues in the year 2040 on interest payments. That is the chart that you pointed out.

Mr. WALKER. That is correct, and I think it is important, however, to look—even if you look at the other chart, which is optimistic, which says even if you don't extend any of the tax cuts and even if discretionary spending only grows by the rate of inflation, we still have a serious long-range imbalance.

Mr. CARDIN. We do, but the interest payments would represent about 20 percent of our revenues if we don't extend the tax cuts. A big difference between close to 100 percent or 20 percent, one change, the extension of our tax cuts, if I understand the two charts that you have presented.

Mr. WALKER. They are factually accurate.

Mr. CARDIN. Thank you. The last point I would point out is that in the year 2042, when we reach this point, even if we didn't make any changes in Social Security, and I agree with you, we should strengthen Social Security today, but we will still have assets in the Social Security Trust Fund if the Actuaries' numbers are accu-

rate. So, when we reach this point where we are spending every dollar of money on interest because we have extended the tax cuts, we will still have money in Social Security. So, you are correct. We should deal with Social Security and we should deal with Social Security now, which is strengthen it. We shouldn't do it by taking money out of the trust fund. The more urgent issue is for us to deal with our budget problems, which include whether we extend these tax cuts or not.

Mr. WALKER. Mr. Cardin, I think my biggest concern is we are on an imprudent path. We have large deficits. We have growing structural deficits projected in the out-years due primarily to known demographic trends and rising health care costs. The problem is not just on the revenue side, it is on the spending side. It is on both. I would commend to you and your colleagues to read this [holding up book] because we have to mend our ways.

Mr. CARDIN. I think your testimony has been extremely helpful. Thank you.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Texas, Mr. Johnson, wish to inquire?

Mr. JOHNSON. Thank you, Mr. Chairman. Mr. Walker, we keep hearing this trust fund stuff. I thought I heard you say that there is not a real trust fund for Social Security, true or false?

Mr. WALKER. True. I mean, if you go by Webster's and if you go by what most people would think a trust fund is, including individuals like myself who have had fiduciary responsibilities to manage trust funds, that is really not what these are. They are called trust funds under the law. They are really a sub-account of the general ledger, a sub-account of the Federal budget.

Mr. JOHNSON. It is a piece of paper, right?

Mr. WALKER. Well, but all bonds are a piece of paper.

Mr. JOHNSON. Okay. Well, as a Federal employee, theoretically, the employer is supposed to put in 6.2 percent into the Social Security fund, whatever we want to call it. Does the Federal Government do that for all of us?

Mr. WALKER. I would be happy to talk to you, Mr. Johnson. You would be amazed. Well, the Federal Thrift Savings Plan is invested in hard assets.

Mr. JOHNSON. Right.

Mr. WALKER. Most trust funds are not invested into hard assets. Most trust funds are invested in non-readily marketable U.S. Government securities backed by the full faith and credit of the United States government. It has legal, political, and moral significance, not real economic significance. It represents no more and no less than a priority claim on future general revenues.

Mr. JOHNSON. That is right, but the government does do their 6.2, only it is another piece of paper, right?

Mr. WALKER. The government, you mean on Social Security is what you are saying?

Mr. JOHNSON. Yes.

Mr. WALKER. The employer portion? No, it pays its portion.

Mr. JOHNSON. A piece of paper, though, not real money.

Mr. WALKER. I would have to follow up on that, Mr. Johnson. I would have to follow up on that. Whether or not that is notational——

Mr. JOHNSON. You just got through telling me that there was no trust fund, per se, and——

Mr. WALKER. You are talking about on the annual payments on the 6.2. There might be an electronic transaction that takes place. The physical cash doesn't go, but an electronic transaction. I mean, the bottom line is when you work it all through, the question is how much money is the government going to borrow each year, because right now, we are in a situation where last year, we ran a $568 billion on-budget deficit. We offset that with a $155 billion Social Security and Postal surplus. So, the real bottom line is, how much money are we going to go out and borrow from foreigners?

Mr. JOHNSON. I understand you, but to get you once more to say there is no asset out there, no real money.

Mr. WALKER. There is a bond, but it is not a readily marketable asset. It is not stocks and bonds. It is not real estate. It is not cash. It is not things many Americans——

Mr. JOHNSON. Right, and the people who think they have a little account set aside for them by Social Security that is going to pay them in the long term is not true. There is no account for each person that pays into Social Security, isn't that true?

Mr. WALKER. There is no account, just like there is no account under a defined benefit pension plan. There is no separate account under a defined benefit pension plan, and that is basically what Social Security is right now. It is a defined benefit pension plan——

Mr. JOHNSON. Can you tell me, do you have any idea how much Social Security dollars are wasted, i.e., given to illegals or dead people?

Mr. WALKER. No, I don't, but we have done some work on that. I can try to provide something for the record. Let me clarify one thing, Mr. Johnson. There is an individual account for certain kinds of defined benefit plans. It is called a cash balance plan, which I would be happy to get back to you if you want. That kind of plan does have an individual account, but it is a defined benefit plan. That is not Social Security, though.

Mr. JOHNSON. Okay. You know, recently, Greenspan emphasized the importance of national savings before the House Budget Committee last week. Frankly, the U.S. personal savings rate has dropped from 12.2 percent in 1982 to 1.6 percent now. Historically, the United States is near the lowest in the world. Economists have long argued that national savings are essential for building capital stock that drives economic growth. In fact, Alan Greenspan made the statement that, "In my view, a retirement system with a significant personal accounts component would provide a more credible means of ensuring that the program actually adds to overall saving and, in turn, boosts the national capital stock." In your view, what retirement policies, inside or outside the Social Security system, could increase net national savings or improve wealth and income for future retirees?

Mr. WALKER. Well, there is absolutely no question that we need to increase our overall savings rate as well as individual savings rate. I think we have to take a look at how best to accomplish that. I personally believe that we need to have more payroll deduction type of arrangements where individuals do not touch the money be-

cause once you touch the money, you tend to spend the money, especially if you don't have a lot of discretionary income.

Mr. JOHNSON. Personal retirement accounts would do just that, would it not?

Mr. WALKER. It could, but you have to understand that if you end up having to borrow money to finance the personal accounts, that does not increase net national savings. So, if you end up putting money into an account but you have to go out and borrow because the government runs bigger deficits in order to fund that, that won't increase net national savings. It is a wash.

Mr. JOHNSON. Okay. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Washington wish to inquire?

Mr. MCDERMOTT. Thank you, Mr. Chairman. Mr. Walker, the Chairman has set up a kind of a straw man. He said if we don't do anything with Social Security, we don't do anything with Medicare, all hope is lost. He refuses to talk about tax cuts that are going to be extended. It seems to me that when Mr. McCrery says everything ought to be on the table, the extension of the tax cuts really ought to be a part of what we are talking about if that line that you have drawn on your chart for us is correct. If by 2042, every cent that we are raising goes to pay interest on the debt, isn't it about time that this place started thinking about that?

Mr. WALKER. Well, in this book [holding up book], what we say, Mr. McDermott, is we say that you have to engage in a baseline review of mandatory spending, entitlement programs, discretionary spending, and tax policy, including tax preferences. I expect the Congress will probably have a healthy debate about whether or not to extend those.

Mr. MCDERMOTT. I listened to you talk, and you have gotten the same kinds of questions from us down the row here. The President creates a crisis. He says there is nothing in that trust fund, where all hope is lost. We have got to start cutting budget—start cutting the benefits now. On the other hand, every solution includes those trust funds as assets. It seems they want it both ways. On the one hand, there is nothing there. We are going to have to raise taxes for that or borrow more money. What I have a hard time understanding, if I was sitting out there in the audience, in the TV audience, and looking at that chart, I would say to myself, you say there are not, those bonds that are in the trust account are not negotiable, you can't market them, you can't sell them and buy them, and so I guess they are just pieces of paper. Now, those are different than the kinds of pieces of paper we sell to the Central Bank of China, is that correct?

Mr. WALKER. Well, and the primary way they are different is that while both are backed by the full faith and credit of the United States government, guaranteed with principal and interest, they are not marketable. I mean, the ones in China are marketable. They can sell them to somebody else so they can raise cash.

Mr. MCDERMOTT. What does that mean, not marketable? Come on. You worked for Arthur Anderson. You know what——

Mr. WALKER. Right now, what——

Mr. MCDERMOTT. I don't know what that means. What do you mean, not marketable?

Mr. WALKER. Well——

Mr. MCDERMOTT. If the bond from the Central Bank of China can be taken in and you get money in your hand, why doesn't it when the trust fund goes over to the Treasury and says, here is a bond, give us the money? Why isn't that just as good as the one for the people of China?

Mr. WALKER. The issue is is that when the government does that, the government has that legal obligation. I do not believe the government will default. The question is, how does the government accomplish that? The way the government will accomplish that is either through raising revenues, decreasing other government spending, or going out and borrowing more from China or elsewhere, okay.

Mr. MCDERMOTT. That is the same thing for the Chinese bond. When the Chinaman shows up with the bond, we are either going to borrow money or raise revenue to pay that bond off, aren't we?

Mr. WALKER. There is a different option, though. The different option is——

Mr. MCDERMOTT. Oh, what is that?

Mr. WALKER. —the Chinese can sell to somebody else and get cash. They don't have to come back to Uncle Sam to get the cash. My point is, the government is going to make good on the bonds——

Mr. MCDERMOTT. They are.

Mr. WALKER. —and that is why I think we have to understand, what is the difference between the trust funds and the bonds that are in the trust funds? The government is not going to default on the bonds——

Mr. MCDERMOTT. Well, will you please tell the rest of the Committee to stop using the argument that there is nothing in the trust fund, because we hear that argument again and again and again. There is nothing in the trust fund. It is just paper. You are saying the full faith and credit stands behind that, and that means it is just as good as a bond for the Chinese or the Japanese or anybody else who buys one of our government bonds.

Mr. WALKER. It is, but I do think that you ought to think about whether or not, on a prospective basis, the bonds that the trust fund gets, as to whether or not they ought to be readily marketable such that when the trust fund starts running a negative cash flow, that the trustees might be able to sell those to somebody else, especially if we have got debt ceiling limit problems, and I haven't thought through all the issues.

Mr. MCDERMOTT. Well, tell us, why aren't they marketable? Why don't we market them now? I mean, we have the Trustees——

Mr. WALKER. You would have to ask——

Mr. MCDERMOTT. —we will ask in a minute, but——

Mr. WALKER. You would have to ask the Secretary of the Treasury that. He is the——

Mr. MCDERMOTT. Is there some accounting reason, from your background at Arthur Anderson, to tell you why?

Mr. WALKER. You know, one of the reasons that it is handled the way that it is right now is because by the government putting back in a bond, that is obviously a certain and generally viewed to be a secure investment. After all, historically, U.S. Government se-

curities have been viewed as one of the safest and most secure investments that you can have, historically. If we don't get our act together——

Mr. MCDERMOTT. The whole world——

Mr. WALKER. If we don't get our act together, that may not be the case in the future, okay, because we are on an unsustainable fiscal path. So, my point is, is that historically, they are viewed as being very safe and secure. Hopefully, they will continue to be if we take the necessary actions. It is not the same as readily marketable investments in which you can end up converting it into cash any time you want to through selling it to somebody else.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from Pennsylvania wish to inquire?

Mr. ENGLISH. Yes. Mr. Walker, I have found this to be a very stimulating exchange and I am particularly grateful that you have been able to, I think, make very clear that the Social Security system is facing a very serious challenge and one that invites creativity on our part and current action to deal with the problem. As I have talked to people in my district, there are some common misconceptions about some of the proposals that have been laid out, and I think your testimony gestures at some of the answers to those misconceptions. At the risk of dragging you back into a discussion of the trust funds, that I agree with you is not a trust fund in any meaningful sense that I had ever understood it to be but is still, as an accounting device, perhaps useful, could you please comment. One hundred percent of the Social Security surpluses are invested in Treasury bonds—we have stipulated that—as required by law, and that happens regardless of whether the rest of the budget is in surplus or deficit, is that correct?

Mr. WALKER. That is correct, although it is my understanding under current law, and you may want to ask the current Public Trustees, that there is the authority to invest in certain other government securities, which government securities could be readily marketable and wouldn't have to necessarily be Treasury bonds.

Mr. ENGLISH. I guess my question gets to the false charge that, somehow, part of the problem here, or the main problem is that this trust fund has been raided. Whether the Treasury uses the invested Social Security surplus to reduce the debt or for other purposes, it does not affect the trust fund balances, is that correct?

Mr. WALKER. That is correct, although, obviously, if you have got a captive source for borrowing, then whether or not the interest rates would have been the same and whether or not the earnings would have been the same on the Social Security surpluses are very much a question.

Mr. ENGLISH. That raises the point of the weakness of the nonmarketability, the fact that it will always show one outcome and one rate of return regardless of what is going on in the market.

Mr. WALKER. Correct.

Mr. ENGLISH. So, in other words, it doesn't show the fluctuations or even the appreciations in value that happened in the marketplace as a result of the economy growing.

Mr. WALKER. Well, that can cut both ways. I think it is important for the Members to understand that Medicare part A is a window to the future. Medicare part A turned negative cash flow last

year. The equivalent of that is Social Security's 2018. Medicare part A is expected to be—the trust fund does dry in 2019, Social Security's 2042. So, we have some experience in what happens when these events are triggered.

Mr. ENGLISH. That is well said, but would you not agree that saying budget deficits resulted in the raiding of Social Security's trust funds is really a fundamentally misleading statement and one that I think reduces the public understanding of what is actually going on here?

Mr. WALKER. Well, the fact of the matter is, even when we had budget surpluses, we were still investing the Social Security surpluses in government securities because of current law. The real problem is not that. The problem is we have large and growing structural deficits. That is the problem.

Mr. ENGLISH. That is very well said and that is a very useful statement for us to have on the record and I think that is something people in my area, my district, have wanted to hear. Now, shifting gears, I see I have very little time left. There has been also raised the issue of risk and whether moving toward personal accounts will expose individuals to unnecessary risk and potentially unnecessary losses. Would you agree that under a voluntary system, no worker would be required to accept any investment risk?

Mr. WALKER. Presumably, they would have the choice as to whether or not they are willing to accept the additional risk for the additional potential return.

Mr. ENGLISH. With the conventional investment choices that have been laid out there, including choosing from government bonds, corporate bond index funds, equity index funds, would you agree that if you had personal accounts grounded in these investment choices, they would offer workers the potential to receive a better income in retirement than what can be paid based on the current pay-as-you-go system, where whatever impact personal impacts could have on solvency, aren't they also—have the potential for strengthening the basic retirement position of younger workers as they move toward retirement?

Mr. WALKER. They could potentially increase adequacy, increase rates of return. Again, you have to analyze the whole package.

Mr. ENGLISH. That is right.

Mr. WALKER. How are you going to pay for them? You are looking at issues in isolation——

Mr. ENGLISH. I don't dispute that, sir. Thank you very much. Thank you, Mr. Chairman.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from Georgia, Mr. Lewis, wish to inquire?

Mr. LEWIS OF GEORGIA. Thank you, Mr. Chairman. Thank you, Mr. Walker, for being here today. Today we have heard a great deal about the challenges Social Security is facing, and we need to deal with those challenges. We need to meet them head on. We have heard very little if anything about the importance of Social Security. As a Member of this Committee, this is my first time hearing you, seeing you before the Committee to talk about Social Security. We are a community. We are one house. We are one family and one Nation. We are all in this thing together. I wish you

would put on the record the importance, the significance of Social Security. What would happen to our seniors, disabled workers, to the survivors without Social Security? What would our country look like? I think it would be important for you, as the Comptroller General, to put it on the record, let me hear some statement from you.

Mr. WALKER. Sure. Mr. Lewis, I think it is important to understand that Social Security is more than a retirement income program. It is also a program for the disabled. It is also a survivor's insurance program. It is arguably the most successful Federal program we have ever had. It represents the foundation of retirement income security, but it should be supplemented by private pension and personal savings. It is a program that is more than retirement income. We have to keep in mind the provisions of Social Security that deal with disability income and survivors income. In any reform effort that is of critical importance.

Mr. LEWIS OF GEORGIA. Could you speak to if we did not have Social Security, what would our Nation look like? If we did not have Social Security in 2005 or 2006, 2007, 2008, 2009, 2019? What would the Nation be like?

Mr. WALKER. Well, first, I cannot imagine anybody who would for a bill that would repeal Social Security, and I think it is important that even if you do nothing, which would be fundamentally imprudent, especially in light of our broader fiscal challenge, people are going to get something from Social Security just based upon the current system. They are going to get 73 cents on the dollar in 2042, gradually declining. If you didn't have Social Security at all for some reason, which I cannot imagine, if you didn't have it at all, then obviously poverty among the elderly would increase significantly among other things.

Mr. LEWIS OF GEORGIA. Thank you. Thank you, Mr. Chairman.

Mr. MCCRERY. [Presiding.] Thank you, Mr. Lewis. Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman. Mr. Walker, thank you for appearing before the Committee today in what is an extremely important hearing, and we appreciate your input. In listening to your testimony and the questions of my colleague, clearly the question before us is do we fix Social Security now or do we wait? Of course, as you have outlined, we need to talk about what are the costs if we wait.

You noted in your testimony and your presentation here some important dates resulting from the changing demographics of our Nation. 2008 the baby boomers enter the Social Security system, and we often think that they will enter at age 65, but it is my understanding two-thirds of those chose to begin collecting Social Security at age 62, and because of that and the sizeable population of baby boomers entering the Social Security system, then 2018 we begin running a deficit in Social Security, and if nothing continues to be done, that in 2042 we exhaust the revenues available.

I would like to just hear from you so we can clearly understand what I think are the consequences of doing nothing, or say if we take a look at the plan that was suggested by the president of the AARP, Mr. Novelli, the plan suggested raising the retirement age, raising payroll taxes, cutting benefits as a solution, what that would mean to the typical taxpayer? I was wondering, can you, if

Congress were to consider just one option which would be a payroll tax increase on workers, how big would that payroll tax increase have to be per worker? Do you have any dollar figure so we can put it in terms of an individual you can share?

Mr. WALKER. I have the percentage that I think we included in the record. I want to say it was 1.89 percent of taxable payroll. I believe that is correct, 1.89 percent of taxable payroll in total is how much would have to happen immediately, but that would only take care of the problem for 75 years, and in fact, you would be out of balance after 1 year because of known demographics where you drop in a good year and you are adding an increasingly bad year every year.

Mr. WELLER. So, that would require they have to keep ratcheting up the tax?

Mr. WALKER. You would have to increase it over time.

Mr. WELLER. Every year you would have to increase it.

Mr. WALKER. Well, not every year, but you would have to increase it over time, and I would strongly encourage the Congress to try to achieve a solution that doesn't just obtain actuarial balance over 75 years, but at the end of the 75 years you are positioned such that hopefully you will not have to deal with it again.

Mr. WELLER. In addition to a tax increase on workers, some have suggested lifting the cap which is currently at $90,000, and implying that that is the solution. If the cap were to be eliminated on 90,000 or more of income, what would that mean for the Social Security system?

Mr. WALKER. Well, it would solve a significant part of the problem but then the question would be—not all of it by any means. You would still have to do more. Then the question would be, what other impacts would that have? That is 12.4 percent, 12.4 percent obviously on people making more than 90,000, so they are obviously better off. On the other hand it would have a disproportionate effect on small business and those that are in that type of business who pay both taxes, they pay it both as the employer portion and the individual portion. It obviously would be one that wouldn't bear an additional burden on middle and lower income workers because you are not changing the payroll tax rate which is the most regressive tax of the major taxes that we have right now.

Mr. WELLER. So, those hit hardest would be the entrepreneur on Main Street who is not——

Mr. WALKER. It would be upper income including entrepreneurs who are self-employed and have other types of entities that are taxable——

Mr. WELLER. Setting aside the idea for tax increases as a solution, say that Congress was solely going to look at a benefit cut, benefit reduction. What would that mean for an individual recipient?

Mr. WALKER. If you ended up reducing benefits immediately, about 13 percent across the board or at least to an average 13 percent——

Mr. WELLER. For an individual recipient?

Mr. WALKER. For an individual recipient.

Mr. WELLER. What does that come to in dollars? Do you have that number?

Mr. WALKER. Not off the top of my head, maybe the trustees do.

Mr. WELLER. About 13 percent of the average?

Mr. WALKER. 13 percent of what the average benefit is right now, but it would be for everybody, or you can adjust it and say, well, we are going to reduce it more for upper income, we are going to reduce it less for lower income or not at all, but it would have to average 13 percent. If you did that today, then you would solve the problem for 75 years, but you would not solve the problem beyond that period.

Mr. WELLER. In order just to get an understanding of the magnitude of how much money is going to be necessary to ensure the solvency for the 75 years the actuaries give us and not thinking about beyond 75 years from now, give us that dollar figure.

Mr. WALKER. Well, the amount of money that you would have to have today invested at treasury rates in real assets would be $3.7 trillion.

Mr. WELLER. That would be combined with the 1½ trillion that is already in——

Mr. WALKER. Correct, that is correct. In other words, we are going to deliver. I mean the government is not going to default on that 1½ trillion, but that is not enough. You would have to have another 3.7 trillion on top of that today, and every day that you delay the more money you are going to have to have.

Mr. WELLER. A very quick follow-up. What is——

Mr. MCCRERY. The gentleman's time has expired.

Mr. WELLER. Thank you, Mr. Chairman.

Mr. MCCRERY. Next to inquire is my good friend from Massachusetts, Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Thank you, Mr. Walker. I think we would all agree that your testimony has been most helpful. We focused up to this point primarily on Social Security's finances, and I think that we have sufficiently established that you agree that carve-out private accounts do not unto themselves improve Social Security's financial position. So, let me shift gears for a moment and think about this from a different angle. If we are contemplating an expenditure of $5 trillion over 20 years in order to establish private accounts, we should think very carefully about what we are getting in exchange. Let me speak specifically to benefits. When Mr. Cardin asked this question you referred to your role as a fiduciary of Social Security, and I also concluded in your former life perhaps other trust funds. You could say yes to that if——

Mr. WALKER. That is correct.

Mr. NEAL. While you were serving in those fiduciary capacities, would you have been willing to sign your name to a report that promised individuals that their private accounts wouldn't lose money?

Mr. WALKER. Well, for one thing, as a fiduciary, I would not be signing that. That would be a promise of the plan sponsor, in your case the government, in deciding what the promise is going to be.

Mr. NEAL. You did draw parallels——

Mr. WALKER. That is not a fiduciary——

Mr. NEAL. You did draw parallels in your comments earlier to trust funds and your description of trust funds and how they operated.

Mr. WALKER. Right. My comment on that, Mr. Neal, was that when most people think of a trust fund, you think of a trust fund that is associated with something like a private pension plan or a personal foundation or whatever.

Mr. NEAL. But, Mr. Walker, would you have guaranteed that those trust funds would not lose money?

Mr. WALKER. If I did that, then I would be very careful about what my investment strategy would be, and I wouldn't do that personally, I wouldn't do that.

Mr. NEAL. You wouldn't do that, okay. That is important. Now, let me follow up on——

Mr. WALKER. Plus I couldn't deliver on the guarantee anyway.

Mr. NEAL. Right. Let me follow up on Mr. Lewis's question because I think it is equally significant. You did not explicitly speak to the issue of how survivors would get by on private accounts. Presumably if a worker leaves behind young children, then their working career didn't last very long. If private accounts are capped at $1,000 a year or indexed, then these accounts won't be very large; is that true?

Mr. WALKER. Obviously, the accounts will be larger depending on how many years and what the compounding is. The bottom line is, I think, Mr. Neal, is we need a lot more details on how any proposal would affect survivor's insurance and disability insurance. We don't have those.

Mr. NEAL. Would you agree then that the survivor's benefit is a terribly important component of Social Security's promise to the American people?

Mr. WALKER. I think survivors benefits as well as the disability benefit.

Mr. NEAL. How would you surmise that a family might get by with survivor's benefits on very small private accounts?

Mr. WALKER. My understanding is, Mr. Neal, is that the private accounts, under no proposal are they intended to be the only thing that an individual would get. The question is, is whether or not they would be a piece of what the individual would be promised.

Mr. NEAL. Has that question been resolved?

Mr. WALKER. Mr. Neal, quite frankly, I don't know what—it depends on whose proposal you are talking about. There are some proposals——

Mr. NEAL. We don't have a proposal in front of us from the President, we have a concept.

Mr. WALKER. No. The answer is from the President that issue has yet to be resolved it seems to me.

Mr. NEAL. Lastly, when you spoke to this issue of trusteeship as it related to your former role with private trusts or a fiduciary of Social Security, your description seemed to parallel the current questioning that is taking place here today in this sense, where it has been described as something that is intangible. We certainly are not arguing that it does not exist.

Mr. WALKER. There is something called a trust fund which is a separate accounting device which has pieces of paper, bonds, backed by the full faith and credit of the U.S. government.

Mr. NEAL. Thank you very much, Mr. Walker.

Mr. WALKER. It is actually a file cabinet I think in Baltimore.

Mr. NEAL. Thank you very much, Mr. Walker.

Mr. WALKER. It is locked.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. MCCRERY. Thank you, Mr. Neal. I would tell the gentleman, as Chairman of the Subcommittee on Social Security, I would welcome your thoughts and ideas on how we make sure we preserve the disability and survivors benefits in the program.

Mr. NEAL. My intention is to be most helpful.

Mr. MCCRERY. Thank you. Mr. Lewis?

Mr. LEWIS OF KENTUCKY. Thank you, Mr. Chairman. Mr. Walker, when you talk about the full faith and credit of the government standing behind the Social Security Trust Fund, the fact is that the U.S. government is the citizens of this country. In order to stand by the bonds, how will the government come up with the money to stand by those?

Mr. WALKER. Thank you, Mr. Lewis. I think the fact of the matter is a lot of people think the government has money. The government has no money. The government owes money. We have huge debt, over $7 trillion right now. When you talk about backed by the full faith and credit of the United States government, what does that mean? It means the power to tax.

Mr. LEWIS OF KENTUCKY. Exactly.

Mr. WALKER. Unless you end up increasing taxes or revenues, unless you end up cutting other government spending and using that money to pay for it, or unless you go out and borrow money to raise cash, which ultimately you are going to have to pay back that debt, and that is part of the problem.

Mr. LEWIS OF KENTUCKY. Exactly.

Mr. WALKER. Debt on debt is not good.

Mr. LEWIS OF KENTUCKY. As we look to the future, as has been stated here today, right now we have a little more than three people paying into the Social Security. Eventually that is going to be two. Eventually it probably will be one. So, how can that be sustained? Just taking the personal accounts off the table—let us just take them off the table—the only way that we can then deal with the problem we have facing us with Social Security would be huge increases in the payroll tax, means testing, increasing the age of retirement, I mean those—basically it comes down to a very narrow window of what we can do to fix the system. I understand that there is some up front cost in personal accounts, and whether it is a carve-out or whether it is an add-on, there is some up-front cost. I have heard estimates of $2 trillion or so, but to transition for those who would like to have personal accounts, when we look at what the cost will be in deficits because of the demographics in 75 years, as Mr. Shaw said earlier, we are looking at double-digit trillions of dollars of debt or huge increases in payroll taxes, or basically having a situation where people are not going to even come close to receiving the benefits that we are receiving today.

Mr. WALKER. Not that we are receiving today. I think it is very, very important to understand how Social Security works. Social Security's benefit is designed to help people have the same relative standard of living based upon tomorrow's standard of living. That is what wage indexing is about, not to maintain your purchasing power based upon today's standard of living, which is what cost of living adjustments are about. So, the fact is, is that even if you end up getting to the point where the trust fund goes insolvent and you would have to end up cutting benefits dramatically by 27 percent and then gradually more over time, that is more than they would get in today's dollars. In other words, because a lot of that is to improve their standard of living to maintain their relative standard of living in future terms, rather than just maintain purchasing power based upon current terms. The bottom line is if you don't have individual accounts you either have to increase taxes, you have to decrease benefits or you have to get a greater rate of return on the investment of the existing trust fund assets or the surpluses that are likely to occur between now and 2018, some combination thereof.

Mr. LEWIS OF KENTUCKY. Thank you.

Mr. MCCRERY. Mr. Tanner.

Mr. TANNER. Thank you very much, Mr. Chairman. I want to say that this has been the most refreshing and enlightening hearing I have been to in this Committee in some time, Mr. Walker. It is refreshing in the sense that one comes here and tells it like it is, even though it is not pleasant to hear. I hope that people who have been listening to this have grasped not only the seriousness of this problem, but more importantly, the seriousness of our budgetary situation. What I have heard is Social Security has a problem, Medicare has a problem, but both pale into insignificance if you look at what is happening to this country. This country is going bankrupt under the present system. If your chart shows that in 20, 40, 35 years from now every dollar coming in here is going to be paid in interest. Is that——

Mr. WALKER. Mr. Tanner, I think——

Mr. TANNER. The magnitude of our budgetary problem right now dwarfs everything else, does it not?

Mr. WALKER. Our current financial condition is worse than advertised. We are on a unsustainable fiscal path, but in fairness I think it is important to note that even in the years that we had short-term surpluses and even in the years where we had projected surpluses, they were temporary projected surpluses. Even in those years we knew we were going to face deficits in the future due primarily to known demographic trends and rising health care costs. So, you are correct in saying that the bigger problem is we have got to get on a more prudent fiscal path.

Mr. TANNER. In the last 31 months the Congress has seen fit to raise the debt ceiling of the country $2.23 trillion. In the last 48 months we have increased the gross debt of the country over 2 trillion. We have borrowed in real money 1.2 trillion. Of that 1.2 trillion, 925 billion or 84 percent of the hard money that we borrowed in the last four years, has been from foreigners. Is that correct?

Mr. WALKER. Those numbers sound about right. Last year it was well over 90 percent.

Mr. TANNER. I know it. If you go back it wasn't quite as bad in 2002. Now it is over 90 percent of the money we are borrowing is coming from foreign interests. Now, what I guess my question is, is could you somehow capsule the fact that this Congress is unwilling to come to grips with the immediacy of what is going on here with four or five hundred, perhaps 600 billion dollar deficits in the budget and the trade deficit? Here we are talking about a $3.7 trillion dollar problem in Social Security over 75 years, when we have an elephant in the room right now, today, and that is mortgaging this country to foreign interests at the rate of 90 percent of our indebtedness that we go into every year. Is there some way to capsule that so we can get the attention of the American people as to how bad the mismanagement is of our finances in this town?

Mr. WALKER. Here is my concern. Take last year, real numbers. We had a $412 billion unified deficit. We had a $568 billion on-budget deficit because we spent every dime in the Social Security surplus and the temporary posted surplus on operating expenses. Less than 25 percent of the unified deficit had anything to do with the global war against terrorism or incremental homeland security costs. That means over 75 percent had nothing to do with that. We had among the strongest, if not the strongest, GDP growth rates of any Nation on the country. We haven't been in a recession since November of 2001. How can we justify running deficits at that level? What is more important is not where we are, where we are headed. I commend to you again, Mr. Tanner, please read this book.

Mr. TANNER. Well, I commend you for telling it like it is, because I think if the American people knew the extent of the mismanagement of what is happening in this town and what has happened the last four—and where we are going, they would demand that something be done about it. Thank you so very much.

Mr. MCCRERY. Mr. Beauprez.

Mr. BEAUPREZ. Thank you, Mr. Chairman. Mr. Walker, thank you for your testimony today. It is truly a pleasure to have you in front of us. There is a whole lot that is being said out there, obviously, and for that reason it is especially good to have you in front of us. Today back home in one of my papers there is an editorial about Social Security that basically makes the case that there really is not that much wrong with it. I want to go through a few of the facts as they cite them, and maybe it is yes/no on a few of these. Within that editorial, that op-ed, it says that if we do absolutely nothing until 2042, 2052, depending whose projections you want to accept, there will still be enough to pay 70, 80 percent inflation adjusted of the current benefit.

Mr. WALKER. Seventy-three percent.

Mr. BEAUPREZ. Okay, 73 percent, so that there still will be funds coming in, right?

Mr. WALKER. Yes. However, if we face the fiscal future that I showed, we may have a much bigger problem because the country may not be able to deliver on its promise.

Mr. BEAUPREZ. Fair enough. The trust fund now has about a trillion and a half dollars in it of those bonds that we have talked about.

Mr. WALKER. That is correct.

Mr. BEAUPREZ. It suggested by 2018 that number will grow to about 5.3 trillion.

Mr. WALKER. I don't have the numbers in front of me, but it sounds reasonable.

Mr. BEAUPREZ. It would grow, okay. Who pays the interest on that trust fund?

Mr. WALKER. The taxpayers.

Mr. BEAUPREZ. So, that comes out of?

Mr. WALKER. It comes out of general revenues, but we have huge deficits so we are borrowing that.

Mr. BEAUPREZ. So, if we pay it on that growing trust fund, we are not going to have it to spend somewhere else?

Mr. WALKER. That is correct. Whatever you pay on interest is for past——

Mr. BEAUPREZ. The op-ed also suggests, if I can go on, that that trust fund balance will increase to about 6.6 trillion over the number of years, till in 2028 they say it will be about 6.6 trillion. Thus, since it is so big and it is earning so much interest, that we will have the funds to pay almost till kingdom come the benefits as they current exist, that the trustees—and this is the question I really want to pose to you—even the trustees say that because that is the case, because this trust fund that we have talked about at length will continue to grow and earn ever more and more and more interest to pay ever more and more benefits, that in the next 75 years according, it says, to the trustees themselves, no benefit or tax cut is necessary at all in the next 75 years. Does that sounds——

Mr. WALKER. The only thing I can assume that they are doing, and you may want to ask the trustees, is the trustees have three simulations or projections that they run each year, a low cost, a high cost, and the intermediate best estimate assumption. That could be based on the low cost or the optimistic scenario. I don't think the optimistic scenario, if it is, if that is what it is based on, is realistic at all. Actual experience has been very close to the best estimate intermediate assumptions, if anything a little bit more toward the high cost. The 3.7 trillion is based upon the best estimate assumptions, 2008, 2018, 2042. Based upon those numbers, that is what I think you ought to go on.

Mr. BEAUPREZ. We are 3.7 trillion in present dollars short of taking care of the next 75 years obligation?

Mr. WALKER. Right. You need a lot more than that if you want to take care of it beyond that.

Mr. BEAUPREZ. That sounds to me like we need to do something. Isn't the big challenge here that we basically have an enormously unfunded liability that we have promised—and I agree with you, will deliver somehow if we have to break the country, we will deliver somehow on that promised benefit. It is an unfunded liability. We don't have the money sitting there to deal with it.

Mr. WALKER. It is an unfunded commitment. It is not currently deemed to be a liability, and the Supreme Court has said that you can change it any time you want. Now, my personal view is, is to the extent that you have got trust fund assets, then at a minimum you are going to deliver on that because that is backed by the full

faith and credit of the United States government. It would be a default if you didn't deliver on that. Anything beyond that is questionable. You have the discretion to——

Mr. BEAUPREZ. The real challenge in front of us is where is the revenue going to be? Where is it going to come from when we have to deliver on the benefits?

Mr. WALKER. Just keep in mind this, it is very important. We have a 43 trillion plus dollar problem. This is a $3.7 trillion problem. You have to solve this in the context of the bigger problem. You can allocate more revenues here if you want, but then what are you going to do when Medicare comes up and you have a $27.8 trillion problem?

Mr. BEAUPREZ. I thank the gentleman because I think that is a critical point because I think in a lot of this discussion that is going on out there, we are trying to deal in isolation as it may benefit our particular argument, and we really need to be dealing in total context of the size and direction of the Federal Government. I thank the gentleman. I yield back.

Mr. MCCRERY. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman. Mr. Walker, thank you very much, and by the way, thank you for the work that you do as the government's watchdog over all programs for the Federal Government. Let me go back to what you said before, and that is that the biggest problem we face, the real problem is that we are on an unsustainable, as you said, unsustainable fiscal path. The fiscal irresponsibility of not the Federal Government's activities in 50 years, in 2042 or 2052 with regard to Social Security, but we are doing today and how we are setting up our priorities on how we spend the taxpayers' dollars when it comes to the Treasury. You just mentioned right now that the problem for Social Security over 75 years the shortfall is about $3.7 trillion, and previously in response to another Member's question, you mentioned that today's Federal Government debt is already more than twice that sum, over $7 trillion. So, the national debt today, not in another 75 years, but today, is already twice as big as the whole problem would ever be for Social Security over the next 75 years. If we could put up the chart that you had put up there at the end, your final chart, I would appreciate that because I would like to get into that for just a second.

Mr. WALKER. Okay.

Mr. BECERRA. It showed that the biggest problem we have come the year 2040, the fastest-growing problem we have come the year 2040 isn't Social Security, it is the interest that we are paying on the national debt, and let's make sure we are clear so folks understand this, we get nothing for the billions or trillions of dollars we spend in paying interest. It is like when someone pays off a mortgage. With your principal you are buying a house. When you pay the principal off on your mortgage you know that that is because you are owning the house. The interest you pay is just because you borrowed money. Interest doesn't create new jobs. Interest payments don't create new jobs. It doesn't create new opportunities for businesses to be developed. It is just lost money in payment on interest. Yet there is another chart that you have in your testimony but that you don't have on your presentation that you

referenced before, which showed that if you were to remove—could we get that chart up? Is it possible to get that chart up? Mr. Chairman, is it possible to get——

Mr. WALKER. Are you talking about the one on page 12?

Mr. BECERRA. Correct. I am hoping that you can put up the chart that you had used before. That is on page 13. I will make reference to the chart that you don't have on display, but that showed that what was the largest and fastest growing part of our expenditures in 2040, the black portion, the interest payments on the national debt shrink dramatically, dramatically, when you take out the cost of the tax cuts. So, that blue bar in the year 2040, which is nothing more than paying interest on the national debt, shrinks dramatically to a third or a fifth of the size when you take out the cost of the tax cuts.

Mr. WALKER. It is not just the tax cuts. It is the tax cuts plus the fact that under this scenario discretionary spending grows by the rate of the economy. Under the other one it grew by the rate of inflation.

Mr. BECERRA. That is a good point. The largest portion of the reduction is due to the fact that you don't extend the tax cuts. Now, that is dramatic to me because if we want to resolve the problems with Social Security today, we had better resolve the problems of our fiscal irresponsibility today as well. That takes us to what you said before, carve-outs in Social Security, where you take money that workers are contributing into the Social Security system, and take it out in what are called private accounts. When you privatize or partially privatize Social Security by taking money out that is supposed to be in Social Security and put it into these private accounts, as you said, that by itself no only doesn't solve the problem, it exacerbates it, which is your word. As far as I can tell—and I think you have said this before—the President has talked to us in terms of Social Security about nothing more than his proposal to carve out a portion of the Social Security moneys going in right now, and create these privatized accounts, where he would take the 4 percent, which amounts to a third of the money that employees currently put in. If we want to have people feel secure about their Social Security, wouldn't the best thing be for the President to tell us how he is going to resolve the solvency issue rather than begin by exacerbating the problem and talking about a carve-out before he tells us how he is going to do the other things to create solvency for Social Security?

Mr. WALKER. I think the President has already made it clear that you would have to have other reforms in order to achieve a sustainable solvency, adequacy and equity, administrative feasibility. He just hasn't provided the details of what he is proposing to do, and that is obviously a political issue.

Mr. BECERRA. I thank you very much.

Chairman THOMAS. [Presiding.] The gentleman's time has expired. Does the gentleman from Texas, Mr. Doggett, wish to inquire?

Mr. DOGGETT. Thank you, Mr. Chairman. Mr. Walker, than you for your service to America and to your willingness again today, as you have previously in testifying to this Committee, to answer the questions regardless of the political consequences of

your answers. Let me say that I very much share what you have stated is your biggest concern, that we are on an imprudent path, and as we consider that imprudent path, I believe in answer to some earlier questions, as far as the total debt we have now, Social Security contributes less than 10 percent of that, does it not?

Mr. WALKER. Right now our total national debt I think is about 7,5 trillion, roughly around there. Social Security I think has about 1.5 trillion of the 7.5.

Mr. DOGGETT. So, while it is extremely important to look at the long-term Social Security issue, the broader problem of fiscal responsibility, the other 90 percent, is also a very big problem that we need to look at?

Mr. WALKER. Right. I think it is important we recognize not where we have been but where we are and where we are headed.

Mr. DOGGETT. Indeed as far as where we are headed, isn't our biggest unfunded liability at this point—you discussed that earlier—isn't our biggest unfunded liability interest on that public debt?

Mr. WALKER. Actually, I would say the biggest unfunded commitment that we have right now is Medicare, about 27.8 trillion, of which 8.1 trillion relates to the new Medicare prescription drug benefit.

Mr. DOGGETT. That is right, and in fact, that liability got much larger after the subsidy that was given in the Medicare bill last year to the pharmaceutical and the insurance industries. Didn't it grow in size after that bill was passed?

Mr. WALKER. Medicare had about a $15.5 trillion unfunded obligation before that bill was passed. The combination of the passage of that bill, as well as changes in estimated long-term cost of health care took Medicare's estimated unfunded commitment from about I think 15.5 trillion to about 27.8 trillion in 1 year.

Mr. DOGGETT. In addition gave us new insight into the accuracy of some of these estimates about what the total cost of some of these initiatives, whether they are a cut in revenue or an addition in spending, where this Committee was told 400 million, then the Administration knew it was really 550, and now it has jumped to almost twice that amount.

Mr. WALKER. That was in billions.

Mr. DOGGETT. Yes, sir, in billions. Excuse me. It does make a difference. Let me talk to you about a term that I think quite appropriately the Chairman of the Subcommittee on Social Security injection into this debate in asking you a question, and that is the term "clawback" because I have never heard President Bush use that term. A clawback is a reduction of Social Security benefits when you sign up for a private account, isn't it?

Mr. WALKER. I think most of us would call it an offset. Clawback is kind of ominous, but, yes, it basically—if you get a private account, typically the way that it would work is, in exchange for getting that private account, you would get somewhat less of the defined benefit. You would still get a defined benefit, but you would get less than otherwise you would have.

Mr. DOGGETT. I am going to use, just to be fair, I am going to use Mr. McCrery's term, because he used the term "clawback," and unless you have a clawback with the private accounts, you pointed

out that private accounts will exacerbate the Social Security solvency long term?

Mr. WALKER. You have to have either a clawback and/or other changes in order to deal with the problem.

Mr. DOGGETT. I think that is very, very important, and I think it is important and appropriate that it was the Chairman of the Republican Subcommittee on Social Security, our Subcommittee, who raised that issue, because president Bush has talked a lot about the ownership society, about the value of private accounts, but he has yet to mention that a clawback, a claw into Social Security guaranteed benefits is an absolutely essential and vital part of his plan to privatize because unless you have a clawback to go along and accompany the private accounts, you actually make the solvency problem worse than it already is. Now President Clinton had a different approach. When he came to the Congress in his State of the Union and talked about saving Social Security first, wasn't a big part of that that in order to save Social Security and preserve Medicare and the other obligations that this country would face as it had an aging population and a declining ratio of workers to that aging population, that now was the time to begin to reduce the public debt and the size of our deficits. You would agree with that objective, wouldn't you?

Mr. WALKER. I testified in 2001 on the issue, and it is on the record as to what I said.

Mr. DOGGETT. Thank you very much. Of course that situation has gotten much worse since President Clinton left office.

Chairman THOMAS. The gentleman's time has expired. The Chair can make sure that anyone reading the record in the future is clear. The comparison of the cost of the Medicare bill at 400 billion was an estimate from the Congressional Budget Office. The statement that it actually costs $532 billion was the Office of Management and the Budget's estimate. Mr. Walker, you put up on the screen that you thought based upon the Social Security actuaries, which would be the equivalent of the Office of Management and the Budget, that we would go below the 100 percent benefit rate in 2042. You had an additional date on the screen, which I believe was 2052.

Mr. WALKER. That is correct.

Chairman THOMAS. That was based upon the Congressional Budget Office's estimate. So, when you get discrepancies either in years of solvency or the costs of programs, it really is not fair to compare one set of estimates for one particular group of numbers that you seem to like and then switch to another group of estimators and utilize their amounts. Would you say that that is probably not, in your experience as an accountant and financial responsibility, a way to explain a problem?

Mr. WALKER. Consistency is a principle that we generally follow in accounting. I would note, Mr. Chairman, as you know, I think the OMB's estimate was based upon the Office of the Actuary at Social Security. They are the ones that came up with the $534 billion estimate I believe—pardon me—Medicare, CMS.

Chairman THOMAS. They were, but they emphasize it through OMB since they utilized the actuaries numbers. So, in both instances they came from the same sources, and in both instances

they are different estimates because in both instances people make different assumptions about the future. I thank the gentleman. Does the gentlewoman from Pennsylvania wish to inquire?

Ms. HART. Yes, I would, Mr. Chairman. Thank you for joining us, Mr. Walker. I appreciate your time today. I want to go down a different track a little bit regarding benefits. One of the concerns, obviously, we have discussed quite a bit is the demographic issue, and how Social Security as it is is not sustainable. The other issue that we haven't touched on much is the way Social Security works for married couples when both members of the couple work, and how benefits for women are often not particularly fair if they are widowed, the way the numbers work. Can you reflect on that a little bit as far as the system works now, the fairness issue for men and women?

Mr. WALKER. Part of the issue is is how long are women in the workforce? If people come in and out of the work force in order to bear children and raise children, then one of the aspects that you have to consider under Social Security is you have to have the equivalent of 10 years worth of credits in order to earn anything, and then the formula is based upon 35 years worth of credits. So, to the extent that women typically don't have as much work experience and they may come in and out of the work force, obviously that could end up affecting their ultimate benefit. As you also know, Ms. Hart, is generally you have to look at how much both working family members earn and——

Ms. HART. Right, there is a total.

Mr. WALKER. Right. Then you have to consider the 50 percent factor. Even if one doesn't work at all, you still are entitled to certain supplemental benefits in the future as it relates.

Ms. HART. So, if you look at the total income of a couple where, for example, Couple A, the woman does not work at all and they make $3,000 a month; and in Couple B the man makes 2,000, the woman makes 1,000, so they have the same total. Their benefits are different?

Mr. WALKER. My understanding is yes, but you may want to talk to the trustees about that. They are probably getting their calculators out right now.

Ms. HART. It is my impression anyway that in the couple where the woman is working and the couples' incomes are close together, in the end it is actually not much of a benefit under Social Security for the couple's total Social Security income. I am not sure if you have analyzed this at all, and we are probably going to have to do a lot more, but I believe as part of the reform we probably want to look at the actual benefit that both Members of the couple would earn under the reform. Is that something you guys have considered at all?

Mr. WALKER. That is something that several reform proposals have looked at things like for women, for survivors. That is an issue I think that should be explored as part of reform.

Ms. HART. I think it should be too. I think that is a great idea. While I have a couple seconds, I just want to talk a little bit more about the personal accounts issue, and I think this would actually also help make the benefits more fair. One of the issues we talk about is the personal savings rate, and I know Mr. Greenspan has

reflected on how personal accounts could actually increase our personal savings rate in the United States. I am concerned anyway about how families are able to receive survivor benefits as a result of Social Security. Obviously if there are children under 18 there are survivor benefits. Under the current system is it not true that if there is nobody under 18 in the family, there is basically no Social Security survivor benefit?

Mr. WALKER. That is my understanding, but you may want to check with the trustees.

Ms. HART. Under a system where we have a personal retirement account, does that change?

Mr. WALKER. I haven't seen a proposal that would change it. Hold on. I think——

Ms. HART. Under the present retirement where you——

Mr. WALKER. My understanding is where you have an individual account.

Ms. HART. Own an account.

Mr. WALKER. Yes, when you own an account, that you would give a survivors benefit that otherwise you would not get because the account would be transferable to the survivor irrespective of their age. That is my understanding, but again I haven't seen a written proposal.

Ms. HART. It is mine, and in the whole change of the nature of the system would be to change the system from a lot of money being paid as a tax into a pot versus money being paid into an account that actually has the beneficiary's name on it.

Mr. WALKER. Right. A portion of the benefit would be in an individual account. A portion of the benefit would be a defined benefit which would be pooled as it is right now for everything. It is clear that under an individual account proposal, certain individuals would receive survivor benefits who do not receive them right now.

Ms. HART. Today.

Mr. WALKER. That is correct.

Ms. HART. That is fair. That is all I needed. Thank you. I yield back.

Chairman THOMAS. Thank the gentlewoman. Does the gentleman from North Dakota, Mr. Pomeroy, wish to inquire?

Mr. POMEROY. Thank you, Mr. Chairman. I would begin by complimenting our witness. David Walker, you are a square one with the numbers, and not everyone that sits at that table is, and I very much appreciate your testimony today as well as your leadership with GAO. Let us just follow up for a moment on this women's fairness question. A principle feature of Social Security is the retirement annuity, pays every month, inflation adjusted for as long as a person lives, right?

Mr. WALKER. After they receive the benefit it is inflation adjusted, yes.

Mr. POMEROY. Women on average live longer than men, is that correct?

Mr. WALKER. That is correct.

Mr. POMEROY. I mean I have heard figures that they live on average six, 7 years longer than men, which means every month they are receiving that guaranteed retirement annuity benefit for six or 7 years, again, in addition to over what perhaps the spouse

would have done. In fact, if my figures are right, a couple at the age of 65 has got a 50 percent chance one of them lives till the age of 92, a 25 percent chance one of them lives till the age of 97, and the chances are that will be the woman, not the man, and that means that that guaranteed inflation adjusted annuity payment coming in every month is a tremendous benefit to women, and indeed, changing to a system that either added risk in terms of the amount to be received or reduced the benefit received would produce a system where a lot of those very elderly women would be in deep trouble. The thing I want to get to about this chart is it shows in very visual terms your point. We got a $43 trillion unfunded liability problem, 3.7 trillion of which is related to Social Security. Is that more or less the essence of your testimony today is we have got a Social Security unfunded liability issue, but it is a smaller part of what is a much bigger picture?

Mr. WALKER. Well, two things. One is, as of September 30, 2004 we had total liabilities in unfunded commitments totaling $43 trillion, of which 3.7 was Social Security. This is looking forward to be able to show what our fiscal future would look like based upon CBO's assumptions for economic growth, based upon the Social Security and Medicare trustees, the best estimate assumptions, and based upon the other factors that I mentioned, discretionary spending grows by the rate of GDP, and all tax cuts are made permanent.

Mr. POMEROY. It appears from the other chart in your testimony that the step of making the tax cuts permanent alone, looks like it quadruples at least the interest payments by the year 2040. Is that——

Mr. WALKER. The difference between the one on page 12 and page 13, I believe—this is the one I believe, on page 13, is both the tax cuts and the discretionary spending growing by the rate of the economy rather than inflation.

Mr. POMEROY. Okay. The blue bar components——

Mr. WALKER. I see what you are saying. Since the green is on top I understand what you are saying.

Mr. POMEROY. Is interest, that is interest.

Mr. WALKER. That is right.

Mr. POMEROY. That goes up. Making the tax cuts permanently increases that, and in fact, increases it by a dimension that is greater than the Social Security unfunded liability.

Mr. WALKER. It is important to keep in mind that that blue is fed also by the entire bar, so the fact that discretionary spending grows by the rate of the economy rather than rate of inflation also serve to increase the green, in addition to the tax.

Mr. POMEROY. I take your point.

Mr. WALKER. I mean it can serve to increase the blue in addition to the tax provision.

Mr. POMEROY. I thought Mr. Beauprez made a very important point when he said we need to not look at this in isolation, but deal with this unfunded liability issue in the entire context. The context I want to reduce it to is to take it away from macroeconomics for a minute to the circumstance of the individual Social Security check. In my State that check averages $834 a month, and we know that the national average is about nearly 30 percent rely on

Social Security for 90 percent or better of their income, and more than two-thirds rely on Social Security for better than half of their income. So, as we face the difficult choices represented by that bar, choices that we would make that would reduce this income from Social Security to the people that are really depending upon it, would be a pretty unwise policy choice in terms of the retirement income security picture, it seems to me. Do you have a comment?

Mr. WALKER. Mr. Pomeroy, I think obviously the Congress would have to make a number of decisions about whether or not it wanted to have individual accounts, if it did if it was add-on versus carve-out plus, to what extent would it be voluntary versus mandatory, to what extent might you want to target it to middle and upper income versus lower income. There are lots of issues that you would have to decide. So, until you actually see the package and understand how it would work, it would be difficult to respond to.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from Florida, Mr. Foley, wish to inquire?

Mr. FOLEY. Thank you very much, Mr. Chairman. Mr. Walker, welcome to the Committee. The tone has changed somewhat, and I am heartened by the fact that many Members recognize at least the difficulty we face in meeting our obligations. Earlier when asked about bankruptcy, you said it is not bankrupt but it is insolvent. We used the example of a dollar into the system and yielding 73 cents as a return in 2018. So, that is technically a default position, correct, in business?

Mr. WALKER. In 2042 I think the accurate term would be is the program would be insolvent because it would not be able to pay full promised benefits when due.

Mr. FOLEY. So, in any business you would either be pushed into a chapter filing, you would be foreclosed on, you would lose your assets technically, correct?

Mr. WALKER. Something adverse would happen, yes.

Mr. FOLEY. However, the government can go along and whistle by the graveyard and print money at this kind of notion if we don't do something soon.

Mr. WALKER. It can print money, it can borrow. It can increase taxes. It has a number of options available that corporations do not have.

Mr. FOLEY. Last year when we were having debates about tax relief—and we have heard a lot of conjecture that if we had not passed tax cuts we wouldn't be in a financial crisis. My colleagues on the other side of the aisle advocated for reduction in the payroll taxes at that time instead of reducing other taxes. Would a reduction in payroll taxes in effect weaken the system?

Mr. WALKER. It would, one, add to the deficit, and it would also reduce the cash flows coming into Social Security, so, yes.

Mr. FOLEY. It would have further exacerbated the problem——

Mr. WALKER. Yes, unless you replaced it somewhere else.

Mr. FOLEY. It is interesting to me as well—I come from the fifth oldest Medicare eligible population in America. Number one is in Florida. I think the top ten are all in Florida. So, certainly Medicare is critical to our constituents. One of the patterns of behavior I notice about my constituents as well is they are very prudent

when shopping for returns on their investment. In fact, several will drive across town, if they can get a higher rate on a CD at a bank. They will use a lot of energy to increase the yield on their own personal savings. I think that is a dramatic representation of how smartly they manage their money. I guess I am talking aback when we talk about giving them a chance to possibly have their own accounts, that somehow there is this fear factor. So, I would like you, if you could, dispel at least the factor of compounding interest. The higher the interest, the larger the aggregate return on investment.

Mr. WALKER. Well, the so-called miracle of compounding. To the extent that you have earnings compounding over time, that is obviously a positive thing. Right now, unfortunately, as a country we have the miracle of compounding working against us. We have debt on debt, interest on interest in the negative sense, which we have to take care of. I think one of the things you would have to keep in mind is if you have individual accounts how many options would people have because you would not want it to be very complex. What type of assistance are you going to give them in determining how to invest their account? What if any default options will you have for people who are not comfortable making those decisions to do it in a manner that considers their age and certain factors like that? I think the Federal Thrift Savings Plan is a pretty good model, that as a foundation, possibly with some enhancements with some age-based investment options or other things, could be a way to move forward if you decide to proceed with individual accounts.

Mr. FOLEY. I am glad you mentioned thrift savings because I have been a member since 1994. I have been here 10 years, and I have looked. Even during difficult years, average return on my investment using either the fixed income formula or the more aggressive equity has been between 6½ and 11 percent over those 10 years on average. So, while there have been excellent years, there have been some declining years based on the bubble of the stock market. Over all over those 10 years the significant return on investment has maximized my retirement savings. I think that is a point that has to be emphasized, that if it is safe enough for Members of Congress, worthy enough for Members of Congress, we should not necessarily fear at least debating it as a conceptual plan for our citizens.

Mr. WALKER. I think you are right in not fearing to debate it, but I think you also have to keep in mind, Mr. Foley, that the Federal Thrift Savings Plan for you is like an employer sponsored plan for somebody in the private sector.

Mr. FOLEY. Correct. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. Does the gentlewoman from Ohio wish to inquire?

Ms. TUBBS JONES. Thank you, Mr. Chairman.

Mr. Walker, good afternoon. How are you, sir?

Mr. WALKER. Well, thank you.

Ms. TUBBS JONES. I want to read a quote from your GAO report, and it says, "Social Security represents the foundation of retirement income for millions of Americans and has helped to prevent many former workers and their families from living their retirement years in poverty. It provides millions of Americans with

disability insurance and survivor benefits, thus providing benefits that are critical to the current and future well-being of tens of millions of Americans." Earlier in your testimony you said that the Social Security Trust Fund wasn't really a trust fund, right?

Mr. WALKER. That is correct.

Ms. TUBBS JONES. To millions of Americans, seeing that we have represented to them that it is a trust fund, and that the people who handle the trust fund are called trustees, and there are reports dating back to 1929, 1938, whenever it was created. You have created a legal fiction that there is a trust fund, correct, sir? Not you personally, but we have represented to America that there is a Social Security Trust Fund.

Mr. WALKER. I think quite candidly, the trust fund really confuses the issue.

Ms. TUBBS JONES. I didn't ask you whether it confused the issue. I have asked you for millions of Americans for decades we have created a legal fiction that there exists a Social Security Trust Fund upon which they can rely.

Mr. WALKER. I think most Americans think that there is a separate trust fund like a trust fund that you would normally think of that has real money in it, and that is not the case.

Ms. TUBBS JONES. Well, but they do know that there are trust fund dollars or Social Security dollars that they have put into a fund and they have an expectation of receiving the benefit, correct?

Mr. WALKER. Absolutely, and I think to the extent that the government has backed by the full faith and credit these bonds, I think it will deliver on them.

Ms. TUBBS JONES. In fact, China, Japan and a whole bunch of other foreign countries think our money is so good that they are willing to invest tons of dollars in the United States and believe we are going to pay them back, correct?

Mr. WALKER. Correct. The question is how much longer.

Ms. TUBBS JONES. So, the people of America shouldn't think that we are going to pay Japan and China back before we are going to pay ourselves, should they?

Mr. WALKER. Oh, absolutely not. Don't——

Ms. TUBBS JONES. I just want to be clear so you don't represent to America, all that is listening, that even it may not be a legal trust fund as you want to say it would be because you are from Arthur Andersen or whatever other accounting firm, that it is in fact a trust fund upon which they can rely and that they paid into?

Mr. WALKER. What they can rely upon is the fact that the bonds that are in the trust fund are backed by the full faith and credit of the United States government.

Ms. TUBBS JONES. Everybody else thinks that the full faith and credit of the United States is big enough for them to invest trillions and billions of dollars into America, and they hold the paper that creates the deficit that we now have as a country, right?

Mr. WALKER. I believe we will deliver on that promise both to people who have—both to the trust funds as well as to those that are public investors outside the trust fund.

Ms. TUBBS JONES. The people of America expect we are going to pay them before we are going to pay Japan and China.

Mr. WALKER. The answer is we are going to pay them when the trust fund—when we get a negative cash flow and these bonds are going to be redeemed to the extent and at the time necessary to pay back——

Ms. TUBBS JONES. All I want to say, Mr. Walker, and all the people of America want to know is that you are not representing that the United States of America will not pay the money owed to Social Security, people who have paid in over decades what they are entitled under Social Security.

Mr. WALKER. I think I have been consistent on that, that the bonds——

Ms. TUBBS JONES. All I am asking for is a yes. Let me——

Mr. WALKER. The government will deliver on the bonds.

Chairman THOMAS. Let Mr. Walker——

Ms. TUBBS JONES. Thank you very much. Now, you did speak to the issue we need facts with a bipartisan solution, is that correct?

Mr. WALKER. Correct.

Ms. TUBBS JONES. Would you say that the Medicare prescription drug program was facts with a bipartisan solution?

Mr. WALKER. I would say you didn't have all the facts, and you certainly didn't have a broad based bipartisan solution.

Ms. TUBBS JONES. We didn't have all of the facts, but what you are advocating right now is facts with a bipartisan solution.

Mr. WALKER. First you have to have the facts. Then you have to develop a bipartisan solution based on them.

Ms. TUBBS JONES. We are saying the same thing, Mr. Walker. I want to enter into the record a copy of a newspaper article from the Cleveland Plain Dealer, which is my local newspaper, today, and what it says is——

Chairman THOMAS. Without objection.

[The information follows:]

March 9, 2005 Wednesday
Final Edition; All Editions

Medicare drug plan backfires on states; Seniors' switch from Medicaid will boost costs by millions

Susan Jaffe, Plain Dealer Reporter

The Medicare prescription drug benefit is backfiring on states—running up millions of dollars in extra drug bills instead of the savings promised by its Republican supporters.

Under the new drug benefit that starts in January, seniors enrolled in state Medicaid programs will get their drugs instead from Medicare, the Federal health plan that covers 41 million older Americans. States will have to pay nearly all the cost.

Ohio will owe Medicare $55.7 million more in 2007 than the state would have paid without the new benefit, estimated Barbara Edwards, Ohio's Medicaid director.

"It's pretty disturbing," she said.

That's enough to restore the proposed cuts in dental and vision coverage for nearly 1 million adults receiving Medicaid, Edwards said. Medicaid provides health insurance for low-income families paid for by state money with a 60 percent Federal matching contribution.

More than 200,000 Ohio seniors on Medicaid will have to switch to Medicare for drugs.

California will spend roughly $215 million more in the first year of the program, said Medicaid Director Stan Rosenstein. He said that amount will only increase in the future.

The payment formula is based on states' 2003 drug bills, which don't reflect the latest cost-savings, among other things. It also doesn't allow states to negotiate prices with drug makers, as they do now to get bargains on Medicaid drugs.

The extra costs couldn't come at a worse time: the Bush administration wants to cut $60 billion from its share of Medicaid. Gov. Bob Taft wants to tame what he calls the Medicaid "monster" by trimming $2.3 billion in the next 2 years. The state's Medicaid spending is outpacing growth in state revenue and consumes the largest portion of the general budget, exceeding the cost of primary and secondary education.

The day before Sen. George Voinovich voted for the Medicare drug benefit in 2003, his spokesman said the legislation would save Ohio's Medicaid program $700 million over 8 years. Messages left with the senator's staff were not returned Tuesday.

What happened? How did the savings turn into a multimillion-dollar liability?

Look in the fine print.

The law requires states to continue to pay 90 percent of their share of drug costs for Medicaid-eligible seniors. But instead of paying actual costs, the drug bill is based on what the states paid in 2003—when the seniors were still in Medicaid—plus an extra adjustment to reflect the annual rise in medical costs, explained Edwards, who has a national reputation as an expert on Medicaid intricacies.

That's a terrible year to base costs on, according to Edwards. It doesn't include rebates from pharmaceutical companies for drugs purchased that year but received in the following year. It doesn't include additional rebates that Ohio negotiated with drug makers that took effect in 2004, along with other measures that reduced costs that year.

"We're not going to get credit for that," Edwards said. "They're starting with a base rate that's too high."

And states will be stuck with it, year after year.

Plus there are other ways the states are getting shortchanged, she said.

"The other thing that causes some heartburn is that we're paying costs for a formulary that doesn't reflect what Medicare is buying," Edwards said.

Medicaid covers any FDA-approved drug, and the Medicare drug benefit does not. Medicaid also covers some over-the-counter medicine and vitamins that are cheaper alternatives to prescription drugs, but they are also not covered by Medicare.

Drugs are not the only costs that states will have to pay. Edwards' staff is still analyzing how much Ohio will have to spend in administrative costs to meet other requirements in the law, including handling applications, educating the public and determining eligibility.

When the Federal Centers for Medicare and Medicaid Services, or CMS, issued rules implementing the drug benefit, agency officials rejected suggestions to make some adjustments in the drug payment formula.

"The law is pretty clear," said CMS spokesman Gary Karr. "We can't change the 2003 base year."

If states have questions about how their drug costs are calculated, they should contact CMS, he said.

"We want to get these payments right."

And states shouldn't lose sight of "the big picture," he added. Along with other employers, states can apply for money from Medicare to subsidize drug coverage for retired state workers. So overall, the new Medicare law will save states money, he said.

Officials at the Ohio Public Employees Retirement System have estimated that the subsidy would save PERS about $50 million a year in drug costs, if they apply for it and meet the eligibility requirements. But it is not clear whether that money must used exclusively by PERS or if it could be applied to shore up Medicaid.

Last week, Gov. Bob Taft and his colleagues in the National Governors Association unanimously supported a resolution asking Congress and the Bush administration to revise the reimbursement formula.

Taft has also written and met with CMS chief Mark McClellan, and he received assurances that the Federal agency will look at how Ohio's drug cost was calculated. California has also objected, seeking a reduction in its drug bill.

Ms. TUBBS JONES. Thank you, Mr. Chairman. That the Medicare prescription drug benefit is backfiring on States, running up millions of dollars in extra drug bills instead of the savings promised by its Republican supporters. Under the new drug benefit that starts in January, seniors enrolled in State Medicaid programs will get their drugs instead from Medicare, the Federal Health Plan

that covers 41 million older Americans. Ohio will owe Medicare $55.7 million more in 2007 than the State would have without the new program. That is what happens when you have not all the facts, and a not only totally bipartisan solution on our government program, is it not, sir?

Mr. WALKER. It evidently did happen last time. Let's hope it doesn't again.

Ms. TUBBS JONES. That is why when you are representing to the people of America about individualized accounts that we must give them the whole truth and nothing but the truth, in fact, that they may have to pay a tax on the individualized account, in fact, that the tax may eat up any individualized or privatized account that they have, and you haven't talked about that today.

Chairman THOMAS. The gentlewoman's time has expired.

Ms. TUBBS JONES. Thank you, Mr. Chairman. I would like an answer in writing, please.

Mr. WALKER. The problem is, is that we need a full plan to be able to comment.

Chairman THOMAS. Mr. Walker, would you supply a written answer?

Mr. WALKER. I would be happy to, Mr. Chairman.

Chairman THOMAS. The Chair, once again for the accuracy of the record, would invite Members to examine the Medicare legislation in which there is a progressive buyout of the State based upon the previous State/Federal relationship under Medicaid transferring seniors to Medicare. That was in the legislation. It was not an inadvertent mistake, as I believe, Mr. Walker, you characterized it.

Mr. WALKER. I don't think I did, Mr. Chairman, but I will check the record. I didn't intend to do that, that is for sure.

Chairman THOMAS. Well, you indicated that you supported her assumption based upon the newspaper article.

Mr. WALKER. My point is I don't think that you necessarily had all the facts, including the cost of the drug benefit. I will check it, Mr. Chairman.

Chairman THOMAS. Her point in the article was transference of an obligation from the State of Ohio.

Mr. WALKER. Right.

Chairman THOMAS. Previously under Medicaid, to a change in the benefit structure of seniors' prescription drug now under Medicare.

Mr. WALKER. Right.

Chairman THOMAS. It was, in fact, in the legislation. That was the only point the Chair wanted to make so that the record is clear rather than perpetuating a misunderstanding. The Chair recognizes the gentleman from——

Ms. TUBBS JONES. Mr. Chairman, for the record——

Chairman THOMAS. —Indiana, Mr. Chocola—yes?

Ms. TUBBS JONES. Mr. Chairman, for the record, I think that we ought to have opportunities to clear up assumptions, as you do, at the end of the testimony or examination of witnesses. I just want to register that for the record. Thank you.

Chairman THOMAS. I appreciate the gentlewoman's clarification, and the job of the Chair—the job of the Chair—is to make sure that the record is accurate, and the Chair will make sure the

record is accurate. The Chairman recognizes the gentleman from Indiana, Mr. Chocola.

Mr. CHOCOLA. Thank you, Mr. Chairman. Thank you, Mr. Walker, for being here today. You and I first met shortly after I was elected a couple years ago at an orientation for new Members in Baltimore. I was impressed with your approach to this issue then, and I hear greater urgency in your voice even today, and I appreciate your factual approach to a very important issue. We hear some characterization of some of the proposals as "risky schemes." Is the current Social Security system without risk?

Mr. WALKER. Well, there is a risk now. The fact of the matter is it is not adequately funded.

Mr. CHOCOLA. Are the benefits guaranteed under law?

Mr. WALKER. No. The Supreme Court has stated that Congress has the right to change it. I think realistically, to the extent that there is adequately payroll tax revenues and to the extent that there are accumulated bonds that are guaranteed by the full faith and credit of the U.S. government, at least to that extent the government will deliver on that. Beyond that, Congress might decide to change it.

Mr. CHOCOLA. So, doing nothing could be characterized as risky?

Mr. WALKER. Doing nothing means that we are going to head to a precipitous decline in benefits. Remember the notch baby problem? This would be a notch baby problem magnified multiple times, and it should not be allowed to happen.

Mr. CHOCOLA. I just want to make sure I heard you correctly in your earlier testimony. I don't want to revisit a lot of the testimony you have given. I think you said that the special issue bonds in the trust fund essentially have no economic value. Did I hear you correctly on that?

Mr. WALKER. I may have said that, and what I mean by that is since they are not readily marketable that you can't exchange them in the market in order to be able to generate revenues. You have to rely solely on the government to be able to do it at the time, to the extent that you need it.

Mr. CHOCOLA. That in part is why you say that the trust fund does not meet your or Webster's definition of a trust fund, because of the lack of marketability of these assets?

Mr. WALKER. No. The other reason is that typically trust funds are deemed to be separate and distinct legal entities. They are not deemed to be a subset of the general ledger of the employer or the foundation. If you look at the financial statements of the U.S. Government, if you look at the budget of the U.S. Government, we are consolidating the results of the trust fund with the ongoing operations of the government. If you look at the financial statements, we are netting these two out. We are not treating it as a separate and distinct legal entity. That is how a trust fund would be treated.

Mr. CHOCOLA. It is, as you said, an accounting device.

Mr. WALKER. Yes, but, again, what is more important is not the accounting device. It is the revenues and it is the bonds. That is what is more important.

Mr. CHOCOLA. So, whether they are add-ons or carve-outs, whatever they may be, if personal accounts are part of a bigger

package of solutions, would personal accounts come closer in the definition of a trust fund?

Mr. WALKER. If you had personal accounts, presumably those personal accounts would be invested in something, for example, possibly like the investment options of the Federal Thrift Savings Plan. Those would have to be held in trust for the benefit of those individuals, and that aspect of it presumably would be characterized more like a regular trust fund. Then you would have to determine how you are going to pay for those, what are people going to get through the defined benefit system, and how is that going to be structured.

Mr. CHOCOLA. So, if you had funded personal accounts, they would be closer to the definition of actual trust fund?

Mr. WALKER. Presumably they would be held in trust, yes.

Mr. CHOCOLA. If you borrowed money to fund these personal accounts, would that be new debt or would that be just recognition of existing unfunded liabilities?

Mr. WALKER. There are two ways to look at it. First, if you borrow money to fund individual accounts, you are not increasing net savings today because what ends up going into the personal accounts has to get barred outside and, therefore, it is a negative for the government, and it is a positive for the individual accounts. Again, your question, I want to make sure I am answer it. Would you please let me know the balance of the question?

Mr. CHOCOLA. Well, if you borrow money to help fund these personal accounts, whether they are inside or outside, carve-outs or add-ons, would it be new debt or would it be just earlier recognition of existing unfunded liabilities?

Mr. WALKER. The answer to that is it would be new debt held by the public, but then you would have to look at what is the total cost of the reform plan on a discounted present value basis versus when that is recognized. So, it would be new debt. At the same point in time, as I mentioned before, when you are doing a reform, I think you have to consider it based on cash flow, which is the budget way that we typically do things, and discounted present value. There could be a circumstance in which you solve the problem long term, but you have negative cash flows quicker that are offset more over time that actually solve the problem, but you are going to take on more debt earlier than otherwise you would have if you did nothing. I hope I didn't confuse anyone.

Mr. CHOCOLA. Thank you very much.

Mr. WALKER. Thank you. I would be happy to meet separately with any of you.

Chairman THOMAS. I thank the gentleman. The Chair understands that many Members believe that when the Chair pauses to correct the record, that that is somehow unfair because they wish to get their point in and then have it be assumed to be factual, accurate, or truthful. The Chair will attempt to correct the record when any Member on either side of the dais makes a statement which really is not sustainable. The Chair will do it again right now because the argument and the discussion—and many of the Members—one of the reasons I want to make sure we begin to get into these debates, Mr. Walker, you brought up the question of notch babies, which somehow provided someone with less than they

should have gotten. The correction in terms of the payment was because Congress made a mistake on an inflator, and it created a double bonus rather than a single bonus.

The actual correction should have been to take those people born prior to 1917 and take money away from them, so they would not have had a greater amount and there would have been no notch. So, to argue that this is analogous to the notch babies means that the benefit reduction that occurred in 1983 created a whole new set of notch babies because they are not going to get the same benefits that the previous dated people got. So, the argument of notch babies and somehow an unfairness of benefits is not analogous in this situation with the previous situation.

Mr. WALKER. Mr. Chairman, I——

Chairman THOMAS. Do you agree with that?

Mr. WALKER. I agree with what you said. Let me tell you what I meant by that. What I means was where you would have individuals who precipitously would be treated differently 1 month later as compared to the prior month—in other words, where you would have individuals that would receive a dramatically different result based upon a moment in time. So, I really that there are differences between those two. That is the point that I am trying to make.

Chairman THOMAS. The Chair will continue to emphasize the fact that in 1983, as he indicated at the beginning, there were two benefit reductions. One, of course, was the retirement age extension. The other one was the 6-month delay in the COLA, which produced literally in 1 month an amount that changed in the next month.

Mr. WALKER. Right.

Chairman THOMAS. "Precipitous" might be the correct explanation of that situation. So, in that situation, it was a notch baby, and the Chair would wish, as we try to examine history and look at what we are doing now and going forward, to underscore the fact that it is not an entitlement. Congress can at any time change the benefits if they believe that a previous decision was imprudent or ill-advised.

Mr. WALKER. Right.

Chairman THOMAS. We have got to keep that in front of us as we move forward, or we are going to quote the record of this Committee as having meant something when, in fact, it should not. That is the reason the Chair feels compelled periodically to correct the record, so when you go back and look at that discussion it does not leave you with the fact that what we are doing is, in fact, creating a whole new universe of "notch babies."

Mr. WALKER. Oh, absolutely not. One of the reasons, Mr. Chairman, that you are making, which is excellent, another reason why we should act sooner rather than later, is so we can transition over a period of time and avoid precipitous and dramatic changes.

Chairman THOMAS. The Chair thanks the indulgence of the Committee, and the Chair would recognize the gentleman from California, Mr. Thompson, if he wishes to inquire.

Mr. MCDERMOTT. Mr. Chairman, a point of information. Will there be a time for us?

Chairman THOMAS. The Chair would indicate that the gentleman from Washington, although he is allowed, the gentleman from Washington, to speak on what he calls a point of information, in fact, there is no such thing as a parliamentary point of information. The gentleman from California is recognized.

Mr. THOMPSON. Thank you, Mr. Chairman. I commend the Chairman for the courage of revisiting the notch baby issue during a televised hearing. Mr. Walker, thank you very, very much for being here, and I agree with our colleague, Mr. Tanner, who said that your presentation is one of the best that we have been exposed to, and your honesty in pointing out these problems is very much appreciated. On page 7 of the chart that you handed out, the color chart—I don't know if we can get that back on the screen. I think this illustrates the amount of interest, and someone else had talked about this earlier, but for my clarification—the bar graphs. For my clarification, this says that if we continue to grow discretionary spending to correspond with GDP and the tax provisions are extended, in 2040 all of the money that we take in at the Federal level will go to pay the interest and that everything above that bar line, the revenue line, will be unfunded. That includes Medicare, Medicaid, all other spending, and Social Security. So, we will have enough revenue—only enough revenue to deal with the interest on our debt.

Mr. WALKER. You could pay a little bit more on that, but not much more.

Mr. THOMPSON. Not much. Well, I think that is the most telling chart of everything that we have seen so far. It brings me to my first question. It seems to me that if we do not take steps—I think we are past due, but we need to take immediate steps to get this under control, notwithstanding anything else that we are doing in Congress today. It seems to me the first step would be to enact a strong or reinstate a strong PAYGO provision so that we do not spend any money that we do not have or that everything we do we pay for. Would you agree that this is an important step?

Mr. WALKER. I have testified previously before the Budget Committees and elsewhere that PAYGO is one of the budget reforms that the Congress should seriously consider and that PAYGO should apply on both sides of the ledger.

Mr. THOMPSON. It was, in my view, a mistake to allow it to expire. It was a bigger mistake not to enact it. You point out the fact that it needs to be on both sides, expenditures and revenues. I think if we do not do that, it does not matter what else we do. We are going to be where Mr. Tanner suggested we are headed, and that is on a course of true bankruptcy, and that is going to be devastating to everything that our great country stands for.

Mr. WALKER. Mr. Thompson, I also think that in addition to looking at it on both sides of the ledger, you also need to consider the discounted present value dollar cost of big-ticket spending and tax proposals before they are enacted into law. For example, in the case of Medicare prescription drugs, take the $395 billion, which was CBO's as the Chairman said. I think it would have been prudent for the Congress to also have the $8.1 trillion number before it voted on the bill.

Mr. THOMPSON. I think there is a lot of more prudent fiscal practices that we can and should take. I want to talk about your findings in regard to savings. You talked specifically about the privatization component of the President's proposal not adding to the savings. I thought one thing was missing that I think should be at least looked at, and that is that in addition to low personal savings right now is the high personal debt. I think it is about a $6,000 per person increase in debt over the last or within the last decade. I don't think you can—I think the two have to be coupled, and it is another alarming indicator that we should be concerned about as we are dealing with this. Your point on the privatization component of the President's proposal not providing any additional savings I think is important for us to consider. Also on those private accounts, reading your statement and what I have heard today, we know that it does not fix the problem that we are all concerned about regarding Social Security. It does not do anything to increase savings, which we are all concerned about. It does not do anything to reduce the amount of private debt. It takes—or it moves Social Security out of the defined benefit box into a more risky column for everyone who is now or will be getting Social Security. So, what does it do?

Mr. WALKER. Well, for one thing, Mr. Thompson, whether or not it would increase savings——

Chairman THOMAS. The gentleman's time has expired, and the Chair would anticipate the General would respond in writing. Does the gentleman from Texas, Mr. Brady, wish to inquire?

Mr. BRADY. Yes, Mr. Chairman. Thank you, Mr. Walker, very much, and I appreciate your overview. You have raised, I think, a very sobering assessment of very serious challenges facing not just Social Security but as a Federal Government and as savers for families. It seems to me from your testimony there are really two questions Congress ought to pose to itself before we tackle the issue of Social Security. The first one is: Are we going to preserve Social Security for every generation? It is clear that we have the funds and the demographics for our seniors today. We may—may—be able to preserve Social Security through the baby boomers. We certainly cannot keep that promise for young people.

One of the issues today, I think, that that question is so serious is because it really dictates the solutions we look at. The second question facing us is: Are we going to solve Social Security once and for all? As you said, sustainable solvency is the goal, not simply kicking the can down the road a few more years. Which brings me to my question. A number of real credible groups and read credible lawmakers have said, you know, Social Security really is not a problem, we can preserve it simply by tweaking it, that we can tweak Social Security to solve the problem. Do you think it is a credible statement given the serious challenges we face to say——

Mr. WALKER. I wouldn't consider $3.7 trillion a tweak.

Mr. BRADY. That is my thought, and it seems to me that it is going to take some serious and substantial reforms looking far beyond a few years in order to really preserve this Social Security system for every generation. The second point you made and cautioned us against, which I think is a critical one—and when I visit in my Social Security workshops that our audiences always appre-

ciate—is the issue of ending up right back where we are today. You made the point that in the past Congress has taken sort of a proven path, raised taxes, decreased benefits. We kick the can down the road 15 or 20 years, almost automatically, but we end up right back where we are only the problem is more severe. Today I heard you caution us again not to seek solutions that kick the can down even farther than that, but end us right back up here only with even a more serious problem at the time. Do you want to elaborate on that?

Mr. WALKER. Typically what has happened in the past is that people have looked to achieve solutions that provide for actuarial balance over 75 years. My point is because of known demographic trends, if you do that, it means you still have a significant long-range problem that otherwise you are going to address. I would respectfully suggest that the Congress should try to, among other things, achieve sustainable solvency, meaning not just actuarial balance over 75 years, but at the end of 75 years the lines both as to projected revenues and expenditures are such that you are not by definition going to have to come back, that hopefully you won't have to, but you are not pre-programmed to have it.

Mr. BRADY. So, in essence, your answer to the question of should we solve it once and for all or should we preserve it beyond just, you know, a set date is yes, we ought to look for a solution that is long-lasting.

Mr. WALKER. You should try to preserve it for current and future generations.

Mr. BRADY. A final point, Mr. Chairman, before I hang up here. In my Social Security workshops, you know, mine have been very encouraging, even in some of my most rural FDR Democrat communities. At the end, most of my seniors say, look, it looks like we are very sound in this, but you need to start working on a solution for young people, and don't put it off any longer. Sometimes I will run into a senior who literally—I had one in east Montgomery County, she literally covered her ears and said, "Social Security has worked beautifully for all these years. Why can't you just leave it alone?" How would you answer that question?

Mr. WALKER. Well, first, most of the proposals that I have heard or seen would leave current retirees and people nearing retirement alone. They would get the current promise. The irony is they are the ones in many cases that are the most insecure. I was in Alabama—I am from Alabama originally. I was down there speaking a week and a half ago to 300 students, business leaders, the faculty, and others. Of the roughly 300 students I spoke to, only five thought they were going to get Social Security. They are wrong. So, the fact is that most of the proposals that I have seen are current retirees and near-term retirees will not be touched. The question is: What are you going to do for the younger people? How is the program going to be reformed to make it solvent, sustainable, and secure for them? That is what the debate is about, I think.

Mr. BRADY. Right. It is hard with all this rhetoric sometimes to get to that end answer, but the sooner we do, the better. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Connecticut, Mr. Larson, wish to inquire?

Mr. LARSON. Yes, I do, Mr. Chairman, and thank you. Thank you, Mr. Walker, for your frank testimony today. Because I know that my mother and a group called the Golden Girls are going to be tuned into this broadcast, for the record—and I think you have said this several times, but I just want to assure them—has Social Security ever defaulted on any payment to any individual, whether they are receiving disability, survivor's insurance, or their retirement?

Mr. WALKER. It has not.

Mr. LARSON. As you have testified, do you anticipate that that would ever happen in the future?

Mr. WALKER. I expect that the government will end up delivering on its promises in relationship to the bonds that are backed by the full faith and credit of the U.S. government. I expect that the Congress will end up reforming Social Security that will make changes to some people going forward.

Mr. LARSON. That is largely because, as you have stated throughout the hearing, it is the full faith and credit of the United States government that stands behind Social Security.

Mr. WALKER. It stands behind the bonds. It does not stand behind Social Security. It is very important to understand the difference. The Supreme Court has already said that the Congress has the right to change Social Security anytime it wants. However, to the extent that people have paid in payroll taxes, which they have to the extent of $1.5 trillion, and to the extent that those bonds are backed by the full faith and credit of the United States government, the government has never defaulted on that, nor do I expect that they will. I think that is important for people to understand.

Mr. LARSON. I thank you for clarifying that point and putting my mother and others at ease. As others have testified and have suggested, your charts are very revealing, and I think—is it safe to say that based on looking at those charts from a novice' perspective, not having the kind of background that you have, the Nation is more likely to go broke before Social Security is based on our inability to pay? If we remain on this unsustainable path that you have——

Mr. WALKER. Based upon the two scenarios you saw, in the case of the first scenario Social Security would go insolvent before the Nation. In the case of the second scenario, it would be about the same time.

Mr. LARSON. So, as you have suggested—and I think this is what Mr. Rangel asked for at the outset of the meeting—what we need is nonpartisan facts and a bipartisan solution. Now, the Chairman has also said on several different occasions—and I commend him for this—that oftentimes we find ourselves pushing the same pieces around in the box, and what we need to do is think outside the box. You came to the precipice—at least I thought you did a couple of times—of recommending a solution. One of them I thought I heard you say—and I would like you to clarify—is looking at getting a greater return on our monies that are being—the surplus dollars that exist. I thought I heard you talking about giv-

ing marketing capability that would provide us. Are those a couple of solutions? Could you enumerate on those, please?

Mr. WALKER. Those are something you could consider. You could consider whether and to what extent any surpluses that exist in Social Security might be invested differently. Keep in mind you are only going to have surpluses now for another 13 years, and then you are going to run to deficits. That by no means would solve the problem. It would not come close to solving the problem, but it could lessen potentially——

Mr. LARSON. Is that something you would suggest to the trustees that they should look at?

Mr. WALKER. Well, I think it is something that needs to be on the table. I think a number of things have to be on the table.

Mr. LARSON. Well, I agree with you that all of those have to be on the table. You also mentioned, in looking at the projected deficit that we had, and you went through our unified budget and the on-line budget, and so forth, and what kind of ramifications, and you said that—and correct me if I am wrong. How much of this deficit is not attributed to the current war on terror?

Mr. WALKER. For fiscal year 2004, we ran a unified budget deficit of $412 billion. Less than 25 percent of that had anything to do with the global war against terrorism or incremental homeland security costs.

Mr. LARSON. I believe you said to Mr. Tanner's questions earlier also that in terms of the debt that we are incurring, 83 percent of that debt was purchased by foreign countries?

Mr. WALKER. I think Mr. Tanner said it was 83 percent during a certain period of time. Last year alone it was over 90 percent.

Mr. LARSON. So, this issue of paying interest exacerbates the problem that we have with Social Security. To Mr. Doggett's point, perhaps we need to be considering taking care of Social Security, and I think you would say Medicare, in that order.

Mr. WALKER. I think you have to take care of both Medicare and Social Security, but I think that Social Security is a lot easier lift. You can get a win on Social Security. You can exceed the expectations of every generation of Americans. Hopefully that will increase our credibility with the markets and enhance confidence to be able to deal with some of the heavy lifting.

Mr. LARSON. So, you would be an advocate of paying into that rather than providing tax cuts, as one, perhaps one of the solutions.

Mr. WALKER. I don't want to get to that degree—I have said that I think it is important that you consider entitlement reform, mandatory spending, discretionary spending, and tax policy review.

Mr. LARSON. Thank you very much.

Mr. WALKER. You are going to have to do all of those.

Mr. LARSON. Thank you, Mr. Chairman.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from Illinois wish to inquire?

Mr. EMANUEL. Thank you, Mr. Chairman. Thank you for being here, Mr. Walker, and for your testimony. You had mentioned I think earlier in your opening testimony about the fact that you see truly a savings deficit in this country, that we have both a trade deficit, account deficit, and we have run up close to about $1.8 tril-

lion in the last 4 years onto the Nation's debt, and we are presently running a little over $450 billion a year in deficit. Correct?

Mr. WALKER. Correct.

Mr. EMANUEL. That the savings crisis we have, as I understand it, is we have about 80 percent of the small business employees in this country do not have an employer-based savings plan. Basically for about 40 percent of the households in America, 28 million households, Social Security is their only retirement plan. Then as you said, I think, less than 50 percent of the people have any savings outside of Social Security. Correct?

Mr. WALKER. I said less than 50 percent of the people are covered by a private pension plan.

Mr. EMANUEL. Private pension plan. You know, what I believe one of the things that we need to be addressing at this point is what I call—you call it the saving deficit—initiating more people saving for their retirement. Some ideas we have put forward, a universal 401(k) account where everybody would get that; direct deposit of your tax refunds into your savings plan as a way to generate that type of savings. There could be structural things we could do to save, improve the savings of Americans. Have you ever looked at anything like that?

Mr. WALKER. I have not looked at that particular one. I do think that one of the things we need to be thinking about is what can be done to try to create easy, potentially even automatic savings vehicles where individuals won't touch the money because once you touch the money, it tends to be spent. Candidly, the government is not leading by example. I mean, you know, we are dissaving. We are running up deficits. We are consuming way more than we have revenues for, and that is what many Americans are doing, too.

Mr. EMANUEL. You acknowledge, though, in the nineties from where we started to the end of the nineties, we added a little over a decade to the longevity and the health of the Social Security trust fund; that by the end of the nineties, beginning on this doorstep of the 21st century, we had added, if I am not mistaken, close to 14 years to the lifetime of the trust fund in the sense that before, one predicted that it would become insolvent or start to run, rather, a deficit. Correct?

Mr. WALKER. It went up, and I would respectfully suggest, Mr. Emanuel, that you may want to talk to the trustees about——

Mr. EMANUEL. Okay. It had gone up, my calculation, if I remember correctly, over 14 years, and one of the reasons was we ran an economic policy, both here in the government and also in the private sector, that basically created surpluses, reduced the capacity of the Nation to borrow, and that, therefore, by having the kind of surplus we had, we increased the savings, total savings dollars for the country and put ourselves in an economic position, given the growth of the economy, to, in fact, improve the longevity of the Social Security trust fund. The first thing you should do is no harm, and that means putting our fiscal house in order.

Mr. WALKER. Well, for a period of time, we ran Social Security surpluses, and we used those surpluses to pay down debt held by the public, because as has been mentioned before, Social Security has to invest in government securities under current policy.

Mr. EMANUEL. If, in fact, over the next—the economy has been growing in the last 25 years on average 2.8 percent. If, in fact, we continue to do that over the next 50 years and did what we did for the last 25 years, you would add close to a little over—a little shy of two decades to the health and longevity of the trust fund without having done anything, just as is. Correct? Incorrect?

Mr. WALKER. I don't know what the exact numbers would be, but that is a higher growth rate than otherwise is being assumed by the trustees, so obviously——

Mr. EMANUEL. No, I understand that. The trustees are assuming that the economy would only grow at 1.8 percent.

Mr. WALKER. At 1.8.

Mr. EMANUEL. They do assume that in your private account while you are investing, you would do close to a little—like 6 percent, which my own view is the only way you can do 6 percent with an economy growing at 1.8 percent is you are buying American stocks short because you think the economy is doing bad. There is no way consistently that you can see the private accounts having a net 6-percent return while the economy is projected by those on the trust fund, the trustees, is growing at 1.8 percent. Yet in the last 25 years, the economy grew at 2.8 percent. If we just did—if we were able to have an economic strategy that permitted for that, rather than borrowing from the future, we would, in fact, have—the longevity of the trust fund would be just—I wouldn't say fine, but, in fact, we would be adding close to two decades.

Mr. WALKER. I think we have to look at——

Chairman THOMAS. The gentleman's time has expired, and I think——

Mr. EMANUEL. Thank you, Mr. Chairman.

Chairman THOMAS. The Chair thinks that is a perfect segue into the trustees so we can ask them directly rather than having Mr. Walker demur in hopes that we would ask the trustees. Mr. Walker, during the discussions, you mentioned a number of particulars. You responded to Mr. Larson. Several times you indicated expanding the taxable wage base. There are other options that you talked about. The Chair would be grateful if you would in a concise fashion, not necessarily bulleted but with short explanations, provide a series of options that the General Accounting Office has looked at and that you wouldn't necessarily recommend but you could certainly provide as a list that we could examine as we go forward. I think that would be useful to us as we move forward.

Mr. WALKER. On behalf of the government Accountability Office, I would be happy to do that. Again, we will not make a recommendation, but we will put a number of things that I think you should at least consider. Thank you, Mr. Chairman.

Chairman THOMAS. It would at least help us in our examination of options because, in putting all options on the table, we want a request from everyone who is involved in this whatever options they think should be on the table. Thank you very much for your testimony. I look forward to your visiting the Committee again.

Mr. WALKER. Thank you, Mr. Chairman.

Chairman THOMAS. Thank you. It is now the Committee's pleasure to ask Mr. Thomas R. Saving and John L. Palmer, both of them Ph.D.s, who are public trustees, Social Security and Medi-

care Trust Funds. Dr. Saving is from College Station, Texas, and Dr. Palmer is from Syracuse, New York. The Chair would once again indicate, as he did with Mr. Walker, that these gentlemen became trustees of the Social Security and Medicare system in the previous Administration. Gentlemen, welcome to the Committee. Your written statements will be made a part of the record, and you can inform us in the time that you have in any way that you see fit. We will probably start with Dr. Palmer and then move to Dr. Saving.

STATEMENT OF JOHN L. PALMER, PH.D., PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE TRUST FUNDS, SYRACUSE, NEW YORK

Dr. PALMER. It is our privilege to be here today to testify regarding the financial outlook of the Social Security Trust Funds as shown in the 2004 Annual Report of the Board of Trustees. Work is now being completed on the 2005 report for release later this month. While Dr. Saving and I will be referring to the 2004 report projections today, there has been no legislation or major economic or demographic change in the last year that would alter significantly the basic thrust of our testimony.

It is important to remember always in Social Security financing discussions that the projections are for a future that is subject to considerable uncertainty. Even very small variations in assumptions and methods can produce wide differences in projections over a long period of time. Thus, the projections in the Trustees Reports are most useful if understood as a guide to a plausible range of future outcomes. As this hearing illustrates, the reports serve as an early warning system that allows us the opportunity to make necessary changes in a timely and responsible manner. Let me now offer just very brief answers to the three questions that were posed to us.

First, what is the financial outlook for Social Security? Here, we have little to add to what you heard from David Walker. He presented the information based on our report, and so I won't take up the time to go through that in any more detail for you. I will simply point out one thing, that Social Security is comprised, as you well know, of two different programs—the Old Age and Survivors Insurance program and the Disability Insurance program. All of the data that he presented was for the combined programs. Considered separately, the OASI trust fund is about 85 percent of the total, and its year-by-year financial outlook more or less tracks the combined funds' outlook that you heard from Mr. Walker. The smaller DI trust fund merits continuing close separate attention because its annual cash flow surpluses are projected to cease in 2007 in its reserves to be exhausted in 2029.

Secondly, why does the Social Security retirement program face financing problems? Here again, I think it is clear that the financial challenge facing the program is largely the result of demographic changes that have their roots back in the last century, particularly the sharp decline in fertility rates subsequent to the birth of the baby boom generation and reductions in mortality rates, particularly at older ages that are expected to continue to result in gradual increases in life expectancy throughout this century.

As was alluded to very briefly earlier, as the large baby boom generation born after World War II begins to retire, annual growth in the labor force will slow dramatically. This not only means fewer workers paying Social Security taxes per retiree, but, also, has wider implications for growth of the American economy. Faster than historical growth in worker productivity could help offset the slower growth of the labor force, but cannot e counted upon to a great extent. Future levels of immigration beyond those currently projected could also boost the growth of the rate of the labor force and improve somewhat the outlook for Social Security finances, but again cannot be counted on to a great extent.

As a result of the retirement of the baby boom, the largest increases in Social Security costs relative to income are projected to occur between 2010 and 2035. The program's costs will then grow more slowly, but still continue to increase thereafter as a share of taxable payroll, since the baby boom generation represents the leading edge of a projected new population age structure in which those over 65 are an ever-growing share of the total population.

Finally, how urgent is the need to improve action for Social Security's financing? Given our fiduciary responsibility as public trustees for Medicare as well, we echo what you heard from David Walker, too, in saying that we would note that the financial challenges posted by Medicare are expected to occur sooner, grow much larger and otherwise be more difficult to address than those facing Social Security. Today's subject is Social Security, and we believe that action on it should not be deferred any longer than necessary for due deliberation and decision. For a decade now, the trustees have recommended action to address Social Security's projected financing shortfalls because the sooner the legislation is enacted, the more varied and the less disruptive to American workers, their families and the economy can be the solutions. I thank you for the opportunity to appear before you and will be pleased to answer any questions that you might have after Dr. Saving has made his oral statement.

[The prepared statement of Dr. Palmer follows:]

Statement of John L. Palmer, Ph.D., Public Trustee, Social Security and Medicare Trust Funds, Syracuse, New York

Mr. Chairman and Members of the Committee:

It is our privilege to be here today to testify regarding the financial outlook of the Social Security Trust Funds as shown in the 2004 Annual Report of the Board of Trustees of those funds. Work is being completed as we speak on the 2005 Annual Report for release later this month. While we will be referring to the 2004 report projections today, there has been no legislation or major economic or demographic change in the last year that would alter significantly the Social Security financial outlook we will describe, the reasons for it, and the need to address Social Security's projected financing shortfall.

As you know, Public Trustees are part-time officials appointed by the President and confirmed by the Senate to represent the public interest in an important process of public accountability. In our private lives, we both trained as economists, have taught at the university level, and have written about Social Security. As Public Trustees our primary activities are directed at assuring that the Annual Trust Fund Reports fully and fairly present the current and projected financial condition of the trust funds. To this end we work closely with the Office of the Chief Actuary in the Social Security Administration to ensure that all relevant information is considered in the development of the assumptions and methods used to project the financing of the Social Security program. Mr. Chairman, we would note for the record what we are sure you and this committee know well: it is an extraordinarily complex task to make financing projections for Social Security far into the future. The

high professionalism and decades of experience of the Social Security actuaries are critical to the production of these Annual Reports.

It is important to remember always in Social Security financing discussions that the projections are for a future that is subject to considerable uncertainty. Even very small variations in assumptions and methods can produce wide differences in projections over a long period of time. Thus, the projections in the Trustees Reports are most useful if understood as a guide to a plausible range of future outcomes. And, as this hearing illustrates, the reports serve as an early warning system that allows us the opportunity to make necessary changes in a timely and responsible manner.

What is the Financial Outlook for Social Security?

As this committee well knows, what we call Social Security is, in statute, composed of two separate programs and trust funds—Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI). On a combined basis the two trust funds are projected in the 2004 Trustees Report to continue to run annual cash flow surpluses of about $100 billion for the next seven years. However, those annual surpluses will steadily decline each year thereafter, until ceasing in 2017. Then, beginning in 2018, the combined OASDI trust funds are projected to begin redeeming bonds held in reserve, by amounts typically increasing from $30-$50 billion each year, until annual redemptions necessary to pay scheduled benefits exceed $350 billion (in today's dollars) in 2041 and the reserves are exhausted in 2042. At that point, the combined funds are projected to receive annual income equal to only about 73 percent of costs. Costs will exceed income each year thereafter by growing amounts, so that by 2080 annual income will cover only 68 percent of currently scheduled benefits. (See the attached figure from the 2004 Social Security Trustees Report for a depiction of this situation.) Thus, measures that would close the financing gap at the time of trust fund exhaustion and thereafter would have to be of far greater magnitude in impact than those that simply address the actuarial deficit over the next 75 years.

Considered separately—as the law requires for financing legislation—the OASI Trust Fund is about 85% of the total, and its year-by-year financial outlook tracks the combined funds' outlook just noted. Although relatively smaller, the DI Trust Fund merits continuing close attention, because its annual surpluses are projected to cease in 2007 and its reserves to be exhausted in 2029. Its history has been much more volatile than that of OASI, and the option of taking income from OASI to increase funding for DI may not be a good one.

Why Does the Social Security Retirement Program Face Financing Problems?

The financing problem that Social Security will begin facing in the next decade is, in essence, the result of demographic changes that began several decades ago. First, life expectancy began to increase at a faster pace in the late 1960s as rapid progress was made in reducing mortality due to heart disease. Progress in extending life expectancy in this country has continued since then, although with distinct shifts in the rate of that progress. The increase in life expectancy is welcome to all of us, but it does mean that retirees will receive Social Security benefits for longer periods of time as life spans continue to lengthen.

The second demographic change affecting Social Security financing was the sharp downturn in fertility that began in the mid-1970s in the U.S. and has now occurred in many countries around the world. The expansion of education and job opportunities for women, combined with the development of reliable birth control, seems to be the leading cause of the decrease in fertility. For Social Security the lower fertility that began 30 years ago has already led to some reduction in the rate of growth of the American labor force over the last 10–15 years. But as the large baby-boom generation born after WWII soon begins to retire, annual growth in the labor force will slow dramatically—about as many workers will retire each year as enter the workforce—and this not only means fewer workers paying Social Security taxes per retiree, but it also has wider implications for the growth of the American economy. Faster than historical growth in worker productivity could help offset the slower growth of the labor force, but cannot be counted on to a great extent. Future levels of immigration beyond those currently projected could also boost the growth rate of labor force and improve somewhat the outlook for Social Security finances, but again are subject to considerable uncertainty and cannot be counted on to a great extent.

As a result of the retirement of the baby boom, the largest increases in Social Security costs relative to income are projected to occur between 2010 and 2035. Social Security's costs will then grow more slowly but still continue thereafter to increase as a share of taxable payroll for the indefinite future. The baby boom generation represents the leading edge of a projected new population age structure in which

those over 65 are an ever growing share of the total population due to the continuation of relatively low fertility rates and lengthening life expectancy.

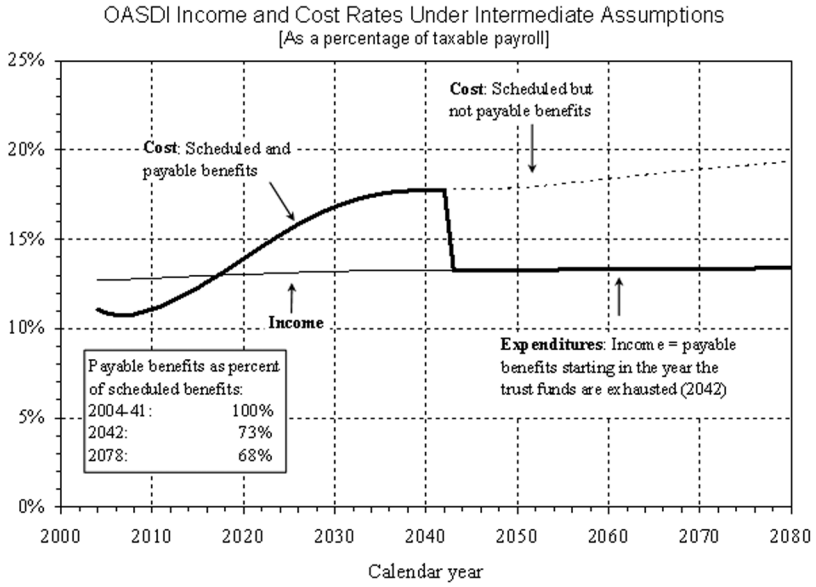
How Urgent is the Need for Action to Improve the Social Security's Financing?

Given our fiduciary responsibility as Public Trustees for Medicare as well, we cannot discuss the need for action regarding Social Security financing without first noting, as we did in our Message in the Summary of the Trustees Reports last year, that the financial challenges posed by Medicare are expected to occur sooner, grow much larger, and otherwise be more difficult to address than those facing Social Security. But today's subject is Social Security, and we believe that action on it should not be deferred any longer than necessary for due deliberation and decision. For a decade the Trustees have recommended each year action to address Social Security's projected financing shortfalls because the sooner legislation is enacted, the more varied and less disruptive to American workers, their families, and the economy can be the solutions. Many years of advance notice to the public and adequate time to phase in changes slowly will allow workers to adjust their retirement plans to take account of those changes. Also, acting sooner rather than later will allow time to spread the burden of any changes across different age groups. Waiting decades to address Social Security financing could mean that the only option, given other needs at that time, might be to reduce benefits to then-retired, or nearly-retired, workers by 25 or 30 percent—an unthinkable outcome, and one that is avoidable if action is taken sooner rather than later.

Conclusion

There is inherent uncertainty in projecting the future and especially the far-distant future. But using the best information and methods available, the Trustees, the Congressional Budget Office, and most private forecasters all project cash flow deficits for Social Security beginning in little more than a decade and growing worse thereafter for the indefinite future because of the demographic changes we have noted. The reason to act soon is to avoid the forced necessity of more precipitous action later.

We have attached the four-page "Message From the Public Trustees" from the *Summary of the 2004 Annual Reports* as well as our biographical information. We thank you for the opportunity to appear before you and will be pleased to answer any questions you may have.



Source: 2004 Annual Report of the Board of Trustees of the Federal OASDI Trust Funds

Chairman THOMAS. Thank you very much, Dr. Palmer. Dr. Saving?

STATEMENT OF THOMAS R. SAVING, PH.D., PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE TRUST FUNDS, COLLEGE STATION, TEXAS

Dr. SAVING. Once again, Mr. Chairman, thank you for having me here. I am going to begin a somewhat different tack than Dr. Palmer, since I think there are some things that we ought to think about. Today, Social Security is America's largest entitlement program. As we know, Medicare is going to become larger, though, in not very many years. It accounted for 18 percent of the Federal budget, 3.6 percent of gross domestic product. Its revenues have exceeded expenditures every year since the 1983 tax reform, and in 2004, Social Security provided the Treasury the equivalent of 6 percent of Federal income tax revenues, additional revenue. This contribution to the Federal budget is going to peak in 2008, something David Walker mentioned, and about 7 percent of Federal income tax revenues, and then it is going to fall rapidly, and it is going to become a deficit in 2018 that is going to be equal to 1 percent of projected Federal income tax revenues. Thus, in the decade 2008 to 2018, Treasury's disposable income will fall by an amount equal to almost 8 percent of Federal income tax revenues as the Social Security system moves from a surplus to a deficit.

In the following comments, I want to discuss several ways to assess the current and future status of Social Security as it pertains to the budget because I think it is the budget that has to fund, eventually, what Social Security is going to have to pay. Social Security's revenue expenses, without consideration of the coming demographic issues, are approximately proportional to the gross domestic product. Its future deficits are the result of a combination of the baby boom generation retirement, falling fertility, increasing lifespans. Importantly, the baby boom generation doesn't represent just a bulge in the population, but it is rather a surge. It is the leading wave of a larger population so that, once the baby boomers are out of the system, the retired population is not actually going to get smaller. It is going to stay the same size, which means the financing shortfalls are going to persist.

We can summarize the status of Social Security in two broad ways, in terms of the present value of its unfunded obligation and in terms of the future budget transfers that are going to be required to funded shortfalls. Social Security is, fundamentally, a generation transfer system in that current taxpayers pay for the benefits of current beneficiaries. That is largely true because even though the 1983 reform was attached to form a prepayment system, the money was spent instead of actually invested in real resources. Social Security debt owed to the current generation, that is, everyone who is currently in the system, working and retired, is, from our 2004 Trustees Report, $12.7 trillion.

The next generation, that is, the people who start working tomorrow and everyone who follows them, is only going to pay off less than a trillion dollars of that, so that we are going to have to find

$11.9 trillion somewhere. As I say, the trust fund itself cannot be considered a dedicated funding resource because the surpluses, while credited to the trust fund, have been used for other purposes and, in exchange, we have received, of course, these trust fund bonds, but the trust funds' assets themselves do not provide any revenue to the Treasury, and it is the Treasury that is going to have to pay the Social Security benefits. I think that is an important concept that we have to bear in mind.

Another approach to understanding the future funding problems facing us is the annual cash flows, and I think we want to express those in terms of Federal income tax revenues. As I pointed out last year, the Social Security surplus contributed just over 6 percent of Federal income tax, an amount equivalent to over 6 percent of Federal income tax revenues. That is going to peak in 2008 and rapidly decline into a cash flow deficit that will occur in 2018, and that is going to be 1 percent of Federal income tax revenues. Within 4 years, the cash flow deficit will be over 5 percent of Federal income tax revenues, and five years later it will be over 10 percent of Federal income tax revenues.

To put those transfers in historical perspective, the largest transfers that we have ever made to Social Security, as a percentage of Federal income tax revenues, have occurred twice—1977, when the transfer was 4 percent, and in 1978 we changed the benefit formula, essentially, reducing future promised benefits, and in 1983, the transfer was 4.5 percent of Federal income tax revenues. Then, of course, we changed, we raised taxes and reduced benefits.

So, we are going to reach, very quickly after we turn to a deficit, more than 5 percent of Federal income tax revenues being transferred to Social Security. Congress has never let that size transfer occur without changing the system. That doesn't mean that will happen in the future, but it is important to understand what has happened in the past.

In conclusion, Social Security pluses and commensurate contributions to the Federal budget are going to peak in the next several years and then begin a rapid decline, becoming deficits. As we have said, John Palmer and myself, for the last 5 years, reforming Social Security, sooner rather than later, is critical. The financial realities we have discussed bear this out. While there is disagreement among the types of reforms that should be pursued, there is little disagreement that reform is necessary. Thank you.

[The prepared statement of Dr. Saving follows:]

Statement of Thomas R. Saving, Ph.D., Public Trustee, Social Security and Medicare Trust Funds, College Station, Texas

Mr. Chairman and Members of the Committee:

It is our privilege to be here today to testify regarding the financial outlook of the Social Security Trust Funds as shown in the 2004 Annual Report of the Board of Trustees of those funds. Work is being completed as we speak on the 2005 Annual Report for release later this month. While we will be referring to the 2004 report projections today, there has been no legislation or major economic or demographic change in the last year that would alter significantly the Social Security financial outlook we will describe, the reasons for it, and the need to address Social Security's projected financing shortfall.

As you know, Public Trustees are part-time officials appointed by the President and confirmed by the Senate to represent the public interest in an important process of public accountability. In our private lives, we both trained as economists,

have taught at the university level, and have written about Social Security. As Public Trustees our primary activities are directed at assuring that the Annual Trust Fund Reports fully and fairly present the current and projected financial condition of the trust funds. To this end we work closely with the Office of the Chief Actuary in the Social Security Administration to ensure that all relevant information is considered in the development of the assumptions and methods used to project the financing of the Social Security program. Mr. Chairman, we would note for the record what we are sure you and this committee know well: it is an extraordinarily complex task to make financing projections for Social Security far into the future. The high professionalism and decades of experience of the Social Security actuaries are critical to the production of these Annual Reports.

It is important to remember always in Social Security financing discussions that the projections are for a future that is subject to considerable uncertainty. Even very small variations in assumptions and methods can produce wide differences in projections over a long period of time. Thus, the projections in the Trustees Reports are most useful if understood as a guide to a plausible range of future outcomes. And, as this hearing illustrates, the reports serve as an early warning system that allows us the opportunity to make necessary changes in a timely and responsible manner.

What is the Financial Outlook for Social Security?

As this committee well knows, what we call Social Security is, in statute, composed of two separate programs and trust funds—Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI). On a combined basis the two trust funds are projected in the 2004 Trustees Report to continue to run annual cash flow surpluses of about $100 billion for the next seven years. However, those annual surpluses will steadily decline each year thereafter, until ceasing in 2017. Then, beginning in 2018, the combined OASDI trust funds are projected to begin redeeming bonds held in reserve, by amounts typically increasing from $30-$50 billion each year, until annual redemptions necessary to pay scheduled benefits exceed $350 billion (in today's dollars) in 2041 and the reserves are exhausted in 2042. At that point, the combined funds are projected to receive annual income equal to only about 73 percent of costs. Costs will exceed income each year thereafter by growing amounts, so that by 2080 annual income will cover only 68 percent of currently scheduled benefits. (See the attached figure from the 2004 Social Security Trustees Report for a depiction of this situation.) Thus, measures that would close the financing gap at the time of trust fund exhaustion and thereafter would have to be of far greater magnitude in impact than those that simply address the actuarial deficit over the next 75 years.

Considered separately—as the law requires for financing legislation—the OASI Trust Fund is about 85% of the total, and its year-by-year financial outlook tracks the combined funds' outlook just noted. Although relatively smaller, the DI Trust Fund merits continuing close attention, because its annual surpluses are projected to cease in 2007 and its reserves to be exhausted in 2029. Its history has been much more volatile than that of OASI, and the option of taking income from OASI to increase funding for DI may not be a good one.

Why Does the Social Security Retirement Program Face Financing Problems?

The financing problem that Social Security will begin facing in the next decade is, in essence, the result of demographic changes that began several decades ago. First, life expectancy began to increase at a faster pace in the late 1960s as rapid progress was made in reducing mortality due to heart disease. Progress in extending life expectancy in this country has continued since then, although with distinct shifts in the rate of that progress. The increase in life expectancy is welcome to all of us, but it does mean that retirees will receive Social Security benefits for longer periods of time as life spans continue to lengthen.

The second demographic change affecting Social Security financing was the sharp downturn in fertility that began in the mid-1970s in the U.S. and has now occurred in many countries around the world. The expansion of education and job opportunities for women, combined with the development of reliable birth control, seems to be the leading cause of the decrease in fertility. For Social Security the lower fertility that began 30 years ago has already led to some reduction in the rate of growth of the American labor force over the last 10–15 years. But as the large baby-boom generation born after WWII soon begins to retire, annual growth in the labor force will slow dramatically—about as many workers will retire each year as enter the workforce—and this not only means fewer workers paying Social Security taxes per retiree, but it also has wider implications for the growth of the American economy. Faster than historical growth in worker productivity could help offset the slower growth of the labor force, but cannot be counted on to a great extent. Future lev-

els of immigration beyond those currently projected could also boost the growth rate of labor force and improve somewhat the outlook for Social Security finances, but again are subject to considerable uncertainty and cannot be counted on to a great extent.

As a result of the retirement of the baby boom, the largest increases in Social Security costs relative to income are projected to occur between 2010 and 2035. Social Security's costs will then grow more slowly but still continue thereafter to increase as a share of taxable payroll for the indefinite future. The baby boom generation represents the leading edge of a projected new population age structure in which those over 65 are an ever growing share of the total population due to the continuation of relatively low fertility rates and lengthening life expectancy.

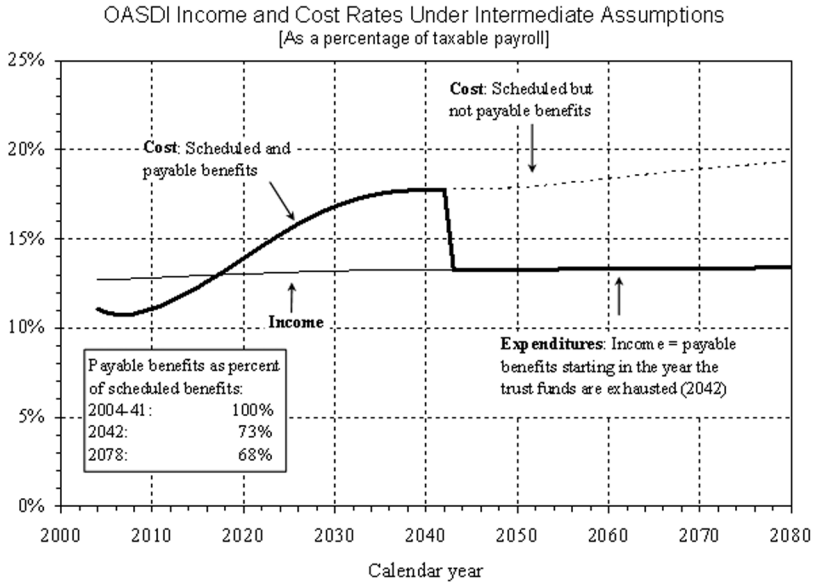
How Urgent is the Need for Action to Improve the Social Security's Financing?

Given our fiduciary responsibility as Public Trustees for Medicare as well, we cannot discuss the need for action regarding Social Security financing without first noting, as we did in our Message in the Summary of the Trustees Reports last year, that the financial challenges posed by Medicare are expected to occur sooner, grow much larger, and otherwise be more difficult to address than those facing Social Security. But today's subject is Social Security, and we believe that action on it should not be deferred any longer than necessary for due deliberation and decision. For a decade the Trustees have recommended each year action to address Social Security's projected financing shortfalls because the sooner legislation is enacted, the more varied and less disruptive to American workers, their families, and the economy can be the solutions. Many years of advance notice to the public and adequate time to phase in changes slowly will allow workers to adjust their retirement plans to take account of those changes. Also, acting sooner rather than later will allow time to spread the burden of any changes across different age groups. Waiting decades to address Social Security financing could mean that the only option, given other needs at that time, might be to reduce benefits to then-retired, or nearly-retired, workers by 25 or 30 percent—an unthinkable outcome, and one that is avoidable if action is taken sooner rather than later.

Conclusion

There is inherent uncertainty in projecting the future and especially the far-distant future. But using the best information and methods available, the Trustees, the Congressional Budget Office, and most private forecasters all project cash flow deficits for Social Security beginning in little more than a decade and growing worse thereafter for the indefinite future because of the demographic changes we have noted. The reason to act soon is to avoid the forced necessity of more precipitous action later.

We have attached the four-page "Message From the Public Trustees" from the *Summary of the 2004 Annual Reports* as well as our biographical information. We thank you for the opportunity to appear before you and will be pleased to answer any questions you may have.



Source: 2004 Annual Report of the Board of Trustees of the Federal OASDI Trust Funds

Chairman THOMAS. Thank you very much, Dr. Saving. Thank both of you. Let me ask you some questions that, obviously, are partially tied to previous questions offered to Mr. Walker to try to get us focused on the kinds of things that you might be able to respond to us about. The Disability Insurance Trust Fund, which is the most recent significant addition to the Social Security system, there was a discussion extended, the Chair thought, over whether or not the Social Security Trust Fund was really a trust fund. To what extent, in your opinion, is the Disability Insurance Trust Fund really a trust fund?

Dr. PALMER. The status of both the Old Age and Survivors Insurance and Disability Trust Funds are identical with respect to all of the issues that have previously been discussed.

Dr. SAVING. I might add, in a sense that you and I imagine trust funds, that is, they yield revenue to you, these trust funds yield no revenue to the Treasury. So, that sense, they are not revenue-producing in assets to the Treasury, and the Treasury ultimately has to write the checks. To the Social Security system, as it stands, it is separate from the Treasury, in a sense, of course, they are assets, they represent liabilities of the Treasury, but they are assets to the Social Security system.

Chairman THOMAS. So, one of the things, if we really want to try to move to a bipartisan solution, is to perhaps overcome or set aside some of the descriptive terms, and all of us are familiar with spending more time than was probably necessary dreaming up attractive names to our legislation so that we would have a broader appeal to our legislation than would otherwise be the case and that

if we, in fact, call this the Disability Insurance Trust Fund, that not only is it not a trust fund, as most people recognize trust funds, it isn't insurance, as most people recognize insurance because notwithstanding the fact a portion of the payroll tax is designated as a premium for disability, the payout on that so-called premium for disability "insurance" in no way conforms to what the disability premium is; is that correct? In other words, you get a payoff of the Social Security payment structure and not off of an insurance program tied to the Disability Insurance Trust Fund.

Dr. SAVING. You are correct in the sense that the amount of disability you get is related to the Social Security benefit formula.

Chairman THOMAS. Not the disability insurance that you pay.

Dr. SAVING. Well, not the disability. The premium is not related to the disability experience is really what you are saying, I believe.

Chairman THOMAS. So, it really isn't a premium, again, as if you moved to the private world, we understand a premium; it isn't a trust fund, as we understand a trust fund; it isn't insurance, as we understand insurance. If we understand that and set that aside, then, we can simply say that we have problems that we need to address, and that really is what I want to get to. To hang on to fictions and then argue a failure to make substantive change based upon an attractive name, which is a fiction, to me, is to deny our ability or certainly hamper our ability to get to a real solution. That is one of the concerns I probably have that will impede us if we continue to try to substantiate the fact that we have what, in fact, we do not have.

The second question I want to ask you was brought up in response to a question to Mr. Walker, and I am glad he did not go too far in the answer because you are clearly the ones that we should ask, and he indicated that, although we may, by statute, require you to invest the trust funds in a particular category of securities, do you have flexibility? My assumption is, if you did and you could maximize the return, you would have done that already, and you may have already done that within the limited capability that we may have provided you, is there an opportunity to change the law to allow you to travel a little farther afield in terms of your investment capability and give us the same protection on the risk side?

My assumption is the answer will be, no. So, what I am looking for is for you to give us a series of potential investment opportunities it might be prudent to consider in changing the Social Security law. Then you could provide us with a graduated risk calculation that we could then judge as to whether or not that would be an appropriate thing to include in legislation. Any reaction from either of the trustees?

Dr. SAVING. I would say, first, the role of the current trustees of the Social Security and Medicare Trust Funds are not in choosing, as you are well aware, the investment in structure, but I think both John and I agree that some prepayment of any of these elderly entitlements in generation transfers is going to be critical to solving these problems. Such a prepayment would imply real investment on the part of either individuals or the system. By "real investment," I mean investment in the real economy.

Chairman THOMAS. Is there any concern, on either of your parts, that since you raised your right hand to be a trustee, that wasn't part of the job when you raised your right hand, and if it became part of the job of making these kinds of judgments that you would probably not be comfortable or you don't think we should provide you with that opportunity?

Dr. PALMER. It certainly would be an expansion and redefinition of the role of the trustees, and I, personally, would simply have to evaluate the issues surrounding that if it were to become a reality. We don't have the same kind of legal fiduciary responsibility that applies in the private sector. I find it most useful——

Chairman THOMAS. Nor am I suggesting that you move, initially, to the private sector or immediately to the private sector. I am wondering if there aren't any baby steps that you might consider suggesting to us, based upon your role and knowledge.

Dr. PALMER. David Walker mentioned possibilities there, certainly, which is to broaden the ability for the trustees to invest in marketable Treasury bonds. Beyond that, there have been, from time to time, it has been raised whether the trust funds might be able to invest even broadly beyond government securities.

Chairman THOMAS. Are the trust funds or the securities, the marketable securities that Mr. Walker talked about that you have the potential to invest in, are they backed by the full faith and credit of the United States?

Dr. PALMER. Well, I think he was raising the possibility of investing in marketable Treasury bills, which would be.

Chairman THOMAS. Are they backed by the full faith and credit of the United States?

Dr. PALMER. Yes.

Chairman THOMAS. Do they produce a higher interest rate?

Dr. PALMER. They could, conceivably. There is a formula that dictates now what the Social Security Trust Fund interest is. It is, basically, the average of the 5- to 15-year issue bonds. So, you could invest in such a way in bills to raise that yield, if you so choose, by going more long term, presumably.

Chairman THOMAS. In your opinion, is that an appropriate and prudent examination this Committee should undertake as one of the many options that may be available to us?

Dr. PALMER. Yes.

Chairman THOMAS. Thank you very much. Does the gentleman from Michigan wish to inquire?

Mr. LEVIN. I think I will restrict my inquiry and assume that you are here as public trustees and not in other capacities. I don't think, Mr. Chairman, we agree for a moment that the trust fund is a fiction. I think Mr. Walker's testimony has indicated that it isn't. Bonds have been redeemed by our government for Social Security purposes I think 11 times backed by the full faith and credit. To call that a fiction I think is a fiction. Also, I think your earlier designation of the benefits we now have is ill advised we, also, don't agree with. I think we can explore the issues that you have raised. Dr. Saving, you made one statement about the utility of having these tax moneys somehow placed in a different way, I don't think I agree with your implication. I think, however, I won't probe that. I think you need to make clear, in any answer you give, that

you are now in a capacity other than a public trustee. You are I think it is now called a consultant for an organization that is in the vanguard of the efforts trying to sell the President's privatization. I think you are consulting for progress for America, are you not?

Dr. SAVING. I am not a consultant for them. I agreed that I would advise them on certain things, but I am not a consultant for them.

Mr. LEVIN. You are an adviser?

Dr. SAVING. Yes, I am an adviser to them. I am telling them, when they say something wrong or something, I will tell them that that is wrong, but I am not a consultant to them.

Mr. LEVIN. You are more than that. I mean, you are an active participant in their work, are you not?

Dr. SAVING. No, I do not view myself as an active participant. I am not a spokesman for them.

Mr. LEVIN. You have received no compensation?

Dr. SAVING. I have received no compensation from them.

Mr. LEVIN. You very much agree with their position, do you not?

Dr. SAVING. I have agreed with personal accounts long before the President ever thought of them.

Mr. LEVIN. You basically agree with the position of Progress for America, do you not?

Dr. SAVING. Well, if you mean do I believe that personal accounts would be a useful thing, the answer to that is, yes.

Mr. LEVIN. Including diversion of Social Security payroll taxes for that purpose, right?

Dr. SAVING. Well, I have suggested——

Mr. LEVIN. Yes or no?

Dr. SAVING. —my own proposals, and they actually include additional revenues coming from individuals. So, I am not——

Mr. LEVIN. You haven't taken the position over the years that you favor using Social Security payroll taxes to be placed in private accounts? That hasn't been your position?

Dr. SAVING. No. My position has been that, in addition to that, people should put additional amounts of their own in into these accounts.

Mr. LEVIN. In addition, not the diverting of Social Security payroll taxes.

Dr. SAVING. As a matter of fact, you would be diverting some, but not anything like what has been suggested by the Administration. I am not involved, in any way, in the Administration's position on this.

Mr. LEVIN. Some, but not as much as the administration.

Dr. SAVING. Well, we have additional moneys. In the proposals that I put forward, there are additional, if you want to call them taxes or contributions by individuals, into their——

Mr. LEVIN. In addition to the 6.2?

Dr. SAVING. In addition to the total of 12.4 or, actually, if it is OASI we are discussing, it is 10.6 percent.

Mr. LEVIN. I am talking all together.

Dr. SAVING. Yes, but the real issue is the proposals that I have had were really about retirement and not about disability. I was leaving the disability alone. It is important to understand that.

Mr. LEVIN. Thank you.

Mr. MCCRERY. [Presiding.] Dr. Palmer, are you an adviser for any group that is out there talking about——

Dr. PALMER. No, I am not.

Mr. MCCRERY. Well, do you agree with the conclusion stated by one of you, and I think it was Dr. Saving, that given the current demographics of the country, and the birth rate, and longevity and so forth, the current Pay As You Go system for financing Social Security benefits has outlived its usefulness, and we need to at least partially prepay some of the future liabilities for this program?

Dr. PALMER. No, I don't agree, stated that way, particularly. I do think it is important that we somehow raise our savings rate, both our private savings rate and our public savings rate or DIS saving at that point, reduce the DIS savings in order to help make the adjustments to an aging society. Whether one would actually prefund a portion of the programs or not, is a separate question and could be part of that, ultimately.

Mr. MCCRERY. So, you don't believe, necessarily, that prefunding Social Security at this point is a good idea?

Dr. PALMER. The action that was taken in 1983 has been integral in helping to build the surpluses that exist in Social Security now and will exist for sometime in the future. Were that money not being used to offset a deficit on the Federal side, we would be, in some more general sense, helping to prefund the program. That I think is important. It can be done through public savings overall. It doesn't have to be in the program, per se.

Mr. MCCRERY. What could we have done differently in 1983 to avert what has happened since then with the surplus?

Dr. PALMER. That would be a question of overall fiscal policy, of treating the——

Mr. MCCRERY. Assuming that Congress would have behaved exactly as it has over the last—when Democrats were in charge and when Republicans were in charge—what could the Congress have done and the Commission to recommend to the Congress in 1983 to prevent that from happening, to prevent Congress from spending all the surplus?

Dr. PALMER. I think if Congress chooses to do that, there is very little that can be done to prevent it.

Dr. SAVING. I think I would suggest that you could have given the trustees, maybe required them to invest the surpluses in the private economy and not in any government securities at all or in the government securities of other Nations, for example, so that they would, when we had to cash them in, they would have to consume less and send us things. That is sort of a "lock box," if you like.

Mr. MCCRERY. Right.

Dr. SAVING. We are not suggesting that. I am saying you asked me a question, a hypothetical, of what we could have done in 1983.

Mr. MCCRERY. That is a very good response. Dr. Palmer, granted that Congress could change its mind and not invest it in negotiable securities of some form or another or allow individuals to invest it in negotiable securities and get, therefore, prefund some of the obligations of the system, but once you start establishing a fund that is in the name of an individual, it would seem to be com-

mon sense it would be more difficult for Congress to take that back, rather than the situation we have had since 1983, which has been Congress got the money, there is nothing else to do with it, except pay down the debt, which we did for a couple of years, but other than those couple of years, we just spent it all. So, I just think anyone who looks at this, and given the history of Congress's behavior, would want to try to at least build a little better wall around that money than we did in 1983. That is my point.

Dr. PALMER. I understand, and I am very much in favor of more fiscal responsibility on the part of Congress.

Mr. MCCRERY. Yes. Mr. Shaw?

Mr. SHAW. Let me just read a short statement, and then I am going to ask you if you think it applies to the Social Security system as we have it today. "An unstable or crucial time or state of affairs in which a decisive change is impending, one with the distinct possibility of a highly undesirable outcome." Do you think that applies in any way to the present state of Social Security?

Dr. PALMER. Could I ask you to repeat that?

Mr. SHAW. Yes, I would be glad to.

Dr. SAVING. I would like you to, as well.

Mr. SHAW. "An unstable or crucial time or state of affairs in which a decisive change is impending, especially one with the distinct possibility of a highly undesirable outcome." Or do you think we are reaching a critical stage?

Dr. PALMER. That suggests, to me, a somewhat more imminent and immediate problem that must be dealt with tomorrow, as opposed to something that I think is——

Mr. SHAW. Well, tomorrow, do you think it would apply, Dr. Palmer?

Dr. PALMER. Well, it is a problem that——

Mr. SHAW. I am talking about——

Dr. PALMER. —will gradually grow worse over time.

Mr. SHAW. Eventually, we will get there before 2018; is that correct?

Dr. PALMER. Well, I don't think there is any magic year here. The surpluses will peak at a certain level, the annual cash flow, and then it will gradually begin to decline, and then it will become negative.

Mr. SHAW. How about you, Dr. Saving?

Dr. SAVING. I think John and I here agree on this. The issue here is that the surpluses, that is, the pressure on you as Congress, because of the pressure of the budget, is going to begin immediately following 2008, when the money available to the Treasury is going to rapidly decline.

Mr. SHAW. So, that would apply in 2008.

Dr. SAVING. So, 2008 is when it is going to peak, and that is when we are going to first feel the budget pressure, and it is just going to continue very rapidly after that.

Mr. SHAW. That definition is taken from the Webster dictionary as the definition of crisis. We seem to be arguing whether there is a crisis or not and spending all the time doing that, when we know we have got one big, big problem, and it is going to reach a crisis stage if we don't do something about it, particularly for young Americans. I thank both of you for your testimony and for being

here. I understand you are both President Clinton's appointees, and I know that President Clinton, himself, was looking to the private sector and searching for some type of a solution to the impending problem that certainly is going to be facing us, and I thank you for your testimony.

Mr. MCCRERY. Mr. Cardin?

Mr. CARDIN. Thank you. There is only a few minutes left, and we have a vote on the floor. Let me just make an observation. I very much appreciate both of your testimonies. It seems to me that if we gave you the traditional powers of a trustee, and you were very kind to point out there is a trust fund, but you don't have the same powers that a normal trustee would have of pension funds, if we gave you the normal powers to do what you thought was prudent, that we would solve some of the problems, not all, but we would at least have a better asset allocation, we would have better dealing with the needs, the cash flow needs of the system, but you are restricted by some of the laws that we pass; that you don't really have a sacred fund. It is commingled too much in the budget process of this Nation and too many restrictions placed on the trustees. I think that is a good point, and I hope, Mr. Chairman, you mentioned that in your comments, I hope that is one area that we can look at because it seems to me the public believes there is a trust fund, and we should at least give you more powers to deal with it in the best interests of the beneficiaries and the Nation. Thank you, Mr. Chairman. I appreciate the time.

Mr. MCCRERY. Mr. Lewis?

Mr. LEWIS OF GEORGIA. Thank you very much. Do you feel like you are a fox in a hen house? Do you ever feel like that? You are the one that said a few years ago that Social Security should be destroyed as we know it. Then you went on to say, also, a few years ago, that the Social Security Trust Fund doesn't exist. It is just a promise. I don't understand how you can reconcile accepting a job as being a trustee of the fund if you don't believe in it. I happen to believe that Social Security is a sacred covenant. It is a trust, and some of us believe in it. It is a serious trust.

Dr. SAVING. Well, I think that is exactly right, what the promise legislation is. The issue with Social Security is it is a promise that Congress can change any time. One of the issues that you have with it is, and, in fact, the only two times in which you have made significant transfers from the budget to Social Security, you changed it. You reduced the benefits both times. The issue here is how do you protect the recipients of Social Security from changes that can occur? I don't know the answer to that, necessarily.

Mr. LEWIS OF GEORGIA. How do you reconcile being a trustee of something that you really don't believe in?

Dr. SAVING. I think it is a misnomer to believe that I don't believe in people planning for the future. I believe that generation transfers is a bad way to do that.

Mr. LEWIS OF GEORGIA. I yield to my friend, Mr. Doggett.

Mr. DOGGETT. Your comment, as I understand it, was, "We must destroy Social Security as we know it in order to save it." I am sure that that is a point of view that you continue to hold. The difficulty we have in trying to achieve a bipartisan solution to the long-term concerns over Social Security is when we hear terms like

claw back, like phased destruction of Social Security, and know that people who are playing key decisionmaking roles in this process really don't believe in Social Security as we know it. I think we can achieve, as indicated by Mr. Walker's testimony, a bipartisan solution to these problems, but we cannot achieve it if it means the phased destruction of Social Security. That is the big concern that those of us on the Democratic side have.

Dr. SAVING. I think you ought to have that. I think you ought to have the thing of guaranteeing the, that individuals have, as Franklin Delano Roosevelt said, the legal, the moral, and the political right to their pension benefits, and I am not sure how to do that. The current system doesn't do that. The question is, is a system in which it is individually based, and this has nothing to do with my role as a trustee——

Mr. DOGGETT. Well, the current system is doing that. It has been doing it since Franklin Roosevelt and a Democratic Congress set up this program, and it can continue doing it completely, according to the Republican-appointed Congressional Budget Office, until about 2050, 2052. It can do almost 80 percent of guaranteed benefits after that. There is a need to take care of the problems after 2050. We should start working on it now, but private accounts don't do anything but make that problem worse not better.

Dr. SAVING. As I say, I am here as a trustee and not as someone proposing private accounts.

Mr. MCCRERY. Thank you very much, gentlemen, for your testimony today. That concludes our hearing for today.

[Whereupon, at 2:30 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Gerald M. Shea, American Federation of Labor-Congress of Industrial Organizations

Thank you for the opportunity to present the views of the AFL–CIO on the financial outlook of Social Security. The AFL–CIO is a voluntary federation of national and international labor unions representing approximately 13 million working women and men of every race and ethnicity and from every walk of life. The mission of the AFL–CIO is to improve the lives of working families—to bring economic justice to the workplace and social justice to our nation. The achievement of a reasonable level of financial security in retirement is an important component of economic justice for all Americans and economic stability for the nation.

The union movement has been one of the strongest advocates for creating and strengthening Social Security over time. Throughout the program's history, we have participated in the system at all levels, including the highest policy levels. The American Federation of Labor actively supported passage of the Social Security Act of 1935. Former AFL–CIO President Lane Kirkland served on the bipartisan National Commission on Social Security Reform (the Greenspan Commission). Union representatives also have served on the quadrennial Social Security Advisory Councils and most recently on the Social Security Advisory Board. These are just some of the many examples of our active work in this area. As our country engages in another debate about the future of Social Security, the union movement and the AFL–CIO, in particular, are committed to working with Congress and the President to strengthen this vital family program for current and future generations.

Social Security's Role

Social Security is America's most comprehensive and important family protection system. It is an insurance-based program that builds individual family security through the combined contributions of everyone. Benefits are designed to replace lost wages and preserve family living standards. Benefit levels are set by law and are a function of a worker's lifetime earnings. This design allows the system to provide predictable, dependable benefits as a foundation for family security on which

families can build, not just for retirement but also in case of the disability or premature death of a worker.

Commentators often refer to Social Security as a safety net program because it provides an important lifeline for low-wage families. The twenty percent of seniors with the lowest incomes in retirement receive 90 percent of their income from Social Security, on average. But, Social Security is considerably more than an anti-poverty program. It is important to all workers and their families, particularly middle class families. Middle class married seniors count on Social Security for more than 56 percent of their income, on average. Middle class non-married seniors, many of whom are widows and widowers, rely on Social Security for nearly 80 percent of their income, on average. The extent to which seniors rely on Social Security is all the more striking given how modest benefits are, averaging just $955 per month for a retired worker and $1,574 per month for a retired couple today.

Social Security plays such an important role, in part, because the private pieces of the retirement system—job-based pensions and retirement plans and individual retirement savings accounts—do not cover nearly enough workers and fail to deliver adequate retirement income to many of those lucky enough to be covered. According to the U.S. Department of Labor, fewer than half of private-sector workers have any kind of retirement plan (defined benefit or defined contribution) on their current job, a huge gap that has persisted for decades. Even among year-round, full-time workers closest to retirement (ages 55–64), retirement plan participation is only 58 percent. According to the Federal Reserve Board, fewer than three-in-five families approaching retirement (ages 55–64) have established any kind of defined contribution retirement savings account at work or on their own (e.g., 401(k)s, 403(b)s or IRAs), and half of those families with any account have less than $55,000 in it, enough to generate only several hundred dollars per month in income.

Social Security's Challenges

Against this backdrop of a secure Social Security and a porous private system, we face projected shortfalls in Social Security over the long run. According to the intermediate projections contained in the 2004 report of the Social Security Trustees, the system would have sufficient resources to pay full benefits for another 37 years, until 2042, and at that time the program would have sufficient revenue to cover 73 percent of current-law benefits if no changes were made. The 75-year shortfall in the system is equivalent to 1.89 percent of taxable payroll. Similarly, the Congressional Budget Office projects that trust fund exhaustion will occur in 2052, at which time the system will be able to pay 78 percent of promised benefits, and that the shortfall equals 0.26 percent of taxable payroll over 50 years (2004–2053) and 1.50 percent of taxable payroll over 100 years (2004–2103).

We strongly believe these projected long-run financial shortfalls should be addressed sooner, not later. Nothing in these projections, however, necessitates a rush to make changes without careful consideration of the impact on current and future workers, retirees and their family members. Given the crucial role Social Security plays in delivering retirement and family economic security, particularly for low-income families and the broad middle class, Congress and the President should take the time to get it right. Furthermore, in recognition of the great uncertainty to which the Trustees' 75-year projections are subject, policymakers should act prudently and avoid drastic and irreversible changes to the benefit structure.

Nevertheless, calls are being made by some policymakers and commentators to change Social Security dramatically and radically. The justification for these changes is the assertion that Social Security faces a looming "crisis" and "catastrophe" and that it is "unsustainable." These kinds of characterizations of Social Security's long-term financial outlook are dramatically out of proportion to official projections for the magnitude and timing of the shortfalls.

For example, some would say that the $3.7 trillion present value of the long-run Social Security shortfall (according to the Social Security Trustees intermediate projections) speaks for itself in establishing the need for drastic changes that over time would phase out much of the current Social Security system and replace part of it with private investment accounts. While on its face this appears to be a big number, over the 75-year projection period, the projected shortfall represents just 0.65 percent of GDP (or 0.35 percent under the CBO projections). By comparison, the present value cost of the 2001 and 2003 tax cuts, if made permanent, would be 1.95 percent of GDP or $11.1 trillion. That is, the revenue losses from the tax cuts amount to between three and five times the size of the projected Social Security shortfall, according to the Center on Budget and Policy Priorities. Tax cuts for the top one percent of income earners would be about as big as the Social Security shortfall.

Similarly, those who cite the infinite horizon present value of the shortfall, $10.4 trillion, give little or no context, such as the fact that the present values of taxable payroll and GDP are projected to be $295.5 trillion and $843.8 trillion, respectively, over the infinite horizon. This projected shortfall represents just 1.2 percent of GDP over the infinite horizon. Furthermore, the serious questions that have been raised about the meaningfulness and appropriateness of measuring the size of system shortfalls into infinity are not mentioned. The American Academy of Actuaries, for example, concluded that infinite horizon projections of Social Security's shortfall "provide little if any useful information about the program's long-range finances and indeed are likely to mislead anyone lacking technical expertise into believing that the program is in far worse financial condition than is actually indicated."

It also is important to consider the timing of the projected shortfalls. As noted above, the Social Security trust funds are expected to be exhausted in 2042 under the Trustees' intermediate projections. Some policymakers and commentators have focused instead on 2018, when benefit payouts are projected to exceed program revenue for the first time, as the real date at which Social Security experiences shortfalls despite the existence of substantial assets built up in the system's trust funds. In effect, the trust funds and the U.S. Treasury bond assets they hold are dismissed as meaningless.

These efforts to diminish or even ignore the effects of the trust funds run counter to the explicit intentions of lawmakers at the time the last significant changes were made to the system. In 1983, Congress enacted and President Reagan signed into law changes in Social Security aimed at partially pre-funding future benefits by accumulating surplus assets. Congress and the President made a decision to set payroll taxes on workers higher than would be necessary to pay benefits each year for decades. As a result, workers' payroll tax contributions exceeded total program costs by $54.4 billion and total tax revenues generated a $67.9 billion cash surplus in 2003.

The clear intention of Congress and the President was to build up trust fund reserves so that they could be spent down to help pay for the retirement of Baby Boomers. At that time, Senator Daniel Patrick Moynihan, who helped shepherd the 1983 reforms into law, called the accumulation of a large reserve fund "a considerable achievement." This policy has resulted in the build up of $1.5 trillion in "cumulative savings" at the end of 2003, as Federal Reserve Board Chairman Alan Greenspan recently noted.

Social Security does not have enough money to cover full benefits in 2018 *only if* Congress and the President choose to default on the bonds held by the trust fund. That would be the first time in its history that the U.S. government defaulted on its debt. It also would be an extraordinary betrayal of the millions of workers who paid in extra to help build up Social Security's assets. A default on the trust fund-held bonds in 2018 would represent a $1.1 trillion transfer from low- and middle-income households (a loss of $10,100 per household) to the richest 5 percent (a gain of $226,900 per household), according to the Center for Economic and Policy Research.

Finally, it is important to note that the financial outlook for Medicare differs markedly from that of Social Security. The financial difficulties facing that program are much larger and come much sooner. According to the 2004 report of the Medicare trustees, the long-run shortfall for the Hospital Insurance (HI) trust fund alone is expected to be 3.12 percent of Medicare's taxable payroll, and the HI trust fund is expected to be exhausted in 2019, 23 years sooner than the Social Security trust funds. The size of the total Medicare program as a share of the economy is expected to grow fivefold, from 2.6 percent of GDP in 2003 to 13.8 percent of GDP in 2078.

Medicare provides crucial health benefits to seniors and disabled workers. It does not provide, however, a deluxe benefits package, and as expensive as health care has become for our country, it would be even more expensive if we simply unloaded the responsibility for it onto individuals. As the debate over what to do about Medicare and health care costs in general proceeds, it needs to be expanded to include a discussion of systemic changes that can reduce long-term growth rates in health care spending. Reducing medical errors, which result in too many needless deaths each year and far too much economic waste, and introducing quality purchasing management may be important tools for simultaneously addressing health care costs and improving the quality of care received by Americans.

Conclusion

Social Security plays a crucial role in the economic lives of Americans because of how it is designed as well as longstanding limitations and inadequacies in the private retirement income system. Its relative importance to American families is un-

likely to change for current or future retirees, making it all the more important that we act to strengthen Social Security and do so with great care.

Some policymakers have used the system's long-run financial outlook to argue that it faces a near-term crisis and that its current benefit structure should be cut back drastically and replaced partly with private accounts. We believe such an analysis is inconsistent with the fundamental projections for the system's future. Social Security is strong today and faces modest financial challenges in the future.

The key question facing policymakers and the public, then, is not whether Social Security can be strengthened. Clearly, it can. At issue, however, is whether policymakers are willing to make strengthening Social Security a national priority in the face of competing interests, such as making tax breaks for the richest Americans permanent. We strongly believe strengthening Social Security for American workers and their families should be a top priority for Congress and the President.

San Diego, California 92130
May 27, 2005

Ways and Means Committee
House Of Representatives
Washington, D.C. 20510

To whom it may concern

The current debate around the privatization of Social Security has prompted me to submit this statement. Around 18 years ago, my wife was diagnosed with a chronic disease, and so qualified for and began to receive Social Security Disability benefits. Five years later, our first child was born, and we were surprised to learn that children of someone receiving disability payments are also eligible to receive payments. We were happy to open a private investment account for our son, and immediately began automatically depositing his Social Security checks into this brokerage account to use as a college savings account. Two years later, our daughter was born, began receiving Social Security checks, and we set up a brokerage account for her as well. For the past thirteen years in my son's case, and eleven years in my daughter's case, we have consistently directed their Social Security checks into these private brokerage investment accounts. We have even adjusted the investment amount to correspond as closely as possible with the income adjustments made by Social Security over the years.

These brokerage accounts were managed by a well-respected firm (Twentieth Century, now American Century), and were considered moderate-risk growth mutual funds. At the end of this year, due to my concern regarding the reckless fiscal policies of the current administration, I decided to convert the shares of these mutual funds into money market assets, so as to minimize any further risk to the account values, as my son will be entering high school next year. I had anticipated realizing a hefty tax burden from this asset transfer.

Imagine my surprise when I learned that not only have I not made money from these accounts over the last thirteen years, but I have lost considerable money from both accounts! This was even more surprising considering the fact that these accounts were added to regularly without fail, making use of dollar cost averaging, and were held mostly during the economic boom years of the Clinton administration..

I'm enclosing performance statements from both children's funds. You'll notice the years each was opened, along with a sample of the regular investments made. You'll also notice that the annualized rates of return on each fund over the past eleven to thirteen years was between 5.7 and 6.2 percent. That looks pretty good until you look at my 2004 tax statement for these accounts, also enclosed, which shows both a short-term and long-term loss from both accounts. According to my tax statement this year, I have incurred a Short-Term loss of $178.34 and a Long-Term loss of $9786.75 upon converting the mutual funds.

You now have an example of empirical evidence which you can use to argue the risks of the kind of *reform* proposed by this administration and it's allies. The ironic thing to me is that I am now 52 years of age, and so if I were to begin privatizing a portion of my own Social Security payments into a brokerage account until retirement age (around 13 years, the same as the data I've provided you), I can forsee a big disappointment looming ahead for me when I retire.

Please feel free to use this data in any way you see fit. I'm willing to meet with committee members to discuss my experience in this regard.

Sincerely,

Stephen Bratman

[The attachment is being retained in the Committee files.]

Statement of Judy and Bobby Lee Everett, Selma, Texas

Thank you for allowing me to send you this message. "If Congress would repeal the ACT/Bill that allowed them to spend/BORROW the reserve monies from Social Security, SS would then continue to have TRILLIONS IN RESERVE AND EARNING INTEREST AS IT WAS DESIGNED. When is Congress going to pay back the large amounts of money that they have borrowed from our money? If you would correct all these things, then we would not have to be concerned with saving the FUTURE OF SOCIAL SECURITY."

Statement of Paul B. Gallagher, Executive Intelligence Review, Leesburg, Virginia

—Reject 'Pinochet' Privatization;—

—An 'FDR' Jobs Boom Would Perpetuate Surplus—

The future of Social Security is the choice between President Franklin Roosevelt's successful retirement insurance program, and privatization modelled on fascist Chile's by dictator Gen. Augusto Pinochet. Privatization was born in 1981 when Chile privatized at the point of a bayonet. Since then, every country in the world which has imitated Chile's Social Security privatization, has destroyed a relatively successful system in favor of one which pumps up the stock and bond markets, but leaves low-income and moderate-income wage earners destitute in their retirement.

President Bush's proposed privatization scheme has been pushed on him for more than 20 years by George Shultz's "Chicago Boys" economists who ran fascist Chile's economy; and in particular by Jose Pinera, General Pinochet's Labor Minister. They are the ideological reason that George W. Bush already in 1978 infamously declared that only privatization could save Social Security from imminent bankruptcy.

Leading Chilean Social Security officials, and economists, and labor representatives are warning the U.S. Congress to reject privatization at all costs. See the attachments from these leading Chileans.

The economic reason you are even considering such dangerous action—overarching the ideological reason—is pressure from the banking community to use Social Security revenue to prop up a collapsing dollar and its markets.

On the subject of attention of your March 9 hearing, any and all forecasts of future Social Security deficits are based on unexamined and unsupported forecasts of extremely low economic growth for most of the 21st Century.

Members of this Committee, with its responsibility to understand sources of government revenue, should be ashamed to be debating policy on the basis of projections which assume virtual zero growth in U.S. employment from 2015 onwards, since Social Security tax revenue depends on employment more than any other factor. With strong U.S. economic growth, Social Security will be solvent, and in surplus, indefinitely.

—Jobs vs. President Bush's 'The Math'—

Why should any intelligent American accept an actuaries' "forecast" about Social Security which is embraced and promoted by President George W. Bush? When Bush received National Intelligence Estimates about [the current situation] in Iraq which displeased him, he called them "just speculation," and "really just guesses." But when he got actuaries' "forecasts" about the income and outgo of Social Security, which stretch out tenuous and very pessimistic assumptions—"guesses"—[a century into the future], they met the President's policy specifications. Bush decided, "This is the math. Learn the math."

How about this math: From 2001–04, in the reign of Bush's jobless economic policies, the total tax revenue of the Social Security system grew by 5% over three years; usually, it grows by 5–7% [every year]. Between 2002 and 2003, Bush held Social Security's revenue growth to zero. No other President has been able to do that in Social Security's 70-year history. The "President of layoffs" is not believable about the program's future prospects; Social Security taxes are paid by people with jobs and companies with employees. Any long-term forecast embraced by Bush is suspect, especially in light of privatization advocates' takeover of the President's Commission, the Social Security Trustees, and the Social Security Administration.

In fact, we'll show that a long-term "Super-TVA"-type infrastructure recontruction an recovery program, creating millions of new productive jobs, would perpetuate the Social Security surplus for decades.

The analyses made by both the Social Security Actuaries and the Congressional Budget Office, are based on predicting economic developments over the long term—in slow motion—which, if happening rapidly, would be called by their proper name, economic collapse. Employment growth stops. Productivity growth and GDP growth fail. Real wages stagnate. A low birth rate and falling immigration bring the growth of the labor force to a crawl. Federal Reserve Chairman Alan Greenspan claimed on Feb. 15 that these were "inexorable demographics"; but in fact, they are the economics of a century-long recession. If Social Security were eventually bankrupted by these economic conditions, the Federal budget, U.S. debt, the housing bubble, and the dollar would all have blown out long before.

The evidence is that Social Security grows, not on trees, nor Wall Streetmutual funds, nor actuaries' forecasts; but on jobs. Let us see to what kind of forecast that evidence leads, and what we have to do to keep Social Security solvent—if we stop President Bush from stealing it.

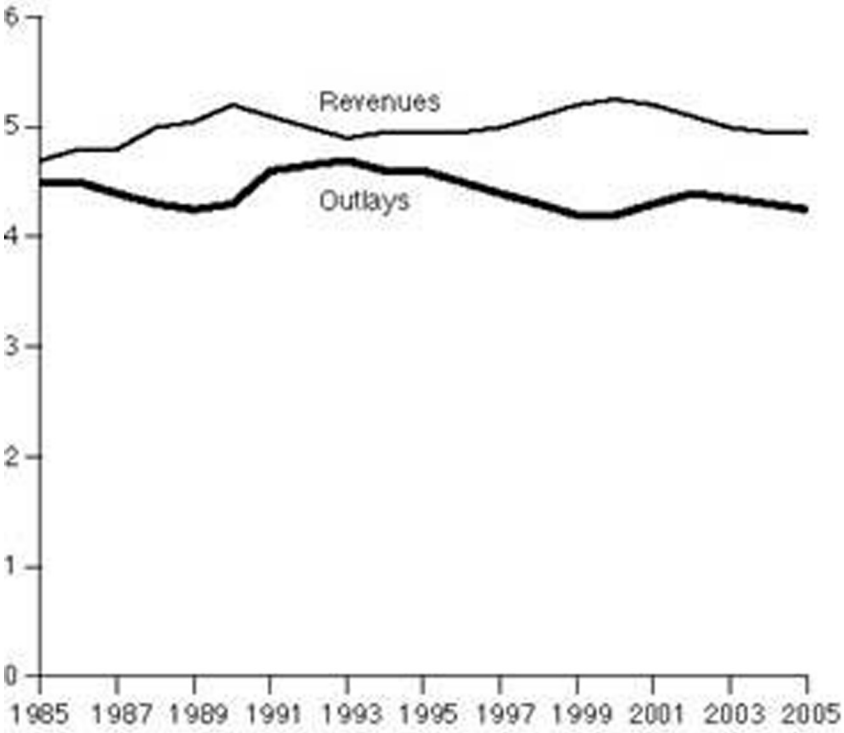
—Forecasts or Predictions—

Look at **Figure 1**, the past 20 years' record of Social Security's tax revenues (the upper graph line) and benefit payouts (the lower line), both expressed as percentages of Gross Domestic Product (GDP). This is taken from the Congressional Budget Office's "Outlook for Social Security, June 2004." But this is not the "forecast" part of the chart, which everyone is usually induced to focus on. This is the actual record of Social Security's income and outgo since its current tax structure was set, in the mid-1980s. [Clearly, this lively variation is anything but long-term "predictable".] It reflects economic policies, and their effects.

FIGURE 1

Social Security Revenues and Outlays as Percent of GDP, 1985-2005

(Percent)



Source: Congressional Budget Office, "Outlook for Social Security, June 2004.

Leave aside the lower, benefit-payout graph for the moment; it is set by law, and resulted from the varying size of generations retiring, particularly the small size of the cohorts of our population born during the Great Depression of the 1930s.

Focus on Social Security's tax revenues relative to GDP. There are two periods of five years or so, in which employment in the U.S. economy grew by 1.5% annually, or more. (They roughly overlap somewhat more than Presidents Reagan's and Clinton' second terms.) During each of those periods, Social Security tax revenues as a portion of GDP rose, by 3–4 tenths of a percent—a fairly sprightly jump. And there are two shorter periods, in each of which U.S. employment grew by substantially [less] than 1.5% a year (1.2% for 1990–94, and 0.4% from 2000–04). During each of those two periods, the payroll tax as a percent of GDP took an unsightly tumble by about 0.3%.

Over the 15-year period 1985–2000 (i.e., leaving out the jobs bloodbath under Bush "43"), employment and the U.S. labor force grew by an average of just about 1.6% a year, 27.7% over the whole 15 years. And the Social Security payroll tax revenue as a portion of GDP, grew by.55% during that time, from 4.7% to 5.25%.

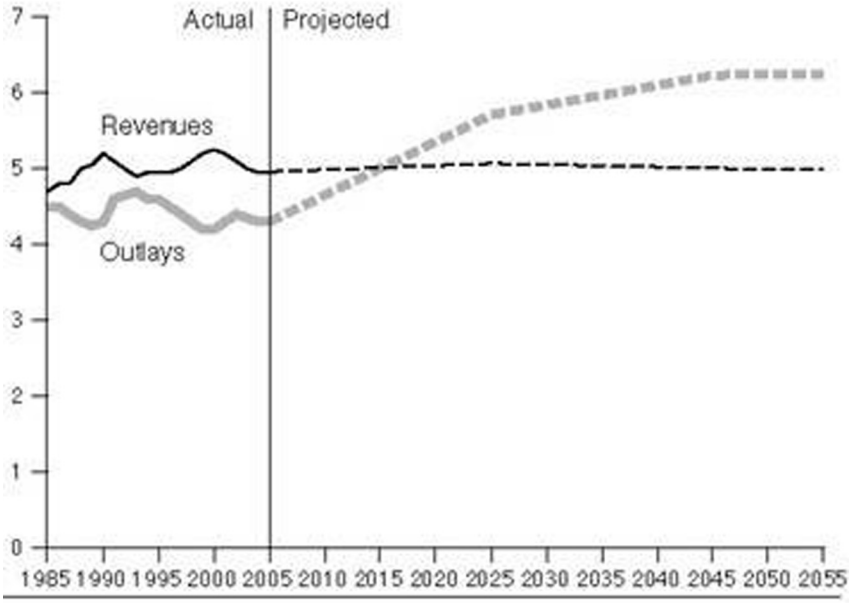
As of 2005, jobs growth of 1.5% means about 2 million net new jobs a year.

In **Figure 2**, following that 20-year record of variation of both jobs growth and the Social Security surplus, we see a virtually flat and level straight line for 100 years! That is a [prediction,] based simply on a set of assumptions; and supposedly it could only be altered, in Bush's "math," by increasing the tax rate.

FIGURE 2

Social Security Revenues and Outlays as Percent of GDP, 1985-2055

(Percent)



Source: Congressional Budget Office, "Outlook for Social Security, June 2004.

But it is not a [forecast], which must be based on an idea of different economic policies which, if followed, would produce differing hypothetical results.

—An American Marshall Plan—

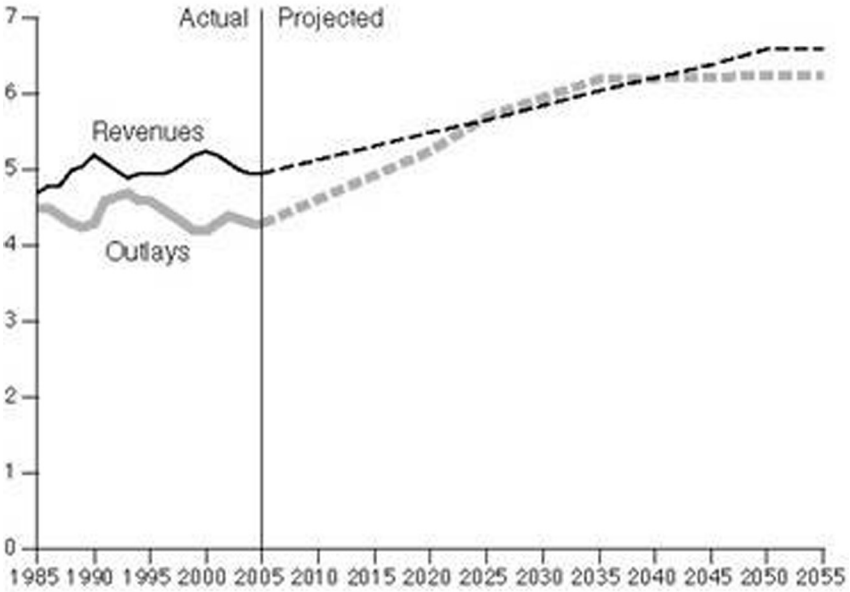
Suppose a bipartisan U.S. leadership, after stopping Bush and Wall Street from stealing Social Security, launches—as a recovery policy from the looming dollar collapse—what Lyndon LaRouche has called an FDR-style "Super-TVA" policy of Federal credits for productive, skilled employment, mainly through high-technology reconstruction of our economic infrastructure. Minority leader Reid has called for "a Marshall Plan for American infrastructure." And suppose such a recovery policy successfully launches an economic growth which keeps productive employment rising at 1.5% a year or better, to the middle of this century? That would mean creating about 2.6 million new jobs a year by 2020, some 3.3 million a year by 2035, and 4 million a year by mid-Century.

If the same relationship of jobs growth, to Social Security revenue growth, which obtained from 1985–2000, were extended to the 2050 horizon, **Figure 3** shows what could happen. The hypothesis is: Implement such an "American Marshall Plan," and Social Security doesn't need its surpluses, its special obligation Treasury bonds, to pay benefits. They could, in fact, be used as the reserve basis for some of the large volumes of Federal credits which would drive such a "Super-TVA."

FIGURE 3

Forecast of Revenues and Outlays, If New Job Creation Is Always 1.5%/Year or Higher, 2005-2050.

(Percent of GDP)



Sources: Congressional Budget Office, "Outlook for Social Security, June 2004"; *EIR*.

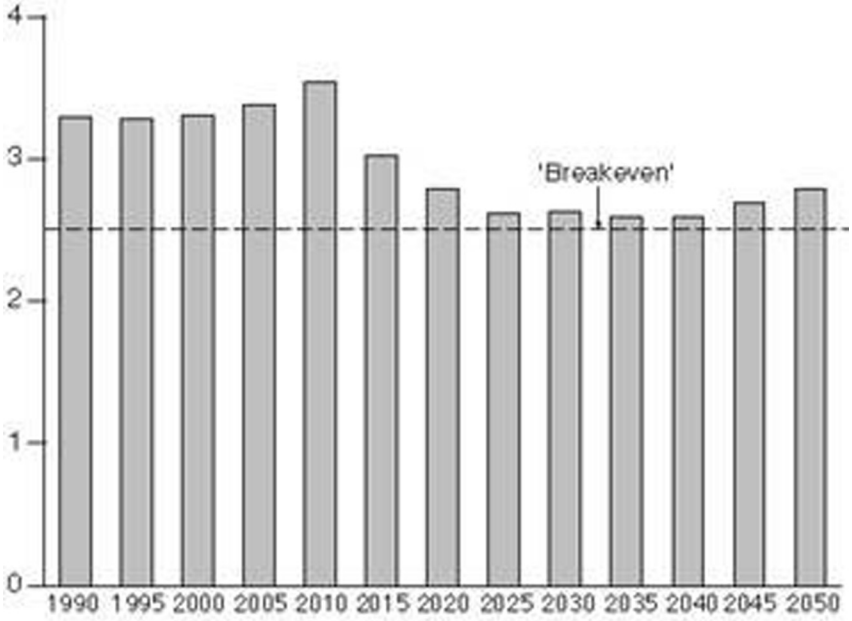
What about Bush's paper-doll cut-outs of "workers" vs. "beneficiaries "—the level of "demographics" his experts think Americans can understand?

The current ratio of contributors to beneficiaries of Social Security, the 3.3-to-1 so much lamented and scorned by Bush, Cheney, et al., has been just about constant for 15 years; and the Social Security system has collected about 130% of what it needs to pay benefits in most of those years. So in fact, a demographic ratio of about 2.5-to-1, employed contributors to beneficiaries, may be the baseline needed—at current average wage levels. (At higher wage levels, the ratio might be lower.) **Figure 4** shows that if the U.S. economy were to keep creating net jobs at 1.5% annually or better, especially productive jobs, that Social Security ratio would stay above 2.5-to-1 to 2050, even through the supposedly death-dealing retirement of the allegedly huge Baby-Boom generation.

FIGURE 4

Ratio of Contributors to Beneficiaries If New Job Creation Is Always 1.5%/Year or Higher

(Multiple Ratio)



Sources: U.S. Census Bureau, Population Pyramids; U.S. Bureau of Labor Statistics; *EIR*.

Bush Has SSA Projecting Depression

Alan Greenspan, Treasury Secretary Snow, the President's Economic Advisors and the actuaries say "inexorable demographics" make this impossible; it would produce the most drastic labor shortages ever seen.

- They assume that immigration into the United States will fall, by 2025 to 900,000 annually, 100,000 less than the Census Bureau forecasts at that time, and perhaps 20% less than today's immigration level;
- they assume that the birth rate and fertility rate will remain just below "replacement level," although they have been rising;
- they assume U.S. population growth will fall fromthe current 1.3% to well below 1% annually, a large drop;
- they assume the growth of the American labor force will almost completely halt during the 20 years the Baby Boomers are supposed to be retiring, from 2011–2030, rising very slowly after that, locking down possible job creation to the level of a century-long, deep economic recession;
- they assume that real national wages won't grow at more than 1.1% a year.

In other words, the actuaries that our illiterate President calls "the math," are [following the Malthusian axiom, so long discredited by American history, that demographic pessimism determines the possibility of economic progress, rather than the other way around.]

It is likely, that the actuaries also assume that Social Security will continue to tax only about 85% of that total national wage—even though it taxed 90% of it only about 15 years ago. The reason? Greater inequality of income—more rich, more poor—takes a greater portion of the national wage above the level at which the Social Security payroll tax applies.

Deliberately Pessimistic Forecasts

As the White House is overseeing two quite different GDP forecasts for the same periods—one to project the Federal budget, the other to project a Social Security deficit—so there are very different projections for the U.S. birthrate and immigration, and the Social Security Administration is using the most pessimistic possible. Like other Administration officials, Treasury Secretary Snow, in testimony Feb. 8 to the House Ways and Means Committee, claimed that "demographics, not economics" determined the Social Security's solvency. The SSA reports' projections of low GDP growth, falling to the deep recessionary level of 1.8% annually for 80 years (2015–2095), are claimed to be "locked in" by even lower labor force growth (and therefore jobs growth) of 0.5% after 2015. This is only one-third of the rate of new jobs creation in the 1990s, and just over one-third the current rate of growth of the labor force.

But the SSA's middle-variant birthrate of 1,950 per thousand women of childbearing age is just a long-term projection of the average of 1975–1995, it is below the U.S. Census Bureau's reported current fertility rate, 2,048 (and increasing, according to Census); well below Census' projected 2025 rate, 2,180, and Census' projected 2050 rate, 2,186. These differences, which approximate 230 births per thousand childbearing-age women by 2025, would translate into about half a million more Americans coming of working age each year during the second quarter of this century.

The same is true for immigration, another important factor in determining the growth of the workforce and potential growth in jobs creation and GDP. The SSA's long-term assumption of 900,000 total immigrants per year is below the projection of the U.S. Census Bureau (which, in turn, are below the current rate of immigration) by 200,000 per year in the second quarter of the century.

One of the most straightforward ways of maintaining an ongoing surplus in the Social Security account, is by continually increasing real wages. Snow's statements might be seen as statements of intent of the Bush Administration, a policy of low and shrinking real wages.

As a first step, simply compare two of the SSA's own scenarios. With their most publicized "Intermediate" set of assumptions, total SSA Income is greater than Cost until 2028, at which point Cost starts to outrun Income. With these assumptions, real wages only increase at 1.1% per year.

But then turn to the SSA's own "Low Cost" scenario, which has real wages growing at 1.6% per year. Over the 50 year period 2005–2055, SSA total Income rises by 84%, and Costs do rise as well, but by a much smaller 9.5%—which produces a barely discernible shift in the Cost curve between the two cases. In other words, the changed parameters between these two sets of assumptions raise the Income 9 times as much as they raise Costs. So in this case, Costs [never] exceed Income—i.e., there is a long-term continuing surplus.

To try to further isolate the wage component from the other variables, [EIR] obtained from SSA officials the outcome of a computer run, using their own model, in which the "Intermediate" set of assumptions were all preserved, except that real wages were increased not by 1.1% per year, but by an average 2.6% per year, over the 75 year horizon from 2005 to 2080. According to the SSA itself, this produced a nearly zero "net actuarial balance" over that time frame—which means that total Income would exceed Cost for approximately the first half of that period, and then Cost would be greater than Income for the second half, and the cumulative total would pretty much balance out.

It is clear that increasing real wages—the natural result of a healthy, growing economy, with continuous growth of real productivity— can help keep the Social Security account in the black.

An "American Marshall Plan" mobilization of productive jobs—infrastructure, industrial, and scientific employment—would raise the wages and salaries that are within the Social Security tax (a manufacturing job pays twice, on average, what a retail job pays, for example). And let us not forget that with that kind of job creation, there are 15 million American workers "sitting on the sidelines" right now—unemployed, dropped out of the labor force, forced to work temp or part-time. If even two-thirds of those Americans were productively employed "FDR-style" in a jobs-creation recovery, they represent five years worth of the needed growth of the

labor force to put Social Security further into surplus, on top of the natural labor force growth and immigration.

Finally, the actuaries are assuming an extraordinary further increase in the average American lifespan, which is not occurring now, but would be based on future "medical miracles," according to Chief Actuary Stephen Goss. This guess certainly increases the forecast Social Security benefits to be paid out. But it would be welcome; a longer life and higher living standard of the elderly, as Italian government economist Nino Galloni has shown, increases the demand for production, and jobs, among the labor force. And it makes it likely that more elderly Americans will choose to keep working productively past the retirement age.

These actuaries' forecasts about Social Security have become markedly more pessimistic, for no good reason. The so-called "demographic facts" which are held up today as meaning big future deficits, were well-known and taken into account in 1983. "It's a less optimistic estimate today," a former Chief Actuary told the [New York Times] in January.

Well, U.S. economic performance under George W. Bush might be enough to make anyone pessimistic.

So Bush has now become "self-fulfilling prophet" of doom for the Social Security system. Stop Bush's privatization drive, get rid of him and Dick Cheney, launch a serious recovery program for the physical economy of the United States, and Social Security will be found to have a long life-expectancy and no serious ailments.

The Fascist Chile Model of Social Security Privatization

President George Bush has repeatedly cited Chile as his model for Social Security privatization. While in Chile last November, he called it a "great example." And in an April 2001 visit to the country, Bush said: "I think some members of Congress could take some lessons from Chile, particularly when it comes to how to run our pension plans."

The architect of Chile's 1981 privatization was Harvard-trained Jose Pinera, who was Chile's Labor and Social Security Minister from 1978–1980, under the Pinochet military dictatorship (1973–1990). Pinera today is Co-chairman of the Cato Institute's Project on Social Security Choice, one of the ideological centers of the Bush assault.

George Shultz, the eminence grise of the Bush-Cheney administration, visited Pinera back in 1981. In his capacity as advisor to the incoming Reagan Administration. Shultz asked Pinera to provide him with a one-page memo on Chile's pension privatization, which had barely been implemented, for Shultz to try to sell the idea to Reagan. Reagan didn't buy it, but George W. Bush has.

What Is the Chile Model?

1) Up until 1981, Chile had a U.S.-style pay-as-you-go system. In 1981, workers already in the system were given a hard-sell "choice" of switching to a new, privatized system. All new entrants to the labor force after 1981 were required to enter the private system—with the exception of the military, who protected themselves by staying in the public system. Under the private system, workers pay 10% of their salaries into private investment accounts, run by financial institutions called Pension Fund Administrators (AFPs).

2) The Chilean privatization and related economic measures were implemented by a fascist police state. From 1973 to 1979, many unions were dissolved and collective bargaining was sharply reduced. Then in 1979, Labor Minister Pinera's "Plan Laboral" abolished the minimum wage, wiped out all collective bargaining, de facto eliminated the right to strike, prohibited trade union federations, reduced unionized workers to less than 10% of the work force, and allowed workers to be fired without cause. Dissidents were rounded up, jailed, tortured, or disappeared.

3) The driving force behind Chile's privatization of social security was the impending meltdown of its entire financial system, under the weight of a giant speculative bubble—a national bankruptcy which in fact occurred a year later, in late 1982. Chile's international creditors were able to refloat the country's banking system, based largely on the multi-billion dollar income stream appropriated through pension privatization, in order to keep looting it. Shultz and related financial hitmen are driving the Bush privatization frenzy today for the similar reasons, only on a much larger scale of impending bankruptcy.

4) After 24 years in operation, the Chilean system today is such a fiasco that almost all political forces in the country now agree that it has to be jettisoned, and some sort of an alternative devised. A few facts summarize the crisis:

5) Half of Chile's 6.1 million labor force is not even captured by the pension system: they are unemployed, in the underground economy, or are seasonal workers.

Of the remaining half, only 1.2 million workers—a mere 20% of the labor force—are covered with a pension greater than the government minimum standard of about $110 per month.

6) The government subsidizes those who receive less than this minimum, paying out more than a quarter of its total budget in social security payments—nearly as much as it does on education and health combined. And government social security payments are rising, with no end in sight.

7) Anywhere from 25 to 33% of worker payments are skimmed off as "administrative fees" by the AFPs.

8) From 1997–2004, the AFP annual profit rate was a cool 50%. Even in 2002, a year of economic recession in Chile, the average AFP profit rate was 50.1%—with one of the largest AFPs achieving a 210% return!

9) There were 18 AFP's when the system began in 1981; now there are only 6, of which 5 are foreign controlled. Out of $36 billion in Assets Under Management in the system, 95% are controlled by these foreign banking interests. These are: BBVA (Spain) with 32% of the total; Citibank (U.S.) 23%; Sun Life (Canada) 16%; Aetna (U.S.) 13%; and Banco Santander (Spain) 11%).

10) From 1982–2004, the annual return on individual accounts with the AFPs has averaged only 5.1%. If two co-workers retire in Chile today, both having the same salary and the same number of years paying into social security—one into the old pay-as-you-go system, and the other into the privatized AFP system—the co-worker in the privatized system today would receive less than half of the pension of the one who remained in the old public system.

The Chilean model is a failure. It means fascist economics, and fascist politics. It should not be repeated in the United States.

Algonquin, Illinois 60102
March 18, 2005

Committee on Ways and Means
1102 LHOB
Washington, DC 20515

To Whom It May Concern:

I am writing to encourage you to support passage of the above bill.

I have worked at William Rainey Harper College for the last 17 years and have, during that time, paid into the State Universities Annuitants Association (SURS). At retirement, I will collect a pension from SURS.

Before Harper I worked in the private sector and paid into Social Security. I have enough quarters to collect a Social Security benefit at retirement.

However, my Social Security benefit would be reduced due to the current law. If that law is changed by the passage of the above bill, I will be able to collect my entire benefit.

How could I benefit from the receipt of my total Social Security benefit? I could buy groceries for a month or the extra money could offset prescription drug and medical costs. The added income would be very helpful to me in retirement.

I encourage you to support the passage of this bill so that people in my situation can receive the entire benefit they actually earned.

I appreciate your time and hope you take this matter under consideration. Thank you.

Sincerely,

Joellen Freeding

Statement of Don Karel Fronek, Toney, Alabama

I am 67 years old and currently drawing Social Security Benefits. I am an Electrical Engineer and Mathematician by training and have worked the "numbers" on the Social Security Trust Fund. What is clear at this point is that the federal government must stop placing individual contributions in the general fund and spending this money. The IOU's credited to individual accounts have no worth at this point. When the money is paid back it is the tax payer (you and me) that pays it back. I therefore pay again for my retirement.

Money coming into the trust fund must be reserved for current obligations and the excess should be accumulated. The accumulated surplus (as it is being called

these days) should not be spent or loaned to the Federal Government. It is this money that has to be paid back by individual tax payers. Accumulated funds could be invested in non-governmental institutions over long periods of time. A committee of experts in investing could be formed to establish interest rates with a very high degree of reliability. But this is not the main comment here.

The single most important aspect of the reformed Social Security system must include keeping the Federal Government from spending the accumulated surplus Social Security trust funds.

Statement of Lara Schwartz, Human Rights Campaign

The Human Rights Campaign, which works to ensure that lesbian, gay, bisexual and transgender Americans can be open, honest and safe at home, at work and in the community, on behalf of its over 600,000 members nationwide, presents the following statement for consideration by the Committee:

The Prevalence of Same-Sex Families in America

As demonstrated by the 2000 Census, there is a significant percentage of American families whose makeup is different from what was once considered a traditional family. Recent studies show that there are more than three million same-sex couples living in committed, long-term relationships. Data also shows that there are over one million children being raised by same-sex couples. Gay and lesbian Americans contribute equally into the Social Security system but are not protected equally because their partners or spouses are excluded from spouse's and survivor's benefits under the program.

Denial of Spousal Benefits

Same-sex partners do not receive survivors' benefits when a partner dies, even though they pay for them equally. This exclusion includes even same-sex couples who are legally married in their home state or participate in another state-recognized union that imposes the same legal obligations as a marriage.

These families are also excluded from spousal benefits under the Social Security Disability Insurance program, even though they pay equally into the program.

Denial of Benefits to Protect Children

Sixty percent of children being raised by same-sex couples live in a jurisdiction where second-parent adoption is unavailable, meaning that these children cannot secure a recognized legal relationship with one of their parents. When a parent dies without such a legal relationship, the surviving child is not eligible for surviving child benefits under Social Security, even though the deceased parent paid into the program, and even if the parent supported the child for the child's whole life.

Social Security provides "surviving parent" benefits to the parent caring for a minor child when the other parent dies. But all children raised by same-sex couples are excluded from this benefit, even though their parents pay equally into Social Security, because it is only given to couples who are recognized as "spouses" under federal law, which same-sex couples are not. Even though the benefit is for children and not spouses, children being raised by GLBT people are denied it because their parents cannot marry.

The following table illustrates the way that families headed by lesbian and gay couples are denied surviving child and surviving parent benefits:

Benefit	Married Parent	Domestic Partner with legal relationship to child	Domestic Partner without legally-recognized relationship to child
Surviving Parent	$900/month	$0	$0
Surviving Child	$900/month	$900/month	$0

Recommendation

In order to meet the needs of today's families, and protect future generations, Social Security must provide equal benefits and protections to all. Lesbian and gay Americans already contribute into the program on an equal basis as other workers. The program must provide equal protections to all Americans regardless of sexual orientation.

Statement of John Gebhardt, John Wood Community College Annuitant Association, Quincy, Illinois

I would like my comments entered into the written record of testimony to support H.R. 15 a resolution in support of removing the federal Social Security GPO/WEP penalties and H.R. 147 to eliminate GPO and WEP.

I am one of the many individuals I know in my community college Annuitants Association who are affected by the GPO/WEP. One of the things I don't think was considered when this provision was passed is how it affects people who move from state to state and job to job. I have been paying into Social Security ever since I began making money in High School in the late 60's. After college, in 1968 I served 7 years on active duty as both an enlisted person and an officer. When I left service to pursue a civilian career I maintained my affiliation with the military serving a total of 31 years. During all of this time I paid into social security. From 1976 to 1987 I worked in Wisconsin, Illinois, Iowa, and Nebraska in jobs where I paid Social Security. I then took a job in Illinois where I worked for John Wood Community College where I was told I no longer could contribute to Social Security—except for the Medicare portion as Illinois had opted out of paying into Social Security system. I was not allowed to continue paying into Social Security—even though I wanted to. They did not inform me, at that time, that because of my employment there, I would lose some of my social security benefits. Evidently there were and as far as I know are "no" requirements for them to have me sign anything informing me of the GPO/WEP offset. If they had, I would probably not have taken the job as I had a lot of years invested in Social Security. When I retired 13 years later, I find out the GPO/WEP will take away benefits i thought I had earned and I am irritated. I am especially irritated on the impact it will have on my wife—if I die before her. I feel I have been wronged by the system. I paid into a system in good faith and now I am denied some of the benefits I felt I was promised. I have been told by the Social Security Administration that I will not loose as much as some of my fellow workers who are in the same situation but, I still stand to loose at least $400/month. Had I not served in the Reserves, I would have lost more! Friends of mine are loosing big time especially women who took jobs in education in Illinois and their husbands had jobs that paid into Social Security. They loose the normal spousal benefit because they draw an Illinois Teacher's pension—even though what they get is a small amount since they did not work for a long time under the system.

I urge you to eliminate this injustice. It is the little people who get hurt here. This is not a "windfall" to us. I blindly believed Social Security would be there when I retired. As to this "double dipping" I keep hearing, why is it, if I worked for ABC company and then took a part time job at Wal-Mart and paid into Social Security it is not considered "double dipping" but, if I work for the public sector it is.

I did the work; I paid into the system why shouldn't I get the pay!

Statement of Barbara B. Kennelly, National Committee to Preserve Social Security and Medicare

On behalf of the 4 million members and supporters of the National Committee to Preserve Social Security and Medicare, we thank the Committee for holding this hearing to explore the financial status of Social Security. In light of the limited panel of witnesses, we believe it is important for our organization to make one key point that cannot be ignored in this debate—regardless of what you believe about the fiscal status of Social Security, it is an undeniable fact that private accounts not only do not improve solvency, they make the situation worse.

Plans to privatize Social Security, such as the one proposed by President Bush, divert payroll taxes out of Social Security and into private accounts thereby substantially increasing Social Security's funding gap. In fact, the date on which Social Security is unable to pay full benefits is moved forward a full decade. Because privatization diverts money out of Social Security and into private accounts, cuts in Social Security benefits have to be significantly steeper than those necessary to bring Social Security into financial balance. Moreover, these larger-than-necessary benefit cuts would be accompanied by trillions of dollars in new federal debt—a debt burden which will be borne primarily by today's young people. It stands to reason that taking money out of Social Security is only going to make its challenges more acute.

Any discussion about the solvency of Social Security must take into account the very real costs of private accounts. Diverting payroll taxes out of Social Security and into private investment accounts only weakens Social Security. Private accounts are not a plan to save Social Security, they are a plan to dismantle Social Security as we know it by making drastic cuts in benefits and passing along trillions of dollars of debt to future generations.

The Administration has gone to great lengths to assure retirees and near retirees that they won't be impacted by privatization. But our members fully understand the potential consequences of adding trillions of dollars in borrowing on top of existing mountain of debt. They are leery of promises to protect future benefits that may become unsustainable in the face of massive new borrowing, and they shudder at the heavy burden it will impose on their children and grandchildren.

It is for those reasons that many in the general public oppose Social Security private accounts, and opposition to the accounts grows as people learn more about the trade-offs involved. Although more Americans are becoming aware of the programs' financial challenges, it is only recently that proponents of private accounts have admitted that privatization does not improve solvency by one day. That fact should be at the heart of any discussion on private accounts, so the American public can truly make informed judgments about Social Security's future.

Despite the rhetoric surrounding the status of the program's finances, both the Trustees and the Congressional Budget Office make it clear that Social Security will be able to pay 100% of benefits due for nearly another four to five decades. The Trustees currently place that insolvency date at 2042, the Congressional Budget Office at a decade later—after which time incoming payroll taxes will still be sufficient to pay between 70% and 80% of benefits for years.

It should also be mentioned that projections that far into the future are notoriously unreliable, and that the projected insolvency dates have edged forward with every single annual Trustees Report of the last two decades. Small differences between the estimates that factor into the financial projections and what is actually realized can result in dramatically different expected insolvency dates, because small differences can become significant when projected over time.

A second issue relating to solvency arises in connection with the year in which the program begins to spend more in benefits than it takes in through payroll taxes, currently estimated by the Trustees to occur in 2018. While those who support privatization often use this date in order to create a sense of urgency about the need to radically change the system, the fact of the matter is that the changes made to Social Security in 1983 generated surpluses that will finance the baby boom generation's retirement. Those surpluses are represented by the bonds held by the Social Security Trust Funds—bonds which represent the debt owed by the federal government to the American worker.

Social Security's bonds represent the same legal obligation that is represented by any other type of government bonds. Default by the United States on those bonds would cause an economic crisis of immense proportions in the international financial marketplace, as our country, which is traditionally considered one of the safest places to invest money, would suddenly join the ranks of the economically unstable. Default on Social Security's bonds represents a breach of faith between the US government and its own workforce—a violation of the covenant between worker and the government that is represented by the payroll taxes that are withheld from every workers' paycheck.

A strengthened Social Security can provide reliable, guaranteed benefits for today's retirees and future generations, providing a strong foundation for America's workers entering the next century.

Statement of Monica Plett and Barry Wauligman, Cincinnati, Ohio

PROTECT OUR TRUST FUNDS–PIA/FAMILY MAXIMUM WINDFALL REDUCTION FACTOR

CURRENT SITUATION—PIA computations determine the amount of T2 benefits payable to wage earners and the family maximum that can be paid to eligible dependents on the worker's record for social security retirement, disability, and survivor applications. Currently this PIA computation is based on averaging the earnings over a specified number of computation years. For retirement PIA computations the number of computation years is typically 35, that is, averaging the highest 35 years of earnings. For disability and survivor PIA computations the number of com-

putation years is dependent on the age when the wage earner became disabled or died. For these disability/survivor cases the number of computation years can be as few as 2 and as many as 35 computation years. Using less than 35 computation years results in an inflated PIA computation since fewer years of earnings are being averaged and lower years of earnings are not being included. The PIA computation in these disability/survivor cases based on fewer than 35 computation years results in an inflated PIA as compared to a PIA computation based on the full 35 years of averaged earnings.

IDEA FOR IMPROVEMENT—All PIA/family maximum computations based on fewer than 35 computation years should have an automatic windfall reduction factor imposed (possibly about 1% per year). This PIA/family maximum reduction factor should be determined based on the number of PIA computation years fewer than 35. For example, a PIA computation based on the highest 30 earning years would possibly have a 5% reduction and a PIA computation based on the highest 4 earning years would possibly have a 31% reduction.

EXAMPLE—A T2 disability claim was recently approved for a young wage earner who was found disabled at age 25. His PIA computation was based on his highest 2 years of earnings resulting in a PIA of about $1,000 and a family maximum of about $1,500. The young wage earner, himself, paid total FICA (social security) taxes of about $6,000 over his relatively short working career and was awarded social security disability benefits of $12,000 yearly and an additional $6,000 yearly for his wife and young child. These payments will continue indefinitely to the worker for as long as he is disabled (potentially the rest of his life) and the payments for his dependents can continue till his child turns age 18 (and possibly longer). The wage earner and his family's social security payments represent a windfall payment as compared to the total amount of FICA taxes that he paid into the social security system. Especially when it is considered that he could potentially receive these benefits, as well as cost of living allowance increases for his lifetime, the amount of money he paid into the system is very small compared to the resultant monthly check and long duration of years the payments could continue.

By applying a PIA/family maximum windfall reduction factor in the above example, the PIA and family maximum would have about a 33% reduction imposed (35 minus 2), resulting in a PIA of about $670 and a family maximum of about $1005. Even these reduced social security payments represent a windfall compared to the $6,000 FICA taxes paid, but the amount is much more reasonable and is still consistent with social security's original purpose as a partial replacement of income lost due to disability or death.

END RESULT

Our agency has imposed various types of windfall offset reductions/computations in determining social security payments. Examples include WEP (windfall elimination provision for government workers), GPO (government pension offset for government workers), worker compensation offset (for individuals receiving worker compensation payments), and SSI offset (for individuals awarded both social security and supplemental security income). Using a PIA/family maximum windfall reduction factor for all computations involving less than 35 computation years seems to fit within the same context of these other types of windfall offset provisions.

The social security trust funds will run out of money within the next 20–30 years and solving this long term problem is something that will only become increasingly more difficult as time passes until a solution is reached. Best guess is that this PIA/family maximum windfall reduction factor would apply in about 50% of disability cases and possibly 20% of survivor cases. Social Security publication #13–11785 states that, in 2003, there were 777,000 disability awards to workers, 482,000 additional disability awards to spouse's and children, and 853,000 survivor awards. Also, the average monthly disability award is $936 to a worker and about $480 total for spouse/children. If we conservatively assume that a PIA/family maximum reduction factor of 1% would apply in 50% of disability awards and that the average reduction would be just 5–6% of the average 2003 payment, this would mean a savings of about $50/mo for the worker and about $25/mo for dependents. For the first year of using this new windfall offset provision, trust fund savings would, conservatively, total about $233,100,000 ($600/yr for each of about 388,500 disability awards) and about $72,300,000 ($300/yr for each of about 482,000 disability dependents. The total first year savings for disability awards would thus total over $300,000,000 and the savings for survivor cases would increase this to a higher amount. For the second year after using this new windfall offset provision, the total savings to the trust funds would be over $900,000,000 since we'd then have 2 years of $300,000,000 savings on the individuals awarded the prior year and another $300,000,000 savings on the individuals awarded disability in the second year. Similarly for the third year

after using this new windfall offset provision, the total savings to the trust funds would be about $1,800,000,000 for disability awards over the 3 year period and the savings for survivor cases would increase this amount even higher. To summarize, the $1,800,000,000 three year conservative estimate of disability award savings represents an amount based on a 1% PIA/family maximum reduction factor. If the PIA/family maximum reduction factor was decreased to ‡%, then the resulting savings would also be one-half of this amount, or $900,000,000.

Insofar as public support for this PIA/family maximum windfall offset reduction factor, the majority of Americans would probably favor it. Individuals directly affected by the provision would have some dissatisfaction but the majority of individuals would probably feel that a reduction is justified based on the fewer number of years the individual worked and paid into the system.

Statement of Hal Daub, Social Security Advisory Board

Mr. Chairman, Mr. Rangel, and members of the Committee. I appreciate the opportunity to submit a statement for this most important hearing. The Social Security program plays a foundational role in retirement security for America's workers. It also provides essential protections to them and their families against the risk of lost earnings as a result of disability or premature death. Congress has always taken special care in dealing with the program to assure that it will be soundly financed in both the short-range future and over the long-haul. In 1994, Congress enacted a law creating an independent, bi-partisan Social Security Advisory Board. One of the specific charges that legislation gave to the Board was to provide recommendations to the President and to the Congress about the solvency of the Social Security program.

The Board has taken that responsibility very seriously. We have carefully studied the financing of the program. We have closely consulted with both the Social Security Administration's actuaries and with the Congressional Budget Office. Twice in the past six years, we have appointed technical panels of expert economists, demographers, and actuaries to review and make recommendations about the assumptions and methodology used in projecting the solvency of the program. And we have, as a Board, issued a report describing the problems facing the program and urging prompt action to address those problems. The Board first developed that report seven years ago and then reissued it four years ago. We are now planning to update and issue it again this year. Over this period of time, the Board has had some change in membership but it has maintained a consistent, unanimous, and bi-partisan position. In brief, the Board's position has been and is that the Social Security program faces a serious financing problem, that there are a variety of proposals available from which policymakers can craft a solution, and that it is most important that action should be taken sooner rather than later.

The Board's report identifies over 20 separate proposals that might be considered as Congress takes up the task of dealing with Social Security's deficit. These proposals cover a broad gamut including eligibility rules, formulas for determining and updating benefits, program coverage, Social Security tax levels and income sources. Some of these proposals would modestly improve the program's financial status and others would make substantial improvements. It was not our objective to urge the adoption of these particular proposals. In fact, as a Board, we have not taken a position for or against any of these proposals nor to rule out additional proposals that may be developed. Rather it was our objective to demonstrate that many options are currently available from which Congress can choose in order to weave together a workable package that will bring Social Security's financing back to a state of solvency. Members of the Board, as individuals, do, of course, have views as to what they feel are the most desirable approaches to this problem, and we make known those individual views in appropriate forums. As a Board, however, we have concluded that we can best serve the interests of the program and the legislative process by pointing out that many options exist and by expressing our unanimous and bipartisan conviction about the importance of taking action soon.

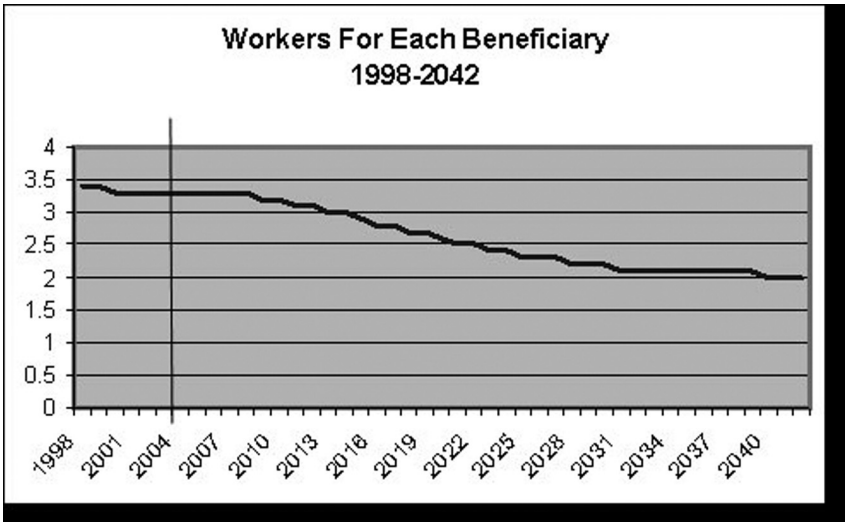
It is true, of course, that we are dealing with the future and that the future is never perfectly foreseeable. Different experts will have somewhat different views as to the date on which outgo begins to be larger than income or the date on which the fund is exhausted. Even the same experts will change their projections somewhat from year to year as they see developing economic and demographic trends or as they make improvements to their forecasting tools. But the essence of the underlying facts that the Board saw 7 years ago when it first issued a report on Social

Security solvency has remained unchanged. Between the Social Security and CBO projections, the differences are less striking than the similarities. The Board's technical panels have recommended some changes in assumption and method, but none of these changes make the problem go away.

The Social Security solvency problem has to be faced, but why now? Why is it important to act now when the Social Security program is still bringing in more than it pays out and will continue to do so for a bit more than a dozen years? There are really two basic answers to that question though they can be subdivided into a number of more refined arguments. The first reason for acting now is that the Social Security program is too important a part of our social fabric for us not to deal with its serious financial problems. The second reason is that we are now enjoying a window of opportunity for taking action, but that window is closing and, when closed, will leave us with much less capacity to deal with the problem.

Social Security affects the current or future economic security of nearly all Americans. It should be unthinkable to allow questions about the program's solvency to remain simply unanswered. Ninety percent of those over 65 are drawing Social Security benefits now, and for roughly two-thirds of them Social Security provides most of their income. America's workers of all ages are also participants in this program. We encourage them to take the time and effort to think about their future. To save. To participate in employment-based retirement programs. To plan ahead so that they can enjoy an adequate income in retirement. But how can they do this, if our foundational program is not soundly financed? How can they make reasonably reliable estimates of what they can expect? Congress set Social Security up with earmarked financing and a commitment to long-range solvency. This was done so that those who draw its benefits in the present and those who hope to do so in the future can have confidence that they can count on this program. When we have year after year of official reports that the program is not sound, how can we expect that that will not undermine the trust and confidence of both beneficiaries and workers?

The need to maintain confidence in the program provides ample rationale for acting promptly. But there also is the very practical reason that we now have a closing window of opportunity. Acting now gives you, the Nation's elected policymakers, a much wider and less unpleasant range of options. Because we are still some years away from the point of inability to meet promised benefits, the cost of repairing Social Security can be spread more evenly across generations and changes can be phased in gradually. Individual taxpayers and beneficiaries will not have to face sudden, drastic changes that disrupt their decisions about consumption and savings. But this time of opportunity is shrinking. Since the Advisory Board issued its 1998 report on the need for prompt action, the baby boom generation has moved seven years closer to the age of eligibility for retirement benefits, and because disability tracks age, a portion of the generation is in fact already on the benefit rolls. The chart below shows you how the window of opportunity is closing. With the baby boom still in the work force, we still have about 3.3 workers for each beneficiary. But in just a few years, in 2009 that ratio is going to start a steady decline. By 2042, the year the trust funds will be exhausted, the ratio will have dropped by 40 percent so that there will be only two workers for each beneficiary. If you look at the vertical line at 2005, you can see that since the Board first urged the need for prompt action in 1998, we have already lost about half the remaining time before those adverse demographics begin to take hold. The Board then said it was important to act sooner rather than later. We are now beginning to approach "later."



Moreover, it is clear that these demographic pressures we face are creating challenges not just for Social Security but for our entire complex of retirement security including such elements as Medicare and Medicaid and privately sponsored programs for retiree income and health benefits. The Social Security Advisory Board has just issued a report based on a year or more of studying this bigger picture. This report *Retirement Security: The Unfolding of a Predictable Surprise* is, like all our reports, available on the Board's website: www.ssab.gov. Different programs have different purposes, and we understandably tend to think about them and deal with them separately. But we need to understand that they are not really unconnected. Social Security benefits help individuals to meet out-of-pocket medical costs not covered by Medicare. For a large portion of the elderly, employer sponsored health and pension programs are, like Social Security, important parts of their retirement security. And all of these elements—and our other national priorities—are affected by these same structural changes taking place in our workforce and population. All retirement support programs, both public and private, draw on a common pool of national economic resources. Efforts to resolve issues in one program will impact our ability and strategy for dealing with the problems in other programs.

In the course of the Board's study, we were repeatedly told that Medicare is a tougher problem than Social Security. That is undoubtedly true, but we don't have the luxury of solving only the less difficult problems. Nonetheless, it certainly makes sense to begin by tackling the Social Security solvency issue now. Perhaps, by meeting that task, we can pave the way and set ourselves an example for dealing with the many other challenges that this Nation also faces in the 21st century.

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