Senate Democratic Policy Committee Hearing

"An Oversight Hearing on President Bush's Social Security Privatization Plan: Will You and Your Family Be Worse Off?"

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I am here as the Executive Director of the *Alliance for Worker Retirement Security (AWRS)* and the *Coalition for the Modernization and Protection of America's Social Security (CoMPASS)*. Combined, these two organizations have led the charge for common sense reform of Social Security, including the option of voluntary personal accounts. While the AWRS has focused its efforts on working with and educating Members of Congress and their staff, *CoMPASS* has focused its efforts outside the beltway educating retirees, workers and young people on the need for reform. In fact, CoMPASS's Generations Together campaign now boasts state chapters in 23 states and 19 Congressional districts.

Our volunteers have held town hall meetings, written letters to the editor, appeared on television and radio, and called our congressman and senators – urging support for fundamental Social Security reform that meets the following four criteria: 1) Protects current retirees; 2) Permanently solves Social Security's finances; 3) Allows voluntary personal accounts; and finally, 4) Does not include tax increases.

Where We Agree

Before I address the very politically charged title of today's hearing, let me begin by discussing the areas where this panel is likely to find agreement. It is my hope that this approach will help lead to a more cordial and thoughtful discussion -- and will help this Committee in what I hope is an earnest attempt to contribute to this important Social Security debate.

First, Social Security has to be fixed. Because Social Security operates almost entirely as a pay-as-you-go system, it is highly sensitive to the dramatic demographic changes over the last several decades. The baby boom has been followed by a baby bust. Increased life expectancies mean more retirees collecting benefits for more years. Together, this falling ratio of workers to beneficiaries will push the system towards insolvency.

In fact, in three short years, Social Security's surpluses will begin to shrink, forcing Congress to come up with other revenues to meet its growing appetite for taxpayer dollars. Six years after that, Social Security will begin running cash flow deficits. These deficits will grow dramatically, and within five years will consume $118 billion, an amount equal to the funding for H.H.S., Homeland Security and the Department of Justice.

Second, the sooner we act, the better. Every year we wait to address this problem, the cost of fixing it grows. This is for the simple reason that Social Security's deficits -- $4 trillion over 75 years or $11 trillion in perpetuity – grow at a faster rate than the payroll tax base that supports the program. While Social Security reform inevitably involves difficult choices, there is no future date at which those choices will be any less difficult than they are today.

Third, Social Security Taxes Ought to be used for Social Security. For the next 12 years, workers will pay more into Social Security than is needed to pay current benefits. Because the federal government can't save this surplus – the so-called "trust fund" is really a deficit – a reflection of a liability, not an asset. Prudence calls for directing those resources into personal accounts owned, managed and protected by American workers. Such accounts would constitute a true and meaningful "lockbox."

I am always baffled that opponents of reform will claim that diverting $100 billion of surplus payroll taxes into personal retirement accounts is "robbing Social Security," while using those same resources to fund other government programs and replacing the funds with IOU's is "protecting Social Security."

Fourth, personal savings accounts ought to be a part of Social Security reform. If we were starting a Social Security program from scratch and knew that future generations would consist of just two workers for every retiree, I find it hard to believe we would rely entirely upon pay-as-you-go financing. A funding component would almost surely be included, since it makes the program less subject to demographic forces and enhances income security for workers and retirees alike.

While most of my fellow panelists would argue that the source of the funding for the personal savings accounts is critical, and would want to know if the funds are being "carved out" of existing Social Security taxes or being "added on" through some other revenue source, I would argue that this is a debate that is mostly lost on the American public. In fact, as long as the overall federal tax rates are held constant and the funding of the accounts is derived from existing revenue or spending sources, there is little if any difference between the two.

Criteria for Comparing Reform – "Apples to Apples" not "Apples to Cumquats"

Now, will workers be better off under the emerging proposals of the Administration? Before answering that, it is important to understand that the criteria for judging various reform options ought to be limited to "apples to apples" comparisons – not the "apples to cumquats" comparisons that have dominated the comparisons to date. Specifically, it is pointless to compare the benefits or taxes related to the various reform proposals against benefit and tax levels of the current system when the promises of the current system are not fundable under existing scheduled tax rates. Comparing reform to fantasy serves no one.

There is no free lunch – you don't get something for nothing. What we get out of Social Security is a function of what we put into it; putting more taxes into Social Security makes workers worse off and retirees better off; putting less taxes into Social Security does the opposite. We can not pretend that these choices and trade-offs do not exist.

Comparing benefits from the Administration's proposal to a current program that cannot pay them without large tax increases is a fantasy that serves no one. Likewise, pretending that a personal accounts plan can pay massively higher benefits than the current program without significant new revenues ignores the inevitable choices and trade-offs we face.

The Cost of Doing Nothing – the "Do Nothing" Plan

With that, let's begin this analysis by looking at what one might call the "do nothing" option – known by some as the "Democratic Leadership Plan." This analysis will then be compared to the President's proposal to provide a fair comparison.

Benefit Cuts From Doing Nothing. Absent reform, Social Security benefits would have to be cut by 26 percent in 2041, growing to over 32 percent in 2079. According to a recent study by the Social Security Administration, these cuts would lead to a doubling of the poverty rate – with almost half of those added to poverty being black or Hispanic and over 60 percent being women. The greatest impact would fall on the young, who would spend the longest in an insolvent system with reduced benefits. The above analysis assumes unrealistically that the cuts are applied to those in retirement at the time. Protecting those already retired at the time would lead to even more draconian cuts of almost 70 percent for those entering retirement after that date. This would lead to even greater increases in future poverty and would put in greatest jeopardy those most at risk due to lower lifetime earnings.

Tax Increases from Doing Nothing. Alternatively, Congress could opt to increase taxes and maintain promised benefit levels. This would require an eventual 50 percent increase in taxes, which would have a dramatic impact on our economy. Social Security is already the largest and most regressive federal tax paid by two-thirds of working families. It is a head tax on employment that is paid on the first dollar of wages earned, whether or not the company is profitable. When Social Security taxes go up in the United States, they do not go up in China. The trade implications of an increase in taxes would be immense. It is an underappreciated fact that increases in payroll taxes, particularly increases in the wage cap, will lead to dramatic reductions in employment. We do not wish to follow Europe's example in this regard.

The CEO of Intel Corp. recently noted that it need not ever hire an engineer in the United States because the market for engineers is no longer bound by borders – as engineers can telecommute from anywhere in the world. Tuesday's *Washington Post* highlighted a company that had outsourced its receptionist and office manager position to an employee in Pakistan, who watches over the office and greats visitors via video and satellite. Radiology is increasingly being handled by lower paid medical technologists in the United States with the actual medical evaluation being done by lower paid doctors in other countries. Increasing taxes, even lifting the payroll cap, will only accelerate this trend.

Let me assume, then; that we all agree: the "Do Nothing" plan is not an option. Doing nothing would result in either draconian benefit cuts, huge tax increases or some combination of both. Understand, obstruction and demagoging of reform will, by default, result in the "do nothing" plan's implementation.

The Benefits of the Emerging Presidential Plan

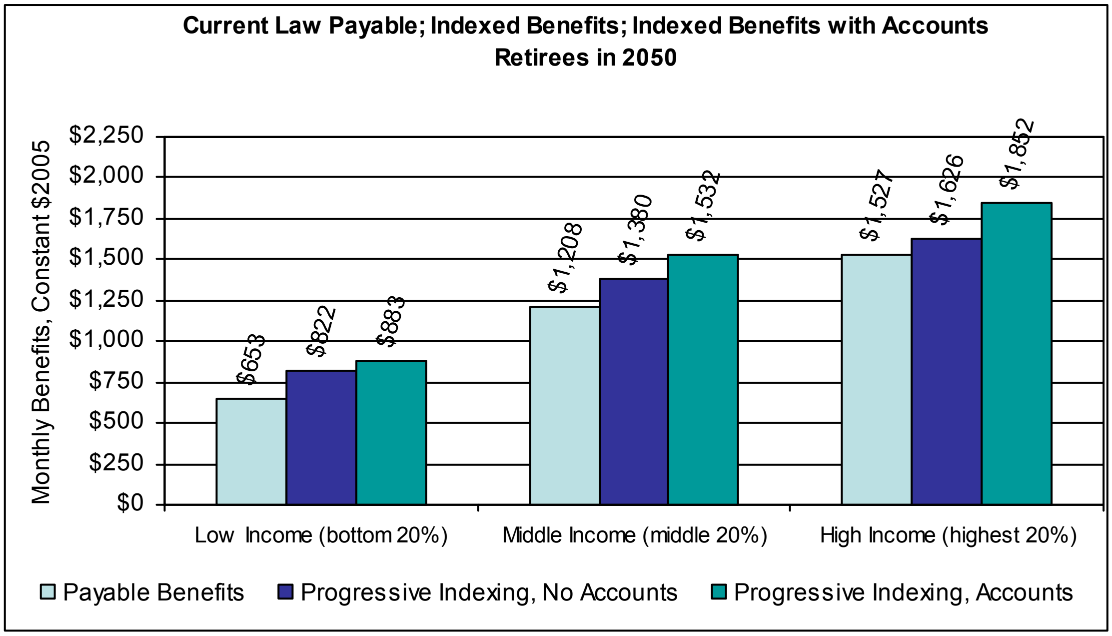
Having built a retirement system that is unfunded and has made promises it cannot possibly meet, certain choices have to be made. These choices have to be made whether or not personal accounts are a part of the solution. Reforms have to be made because we can not afford the level of promises that we have made, and continue to make to tomorrow's retirees. The administration has opted to do two things for which it ought to be applauded – particularly from those with traditionally Democratic leanings:

First, the President has opted rightly to protect those already in or near retirement; promising that benefits for workers or retirees born prior to 1950 will not be affected by any reform measures undertaken.

Second, the administration has opted to place the burden of reform on higher wage workers while protecting middle and low income workers. Now, let me be clear – and say something that you may find radical: **Every future retiree, by definition, under any plan that indexes benefits based on prices, will be guaranteed a benefit in real dollars at least equal to the benefits received by today's retirees. The President's recent embrace of "progressive indexing" improves on this by promising lower and middle income workers substantially more than current retirees – while giving the highest wage workers an amount equal to today's retirees.** Considering the size of the shortfall we face, this seems like a reasonable and non-controversial adjustment.

Despite this, supporters of the "do nothing" approach have made irresponsible claims that indexing will lead to drastic cuts for low and middle income workers. In fact, Senator Reid has been quoted calling an individual who earns $36,000 per year his whole life "low wage" and someone earning $59,000 "average" – the truth is that the first worker earns more than half the population while the second earns more than 85 percent of the population. The "inflation" of the middle class has gone to insane levels with Representative Pelosi calling career $90,000 earners "solidly middle class" despite the fact that less than one percent of workers will have comparable lifetime earnings. Such rhetoric is indefensible.

Rather than look at "stylized" workers who do not exist, a better methodology is to look at a sample of actual workers, as was done by the Social Security Administration. By taking their actual work histories we can simulate the effects of progressive indexing into the future on this representative population. This model, the SSA's Modeling Income in the Near Term (MINT), can produce results by gender, race, education, marital status and income levels. By looking at individuals in the top, middle and bottom of the income quintile we can get an accurate picture of what progressive indexing would look like when compared to what the current law can afford to pay to those same workers. We can then include in this analysis what these workers could expect to get in retirement if we included the income from a 4 percent personal account (up to $1,000). The benefits of this approach are evident in the chart below. All workers, low, middle and high do better under progressive indexing than the current system can afford to pay, and even better when accounts are considered.



By isolating the affects of reform on low-income workers, we can see that such workers will experience significant growth in their benefits over time – improved again, by the returns from personal accounts.

Benefits to Low Income Retirees, 2005 Dollars				
	2004	2022	2050	2061
Progressive Indexing without accounts	$514	$702	$804	$854
Progressive Indexing with accounts	NA	$702	$838	$948
Source: SSA Office of Policy, MINT Model				

A similar analysis can be used to single out the effects of reform on widows and divorced individuals. Again, it is clear from the attached charts that both will do significantly better than they would under an unreformed Social Security system and many will actually be pulled out of poverty under the President's approach. Furthermore, these populations receive significant increases when personal accounts are included in the analysis.

Benefits to Retired Widows, 2005 Dollars				
	2004	2022	2050	2061
Progressive Indexing without accounts	$979	$1,324	$1,473	$1,551
Progressive Indexing with accounts	NA	$1,326	$1,682	$2,019
Source: SSA Office of Policy, MINT Model				

Benefits to Retired Divorcees, 2005 Dollars				
	2004	2022	2050	2061
Progressive Indexing without accounts	$948	$1,198	$1,326	$1,409
Progressive Indexing with accounts	NA	$1,199	$1,473	$1,720
Source: SSA Office of Policy, MINT Model				

Conclusion

Let me conclude by reiterating: Social Security has to be fixed. Absent reform, our economy will suffer. This is not a Democrat or Republican issue – it is an issue that affects employers, employees, retirees, and will have a significant impact on future generations. This issue is too important to be used as a political tool to score short term political points. It is time for Democrats and Republicans to come together and begin the hard work of addressing this problem. I am sure that every panelist will agree – the solution to what ails Social Security will only get harder – and the choices more painful. Acting now is imperative. The "do nothing" plan must be defeated.

Thank you for allowing me to be here today, and I look forward to your questions.