

**THE PRESIDENT'S AND OTHER BIPARTISAN
ENTITLEMENT REFORM PROPOSALS**

HEARING
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED THIRTEENTH CONGRESS

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**THE PRESIDENT'S AND OTHER BIPARTISAN
ENTITLEMENT REFORM PROPOSALS**

THURSDAY, MAY 23, 2013

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

The subcommittee met, pursuant to call, at 9:29 a.m., in Room B-318, Rayburn House Office Building, the Honorable Sam Johnson [chairman of the subcommittee] presiding.
[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Chairman Johnson Announces Hearing on the President's and Other Bipartisan Entitlement Reform Proposals

Washington, May 2013

U.S. Congressman Sam Johnson (R-TX), Chairman of the House Committee on Ways and Means Subcommittee on Social Security, today announced the third in a series of hearings on the President's and other bipartisan entitlement reform proposals. This hearing will focus on proposed adjustments to Social Security benefits, as included in the President's Fiscal Year 2014 Budget, the report by the National Commission on Fiscal Responsibility and Reform, and the report of the Bipartisan Policy Center's Debt Reduction Task Force. **The hearing will take place on Thursday, May 23, 2013, in B-318 Rayburn House Office Building, beginning at 9:30 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Social Security Act (P.L. 74-271), signed into law by President Franklin D. Roosevelt on August 14, 1935, established the original retirement age of 65 for all retired workers. The early retirement age of 62, which allows workers to claim benefits earlier but permanently reduces the monthly level, was established first for women only in the Social Security Amendments of 1956 (P.L. 84-880) and for men in the Social Security Amendments of 1961 (P.L. 87-64). The Social Security Amendments of 1983 (P.L. 98-21) gradually increased the full retirement age, reaching 67 for those born in 1960 and later. Life expectancy for a person at age 65 has increased from 12.7 years in 1935 to 19 years today.

The Social Security Amendments of 1977 (P.L. 95-216) enacted the new benefit formula, under which benefit amounts are determined by applying a three-tiered formula to the monthly average of the highest 35 years of wage indexed earnings. The benefit formula is designed to replace a certain percentage of a worker's career earnings and is very progressive, replacing 90 percent of lower earnings and only 15 percent of higher earnings. As a result, retirees who had lower earnings throughout their careers have more of their average lifetime earnings replaced than retirees with higher career earnings.

Bipartisan proposals to adjust benefits have included increasing both the full and early retirement ages to account for increases in life expectancy, including a hardship exemption from retirement age increases for certain workers, indexing the benefit formula to account for increases in longevity, allowing beneficiaries to receive up to half of their benefits beginning at age 62, slowing the growth of benefits for higher lifetime earners, increasing benefits for low lifetime earners, and increasing benefits for long-time beneficiaries.

In announcing the hearing, Subcommittee Chairman Sam Johnson (R-TX) stated, **"At this hearing we will carefully examine the impacts of bipartisan proposals to adjust benefits for future beneficiaries. With Social Security already in the red, Americans know the longer we wait to fix Social Security, the tougher it will be to do so. It's time we work together to make sure Social Security is there for today's workers and their children and grandchildren."**

FOCUS OF THE HEARING:

The hearing will examine bipartisan proposals to adjust Social Security benefits and their impacts on the program's finances, beneficiaries, workers, and the economy.

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 "Hearings." Select 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, submit all requested information. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, June 6, 2013**. 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 or (202) 225-3625.

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.

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.

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

Chairman JOHNSON. Good morning and welcome to the third hearing in the Committee's series on the President's and other bipartisan entitlement reform proposals. I appreciate all of you being here. Workers have worked hard, played by the rules.

Workers have earned the right to a secure retirement that no one can take away, yet unless Congress acts to protect and preserve Social Security, beginning in 2033, Social Security will be unable to pay full benefits, according to the Board of Trustees.

Here is why Social Security has to be fixed. Under Social Security, workers' payroll taxes aren't saved in the worker's own retirement account. Instead, their taxes are immediately used to pay benefits for today's retirees. This kind of system works when many people are paying in and very few collecting benefits. In the 1950s, for instance, there were 16 workers paying for each retiree collecting benefits, but today, families are having fewer children and people are living longer. As a result, even though the number of workers is growing, the number of retirees is growing much faster. Today there are just over three workers supporting each retiree. In the future there will be less than two.

Back in 2008 the first baby boomers started collecting retirement benefits. Costs rose quickly, and 2 years later in 2010, Social Security began running permanent cash flow deficits, reaching \$1.3 trillion over the next 10 years. And those deficits will grow larger and very fast.

When today's 47-year-old workers reach their full retirement age in 2033, they and everyone else already receiving benefits face a 25 percent cut unless Congress does its job.

Fixing Social Security is a serious challenge. If we wait, it will become a crisis. The sooner we act, the sooner changes can be phased in gradually over a number of years. If we fail to act, future generations will be faced with changes that are sudden and even larger.

Today our witnesses include representatives from two bipartisan groups who have taken a hard look at Social Security and come up with ways to fix it. It wasn't easy work, but they know we can't afford to wait. Their two plans have a lot in common. They would slow the growth of benefits for higher earners, take into account the fact people are living longer, and make important changes to improve benefits for some of those poorly served by the current system.

Since these plans were written, Social Security's 10-year cash flow deficit has increased by over 450 percent. Across-the-board cuts will occur 7 years sooner, and Social Security's long-term shortfall is almost 60 percent larger. It is unfair and wrong to leave with our kids and grandkids a Social Security system that can't pay full promised benefits.

The good work of Simpson-Bowles and the Bipartisan Policy Center Debt Reduction Task Force shows us there are bipartisan solutions to fix Social Security, and as I have said before, the President likes to say if we agree on a policy, then we should act and not let our differences hold us up. Today we will again carry out our responsibility to every American to closely examine each bipartisan policy option. When we agree, we ought to act, and we will.

I now recognize the ranking member, Mr. Becerra, for any opening statement you care to make.

Mr. BECERRA. Thank you, Mr. Chairman, and I think we can all agree on some basics. First, Social Security has never contributed a penny to our current deficit or to our national debt. So any changes to Social Security should be solely to address its long-term challenges and not to make Social Security pay for the debts run up by tax cuts for the rich or two unpaid-for wars.

Second, Americans support Social Security. They have earned it through their weekly payroll contributions, and they are counting on their elected representatives to protect it as well.

And finally, at least for me, the America I grew up knowing and loving has always risen to the challenge of building a better place for our children, providing for that in any way possible, whether that means college, a strong and secure Nation, or Social Security once we retire. We build; we don't tear down in America.

And so here we go, Social Security has never contributed a penny to our current deficit or debt. I want to emphasize that. Social Security today has \$2.7 trillion in Treasury certificates that have never been used and are available for those who need retirement, to go into retirement or are disabled, or if you happen to have lost your parent who was a worker, you then as a survivor get to receive Social Security benefits. \$2.7 trillion.

And I would like to show a chart at this stage that I think proves that Americans not only have supported Social Security, but continue to support Social Security today, overwhelmingly, and they are counting on their elected representatives to protect Social Security. As you can see from the chart, even though lots of folks have heard a lot of scare talk about Social Security being bankrupt or going under, and sometimes Americans' confidence may fluctuate, the reality is this, as this chart shows, Social Security has always had the confidence of the American public.

How many people in America think Social Security spends about the right amount, or maybe it doesn't give quite enough in its benefits? Well, that has always hovered somewhere around 89 percent of Americans who think it is too little or about right. Less than 10 percent of Americans since 1984 have said that Social Security pays out too much, that it is too generous. And so support for Social Security is strong. The vast majority of Americans are there. A recent poll by the National Academy of Social Insurance found that 74 percent of Republicans and 77 percent of people born after 1980 said they wanted to preserve Social Security even if it meant working people would have to pay a little more in taxes.

Now, the America I know can and will rise to this challenge of meeting Social Security's future challenges. There is no question that Social Security will need to make some changes to ensure its future that is vibrant, but in the America I know, we wouldn't start by planning to cut benefits for seniors, disabled workers, and children who have lost their parent. America's workers deserve much better than that. The vast majority of Social Security recipients, both today and in the future, have very modest incomes and few resources. For six out of 10 retirees in our country, Social Security provides the majority of their income.

There are some who seem to suggest that deep Social Security cuts are inevitable, so we should just make them now. That to me is discouraging, and that is certainly not the America I grew up in. To give up and to say that we can't assure a measure of dignity to those who have worked hard all their lives, paid into Social Security, and were planning on it for retirement, that we have no choice? No.

Let me show you a different chart. Here is the average benefit on the far right that you see that Americans earn from Social Secu-

urity. On average, about \$14,000 per retiree comes from Social Security and a little less if you are a disabled worker. Now, that is quite a bit less than what the average worker today makes, which is about \$50,000, as you see on the chart. But then look at the most fortunate in our country, the most well-off people in society, the top 1 percent of workers earned five times as much as the average worker in America and 18 times as much as the average Social Security beneficiary who is retired. When you get to the stratosphere, the top one-tenth of 1 percent, they made an average of 41 times what the typical Social Security retiree gets, and if you look all the way to the left, you see what an average CEO in America would make, about \$12 million in 2011, on average. On average. That is 869 times what the average retiree receives from Social Security.

So I ask you, where shall we start as we think about how to address Social Security's challenges in the future? Should we take it from the Social Security beneficiaries' modest checks or should we look to those most fortunate and see if they can contribute a little bit more? Should we ask the widow to give up her modest benefit or ask the CEO to pitch in a little bit more?

Social Security will face a challenge, there is no doubt. But in America, at least the America I know and love, we can rise to this challenge. And, so Mr. Chairman, I am looking forward to this hearing. I think we need a lot, we can learn a lot from the witnesses who are here, and we need to listen quite a bit, so I am anxious to hear their testimony, and I yield back.

Chairman JOHNSON. Thank you. The gentleman's time has expired. I would like to just state that Congress has been raising taxes on workers since the beginning of the program, and it still hasn't worked. In 1935 the tax rate for employers and employees was just 1 percent on earnings up to \$3,000 a year. Congress has raised the payroll tax rate 14 times since then.

As is customary, any member is welcome to submit a statement for the hearing record. Before we move on to our testimony, I want to remind our witnesses to please limit your statements to 5 minutes. However, without objection, all of the written testimony will be made a part of the hearing record.

We have one witness panel today, one of whom is stuck in traffic, as I was this morning, so I understand that. G. William Hoagland, senior vice president, Bipartisan Policy Center; Jason Fichtner, Ph.D., senior research fellow with Mercatus Center; Leticia Miranda, senior policy adviser, the Economic Security Policy, National Council of La Raza; Donald Fuerst, senior pension fellow, American Academy of Actuaries; and Eugene Steuerle, Ph.D., institute fellow, Urban Institute; and Mr. Lorenzen isn't here, so Mr. Hoagland, I am going to recognize you. Please go ahead.

**STATEMENT OF G. WILLIAM HOAGLAND, SENIOR VICE
PRESIDENT, BIPARTISAN POLICY CENTER**

Mr. HOAGLAND. Thank you, Mr. Chairman. Mr. Becerra, Members of the Committee, thank you for inviting me here today to discuss the recommendations to the Social Security program made by the Bipartisan Policy Center's Domenici-Rivlin Debt Reduction Task Force. I was privileged to serve on that bipartisan group that released its recommendations in November of 2010. Our report

came out about the same time as the President's National Commission on Fiscal Responsibility and Reform upon which Dr. Rivlin also served along with Mr. Becerra.

The Domenici-Rivlin report was designed as a total plan of policies to spur economic recovery and to reduce our debt to GDP down to our goal then was 60 percent by the year 2020. But as we examined the various options to address the Social Security program, the overarching question was not how do we produce savings for the program, but rather more, how can we improve the current system, make it fairer, and ensure that it is a viable program around for decades to come.

Our benefit recommendations were four. The first was indexing the Social Security benefit formula to account for longevity; the second was to increase the progressivity of the benefit formula; the third was to provide a more robust minimum benefit; and the fourth was to implement a benefit bump-up for older beneficiaries.

Now, related to the first recommendation on indexing of longevity, the biggest issue confronting Social Security today, and of course it is due to demographics. As the large cohort of baby boomers, of which I am one, retire, we will collect benefits for longer than previous age cohorts. Our task force felt that any viable reform package must confront this trend head on. We also understood that certain individuals, particularly those working in hard industries, such as mining, fisheries, loggers, firefighters, steel mills, among others, they may want and they may need to take early retirement at age 62, unlike those of us who work for soft think tanks.

Therefore, beginning in 2023 instead of indexing both the early and the normal retirement age to longevity, meaning that they would increase by 1 month every 2 years, we proposed to index the benefit formula for increases in life expectancy. This would ensure that those seniors who could not remain in the labor force well into their 60s would retain the option to begin collecting reduced benefits at age 62.

Now, specifically the provision would index the bend points to longevity by reducing those factors starting in 2023 to reflect the ratio of, the life expectancy at 67 measured in 2018 to the life expectancy at 67 for 4 years before the initial benefit eligibility. This change in life expectancy is estimated today to reduce the benefit levels by about three-tenths of a percent a year, and this policy of indexing the benefit formula to longevity comprised nearly half of the savings achieved by the plan to get to actuarial balance.

The second recommendation was a modest increase in the progressivity of the benefit formula. Currently, as you know, monthly wages above roughly \$4,800, the top most bend point are replaced at 15 percent. We recommended gradually phasing that down over a decade to 10 percent.

The third recommendation related to the minimum benefit. Our task force proposed to provide a special minimum benefit tied to 133 percent of the Federal poverty level for retirees who have at least 30 years of creditable work.

Fourth, we similarly agreed to the importance of providing some protection to beneficiaries from the danger of outliving their savings, and to address this, we suggested a benefit bump of 1 percent

of the average monthly Social Security benefit to be administered each year between the ages of 81 and 85, and these two proposals, the minimum benefit and the old age bump-up, would be integral to one of the task force's other proposals, I realize that is not the purpose of this hearing, and that was indexing the cost of living adjustment to the chain weighted price index. Further, beginning in 2020, the task force also proposed that newly hired State and local government workers be incorporated into the program.

Finally, and again, a subject for another day, our total package recommended restoring the taxable maximum to cover 90 percent of all earnings, and as part of our task force's broader tax reform, we proposed to cap and phase out the exclusion of employer-provided health insurance, which would bring additional payroll receipts into the trust fund.

The Domenici-Rivlin Task Force members concluded that this package would accomplish sustainable solvency, and it was verified by the chief actuary of Social Security. It would do this in a progressive manner, protecting vulnerable beneficiaries and distributing the burden in an evenhanded and responsible manner among taxpayers and retirees while assuring Social Security will be there for our children and our grandchildren in the years to come. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you. I appreciate your comments.
[The prepared statement of Mr. Hoagland follows.]

Statement of
G. William Hoagland
Senior Vice President, Bipartisan Policy Center

Before the
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives

May 23, 2013

Mr. Chairman, Mr. Becerra, and Members of the Committee – thank you for inviting me here today to discuss the recommendations related to the Social Security program made by the Bipartisan Policy Center’s (BPC’s) Domenici-Rivlin Task Force. I was privileged to serve on this bipartisan, independent group that released its recommendations in November 2010. I should also note that I now serve as Senior Vice President at BPC.

The Task Force’s report was designed as a total plan, consisting of policies to spur economic recovery and to reduce the debt as a share of our gross domestic product (GDP). At the time of our report, we set a goal to reduce our debt held by the public to 60 percent by the year 2020 – through spending restraints and revenue increases. We know that today’s projections continue to place debt at over 70 percent of GDP ten years from now and rising thereafter. Although our proposals to reform Social Security represented a small piece of the total 10- and 20-year debt reduction that was proposed in the total plan, those savings would grow in the out years.

The Old-Age and Survivors Insurance (OASI) program – or Social Security, for short – has served as a retirement foundation for hundreds of millions of American workers ever since its creation in 1935. Today, low-income seniors – those with incomes below \$20,100 – receive over 80 percent of their income from the Social Security monthly check. Even for those in the middle quintile – with incomes between \$20,100 and \$32,600 – over two-thirds of their monthly income is a result of Social Security. By any reasonable standard, Social Security has been the most successful antipoverty program in the nation’s history. The program currently serves over 47 million Americans, and it must continue to serve as a social safety net in the future.

Social Security’s fiscal outlook, however, is unsustainable, due largely to three factors.¹ First and foremost, the Baby Boom generation is on the cusp of retirement, carrying with it a wave of new beneficiaries who will draw upon (rather than contribute to) the Social Security Trust Fund. The

¹ The program is unsustainable with current law scheduled benefits and tax rates.

ratio of workers to retirees has been stable for many years, but the retirement of the baby boomers will rapidly shrink this ratio over the next two decades.²

Second, Americans are living longer than their predecessors, but today's workers are, on average, retiring earlier than previous generations. Therefore, workers are contributing fewer years of payroll taxes to the Trust Fund, while retirees are collecting more monthly benefits.

Third, due to the rising distributional disparity in wages, a smaller percentage of the nation's income is subject to the Social Security payroll tax, eroding funding for the program.

This combination of demographic, benefit, and revenue effects is already reducing the solvency of Social Security. In almost every year of the program's existence prior to 2010, it collected more revenues from payroll taxes than it paid in benefits to retirees. But in 2010, for the first time in many years, the program's Trust Fund became cash flow negative, meaning that it was taking in fewer revenues than it was paying out in benefits. As a result, Social Security had to draw on its "savings" that have accrued from prior payroll tax contributions.

Just last week, the Congressional Budget Office estimated that Social Security's primary deficit will reach nearly \$40 billion this year and exceed \$900 billion over the next decade.³ As a result, unless changes are made, the program will continue to drain the Trust Fund until it is exhausted in 2035. At that point, current law would prohibit the program from borrowing additional monies to continue disbursing scheduled payments; thus, an across-the-board 25-percent cut in monthly benefits would occur, undoubtedly accompanied by severe consequences and hardship for millions of Americans.

While the Trust Fund is "off budget," the current negative cash flow does impact the total federal unified budget and will increasingly add to our public debt in the coming years. The current trajectory of Social Security's finances are unsustainable – both for the program itself and for the broader budget picture. Therefore, the issue is before the public today, not roughly 20 years from now, as some would argue, when the Trust Fund expires.

To ensure that Social Security can provide benefits for future generations of retirees, Congress should adopt measures that avert the impending drop-off in benefits and return the program to

² In particular, the U.S. birth rate fell off its post-war high and appears to have settled at a permanently lower level thereafter. Thus, there have not been a sufficient number of workers joining the workforce to compensate for the impending exit of the baby boomers (SSA). Also, see the long-range estimates in the 2012 OASDI Trustees report, Table IV.B2 – these can be accessed at: http://www.ssa.gov/oact/tr/2012/IV_B_LRest.html.

³ Congressional Budget Office, "Combined Old-Age, Survivors, and Disability Insurance Trust Funds – May 2013 Baseline." http://cbo.gov/sites/default/files/cbofiles/attachments/44208_Old%20AgeSurvivorsDisabilityInsuranceTrustFunds.pdf.

long-term solvency. Doing so will require bipartisan cooperation and a modest amount of sacrifice by workers and retirees, but addressing the problem now in a rational and equitable manner will be far easier than waiting until the crisis is near, when much more severe actions would be necessary.

BPC's Domenici-Rivlin Debt Reduction Task Force, after considering an extensive list of options, assembled a package that includes modifications to benefits, revenue increases, and the incorporation of currently uncovered populations into Social Security. As we examined the various options to address the program, the overarching question was not "how do we produce savings for the program," but more, "how can we improve the current system, make it fairer, and ensure that a similarly-robust program is around for decades to come?"

The package in its entirety was scored by the Chief Actuary of the Social Security Administration (SSA), who projected that it would achieve "sustainable solvency" – a metric that means the program would be on stable financial footing for the next 75 years and beyond.

We recognized that Social Security is a defining piece of the country's social fabric. On signing the Social Security Amendments of 1983 into law on April 20, 1983, President Reagan stated:

"A tumultuous debate about Social Security has raged for more than two decades in this country; but there has been one point that has won universal agreement. The Social Security system must be preserved ... Today we reaffirm Franklin Roosevelt's commitment that Social Security must always provide a secure and stable base so that older Americans may live in dignity."

The Task Force's plan, taken in its entirety, would restore the faith of younger generations in the program and restore its viability for them in their old age, thus fulfilling the commitment that society owes to the current generation of American workers, as well as their children and grandchildren.

Our Social Security proposal had eight components – five focusing on benefits, two on payroll taxes, and one on program coverage – but I will primarily discuss four of our benefit adjustment recommendations below, which are the focus of today's hearing: 1) Index the benefit formula to account for longevity; 2) Reduce the growth in benefits for roughly the top one-quarter of beneficiaries; 3) Provide a more robust minimum benefit; and 4) Implement a modest benefit bump for older beneficiaries.

1) Index the Benefit Formula for Longevity

Life expectancies at older ages are continuing to increase in the U.S. and other developed countries. This clearly positive development, however, also increases upward pressure on Social Security spending. Today, the life expectancy of a 65-year-old man has reached 83 years, and that of a 65-year-old woman, 85 years.

Additionally, as a large cohort of baby boomers is set to retire soon, the number of retired workers between now and 2023 is expected to increase by nearly 50 percent, from 37 million today to nearly 55 million. Including survivors, the number of beneficiaries will reach around 63 million.

Beginning in 2023 (after the scheduled increase of the normal retirement age to 67 is completed), we proposed adjusting the benefit formula to account for improvements in life expectancy. Specifically, the replacement rates used to calculate benefits each year for new beneficiaries would be 99.7 percent of what they were in the previous year – which over time would offset about two-thirds of the additional costs associated with estimated longevity increases.

Compensating for increasing life expectancies is the single most important step to ensure Social Security's sustainability for future generations. This policy of indexing the benefit formula to longevity comprised nearly half of the solvency achieved by the Task Force for the 75th year of the Trust Fund. Essentially, indexing for longevity would compensate the Trust Fund for the aggregate life expectancy increase, but protect retirees from individual risk by providing an annuitized benefit that would be unaffected by how long they live. Further, indexing the benefit formula for longevity, as opposed to increasing the age at which a worker could claim benefits, would importantly retain the option to retire at age 62 for those who are unable to work longer. This is especially important in hard industries, such as mining, fisheries, natural resources, and steel mills.

While the Task Force proposed maintaining the early eligibility age at 62, we also recommended that SSA be required to inform recipients more fully about the costs and benefits of taking early retirement. Recent estimates have found that half of American workers declare retirement and begin collecting Social Security benefits at age 62.⁴ To the extent possible, extending employment for seniors beyond the early retirement age is a positive to the individual, to society, and to the economy at large.

Retirees have not sufficiently heeded the warnings from SSA about the disadvantages of early retirement – most importantly, reduced benefits for the rest of the retiree's life. This proposal would direct SSA to highlight the benefits of delayed retirement. Each additional year in the workforce translates to higher Social Security benefits each month, regardless of how long the worker lives. Years later, this benefit boost could mean the difference between poverty and a

⁴ John Turner, *Promoting Work: Implications of Raising Social Security's Retirement Age*, Center for Retirement Research at Boston College, Boston College, MA, http://crr.bc.edu/images/stories/Briefs/wob_12.pdf.

more comfortable lifestyle. Yet workers currently appear to be making uninformed or uncalculated decisions.

Specifically, our proposal suggested directing SSA to aggressively revise its communications and messaging regarding the retirement choice, gleaning lessons from the emerging field of behavioral economics. The material provided to workers during their careers about retirement decisions must more clearly show the implications of collecting benefits at different ages. It must highlight the permanent financial consequences of this choice, not only for workers, but for spouses and survivors as well. In particular, SSA should remind workers of uncertainties in retirement, such as potential healthcare costs and the possibility of living for many years after retiring.

There are a variety of potential steps that SSA should consider in its attempts to better inform recipients about the disadvantages of early retirement. For example, SSA should consider providing more potent warning measures that every Social Security participant will notice. The periodic Personal Earnings and Benefit Estimate Statement (PEBES) sent to every worker should more emphatically state that delayed retirements are far more generous on a monthly basis. Another possibility is renaming Social Security's "Early Eligibility Age" as, for instance, the "Reduced Benefit Early Option." Other efforts should improve the ability of older workers to stay in their jobs or transition to less strenuous occupations.

This combination of education and functional approaches will give workers the flexibility to continue making their own choices about retirement, but with the information and incentives to make prudent decisions. The Task Force believed that policies influencing behavior are preferable to those that force people to delay retirement. With workers spending more years in the labor force, production would rise and more retirees would have increased savings and standards of living.

2) Slightly Reduce the Growth in Benefits for Roughly the Top One-Quarter of Beneficiaries

In determining a worker's benefits, Social Security's progressive benefit formula is applied to the worker's average indexed monthly earnings. Currently, this formula for an individual reaching age 62 in 2013 equals:

- 90 percent of the first \$791 of the worker's average monthly earnings;
- plus 32 percent of any average monthly earnings between \$791 and \$4,768;
- plus 15 percent of any average monthly covered earnings above that.

The dollar amounts of \$791 (at which the 90 percent replacement rate ends and the 32 percent replacement rate begins) and \$4,768 (at which the 32 percent rate ends and the 15 percent rate begins) are known as the program's "bend points." The placement of the bend points is adjusted each year to reflect the change in average wages. If a worker retires before the normal retirement age, the monthly benefit is actuarially reduced, whereas if the worker retires past the normal retirement age, the monthly benefit is actuarially increased.

Beginning in 2023, our Task Force proposed reducing the replacement percentage in the top bracket of the benefit formula from 15 percent to 10 percent over a 30-year period. Thus, under this option (and momentarily ignoring that it will be phased in over time), the benefit formula for an individual turning age 62 in 2013 would equal:

- 90 percent of the first \$791 of the worker's average monthly earnings;
- plus 32 percent of any average monthly earnings between \$791 and \$4,768;
- plus 10 percent of any average monthly covered earnings above that.

This moderate reform would be a particularly progressive change to the benefit structure, and would hold harmless approximately the bottom 75 percent of beneficiaries. While not a major part of the solution, the formula adjustment would help Social Security's sustainability by reducing program costs.

3) Update the Special Minimum Benefit and Include a Child Care Credit

Social Security began to provide the special minimum benefit in 1972 to raise benefits for people who had low earnings over a long working lifetime. The concept behind the minimum benefit was similar to the principle behind Social Security itself: Americans who have contributed to the economy with a full career should be protected and kept free from poverty in retirement.

Unfortunately, the minimum benefit is now outdated. Today, the minimum monthly benefit for an individual ranges from \$39 a month for 11 qualifying work years to \$804 for 30 years of work coverage. The original minimum level was indexed to prices, whereas benefits under the standard Social Security formula are indexed to earnings. Because earnings have grown faster than prices over the years, standard benefits have risen in real terms while the minimum benefit has not, rendering it largely obsolete.⁵ Moreover, the standard Social Security formula has consistently failed to provide decent assistance for career minimum-wage earners; in fact, their benefits put them below the poverty line.

The Task Force proposed updating the special minimum benefit to 133 percent of the federal poverty level (approximately \$1,250/month) for retirees with at least 30 years of creditable

⁵ For more information, see <http://www.socialsecurity.gov/retirementpolicy/projections/special-minimum.html>.

work.⁶ Updating the minimum benefit would reinforce the program for many retirees in the bottom half of the earnings distribution.

Additionally, consideration should be given, through the implementation of a child care (or caregiver) credit, to long-term workers who take time out of their careers to care for young children. The credit would count as “creditable work” up to eight years of caring for a child under the age of six. Care-giving can cause shocks to work ability and, thus, irregular work histories for individuals. This can lead to inadequate benefits for these individuals when they become eligible for Social Security. Time and income forfeited from working and/or advancing a career to care for a child can have large negative impacts on Social Security benefits to the point that a secure retirement can be jeopardized. The goal of these credits would be to give Social Security benefits to caregivers that more accurately capture an individual’s work history and added value to society.

4) Protect the Most Vulnerable Elderly with a Benefit Bump

One of the most vulnerable retiree categories consists of workers who outlive their savings and face increasing medical costs in old age. The percentage of elderly people in poverty rises with age, and the problem is especially prevalent among older women. Many elderly Americans outlive their savings and find it hard to survive on Social Security benefits alone. Older retirees tend to rely on benefits for an increasing proportion of their retirement income. With an eroding savings base and rising medical costs, seniors who live in retirement for many years often find themselves near or below the poverty line.

To address that issue, our Task Force proposed providing beneficiaries with a modest benefit bump – equivalent to 1 percent of the average worker’s monthly benefit amount – in each year between ages 81 and 85. This benefit increase will be a uniform dollar amount across the wage distribution, meaning that while the bump would help all older retirees, in particular it would give adequate support to low-income beneficiaries who are most in need.

Measures like the benefit bump for elderly beneficiaries, the increase in the minimum benefit, and the implementation of a child care credit would, if not lift hundreds of Americans out of poverty, at least lessen the burden on them in retirement. These provisions would guarantee that the system continues to provide a good standard of living in old-age for *all* working Americans.

⁶ The revised special minimum benefit would ensure that a long-term earner is eligible for a benefit equal to 133 percent of the federal poverty level (about \$1,250/month) at the normal retirement age. Earnings required for a year of qualifying coverage would remain at 20 percent of the “old-law” taxable maximum (\$15,880 in 2010), but a creditable year would be worth nearly \$42 per month (i.e., 30 years * \$42 = \$1,250/month), rather than approximately \$25 under current law. The credit would be indexed to average wage growth rather than prices. A maximum of 30 years of qualifying coverage could be applied, a minimum of 20 years would be required, and up to eight years of caring for a child under age six could be classified as a qualifying year.

Other Components Essential in Achieving Sustainability for Social Security

Change to More Accurate Annual Cost-of-living Adjustment Calculation

The current measure of inflation used to calculate cost-of-living adjustments for Social Security does not accurately capture changes in consumer spending patterns, and it overstates overall inflation. Our Task Force proposed shifting the calculation of annual cost-of-living adjustments from the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) to the “chain-weighted” Consumer Price Index for All Urban Consumers (CPI-U), an alternative measure of inflation developed by the Bureau of Labor Statistics.

This proposal is one that has been stressed in many different reports. Adopting the Chained CPI-U calculation would more accurately capture changes in the cost-of-living without endangering the welfare of low-income and older beneficiaries of Social Security, particularly when combined with the benefit changes that the Task Force recommended.

Expand Social Security Coverage to Newly Hired State and Local Workers

About 96 percent of all workers contribute Social Security payroll taxes and are eligible for benefits upon retirement. The largest group of workers that is not covered consists of about one-quarter of state and local government employees. Unlike private-sector workers (and some public-sector workers), these employees currently are not required to enroll in the system. Our Task Force proposed that all newly-hired employees of state and local governments after 2020 be required to be covered under Social Security. This proposal reflects the goal of increasing the universality of Social Security.

Finally, while we acknowledge that the purpose of this hearing is to address benefits, we feel a balanced approach dealing with additional reforms to Social Security, including increases in revenue, is essential to the viability of the program.

Gradually Raise the Amount of Income Subject to Payroll Taxes

In the 1977 amendments to the Social Security Act, Congress attempted to stabilize the taxable share of covered earnings at the 90 percent level by raising the cap and then indexing the dollar amount of the cap to average annual wage growth. Over the past quarter-century, however, earnings at the top of the wage scale have grown much faster than average wages. As a result, the share of earnings above the cap (and thus untaxed) has grown.

The payroll tax that funds Social Security is currently collected on wage income only up to a maximum of \$113,700 – a level that, under normal economic conditions, encompasses about 83 percent of total national wages. Our Task Force proposed raising the cap very gradually, over a 38-year period, to a level covering 90 percent of national earnings. After reaching the 90 percent target, the cap would be adjusted annually to maintain the 90-percent standard.

Cap and Phase Out the Tax Exclusion for Employer-Sponsored Health Insurance (ESI)

Under current law, employer contributions to employee health benefits are not taxable to the employee, causing a revenue loss of hundreds of billions of dollars per year; in fact, the exclusion is the single largest tax expenditure. In addition, many employers have set up a mechanism through which employee contributions come from pre-tax income. The tax exclusion for ESI makes benefits, including high-cost health insurance, a more attractive form of employee compensation than cash wages. In addition to the revenue loss, the exclusion is regressive; it generally subsidizes high-income individuals more than those at lower incomes. We saw no reason for having such an open-ended subsidy mainly for upper-income individuals.

As a result, The Task Force proposed phasing out the tax exclusion for employer-sponsored health insurance. Taxing these insurance premiums (or the increased wage compensation) as regular income would provide additional payroll tax revenue for Social Security, increasing the solvency of the program.

Disability Insurance

While the Domenici-Rivlin Task Force recognizes that the Disability Insurance program must be reformed – its Trust Fund is projected to be exhausted by 2017 – our group did not possess the necessary expertise to put forth comprehensive and specific reforms for that piece of the federal budget.

Conclusion

Social Security reform is a necessity for millions of Americans. Since it was enacted in 1935, Social Security has served as a reliable safety net for beneficiaries throughout retirement. But if the system in place today remains unchanged and continues to run high deficits, as projected, it will exhaust its funds by 2035. The longer policymakers wait to address Social Security reform, however, the more severe and abrupt these changes will have to be to achieve the ultimate goal of long-term solvency.

A number of reputable sources have produced plausible and detailed reports outlining proposals to achieve this objective. I believe that Congress can reach a similar conclusion through bipartisan efforts to enact Social Security reform.

In the early 1980s, Social Security's finances were in a similarly precarious position. The Trust Fund was nearly exhausted and Social Security checks to some 36 million Americans were on the verge of being held up. But President Reagan, Senate Majority Leader Howard Baker (a founder of the BPC), and Speaker Tip O'Neal established the National Commission on Social Security Reform (the Greenspan Commission) and brought together a bipartisan coalition that, along with the Pickle amendment to the Commission's product – which increased the age of full benefit eligibility to 67 – added roughly 50 years of solvency to the Trust Fund.

With the program running a primary deficit today, Congress should consider taking action now in order to gradually phase in the necessary reforms, and provide adequate time for future beneficiaries to adjust. Ensuring the sustainability of a program that means so much to so many should not be partisan. The sooner Congress and the Administration act, the sooner all Americans can rest assured that Social Security will be there for their children and grandchildren in the years to come.

Appendix: Actuarial Scoring of BPC's Domenici-Rivlin Social Security Plan

| Bipartisan Debt Reduction Task Force Plan As of November 10, 2010 (OASDI Trust Fund) | Change in 75-year Actuarial Balance (% of taxable payroll) Projected Deficit = 1.92 | Change in 75 th year Annual Balance (% of taxable payroll) Projected Deficit = 4.12 |
|--|---|--|
| 1) Increase taxable maximum 2 percent per year beginning in 2012 until a taxable ratio of 90 percent is achieved. Additional taxable earnings would enter in the benefit base. Current law bend points and PIA formula factors are unchanged. | 0.60 | 0.68 |
| 2) Beginning with the December 2012 benefit adjustment, base the increase on the 3 rd quarter to 3 rd quarter increase in the Chain-weighted Consumer Price Index for Urban Consumers rather than the Consumer Price Index for Urban Wage-Earners and Clerical Workers. (Related 2009 solvency provision A3.) | 0.49 | 0.70 |
| 3) Cover newly hired state and local government employees beginning in 2020. | 0.16 | -0.12 |
| 4) Phase out the income and payroll tax exclusion for employer-sponsored health insurance beginning in 2018. Set exclusion at the 75 th percentile of premium distribution in 2018, with amounts above that subject to tax. Reduce the exclusion level by 10 percent annually with exclusion fully eliminated in 2028. (Related 2009 solvency provision F2, but phased-out over a 10-year period rather than all at once.) | 0.93 | 1.06 |
| 5) Reduce the upper 15 percent PIA formula factor by 1/3 over a 30-year period beginning in 2023 and through 2052, with an ultimate factor of 10%. Affects OASI and DI. | 0.07 | 0.20 |
| 6) Reconfigure the special minimum benefits to ensure that someone earning at least 20% of the old law tax max in each of 30 years would receive a PIA of 133 percent of the federal poverty level, with the formula phased up to 133 percent of poverty linearly for workers over 19 creditable years. Up to 8 years of care-giving could be used as creditable years for care of a child under the age of 6, if it is not otherwise counted as a creditable year (earnings < 20% old law tax max). Scale requirements for DBs including child care credit years. Effective for new eligibles in 2012. Wage-index the poverty level from 2009 up to 2 years prior to benefit eligibility. | -0.09 | -0.14 |
| 7) Tax all voluntary salary reduction plans like 401(k)s for payroll tax purposes, effective 2012. | 0.22 | 0.13 |
| 8) For those attaining age 62 in 2023 and later, reduce all benefit formula factors by the increase in period life expectancy, with a 4-yr lag (2023 versus 2022 for the first year.) Apply for OASI only, with DI benefits proportionally reduced at conversion. | 0.48 | 1.75 |
| 9) Provide the same dollar amount increase to the benefit level of any beneficiary who is 85 or older at the beginning of 2012 or who reaches his or her 85 th birthday after the beginning of 2012. The dollar amount of increase equals 5 percent of the average retired worker benefit in the prior year. Phase in at 1% per year from 81 to 85. | -0.13 | -0.18 |
| 10) Change in personal income tax structure | -0.01 | -0.06 |
| Effect of total proposal | 2.51 | 3.48 |

Chairman JOHNSON. Mr. Fichtner, you are now recognized for 5 minutes.

STATEMENT OF JASON FICHTNER, PH.D., SENIOR RESEARCH FELLOW, MERCATUS CENTER

Mr. FICHTNER. Thank you, sir. Good morning, Chairman Johnson, Ranking Member Becerra, and Members of the Committee, thank you for inviting me to testify here today. My name is Jason Fichtner, and I am a senior research fellow at the Mercatus Center at George Mason University where I research fiscal and budgetary issues, including Social Security. I am also an adjunct professor at Georgetown University, Johns Hopkins University, and Virginia Tech, where I teach courses in economics and public policy. All opinions here today are my own and do not necessarily reflect the views of my employers.

For my oral remarks, I want to briefly discuss how various features of Social Security, from the technical details of the benefit formula to the benefit eligibility at age 62 to the nonworking spouse benefit all act to encourage early retirement and as a disincentive to continued work.

Most analyses of Social Security have concluded that its current design offers substantially negative incentives for work, especially for younger seniors and for secondary household earners. Research has found that Social Security's return on payroll tax contributions by those age 62 to 65 is a negative 49.5 percent, meaning that the program literally pays back just pennies in additional benefits for each additional dollar contributed. Other research has found that the broader array of Federal laws strongly inhibits continued work by seniors, with disincentives growing stronger as they age. It is notable that labor force participation did not decline for those younger than 65 until Social Security's early eligibility age of 62 was established. After the creation of the EEA, labor force participation by males age 55 to 64 also began to trend downward, dropping over 20 percent, from 87.3 percent in 1960 to 67.7 percent in 1990.

Workforce participation trends among older workers are not driven primarily by issues of physical incapacity. Labor force participation among males over 65 was much higher in the mid 20th century than it is now, despite substantial gains in national health and longevity since then. Incentives have played a much greater role. The design of the basic Social Security benefit formula imposes net incremental income losses on those extending their careers. The primary reason for the work disincentive is that Social Security's benefit formula is progressive while also based on a worker's top 35 years of earnings on average.

Indeed, someone who takes a part-time transition job on the way to full retirement may well pay a full year's worth of additional taxes while receiving no additional benefit credits whatsoever. This is a substantial work disincentive at precisely the time when a worker is likely to make a retirement decision. Social Security's early retirement age of 62 is actually the most common age of benefit claiming. In fact, over 70 percent of beneficiaries take advantage of the opportunity to claim Social Security retirement benefits before the normal retirement age, despite receiving lower monthly

benefits by doing so. Early retirement is only certain to make beneficiaries better off in the short run. The reduction of monthly benefits that accompanies early claims also results in net lifetime benefit reductions for those who live to especially advanced ages, often a time in life when beneficiaries are most likely to rely on Social Security benefits to pay their expenses.

Also, Social Security specifically provides a disincentive to tax-paying work by more than one earner per household. Incremental returns on taxes paid by women have been estimated at negative 32 percent relative to what they would receive by staying out of the paid workforce altogether and instead often collecting the non-working spouse benefit. As a general rule, Social Security aggressively distributes income from two-earner married couples to one-earner married couples, penalizing a household decision to have both spouses work and contribute payroll taxes.

A medium-wage two-earner couple both born in 1955 can expect to receive back only 80 cents from Social Security of each dollar contributed, whereas a one-earner couple can expect to receive \$1.39. Much of the original welfare system was designed to support single earner families. Today, 61 percent of married women participate in the labor force compared to only 32 percent in 1960. Social Security needs to reflect the evolving workplace and not penalize two-earner couples.

It is unsurprising that our future economic growth outlook is depressed by current projections for labor force participation, relative to what would be the case if more of our national gains in longevity and health were converted into longer periods of taxpaying work. Extending workforce participation would pay dividends for individual seniors and for the economy.

With age 62 now the most popular age to claim benefits, raising the EEA would necessarily delay many claims and would likely correlate to continued employment. Researchers estimate that raising the EEA to 65 would increase the long-run GDP by 3 or 4 percent. Another reform would be to offer the full retirement credits as a lump sum option, which could potentially provide an incentive to continued working without additional financing costs to the system. I would also point out that you could change the benefit formula from instead of being on 35 years of work history to looking at an average and doing it per year. This would help take care of complications caused by the windfall elimination provision and government pension offset.

Others have suggested that payroll tax relief be offered to seniors. We should be careful if we do this, but the overall positive effect that such a policy can have on labor participation by seniors should not be dismissed. Thank you for your time and opportunity to testify today. I look forward to your questions.

Chairman JOHNSON. Thank you, sir.

[The prepared statement of Mr. Fichtner follows:]



TESTIMONY

REFORMING SOCIAL SECURITY TO BETTER PROMOTE RETIREMENT SECURITY

JASON J. FICHTNER, PHD

United States House of Representatives
Committee on Ways and Means
Subcommittee on Social Security

Hearing on "The President's and Other Bipartisan Entitlement Reform Proposals"

May 23, 2013

Good morning, Chairman Johnson, Ranking Member Becerra, and Members of the Committee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I'm a senior research fellow at the Mercatus Center at George Mason University where I research fiscal and budgetary issues, including Social Security. I am also an adjunct professor at Georgetown University, Johns Hopkins University, and Virginia Tech, where I teach courses in economics and public policy. All opinions I express today are my own and do not necessarily reflect the views of my employers.

I'd like to begin by thanking Chairman Johnson and Congressman Becerra for the leadership you provide this committee in ensuring that important public policy issues involving Social Security and retirement security get the attention and debate they deserve, and also for ensuring that ideas and viewpoints from all sides are aired in a collegial and respectful manner. It is truly a privilege for me to be here testifying before you today.

My testimony focuses on the Social Security program's incentives—specifically, how the current structure provides disincentives to work and save. I will also discuss how Social Security reform, if done correctly, can increase US savings, labor force participation, economic growth, and federal revenues.

THE ECONOMY'S EFFECTS ON WHEN PEOPLE CLAIM SOCIAL SECURITY BENEFITS

The financial crisis that began in 2008 resulted in a great and unanticipated loss of wealth for millions of Americans. The US stock market, as measured by the broad S&P 500 index, fell nearly 57 percent from a peak on October 10, 2007, to a bottom on March 9, 2009.¹ Housing prices plummeted and unemployment rose quickly to double digits. Survey research suggests financial wealth declined by 15 percent for the median household as a result of the 2008 financial crisis.² General confidence in the financial system was greatly weakened.

The widespread economic crisis affected a range of ages and income levels. According to data from the Health and Retirement Study (HRS),³ about 28 percent of surveyed households reported that they had been affected "a

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lot” by the financial crisis, 46 percent responded they had been affected “a little,” and only 26 percent reported not having been affected.⁴

Though the broad stock market has recovered much of its losses and reached new highs, and housing prices have started to recover, unemployment is still too high. Unemployment rates for workers ages 55–64 averaged 7 percent for the years 2009–10 compared to 3 percent for the period 2005–8.⁵ As of April 2013, the unemployment rate for workers ages 55–64 was 5.1 percent—still far above the 3 percent average between 2005 and 2008.⁶

A sudden and unplanned drop in wealth and income can have significant effects on retirement behavior. Research I’ve done with coauthors John Phillips and Barbara Smith finds that more people will elect to begin taking Social Security retirement benefits as soon as eligible, due to financial shocks, increases in unemployment because of the global financial crisis,⁷ and an arrested economic recovery.⁸

A study by Michael Hurd and Susann Rohwedder after the 2008 crisis finds that 3.5 percent more individuals expected to work past the age of 62 than previously, while an additional 4.3 percent planned to work past the age of 65.⁹ A financial shock, such as steep drops in the value of stock prices, investment portfolios, and housing assets might cause a delay in people’s retirement plans,¹⁰ with workers remaining in the workforce longer than originally planned to rebuild retirement savings.¹¹ Those near or post-retirement are more limited in their ability to attain or maintain a secure retirement. For current retirees, sudden declines in wealth from housing assets and financial portfolios might force immediate changes in consumption.

The loss of a job has particularly pronounced effects on workers above the age of 55 and on the decision to retire. According to a special study in 2010 from the US Bureau of Labor Statistics,¹² older workers who lose their jobs are likely to have longer durations of unemployment than younger workers. A Congressional Research Service study finds that older workers who are unemployed have a higher incidence of withdrawing from the labor market than younger workers.¹³ When they do retire, they replace earnings with available sources of income, such as pensions and Social Security benefits. Workers who retire early may experience lower lifetime benefits from Social Security, and their removal from the workforce slows economic growth.

Though the decision to start receiving Social Security benefits can be concurrent with retirement, electing to receive benefits is not necessarily a predictor of leaving the workforce.¹⁴ In fact, the decision whether to stop working can be completely independent from the decision whether to begin collecting Social Security benefits. For example, a worker might choose to stop working but delay receipt of Social Security benefits to take advantage of higher monthly benefit amounts that accrue the later one waits to claim (up to age 70). Or a worker might decide to elect retirement benefits as early as age 62, receiving a permanently reduced monthly benefit,¹⁵ yet continue to work full- or part-time for continued income support.¹⁶ In some cases, a worker might opt to select Social Security benefits and then return to work.¹⁷

Researchers have long recognized the role Social Security benefits play in a secure retirement.¹⁸ Social Security retirement benefits provide income security for millions of Americans, with 65 percent of all aged recipients¹⁹ relying on Social Security for 50 percent or more of their income, and 36 percent relying on Social Security for 90 percent or more of their income.²⁰ Because low-income households use Social Security benefits for a larger portion of annual income, the financial crisis has affected these retirees less.²¹ As a result, the structure of Social Security has its most significant economic and behavioral effects on the middle class.

NEGATIVE EFFECTS ON LABOR FORCE PARTICIPATION

Most analyses of Social Security have concluded that its current design offers substantially negative incentives for work, especially for younger seniors and for secondary household earners. Research by Gayle Reznik, David Weaver, and Andrew Biggs has found that Social Security’s return on payroll tax contributions by those aged 62–65 is –49.5 percent,²² meaning that the program literally pays back just pennies in additional benefits for each additional dollar contributed. Barbara Butrica and her coauthors have found that the broader array of federal laws strongly inhibits continued work by seniors, with disincentives growing stronger as they age: “The implicit tax rate on work increases rapidly with age, rising for our representative worker from 14 percent at age 55 to 50 percent at age 70.”²³

Notably, labor force participation did not immediately decline for those younger than 65 (and thus originally ineligible for Social Security benefits) until Social Security's early eligibility age (EEA) of 62 was established.²⁴ After the creation of the EEA, labor-force participation by males aged 55–64 also began to trend downward, from 87.3 percent in 1960 to 67.7 percent by 1990. As the Bureau of Labor Statistics notes, "Labor force participation decreases started in the 1960s for those 55 to 64. Since this time, some of the 20-percentage points decrease for men in this age group has to be attributed to the availability of Social Security benefits to men 62 years of age."²⁵ The Bureau of Labor Statistics report also notes the new availability of Social Security's disability benefits and suggests that they further dampened middle-aged labor-force participation.

How Does Social Security Penalize Work?

The basic Social Security benefit formula is itself designed to impose net incremental income losses on those who extend their working careers.²⁶ Previous studies by Charles Blahous;²⁷ Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov;²⁸ and others have explained how returns on contributions generally diminish the longer one works and why they become even more sharply negative once a worker has contributed for 35 years.

The primary reasons for the work disincentives are the facts that the Social Security benefit formula is progressive, while also based on a worker's top 35 years of earnings on average. Thus, the longer one works, the more "zero earnings years" in one's wage history are replaced with positive earnings years and the more one's "average earnings" rise (so that one is gradually considered a relatively higher-wage earner), and thus the worse one's returns under the program's progressive benefit formula.²⁹

This worsening becomes particularly pronounced after 35 years of earnings,³⁰ when the best a worker can hope for is to replace a previous year in the highest 35 years of one's wage history with a higher earnings year. That is to say, after 35 years of work, one's benefit can only rise in proportion to the differential between two previous earnings years, despite paying a full additional year of payroll taxes. Indeed, someone who takes a part-time "transition job" on the way to full retirement may well pay a full year's worth of additional taxes while receiving no additional benefit credits whatsoever. This embodies a substantial work disincentive at precisely the time when a worker is likely to make a retirement decision.

Penalties against Seniors and 55–65-Year-Olds

Though this sustained trend toward early retirement has bottomed out and begun to reverse somewhat in recent years, Social Security on balance clearly remains a substantial barrier to labor participation by Americans in their late middle age. For example, seniors who continue to work after claiming Social Security benefits at 62 (but before normal retirement age [NRA] of 66) are subject to an earnings limitation under which they are required to temporarily give up as much as \$1 in benefits for every \$2 earned above a \$15,120 threshold.³¹ This rule is but one of the program's facets that nudge individuals into early retirement.

Social Security's EEA of 62 is, in fact, the most common age of benefit-claiming.³² Over 70 percent of beneficiaries take advantage of the opportunity to claim Social Security retirement benefits before NRA, despite receiving lower monthly benefits by doing so.³³ Not long ago, Social Security Administration (SSA) field offices often encouraged early retirement under the mistaken belief that it leaves beneficiaries better off. Early retirement is only certain to make beneficiaries better off in the short run, however. The reduction in monthly benefits that accompanies early claims also results in net lifetime benefit reductions for those who live to especially advanced ages—often a time in life when beneficiaries are most likely to rely on Social Security benefits to pay their expenses. Fortunately, the SSA has more recently adopted policies recognizing that individual circumstances must be carefully considered when determining one's optimal age for claiming benefits.³⁴

Penalties for Two-Earner Couples

Social Security specifically provides a disincentive to taxpaying work by more than one earner per household. Incremental returns on taxes paid by women have been estimated at -32.0 percent relative to what they would

receive by staying out of the paid workforce altogether and instead often collecting the nonworking spouse benefit.³⁵ As a general rule, Social Security aggressively redistributes income from two-earner married couples to one-earner married couples, thus penalizing a household decision to have both spouses work and contribute payroll taxes. For example, a medium-wage two-earner couple, both born in 1955, can expect to receive back only 80 cents from Social Security on each dollar contributed (in present value), whereas a one-earner couple can expect to receive \$1.39.³⁶ Today 61 percent of married women participate in the labor force, compared to only 32 percent in 1960—and there are more women than men in the modern-day workplace.³⁷ Much of the original welfare system was designed to support single-earner families.³⁸ As a result of changing demography, Social Security needs to reflect the evolving workplace and not penalize two-earner couples.

One reason for this income redistribution and these negative labor participation incentives is the structure of Social Security's nonworking spouse benefit. Individuals without any history of paid employment can be entitled to receive a benefit equal to 50 percent of their spouse's earned benefit. Consequently, an individual who is married to a high-wage earner may receive a benefit well exceeding what another individual might earn based on an entire working career of payroll tax contributions.

Despite the complexities involved in determining one's net effective tax rate on Social Security-covered work, there is evidence that individuals and two-earner couples do respond rationally to these disincentives. As Jeffrey B. Liebman, Erzo F. P. Luttner, and David G. Seif point out in a 2008 study, "Our estimates conclusively reject the notion that labor supply is completely unresponsive to the incentives generated by the Social Security benefit rules. We find reasonably robust and statistically significant evidence that individuals are more likely to retire when the effective marginal Social Security tax is high."³⁹ For most seniors, these effective marginal tax rates are indeed enormously high.

These various features of Social Security—from the technical details of its benefit formula, to the earnings limitation, to the benefit eligibility at age 62, to the nonworking spouse benefit, to others—all act as a drag on labor-force participation and thus interfere with the goal of maximizing future economic growth.

THE FISCAL IMPORTANCE OF LABOR-FORCE PARTICIPATION

The financial unsustainability of current federal entitlement programs is substantially attributable to insufficient projected growth in the US labor force. This conclusion can be substantiated by some simple math. Social Security's initial benefit formula, for example, increases along with growth in the national Average Wage Index.⁴⁰ Because program payroll tax revenues also automatically grow with national wages, this benefit formula would be financially sustainable within a stable tax rate if the worker-to-beneficiary ratio never declined—or in other words, if gains in longevity and health were always matched by proportional increases in the duration of workers' taxpaying careers.⁴¹ This proportionality, however, is not being maintained. Worker-beneficiary ratios are projected to become much more unfavorable going forward.

Though press attention rightly focuses on how the Baby Boomers' Social Security and Medicare benefit claims will increase federal spending, the other side of the coin is the corresponding reduction in labor force growth rates as the Boomers cease working. Whereas from 1963 through 1990 inclusive annual labor-force growth rates never once dropped below 1.2 percent despite periodic recessions, from 2019 onward labor force growth rates are projected never to exceed even half that rate (0.6 percent).⁴² Thus, to the extent that Baby Boomers and subsequent generations perceive greater rewards for extending their working lives, the picture of our national economic future will brighten enormously.

It bears emphasis that workforce participation trends among those in their 60s are not driven primarily by issues of physical incapacity. Labor-force participation among males over 65 was much higher in the mid-20th century than it is now despite substantial gains in national health and longevity since then. Incentives have played a much greater role. Beyond the fact that it is generally more attractive to enjoy additional years of leisure rather than to continue work, our federal entitlement policies have made the decision to retire virtually irresistible financially as well. Given these incentives, it is unsurprising that our future economic growth outlook is depressed by current projections for labor-force participation, relative to what would be the case if more of our national gains in longevity and health were converted into longer periods of taxpaying work.

The economic benefits of longer working careers well exceed, however, what is shown in federal scorekeepers' analyses of program finances. Repeal of the Social Security earnings limitation, for example, is scored under current SSA methodology as actuarially neutral, although it would almost certainly incentivize longer working careers, both generating additional government tax revenue and benefiting the economy as a whole. Similarly, proposals to raise Social Security's EEA of 62 are not scored by the Social Security actuaries as producing direct financial gains for the program, though the change would better incentivize taxpaying work by those in their early 60s.

A recent Congressional Budget Office (CBO) analysis of raising the EEA acknowledges this effect conceptually but does not attempt to quantify it: "This option also would probably lead workers to remain employed longer, which would increase the size of the workforce and boost federal revenues from income and payroll taxes. Moreover, the additional work would result in higher future Social Security benefits, although the increase in benefits would be smaller than the increase in revenues." But "the 10-year estimates for this option do not include those two effects."⁴³ Other CBO analyses, including those of the Diamond-Orszag and the Bush Commission's proposals, quantify some potential advantages of reforming Social Security benefits for promoting economic growth. CBO found that the Bush Commission plan to constrain the growth of benefits beyond price inflation would increase national GNP relative to the budget baseline, whereas the Diamond-Orszag proposal to raise Social Security taxes would reduce it. These findings in turn reflected analyses that the Bush Commission proposal "could cause some people to work longer or harder,"⁴⁴ whereas under the Diamond-Orszag proposal, "households would choose more leisure."⁴⁵

Extended workforce participation would pay dividends for individual seniors as well as for the economy as a whole. As Butrica and her coauthors noted in 2004, "Working longer increases the net output and productivity of the economy, generates additional payroll and income tax revenue, and reduces the number of years that individuals receive retirement benefits. . . . [P]eople could increase their annual consumption at older ages by more than 25 percent simply by retiring at age 67 instead of age 62. The increased tax revenues generated by this work could be used to support a wide range of government services, including public support for the aged."⁴⁶

For these and many other reasons, Social Security reform as well as broader entitlement reform should be undertaken with an eye toward rewarding those in late middle age who decide to extend their working careers.

SOCIAL SECURITY REFORMS TO IMPROVE WORK INCENTIVES

Bowles-Simpson and the Bipartisan Policy Center Plans

The impact of Bowles-Simpson and the Social Security reforms of the Bipartisan Policy Center (BPC) on work incentives vary depending on the specific provision examined. While some reforms encourage greater participation in economic activity, others limit the desirability of work and could incentivize even earlier retirement. Some proposals would encourage significant behavioral shifts while others would encourage only marginal changes.

Both plans include the following policy recommendations that would encourage greater labor force participation: adjusting the cost-of-living adjustment (COLA) to be indexed according to a Chained-CPI-U, to account for substitution effects as consumers change what goods they purchase in response to changes in prices; reducing the growth of benefits for the highest-earning beneficiaries; and indexing the benefit formula for longevity. Of these three reforms, indexing the COLA to Chained-CPI-U would most increase the desirability of individual saving. President Obama has also proposed indexing the COLA to the Chained-CPI-U in his FY 2014 budget.

The proposed CPI-U price index accounts for living expenses for around 87 percent of the US population. It is a measure of inflation facing all urban consumers. The current CPI-W index, however, measures the higher rate of inflation experienced by all urban workers, roughly 32 percent of the population.⁴⁷ Because the W index represents a subset of the U population, many Social Security recipients experience inflation-adjusted wages that exceed their actual cost-of-living increases. Adjusted wages in excess of inflation incentivizes less individual saving and lower labor-force participation in exchange for greater reliance on Social Security.

The two other benefit reductions considered by the Bowles-Simpson and BPC plans are designed to make the benefit structure more progressive and to slow the growth of benefits for higher-income workers. The first would marginally reduce the growth of benefits for approximately the top 25 percent of beneficiaries. The proposal by BPC would slowly reduce the top bend point in the primary insurance amount (PIA) formula applied to a person's average indexed monthly earnings from 15 percent to 10 percent over a 30-year period.⁴⁸ For someone eligible for benefits in 2013, this percentage would apply to additional monthly covered earnings in excess of \$4,768. The Bowles-Simpson plan would also adopt a more progressive benefit formula that slows the growth of benefits for higher-income earners by expanding the amount of earnings at the bottom end that are covered by the 90 percent replacement rate and would subject higher-income earners to a new and lower top-end replacement rate of 5 percent. While this reform should encourage the top 25 percent of beneficiaries to work longer and save more, a more progressive benefit formula that gives a higher benefit amount to lower-income workers could have the opposite effect and would not encourage additional saving or longer labor-force participation.

The second benefit change considered by both Bowles-Simpson and BPC is to adjust benefits for expected increases in longevity. As Americans live longer, the financial commitment of Social Security increases as well. Lifetime benefits for Social Security recipients are greater than ever and will continue to increase. BPC would reduce benefits beginning in 2023 (after the full retirement age increases to 67 under current law) by 0.3 percent each year in order to offset part of the additional costs of estimated longevity increases. Bowles-Simpson would gradually increase both the early eligibility age and normal retirement age to account for increases in longevity. Adjusting Social Security to reflect increases in longevity would encourage greater labor-force participation and saving.

The following policy recommendations would penalize the decision to work and encourage earlier retirement: raising the amount of income subject to payroll taxes and increasing the special minimum benefit. Raising the amount of income subject to payroll taxes could have negative implications for investment and saving levels. I won't elaborate in detail in my testimony on the negative economic effects of raising payroll taxes, as previous witnesses have testified before this committee extensively on the topic.⁴⁹ But, in brief, raising Social Security payroll taxes would generally mean that people would work less, because the financial return from work has been decreased; save less, because they now have less after-tax income with which to save; and retire early, because the replacement rate of Social Security benefits will rise.⁵⁰

The final policy recommendation from the BPC and Bowles-Simpson is to increase the special minimum benefit and to provide a "bump up" in benefits for beneficiaries in their 80s. The special minimum benefit was enacted in 1972 to provide minimum financial protection for low-income workers.⁵¹ However, the current minimum benefit is adjusted for changes in prices, not wages. As wages have grown faster than prices, the PIA for most low-wage workers is higher than the special minimum PIA. The BPC plan would propose a special minimum benefit set at 133 percent of the poverty level for retirees with at least 30 years of covered work. The Bowles-Simpson plan would set the special minimum benefit at no less than 125 percent of the poverty level in 2017 and index it to wage growth thereafter. The proposed "bump up" is a small boost in income that retirees would receive between the ages of 81 and 85 (BPC plan), and for those on benefits 20 years after the earliest eligibility age (Bowles-Simpson), as saving levels tend to be significantly reduced once beneficiaries reach this age range.

The goal of the special minimum benefit and "bump up" for those in their 80s should be to reach beneficiaries who would otherwise be unable to provide for themselves rather than to provide a general welfare expansion for all retirees. Social Security's benefit structure already discourages labor-force participation. So, while we should definitely ensure that our society's most vulnerable members are protected against poverty, an expansion of the special minimum benefit should reach only those most in need in order to avoid having further negative impacts on the labor-force participation rate.

Raising the Early Eligibility Age

With age 62 now the most popular age to claim benefits, raising the EEA would necessarily delay many claims and would likely correlate with continued employment.⁵² Research has estimated that raising the EEA to 65 would increase long-run GDP by 3–4 percent.⁵³

Several key points should be kept in mind with regard to raising the earliest eligibility age. First, an EEA increase of three years, for example, would merely bring the age of earliest eligibility to what it was at the program's inception; it would not begin to adjust for the substantial health and longevity gains since. Period life expectancy at birth has grown by more than 14 years since 1940, while life expectancy at 65 has grown by more than six years.⁵⁴

Second, raising the EEA to bring it closer to the NRA would likely reduce poverty among seniors, as they would be subject to a smaller early retirement penalty. As previously noted, annual benefits under Social Security law are adjusted downward from full benefit levels in proportion to how early one claims before reaching the NRA. This keeps expected lifetime benefits constant, regardless of the age of claim; some of the risk of old-age poverty resides with seniors who retire early, have "too low" an annual benefit, and then outlive their other savings.

Increase the Delayed Retirement Credit

Another positive work incentive could be created by increasing the program's actuarial penalty for early retirement as well as its delayed retirement credit (DRC). The current actuarial penalty for early retirement is a 25 percent reduction in annual benefits for those who retire at 62, four years before the current NRA of 66, or about a 6 percent reduction for each year.

On the other hand, the delayed retirement credit is an 8 percent increase in annual benefits for each year (up to age 70) claims are delayed beyond the NRA. For someone delaying claiming benefits until age 70, this credit amounts to a 32 percent increase in the monthly benefit.⁵⁵ These current-law adjustments hold expected lifetime benefits constant for a typical retiree, and thus do not account for the value of additional payroll taxes likely contributed if an individual delays claiming benefits and continues working. Increasing these adjustments may better reflect the value of additional payroll taxes contributed by working seniors.

Offering the DRC as a lump-sum option could potentially provide an additional incentive to continue working, without adding a financial cost to the system. The current DRC offers an increase in one's monthly Social Security benefit proportional to the time over which the benefit claim is delayed. However, only a minority (between 5 and 6 percent in 2011) take advantage of this option.⁵⁶ It is also worth noting that more than 70 percent of those claiming retirement benefits in 2011 did so before their normal retirement age, thus receiving reduced monthly benefits.⁵⁷ An option potentially more attractive to workers would be to allow an individual to receive the entire DRC as a lump sum when claimed, while also receiving the basic monthly benefit as it would have been calculated at NRA. This option could potentially allow claimants to receive a lump sum of tens of thousands dollars on the date of their delayed claim. Recent research by Jingjing Chai and his coauthors confirmed that offering a lump-sum option could boost the average retirement age by 1.5–2 years.⁵⁸

The precise amount of a lump-sum DRC could be calculated to be the actuarial equivalent of the standard monthly DRC, thus creating no additional system costs but potentially spurring longer taxpaying work. But even if the lump sum were designed to be slightly smaller in present value than the DRC would have provided as a monthly benefit stream—thus producing a net improvement in system finances—many individuals might still find the lump-sum option more attractive because they would have immediate access to and control over the funds.

The various reforms mentioned above would likely be useful if enacted separately, but would work best in tandem. Steepening the actuarial penalty for early benefit claims could, despite its other policy benefits, potentially worsen some early claimants' subsequent risk of poverty if enacted as a standalone measure, but would not do so if accompanied by an increase in the EEA. If the NRA is increased while the EEA is held at the current age of 62, a higher minimum benefit could be offered to those in physically challenging jobs unable to work past age 62. However, it is worth noting that SSA only has wage data available and determining which individuals would be allowed a higher minimum benefit at EEA, instead of a regular actuarial

reduction, would be administratively challenging and burdensome to say the least, and may be impossible to administer.

As mentioned earlier in my testimony, both the Bowles-Simpson and BPC plans would offer an increased minimum benefit to protect low-wage workers, as well as a bump-up in the benefit amount for those in their 80s and the long-term disabled. While the Bowles-Simpson plan recommends increasing the early eligibility and normal retirement ages, the plan also recommends that the Social Security Administration be tasked with designing a policy that would allow a hardship exemption for those that cannot physically work past age 62.

Adjust the Benefit Formula

Another potentially important work incentive reform would be to redesign the basic benefit formula so that it operates on each separate year of work rather than on one's career average earnings. As discussed previously, the current formula causes one's returns from Social Security to drop with extended work, as one's career average earnings rise and the system's progressive benefit formula thus delivers lower returns.

An alternative suggested by Charles Blahous, a public trustee for Social Security, would be to calculate benefits by considering every year of one's earnings, rather than only the highest average 35 years of earnings.⁵⁹ In addition to greatly improving work incentives for seniors, this reform would have other advantages. For example, the current formula often mistakes intermittent high-wage earners for low-wage earners because their career "average earnings" look the same. This confusion causes problems in the treatment of those who move in and out of Social Security coverage—for example, higher-wage state and local employees and immigrants, whom the formula mistakes for needy low-wage workers—necessitating complex fixes such as the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). Such controversial complexities would become unnecessary if Social Security simply accrued proportional benefits with each additional year of tax-paying work, since all intermittent workers would be treated the same, more in the fashion of a traditional private-sector pension.

Constrain Nonworking Spouse Benefits for High Earners

Another work-incentive reform would be to gradually restrain the growth of nonworking spouse benefits associated with higher earners. The nonworking spouse benefit does play a useful role within Social Security by recognizing the value of stay-at-home work and of raising the next generation of wage earners. It is, however, inefficiently designed in that it is both regressive and a significant disincentive to paid employment. A two-earner couple both with low wages, for example, receives lower returns from Social Security than a high-wage one-earner couple,⁶⁰ despite the intended progressivity of the basic benefit formula.⁶¹ Additionally, someone married to a high-earning spouse might well receive a higher nonworking spouse benefit than another individual might earn based on a full career of paying payroll taxes on modest annual earnings.

It is not necessary to eliminate the nonworking spouse benefit to address the inequities described above. One option is simply to constrain its growth so that no future nonworking spouse can receive a benefit exceeding the inflation-adjusted value of the benefits that today's low-wage workers receive based on a full career of payroll tax contributions.

Payroll Tax Relief

Others have suggested that payroll tax relief be offered to seniors who extend their working lives.⁶² There are policy downsides to this approach. For example, it would reduce much-needed Social Security tax revenues, though it would increase regular income tax revenues. Also, if enacted in the wrong way, eliminating or reducing the payroll tax contributions for seniors could embody age discrimination. That said, the positive effects such a policy could have on labor participation by seniors should not be dismissed. Versions that avoid the age-discrimination pitfall have been put forward by Mark Warshawsky and John Shoven.⁶³ The basic idea would be to establish a status of being "paid up" under Social Security after a given number of years of contributions (45

in the Warshawsky formulation), after which no further payroll taxes would be collected. Notably, this change would offer a work incentive to individuals on the way to paid-up status, and not only upon reaching a given age.

One policy challenge associated with improving Social Security's work incentives is that doing so will likely shift the distribution of Social Security income somewhat from women (who are more likely to have work interruptions to bear and raise children) to men (who are more likely to have longer working careers). This income shift is indeed a likely effect of enacting work-incentive repairs in isolation, and it is a concern if one wishes to preserve the full amount of income redistribution from men to women that occurs under current-law Social Security. The concern can be addressed, however, by making the basic benefit formula incrementally more progressive at the same time that work incentive improvements are enacted.⁶⁵

There is no way to know for certain how much Americans in late middle age would respond to reforms to render Social Security friendlier to those who extend their working careers. Evidence from Liebman, Luttner, and Seif suggests that there would be a positive labor supply effect and thus a positive effect on federal revenues, retirement income security, and broader economic growth.⁶⁶ At a time when America desperately needs the labor productivity of our skilled, healthiest younger seniors to foster economic growth, we would do well to advance a Social Security system that sides with those who provide us with the benefits of their continued work.

Financial Literacy

The Social Security Administration plays a unique role in the financial security of millions of Americans, and in helping people better prepare for retirement. Therefore, both the Bowles-Simpson and BPC plans encourage the SSA to increase financial literacy efforts to inform people about their retirement choices and to increase savings. Specifically, the BPC plan

directs SSA to revise aggressively its communications and messaging around the retirement choice. The material provided to workers during their careers about the retirement decision must more clearly show the implications of collecting benefits at different ages. It must highlight the permanent financial consequences of this choice, not only for workers, but for spouses and survivors as well. In particular, SSA should remind workers of uncertainties in retirement, such as potential health-care costs and the possibility that they may live for many years after retiring.

Although people are living longer, a significant fraction of workers continues to start receiving Social Security benefits early, though this permanently reduces monthly benefits. Research links financial literacy and saving behavior, indicating that the less financially literate are also less likely to plan for retirement.⁶⁶ Better informing people about the full costs of claiming benefits early may lead to more people choosing to delay claiming until the full retirement age, or longer, thus improving labor-force participation among seniors. For example, an innovative study by Jeff Brown, Arie Kapteyn, and Olivia Mitchell uses the American Life Panel to experiment with different ways of framing monthly benefit information. The authors hold constant the factual information presented but vary how the information is presented to highlight the financial gains of delaying or claiming. That study finds that framing information strongly shaped respondents' expected claiming ages.⁶⁷

Promoting financial literacy should be done regardless of any Social Security reform plan, in part because research finds differences between how much people expect to receive in Social Security benefits when they retire and what they actually receive. For example, only 19 percent of workers can correctly identify the age at which they will be eligible for full benefits from Social Security.⁶⁸ Further, the 2011 Retirement Confidence Survey (RCS) found that current workers are half as likely to expect Social Security to provide a major share of their income in retirement (33 percent) as current retirees are to say Social Security makes up a major share of their income (68 percent).⁶⁹ However, research conducted by the Employee Benefit Research Institute (EBRI) found that 60 percent of those aged 65 or older received at least three-quarters of their income from Social Security in 2009.⁷⁰ Additionally, although people are living longer, a significant fraction of workers continues to take Social Security benefits at age 62 even though this permanently reduces monthly benefits for the rest of their lives. Research also links financial literacy and saving behavior, indicating that the less financially literate are also less likely to plan for retirement.⁷¹

A number of Social Security reforms could be implemented that provide incentives to healthy seniors to continue working. Some of these changes would produce net direct savings for the program, whereas others would benefit individual participants at some expense to program finances. The following often-discussed proposals to raise Social Security eligibility ages would likely have a positive effect on worker output and economic growth.

CONCLUSION

Social Security faces real financial challenges. Dismissing the real and current fiscal challenges facing the Social Security system and kicking the “reform can” further down the road will only increase the severity of the burden associated with reforms when they inevitably must take place.

In order to ensure that Social Security remains solvent and continues to provide retirement security for generations to come, while minimizing the burden on current and future generations, reforms must happen sooner rather than later. The Social Security Trustees

recommend that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes and give workers and beneficiaries time to adjust to them. Implementing changes soon would allow more generations to share in the needed revenue increases or reductions in scheduled benefits. Social Security will play a critical role the lives of 56 million beneficiaries and 159 million covered workers and their families in 2012. With informed discussion, creative thinking, and timely legislative action, Social Security can continue to protect future generations.⁷³

These reforms should not only address the program’s fiscal solvency issues, but also remove the disincentives to working later in life.

Thank you again for your time and this opportunity to testify today. I look forward to your questions.

ENDNOTES

1. The data are available from Yahoo Finance’s Historical Prices calculator, <http://finance.yahoo.com/q/hp?s=%5eCSPC+Historical+Prices>. S&P 500 index value at market close on October 10, 2007, was 1562.47. Index value at close on March 9, 2009, was 676.53. The National Bureau of Economic Research, the arbiter of the start and end dates of a recession, determined that the recession that began in December 2007 ended in June 2009, roughly coinciding with the peak and trough dates of the S&P 500 index.
2. Michael D. Hurd and Susann Rohwedder, “The Effects of the Economic Crisis on the Older Population” (MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010).
3. The Health and Retirement Study is a longitudinal survey of health, retirement, and aging that has been conducted every two years since 1992 and interviews more than 22,000 Americans over the age of 50. For more information on the study, see <http://hrsonline.isr.umich.edu>.
4. Hurd and Rohwedder, “Effects of the Economic Crisis.”
5. US Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, accessed May 15, 2012, www.bls.gov/data/#unemployment.
6. US Bureau of Labor Statistics, “Employment Status of the Civilian Noninstitutional Population by Age, Sex, and Race,” Labor Force Statistics from the Current Population Survey, accessed May 15, 2012, <http://www.bls.gov/web/empsit/cpseea13.htm>.
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8. Congressional Budget Office, “Estimates of Potential GDP and the Related Unemployment Rate,” February 5, 2013, <http://www.cbo.gov/publication/43903>. The spreadsheets span January 1991 to February 2013.
9. What is described here are the expectations of working past either age 62 or age 65. Michael Hurd, Monika Reti, and Susann Rohwedder have found that these retirement expectations are predictive of actual retirement. Hurd, Reti, and Rohwedder, “The Effect of Large Capital

- Gains or Losses on Retirement," in *Developments in the Economics of Aging*, ed. David A. Wise (Chicago: University of Chicago Press, 2005).
10. In this context, "retirement plans" refers to peoples' goals, strategies, and behaviors, not to defined-contribution or defined-benefit retirement plans.
 11. Gary Bosworth and Gary Burtless, "Recessions, Wealth Destruction, and the Timing of Retirement" (CRR Working Paper No. 2010-22, Center for Retirement Research at Boston College, Chestnut Hill, MA, 2010). The timing of retirement can be affected by more than age, including accumulated savings, the availability of an employer-provided pension, the willingness or ability to continue working part-time in retirement, personal health, access to health coverage, and general economic conditions.
 12. Emy Sok, "Record Unemployment among Older Workers Does Not Keep Them Out of the Job Market." US Bureau of Labor Statistics, Issues in Labor Statistics, Summary 10-04, March 2010, www.bls.gov/opub/ils/summary_10_04/older_workers.htm.
 13. Julie M. Whittaker, "Unemployment and Older Workers" (CRS Report for Congress, Congressional Research Service, August 29, 2007), <http://www.aging.senate.gov/crs/pension27.pdf>.
 14. Bosworth and Burtless, "Recessions, Wealth Destruction, and the Timing of Retirement."
 15. Social Security benefits taken between ages 62 and the full retirement age (FRA), currently 65 or 66 depending on birth year, are actuarially reduced so that the expected value of total lifetime benefits received is approximately the same regardless of when benefits are claimed.
 16. Income earned by individuals who claim benefits prior to attaining the full retirement age (FRA) is subject to the retirement earnings test. There are two different exempt amounts depending on when the individuals attain FRA. For individuals claiming benefits and working in 2012 but attaining FRA in 2013 or later, the annual exempt amount in 2013 is \$15,120. For those individuals attaining FRA in 2013, the exempt amount is \$40,080 and applies only to income earned in the months prior to attaining FRA. After attaining FRA, individuals are no longer subject to the earnings test. SSA withholds \$1 in benefits for every \$2 in earnings in excess of the lower exempt amount and \$1 in benefits for every \$3 of earnings in excess of the higher exempt amount. US Social Security Administration, "Exempt Amounts under the Earnings Test," <http://www.ssa.gov/oact/cola/rtea.html>.
 17. US Social Security Administration, "Retirement Planner: Getting Benefits While Working," <http://www.ssa.gov/retire2/whileworking.htm>.
 18. For a summary of research work on this area, see Richard Burkhauser, Alan Gustman, John Laitner, Olivia S. Mitchell, and Amanda Son-nega, "Social Security Research at the Michigan Retirement Research Center," *Social Security Bulletin* 69, no. 4 (2009).
 19. An aged beneficiary or "unit" is either a married couple living together or a nonmarried person, which also includes persons who are separated or married but not living together. A married couple's age is defined as the age of the husband—unless he is under age 55 and the wife is 55 or older, in which case it is the age of the wife. The example in the paper refers to aged units that are 65 years of age or older. In this case, the age of the married couple is the age of the husband if he is 65 or older; if the husband is younger than 55 and the wife is aged 65 or older, the age of the married couple is the age of the wife. See http://www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/.
 20. United States Social Security Administration, "Relative Importance of Social Security, 2008," *Fast Facts & Figures*, August 2010, http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2010/fast_facts10.html#agedpop.
 21. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population" (MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010).
 22. Gayle Reznik, David Weaver, and Andrew Biggs, "Social Security and Marginal Returns to Work near Retirement" (SSA, April 2009), <http://www.ssa.gov/policy/docs/issuepapers/ip2009-02.html>.
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 24. Geoffrey Kollmann, "Social Security: Summary of Major Changes in the Cash Benefits Program," May 18, 2000, <http://www.ssa.gov/history/reports/crsleghst2.html>. The option was created for women in the 1956 amendments and for men in the 1961 amendments.
 25. Fullerton, "Labor Force Participation."
 26. SSA, "When to Start Receiving Retirement Benefits," August 2012, <http://www.socialsecurity.gov/pubs/T0147.pdf>.
 27. Charles Blahous, "Social Security and Work," *National Affairs* 2 (Winter 2010).
 28. Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov, "Removing the Disincentives in Social Security for Long Careers," NBER, December 15, 2006, <http://www.nber.org/programs/ag/rrc/NB06-06%20Goda,%20Shoven,%20Slavov%20FINAL.pdf>.
 29. See Testimony of Charles Blahous before the Subcommittee on Social Security of the U.S. House of Representatives Committee on Ways and Means, July 8, 2011, <http://waysandmeans.house.gov/uploadedfiles/blahoustestimony78.pdf>.
 30. Goda, Shoven, and Slavov, "Removing the Disincentives."

31. SSA, *How Work Affects Your Benefits*, 2013, www.ssa.gov/pubs/EN-05-10069.pdf.
32. SSA, "Annual Statistical Supplement, 2012," <http://www.ssa.gov/policy/docs/statcomps/supplement/2012/6b.html#table6.b5>.
33. *Ibid.*
34. SSA, "When to Start Receiving Retirement Benefits," August 2012, <http://www.socialsecurity.gov/pubs/10147.pdf>.
35. April 2007 memorandum from SSA to Charles Blahous.
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40. The Average Wage Index is a measure of average wages in the economy as a whole. It is explained in greater detail in a number of Social Security Administration Office of the Actuary publications, including "Average Wages for Indexing Under the Social Security Act," Actuarial Note 103, May 1981, <http://www.ssa.gov/oact/NOTES/note1980s/note103/introduction.html>.
41. This scenario is complicated somewhat by the fact that benefits after initial claim are adjusted for growth in the Consumer Price Index, but it is nevertheless true as a zeroth-order approximation.
42. Social Security Trustees Report.
43. *Reducing the Deficit: Spending and Revenue Options* (Washington, DC: CBO, March 2011), <http://www.cbo.gov/ftpdocs/120xx/doc12085/03-10-ReducingTheDeficit.pdf>, page 63.
44. Holtz-Eakin to Craig, "Long-Term Analysis of Plan 2."
45. Holtz-Eakin to Craig, "Diamond-Orszag Social Security Plan."
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Chairman JOHNSON. Mr. Lorenzen found his way through traffic, but I am going to come back to you, since we have already started.

Ms. Miranda, you are welcome. Please go ahead.

**STATEMENT OF LETICIA MIRANDA, SENIOR POLICY ADVISOR,
ECONOMIC SECURITY POLICY, NATIONAL COUNCIL OF LA
RAZA**

Ms. MIRANDA. Thank you for inviting me to speak with you today. I am a senior policy adviser at NCLR. NCLR has been working to advance retirement security among Hispanic Americans for over a decade, and my work is centered on this topic.

Social Security serves 56 million retirees, disabled adults, and survivors of deceased workers and their families. The focus of today's hearing is to discuss options to strengthen Social Security so that this critical program can continue providing benefits into the future. In this regard, I want to make three key points:

First, Social Security benefits are modest yet critical to most seniors, especially because pensions are becoming weaker. Second, most—the proposed benefits will cause deep harm to a vast majority of seniors. Third, we need meaningful benefit enhancements for the most vulnerable.

I will close my remarks with some principles for reform. First, Social Security provides modest benefits that are very important to those who receive them. The average Social Security retiree benefit last year was approximately \$14,800. Seniors rely heavily on their benefits. Two-thirds of beneficiaries rely on Social Security for at least 50 percent of their income, and one-third rely on it for almost all of their income. Among seniors of color, 55 percent of Hispanics, 49 percent of African-Americans, and 42 percent of Asians rely on Social Security for almost all of their income.

Low-income workers face inadequate benefits. Social Security replaces only 40 percent of prior earnings for low-income workers who retire at age 62. Pension coverage is getting weaker. Pension coverage among private sector workers has fallen from 50 percent in 1979 to 42 percent now. American men have lost the most ground over this time period.

The quality of pension coverage has also declined. Risky, inadequate 401(k)-style plans have replaced more secure defined benefit plans, and Americans are not saving enough in their 401(k)s. More and more, the only stable form of retirement income that most people can count on is Social Security. Given all of this, our Nation should not reduce Social Security benefits. Yet many ideas are being proposed to cut Social Security benefits. I will talk about two of these harmful proposals.

First, the partial price indexing option deeply cuts benefits for seniors with already modest income. Under one PPI plan, the average monthly benefit would fall from \$1,250 to less than \$900 per month. Second, increasing the retirement age or enacting longevity indexing also cuts benefits for all workers, including those with the lowest incomes. Each 1-year increase in the statutory retirement age is equivalent to a benefit cut of approximately 7 percent.

The most important problem with these proposed benefit cuts is that vulnerable people will be pushed into greater poverty and

hunger. NCLR held six town halls with Latino seniors in 2011 to hear their views on Social Security's future. One senior in Los Angeles, who spoke from his wheelchair, said he lives alone on \$750 per month, and he cannot afford to buy food after paying for rent and other bills. He relies on local food banks to survive. People like him cannot afford further reductions to their already inadequate benefits. Basic living expenses do not decline simply because the overall population is living longer.

My third major point is that we do need benefit enhancements for the lowest income workers, but these need to be meaningful. Benefit increases that are only proposed to lessen the impact of a benefit cut do not constitute a benefit improvement. Neither does structuring a benefit improvement so that few people will qualify.

Lastly, I would offer a few principles to keep in mind as you approach reform. First, maintain what works with Social Security. For example, don't make it a means-tested program, and keep it universal. Second, include revenue as part of the solution to get to long-term solvency. Americans will support this, as many surveys show. Revenue increases can make harmful benefit cuts unnecessary. Third, truly improve benefits so that low-income workers can retire with benefits that keep them out of poverty and protect low and moderate income people from any benefit cuts. Thank you. I am happy to answer any questions.

Chairman JOHNSON. Thank you.

[The prepared statement of Ms. Miranda follows:]

NCLR
NATIONAL COUNCIL OF LA RAZA

**The Impact of Proposed Changes to Social Security
On American Retirement Security**

Presented at

“The President’s and Other Bipartisan Entitlement Reform Proposals”

Submitted to
Committee on Ways and Means
Subcommittee on Social Security

Submitted by
Leticia Miranda
Senior Policy Advisor, Economic Security Policy
National Council of La Raza

23 May 2013

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Thank you for inviting me to speak with you today. I am the Senior Policy Advisor for Economic Security Policy at the National Council of La Raza (NCLR), the largest national Hispanic civil rights and advocacy organization in the United States, an American institution recognized in the book *Forces for Good* as one of the best nonprofits in the nation. We represent some 300 Affiliates—local, community-based organizations in 41 states, the District of Columbia, and Puerto Rico—that provide education, health, housing, workforce development, and other services to millions of Americans and immigrants annually. NCLR is dedicated to improving opportunities for Hispanic Americans. NCLR has been providing policy analysis, advocacy, and public education on retirement security issues affecting Hispanic Americans for over a decade.

In addition to my position at NCLR, I am also a member of the Commission to Modernize Social Security, which produced a plan to improve Social Security in 2011.

The focus of today's hearing is to discuss options to strengthen Social Security. In my testimony, I will make three key points:

- 1) Social Security benefits are modest yet critical to the vast majority of seniors, especially in a time when pension coverage is falling;
- 2) Proposed benefit cuts will cause deep harm to the retirement security of almost all Americans; and
- 3) We need meaningful benefit enhancements that can improve the adequacy of benefits for the most vulnerable.

I will close my remarks with recommendations on how we can improve Social Security.

1. Quick Facts about Social Security Beneficiaries

Of the 56 million beneficiaries of Social Security, 70% are retirees, 11% are survivors of deceased workers and 19% are disabled workers or their family members.

Social Security benefits are modest. The average Social Security benefit of a typical retiree (medium worker) was \$1,234 per month or \$14,808 annually in 2012.¹ Differentiated by gender, the average Social Security benefit for women 65 and older is about \$12,700 per year, compared to about \$16,700 for men 65 and older.²

In 2011, the average annual Social Security income received by African American men 65 years and older was \$13,458 and for women it was \$12,173.³ Average Social Security benefits for Hispanic men 65 and older were \$12,921 and \$10,438 for Hispanic women in 2011.⁴

These average benefits replace only 41% of previous earnings for the medium worker and are the 5th lowest in terms of earnings replacement ratios among all of the developed countries in the

Organization for Economic Co-operation and Development (OECD).⁵ These benefits are indeed modest, yet very important to those who depend on them.

Social Security beneficiaries rely heavily on their benefits. For example, two-thirds (65.3%) of beneficiaries rely on Social Security for at least half of their income. Among all elderly beneficiaries, over one in three (36%) rely on Social Security for almost all (at least 90%) of their income. Among seniors of color, 55% of Hispanics, 49% of African Americans, and 42% of Asians relied on Social Security for almost all their income in 2010.⁶ These figures are higher than those of the population as a whole.

Highly reliant low-income workers face inadequate benefits. For low-income earners, 75% rely on Social Security for all of their income. Yet, Social Security replaces only 40% of prior earnings for low-income workers who retire at age 62. For those retiring at 65, benefits replace 58% of prior earnings. Social Security benefits for these retirees are further reduced by deductions for Medicare premiums, which affect half of low-income earners.⁷

Social Security is an important source of income for the vast majority of seniors. In 2008, for example, the lower income seniors (those with incomes below \$19,880) received more than 80% of their total income from Social Security. Middle income seniors rely on Social Security benefits as well: two-thirds of their income comes from Social Security. Median total income was only \$20,000 for middle income seniors in 2008.⁸ Those in the next-to-highest income group (those with income between \$31,300 and \$55,890) still depended on Social Security for nearly half their income (44%). Only the highest quintile of retirees had a lower reliance (18%) on Social Security, in part because almost half continued working past age 65.⁹

Higher income seniors tend to have more income from pensions, other assets, and earnings from work after age 65 in comparison to lower income seniors. Seniors with the lowest income are least likely to have a pension. Only 3% of seniors in this category receive retirement income from pensions and 2% receive income from assets. Middle-income seniors had 16% of their income from pensions, 10% from earnings, and 7% from assets. Upper middle-income seniors had 26% of income from pensions, 19% from earnings, and 8% from assets. The top one-fifth of seniors had 18% of their income from pensions, 44% from earnings, and 18% from assets.¹⁰

Stagnating wages harm workers' ability to save for retirement. Over the past 60 years, real hourly compensation for production non-supervisory workers has risen by 113%, while the productivity of these workers has risen by 254%. Most of the real wage increases for these workers occurred before 1970, with real wage growth flattening since then, despite continued increases in productivity.¹¹ Because Social Security benefits are tied to earnings, benefits will stagnate along with earnings. Moreover, workers today have relatively less income available to save than they would have had if wages had continued climbing in line with productivity.

Pension coverage is getting weaker, clouding the outlook for future retirement security. Pension coverage for all workers dropped from 58% in 1986 to 54% in 2011. Workers of color are much less likely to have access to a pension. Half of Black workers and one-third of Hispanic workers have access to a pension plan through their work, compared to 60% of White

workers. Workers with lower levels of education, who are younger, who earn less, or who work for smaller firms, or certain industries are less likely to have access to a retirement savings plan at work.¹²

Pension coverage in the private sector is dropping fast. More than half of private sector workers age 25 to 64 now do not have access to any type of pension plan at work. Pension coverage among private sector workers declined markedly from 50% in 1979 to 42% in 2010. Loss of pension coverage has hit American men the hardest: pension coverage for American men fell from 60% in 1979 to 43% in 2010. Women had a modest increase in their pension coverage from 38% to 41% over the same time frame.¹³

In addition, the quality of the pension coverage has declined. In 1980, 39% of workers with pension plans had a defined benefit (DB) pension, while 8% participated in a defined contribution (DC) plan. By 2011, this had flipped so that 18% of workers were in a DB plan, and 31% were now in a DC plan.¹⁴ The difference is that DB plans have defined benefits during retirement, have professionally managed accounts, and typically have annuitized payouts over a lifetime, whereas DC plans do not have these features.

Workers in DC plans have inadequate retirement savings. For households approaching retirement age and with positive 401K balances average retirement assets total approximately \$120,000, which translates to only \$575 in monthly income.¹⁵ Median net worth for households, which includes the value of all assets including retirement savings and homes minus all debts, varies significantly by race and ethnicity with balances of \$110,729 for Whites, \$69,590 for Asians, \$7,424 for Hispanics, and \$4,955 for Blacks.¹⁶

With this backdrop—high dependence on modest Social Security benefits, stagnating wages, a faltering private pension system, a move away from more secure defined-benefit pension plans—our nation should not consider making Social Security benefits even lower. Cutting Social Security benefits will lead to even greater financial insecurity for future generations.

2. Impact of benefit cuts

A. Progressive Price Index Option: A Large Benefit Cut

The Progressive Price Indexing (PPI) option deeply cuts benefits for seniors with already modest incomes. Under current law, *initial* benefits for Social Security are tied to the growth of average wages. Wages typically increase faster than the prices of goods and services. The PPI option would instead tie initial Social Security benefit levels to the slower growing price inflation index, resulting in a sizeable benefit cut.¹⁷

For example, Representative Paul Ryan proposed a Progressive Price Index option in his 2010 budget entitled *Roadmap for America's Future*. This proposal would subject 70% of all workers to the PPI, including all workers with earnings above \$22,000 in today's dollars. The medium earner (now earning \$43,000 annually) in the future would see his or her benefits reduced by 28% due to the PPI. Thus, the average monthly benefit level of \$1,249 would fall to \$888 for

future retirees. The Ryan PPI proposal exempted the bottom 30% of earners (those with average lifetime earnings below \$22,000) from the PPI.¹⁸ Yet, workers who are nearly poor, those with average lifetime earnings of \$24,000, were not exempted. These nearly poor workers would be subject to a drastic PPI benefit cut.

A recent poll found that 84% of Americans say that Social Security does not provide enough income to retirees, and believe we should consider raising future Social Security benefits in order to provide a more secure retirement for working Americans.¹⁹ Yet proposals like the PPI would reduce benefits by up to 28% for the average worker retiring in the future.

B. Retirement Age Increase: Another Benefit Cut

Increasing the retirement age is another way of cutting benefits for all workers, including vulnerable people. Currently, the full retirement age is 66, but will rise to age 67 for people born after 1959. Various proposals have been offered to raise the age still further to age 69 or 70. Each one-year increase is equivalent to a benefit cut of approximately 6.5% to 7%.²⁰ While these proposals typically still allow a person to retire at the earliest eligible age of 62, the retiree would have to accept a larger cut in benefits to retire at this earliest age.

Cuts would occur regardless of the age the retiree begins to collect benefits. Under current law with the full retirement age at 66, a worker who retires at age 62 would have to accept a 25% reduction in benefits: \$750 instead of \$1,000 in monthly benefits. If the retirement age were to increase to age 69, monthly benefits would drop further to \$610 for this 62 year-old retiree. Similarly, with the full retirement age at 66, a person who begins collecting benefits at age 69 would receive \$1,240; however, if the full retirement age were changed to 69, these benefits would drop to \$1,000.²¹

The *Roadmap for America's Future* proposed combining the PPI option with increasing the retirement age by two years, for a 39% benefit cut in total for the medium wage earner. Thus, average Social Security benefits would be cut from \$1,249 under current law to \$759 for those retiring in 2080.²²

Proposals to enact longevity indexing are also benefit cuts. The longevity index seeks to disguise a direct increase in the eligibility age by changing the benefit formula in a way that mimics the benefit-reduction caused by raising the age directly.

C. Consequences of Proposed Benefit Cuts

The main consequence of these proposed benefit cuts is that vulnerable people will be pushed into greater poverty and hunger. NCLR held six town halls with Latino seniors in 2011 to hear their views on possible cuts to Social Security. One senior in Los Angeles, who spoke from his wheelchair, shared that he lives alone on \$750 per month; he cannot afford to buy food after paying his rent and other bills. While he is ashamed, he said he has no other choice than to rely on local food banks for survival. He stressed that the millions of others like him cannot afford any further reductions to already low benefits. If widespread benefit cuts take effect, regardless of their justification, more vulnerable people like this gentleman will face

increasingly desperate circumstances. Basic living expenses do not decline simply because the overall population is living longer.

A second problem with increasing the retirement age relates to the variability of life expectancy among subgroups in the population. For example, men in the top half of the income distribution gained six years of life expectancy in the past 30 years, whereas men in the bottom half have gained only 1.3 years in this same timeframe.²³ African Americans and Native Americans tend to have significantly shorter life expectancies than other Americans, meaning they are more likely to claim benefits for a shorter time period or die before receiving any benefits at all.²⁴ Life expectancy among less educated Whites has actually fallen between 1990 and 2008; white women without a high school diploma lost five years of life, while White men also without a high school diploma lost three years.²⁵ Linking Social Security benefits to overall longevity wrongly assumes that life expectancy has risen equally for everyone.

A third consequence of increasing the retirement age is that this is an added burden on older workers in physically demanding jobs. Certain demographic groups are more likely to be engaged in jobs that have difficult working conditions than others. These groups include men, Hispanics, the least educated, immigrants and the lowest wage earners. For example, older workers with less than a high school education are much more likely (77%) to have a physically demanding job than those with an advanced degree (22%). Immigrant workers age 58 and older are more likely (48%) than non-immigrant workers to work in a physically demanding job. Finally, about 62% of older Latino men worked in physically demanding jobs.²⁶ Related to these trends, the Government Accounting Organization found that older Latino workers (48%) and African American workers (38%) were more likely than whites (20%) to report being in fair or poor health.²⁷ Delaying the full retirement age will place a great hardship on these workers.

Many of the proposals mentioned above which increase the retirement age, do so at the expense of younger Americans who are more racially diverse. We will be leaving our children with an increasingly inadequate future social insurance system.

D. Public Opinion Opposes Benefit Cuts and Supports Strengthening the System

Given all these negative consequences, it is no wonder that the majority of Americans do not support increasing the retirement age or benefit cuts in general as the way to address Social Security's long-term financing gap. When asked in a 2009 survey how they would prefer to protect Social Security's ability to continue paying out benefits only 10% of Americans supported cutting benefits and just 31% supported increasing the retirement age.²⁸ In a more recent survey, only 17% of Republicans and 3% of Democrats favored cuts to Social Security.²⁹ Another recent survey found that rather than maintain the status quo, 71% of Americans would prefer a package of changes that increases Social Security revenues, pays for benefit improvements, and eliminates more than 100% of the projected financing gap.³⁰

3. Meaningful Social Security Benefit Improvements are Needed

Benefit increases that improve the adequacy of benefits for those with the lowest incomes are needed; but these benefit increases must be real and meaningful. Benefit increases that

are only proposed to lessen the impact of a benefit cut do not constitute benefit improvements. For example, adding an increase in benefits to seniors at age 85 is an excellent proposal on its own; however, this proposal has been tied to a benefit cut known as the chained-CPI. Combining this benefit increase with the benefit cut seniors will feel from a chained CPI still results in a 2% average cut. Even lower income seniors would still experience a cut of about 1.5% through age 81.³¹

Structuring a benefit improvement so that few people will qualify is also not a valid benefit improvement. For example, the National Commission on Fiscal Responsibility and Reform proposed to enhance the Social Security minimum benefit so that long-time low-wage workers may have a benefit level that leaves them above the poverty line instead of below, as is currently the case. However, the Commission plan requires that a low-wage worker have 30 years in covered earnings in order to qualify for the full benefit enhancement, with a partial enhancement for those with fewer years in their work history. Yet, low-income workers and those with less education have the fewest years in covered earnings. According to an analysis conducted by the Urban Institute, this 30 year-requirement would disqualify almost all (80% to 95%) low-income workers from receiving the full benefit enhancement.³²

4. Recommendations

The following recommendations are based on NCLR's Principles on Social Security.³³

Strengthen Social Security. Social Security is critical to the well-being of the vast majority of seniors. Take steps to strengthen the Social Security system so that it is available and strong for future generations.

Include revenue options. Revenue should be a meaningful part of the solution to ensure long-term solvency of the program. Revenue increases can make harmful benefit cuts unnecessary.

Improve adequacy. Increase the adequacy of Social Security benefits so that low-income workers can retire with benefits that keep them out of poverty. Protect low- and moderate-income people from benefit cuts.

Increase access. Increase access to Social Security for workers who currently have difficulty accessing benefits and coverage, such as legal immigrant domestic workers and farm workers.

Maintain what works. Retain the progressive nature of Social Security, but do not make it a means-tested program. Keep the program as social insurance and maintain a guaranteed benefit. Keep it universal. Retain the value that those that pay into the system earn access to its benefits.

Ensure generational equity. Distribute the burden of achieving long-term solvency within Social Security equitably across generations. This means not making today's young people bear the entire burden of achieving solvency.

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²⁵ Sabrina Tavernise, "Life Spans Shrink for Least-Educated Whites in the U.S.," New York Times. September 20, 2012. http://www.nytimes.com/2012/09/21/us/life-expectancy-for-less-educated-whites-in-us-is-shrinking.html?pagewanted=all&_r=1 (accessed May 2013)

²⁶ Hye Jin Rho, *Hard Work? Patterns in Physically Demanding Labor Among Older Workers* (Washington, DC: Center for Economic Policy Research, 2010), <http://www.cepr.net/index.php/publications/reports/patterns-in-physically-demanding-labor-among-older-workers> (May 2013)

²⁷ U.S. Government Accountability Office, *Raising the Retirement Ages Would Have Implications for Older Workers and SSA Disability Rolls*. (Washington, DC: U.S. Government Accountability Office, 2010).

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³⁰ Jasmine V. Tucker, Virginia P. Reno, and Thomas N. Bethell, *Strengthening Social Security: What do Americans Want?* (Washington, DC: National Academy of Social Insurance, 2013), http://www.nasi.org/sites/default/files/research/What_Do_Americans_Want.pdf (accessed May 2013)

³¹ Kathy Ruffing and Paul N. Van de Water, *Chained CPI Proposal Would Cut Social Security Retirement Benefits by About 2 Percent, on Average*. (Washington, DC: Center on Budget and Policy Priorities, 2013), <http://www.cbpp.org/cms/?fa=view&id=3957> (accessed May 2013)

³² Melissa M. Favreault, and C. Eugene Steuerle, *The Implications of Career Lengths for Social Security*. Working Paper #2008-05, (Boston: Center for Retirement Research at Boston College, 2008), p. 25, http://www.urban.org/UploadedPDF/411646_careerlengths.pdf (accessed May 2013)

³³ National Council of La Raza, "NCLR Principles on Social Security," Washington DC, 2010, <http://www.nclr.org/images/uploads/pages/NCLR%20Social%20Security%20Principles%202011.pdf> (accessed May 2013)

Chairman JOHNSON. Mr. Fuerst, you are welcome here and please go ahead.

**STATEMENT OF DONALD FUERST, SENIOR PENSION FELLOW,
AMERICAN ACADEMY OF ACTUARIES**

Mr. FUERST. Chairman Johnson, Ranking Member Becerra, and distinguished Members of the Subcommittee, thank you for the opportunity to appear before you to assist in your examination of bipartisan proposals to adjust Social Security benefits. I am here on behalf of the American Academy of Actuaries, where I am the Senior Pension Fellow. The Academy is the nonpartisan association representing all actuaries in the United States on public policy issues. My statement will focus on retirement age.

Americans are living longer. Of particular relevance to Social Security, the life expectancy of the elderly is increasing. A longer life creates numerous benefits for individuals but brings with it an expensive challenge—how to provide financial security for our seniors. Simply put, the longer someone lives, the more benefits Social Security must pay. Since 1940, the life expectancy of a 65-year-old has increased 6 years for both males and females, and we expect this trend to continue.

An increase in longevity among the elderly, without a corresponding change in the full retirement age, actually constitutes an increase in lifetime benefits. Although the monthly amount a retiree receives is unchanged, the number of payments increases with longer life spans.

Raising the full retirement age addresses Social Security's long-range financial problems while responding to changing demographic factors. In particular, raising the full retirement age will compensate for increases in longevity, preserve the current benefit formula, increase labor force participation, and preserve disability benefits.

The Academy supports retirement age changes but does not advocate a specific proposal. An increase in the retirement age should not be the sole solution to the imbalance in the system. Potential methods for increasing the full retirement age include both fixed schedule and indexing methods. The Simpson-Bowles report includes a proposal to index both full and early retirement ages to increases in longevity, and a hardship exemption for workers who cannot continue working past age 62 but do not qualify for disability benefits.

The Bipartisan Policy Center proposed adjusting benefits for longevity by decreasing the formula as people live longer. This method could produce the same benefit amounts as a change in the full retirement age. However, it does not deliver the same message to American workers as an increased retirement age, which signals workers that they can and should continue in the labor force.

We recognize that there are obstacles to raising the full retirement age. This would have a disproportionate effect on low-wage workers because longevity increases are not uniform across all demographic groups. Additionally, jobs may not be readily available for all older workers. But there are targeted policy options that might address these problems, including liberalizing disability benefits for older workers, revising the early retirement factors to pro-

vide a lesser reduction on benefits below the first bend point, enhanced job training and incentives for employers to hire and retain older workers.

Raising the early eligibility age beyond 62 should also be considered to encourage individuals to work longer, to help avoid the problem of inadequate benefits caused by early retirement reduction. This would not significantly change Social Security's financial position. Forty-four percent of workers receive benefits at age 62, the most popular age for electing benefits, despite the larger benefits that are available at later ages. Retaining age 62 as the early retirement eligibility, or allowing partial benefits at age 62 is likely to result in many people selecting commencement at this early age, with a smaller benefit which may prove to be inadequate.

Estimates show that the proportion of jobs that are physically demanding has shrunk to less than 8 percent of our workforce, and less than 20 percent of workers who retire early do so for health reasons. The problems of these groups could be addressed by other programs, and Social Security benefits could be designed to provide adequate lifetime income at appropriate ages.

In closing, I again thank the subcommittee for this opportunity. Addressing Social Security's solvency now permits more modest changes that Congress could phase in over many years. This would ensure that the system will continue to provide retirement security for generations to come. Thank you.

Chairman JOHNSON. Thank you.

[The prepared statement of Mr. Fuerst follows:]



AMERICAN ACADEMY *of* ACTUARIES

Statement of
Donald E. Fuerst, MAAA, FSA, FCA, EA
Senior Pension Fellow
American Academy of Actuaries

To the
Committee on Ways and Means
Subcommittee on Social Security
U.S. House of Representatives

Hearing on
Proposed adjustments to Social Security benefits, as included in the
President's Fiscal Year 2014 Budget, the report by the National
Commission on Fiscal Responsibility and Reform, and the report of the
Bipartisan Policy Center's Debt Reduction Task Force.

May 23, 2013

The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Chairman Johnson, Ranking Member Becerra – and distinguished members of the subcommittee. Thank you for the opportunity to appear before you today to assist in your examination of bipartisan proposals to adjust Social Security benefits and their impacts on the program’s finances, beneficiaries, workers, and the economy.

I appear before you today on behalf of the American Academy of Actuaries, where I am the Senior Pension Fellow. The Academy is the nonpartisan professional association representing all actuaries in the United States. Our mission is to serve the public and the actuarial profession by providing independent and objective actuarial information, analysis, and education to help in the formation of sound public policy.

Background

Americans are living longer today than they did in the past, thanks in part to improvements in public-health systems, the quality and quantity of our water and food supply, healthcare, and medical technology. These improvements have led to substantial increases in life expectancy, and in particular, the life expectancy of the elderly. A longer life creates some obvious and numerous benefits for individuals, but brings with it not only personal challenges, but a societal challenge in how to prepare for and manage financial security in retirement.

Social Security is a major component of financial security for the elderly. However, the financial sustainability of the program is itself facing challenges. As the Social Security actuaries remind us each year, the program is not in actuarial balance. At some point in the near future—2033 according to the 2012 Trustees Report—absent corrective measures, the program will no longer generate enough revenue to pay full benefits in a timely fashion. Addressing the program’s solvency now would allow Congress to have a fuller range of options to consider, many of which could be more modest in their adjustments, such as slow phase-ins over many years. Deferring efforts to address the solvency of the program to the next decade or beyond will more profoundly affect beneficiaries and the taxpaying public.

Social Security’s Old-Age and Survivors Insurance (OASI) challenges stem from our population demographics: Partly from lower birth rates and immigration levels, and in part from Americans living longer. Simply put, the longer someone lives, the more benefits Social Security must pay. In 1940, when the new Social Security Administration began paying monthly retired-worker benefits, the “full retirement age” was 65. At that time, workers who survived to age 65 had a remaining life expectancy of 12.7 years for males and 14.7 years for females. In 2011, life expectancy at age 65 was 18.7 years for males and 20.7 years¹ for females, an increase of six full years for males and females.²

Actuaries expect the trend to continue into the foreseeable future. Under the Social Security actuaries’ intermediate projection, future life expectancy is projected to increase about one year

¹ 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, Table V.A4.—Cohort Life Expectancy.

² For more information, please view the table located in the appendix.

per decade. In 20 years, life expectancy at age 65 for males is expected to be more than 20 years and more than 22 years for females.

The Social Security Amendments of 1983⁴

The 1983 Social Security Amendments made increases in the full retirement age partially reflect the improvements in life expectancy since 1940. These scheduled increases were part of a package of changes adopted to fend off near-term program insolvency. Under the 1983 adjustments, the full retirement age has gradually increased to age 66 for workers born in 1943 (who reached age 66 in 2009). Still to come as a result of the 1983 amendments, the full retirement age gradually increases to age 67 for workers born in or after 1960. These increases are summarized in the table below.

| Year of Birth | Current Law Social Security Full Retirement Age |
|---------------|---|
| 1943—1954 | 66 |
| 1955 | 66 and 2 months |
| 1956 | 66 and 4 months |
| 1957 | 66 and 6 months |
| 1958 | 66 and 8 months |
| 1959 | 66 and 10 months |
| 1960 & older | 67 |

From today's perspective, however, the 1983 schedule of increases in the full retirement age account for only two of the additional six years of life expectancy that we're experiencing today. Congress should enact additional raises to the retirement age to keep healthy older Americans productively working and to keep Social Security affordable.

The 1983 amendments solved what was then an immediate crisis—full benefits could not have been paid later that same year without action. But valuations done at the time of the 1983 amendments projected solvency for 75 years, and did not project sustainable solvency beyond that time frame. Today, the Social Security actuaries' projections anticipate the crisis arriving sooner than projected in 1983. Congress should act now to provide sustainable solvency for future generations. An important component of a change that will promote sustainable solvency should be raising the full retirement age with a provision for additional raises if life expectancy after full retirement age continues to increase.

⁴ Public Law 98-21.

Raising the Full Retirement Age

Social Security defines the full retirement age as the earliest age an individual can receive unreduced old-age benefits. For 60 years, starting in 1940, the full retirement age was 65.

Actuaries and demographers project increases in life expectancy to continue, although the rate of increase is the subject of ongoing debate. Regardless, any increase in longevity among the elderly population without a corresponding change in the full retirement age actually constitutes an increase in the amount of benefits paid, and this has a profound effect on the system. First, although the monthly amount a retiree receives remains unchanged under current law formulas, the number of payments a retiree will receive obviously increases with longer life spans. These additional payments lead to a higher value of benefits, increasing the cost of the system. Second, as life expectancy increases, one's lifetime proportion spent in retirement increases, while the proportion spent working decreases. That means that individuals receive benefits for a greater portion of their lives and pay Social Security taxes for less, even if the number of years they pay into the system remains the same.

To address the effect of longevity increases on Social Security, increases in the retirement age could be structured at least three ways: 1) a modest increase to merely restrain the growth in the value of future benefits, 2) an increase designed to keep benefits approximately the same in value, or 3) more significant increases that would reduce overall benefits. It should be noted that the third method goes beyond addressing longevity increases and would actually reduce the lifetime value of benefits.

Based on the assumptions in the trustees report, the full retirement age would need to increase by about one month every two years in order to offset the effects of increasing life spans on the system.

The Actuarial and Public Policy Case for Raising the Full Retirement Age

The shifting balance between working years and retirement years has contributed to the system's long-term actuarial imbalance. As actuaries, we see this as a demographic problem that demands a demographic solution.

That said, the Academy does recognize that an increase in the retirement age is not a solution to address the entire imbalance in the system. It is but one component, though a necessary one, of restoring Social Security's long-term financial health. In particular, raising the full retirement age will:

- *Compensate for Increases in Longevity* – Raising the full retirement age connects Social Security directly to covered workers living longer. Even large proposed increases in the full retirement age would still provide for a lengthier retirement on average than workers enjoyed during most of the time their full retirement age was 65. Current retirement surveys consistently show that, in order to maintain one's current standard of living, most workers expect they will need to or want to work longer to accumulate the needed retirement savings in employer-sponsored plans and personal savings accounts.

- *Preserve the current benefit formula.* The current benefit formula has existed for more than 30 years and provides a certain balance to the circumstances of the many demographic groups among Social Security's covered population. Raising the retirement age addresses the financial challenges associated with longevity without having to modify the current formula.
- *Increase labor force participation.* Raising the full retirement age can induce workers to remain in the labor force longer. Part of this effect is behavioral: to the extent Americans consider a higher full retirement age the "normal" retirement age, workers will view delaying retirement as the "new normal." More significantly, workers could continue full-time employment in order to retire later with an adequate Social Security benefit or switch to part-time employment to supplement a lower benefit. Making greater use of older workers increases total economic output and raises the living standard for both active and retired workers.
- *Preserve disability benefits.* Raising the full retirement age will not reduce disabled-workers' benefits, while a direct reduction in Social Security's benefit formula would reduce these benefits.

Considerations When Raising the Retirement Age

Possible negative consequences of raising the full retirement age include:

- *Disproportionate effect on low-wage workers.* Not all demographic groups will experience the same increases in longevity. Lower-wage workers and those with lower levels of education generally have experienced smaller increases in longevity compared to more highly compensated and more educated workers. Also, lower-wage workers often may not be able to work to a higher full retirement age because they tend to work in more physically demanding jobs. An increase in the full retirement age can adversely affect these workers who may have a need for claiming benefits early. Notably, lower-wage workers also rely most heavily on Social Security for income, sometimes as their only income source.

Policy options that might address these problems include liberalizing the current "vocational factors" that are used to define disability for workers at age 40 or older, or revising the early retirement factors to provide a lesser reduction on benefits below the first bend point.⁴

- *Jobs may not be available.* Barriers exist to keeping elderly workers in the labor force, especially if younger workers are readily available. If the economy cannot provide jobs for older workers, raising the retirement age will constitute a financial hardship for many

⁴ Social Security's bend points, where the factors in the formula change, are dollar amounts indexed over time by increases in average wages. The 2013 bend points, for example, are \$791 and \$4,768.

who may have to retire with reduced benefits. The seriousness of this concern depends on how the labor market responds over the coming decades to the gradual aging of the population.

Options for Increasing the Full Retirement Age

While the American Academy of Actuaries advocates for inclusion of an increase in full retirement age in efforts to restore Social Security's long-term actuarial balance, it has not endorsed any one proposal as there are several approaches that can make this adjustment. Increasing the retirement age can contribute significantly to stemming the impact of the program's inadequate financing as a result of the demographic trend of increased longevity and help put the program back on track toward actuarial balance.

Some approaches for increasing the Social Security full retirement age include the following:

- *Fixed-schedule increases to full retirement age.* Various methods exist to increase the retirement age. The Social Security Administration's Chief Actuary Steve Goss and his staff have developed eight examples, including the most accelerated – beginning the increase in the full retirement age from age 66 to age 67 immediately, followed by increases by one month (in retirement age) every two years (in birth-date years) until the full retirement age reaches age 70. This would reduce the long-range actuarial deficit by about one-third. Further reductions of the long-range deficit would require a rate of increase more rapid than one month every two years.
- *Index based on years in retirement.* This method would index the full retirement age in a manner that keeps life expectancy at the full retirement age constant over time. For example, life expectancy at age 65 (weighted between males and females and rounded to the nearest whole year) is now nearly 20 years. To keep a 20-year life expectancy at full retirement age, the full retirement age would have to increase about one month every year or two for life based on the expected increases in longevity from the trustees report. This method would decrease system costs over time because the payout period for benefits would remain the same, while the period over which payroll taxes increases, although the savings from this change alone would not restore actuarial balance. Another, perhaps more accurate, method would index retirement age based on demographic trends as they develop, given that experts disagree on the long-term rate of mortality improvement.
- *Index based on ratio of retirement to working years.* This indexing would change the period from workforce entry age to the full retirement age to increase at the same rate as life expectancy at the full retirement age. This method, which was recommended in 1983 by a majority of the members of the National Commission on Social Security Reform, would increase the full retirement age a little more slowly than maintaining a constant life expectancy at full retirement age and, therefore, would reduce program costs to a lesser degree. But by using this method, policymakers may intend that some portion of the increase in life expectancy at full retirement age may reflect years of unhealthy life during which workers could not continue working and that extra years of life expectancy

should be split in some manner between work and retirement.

- *Index to maintain actuarial balance.* If actuarial balance of the OASI Trust Fund occurred through reforms, Congress could put in place a mechanism that would automatically adjust the full retirement age as necessary to restore actuarial balance going forward. An adjustment of this nature also could be combined with automatic adjustments to the payroll-tax rate or benefit amounts to maintain actuarial balance. The Academy's issue brief, *Automatic Adjustments to Maintain Social Security's Long-Range Actuarial Balance*⁵, discusses this topic in great detail.

Similar Modifications

The National Commission on Fiscal Responsibility and Reform (Bowles-Simpson/Simpson-Bowles) report includes a proposal to index both the full retirement age and the early retirement age to increases in longevity after 2027, the first year workers receive unreduced benefits at age 67 under current law. The proposal also contains a directive to the Social Security Administration to create a "hardship exemption" for workers who cannot continue working past age 62 but who do not qualify for disability benefits. It is estimated the proposal would reduce the long-range actuarial deficit by 18 percent.

The proposal would not fully reflect the improvement in longevity since 1940. This could be accomplished by ad hoc increases to the full retirement age instead of or in addition to indexed increases. However, this could be done by increasing in accelerated fashion the full retirement age enough to eliminate Social Security's long-range actuarial deficit entirely. This still would not take into account the full extent of improvements in longevity, but few major proposals eliminate more than approximately one-third of the deficit through adjustment to the full retirement age. This is due in large measure to concern for workers in strenuous jobs, who might not be able to continue working beyond the current full retirement age.

The Bipartisan Policy Center Debt Reduction Task Force (Domenici-Rivlin) proposed a way to adjust benefits for longevity by decreasing the 90 percent, 32 percent and 15 percent factors used in calculating the Primary Insurance Amount as people live longer. The factors would be multiplied by the ratio of life expectancy of someone reaching age 67 in 2018 to the life expectancy of someone reaching age 67 in the fourth year before benefit eligibility. The Task Force proposal also would apply to disabled workers at the time of conversion to disabled worker status, with the ratio only applying to the proportion of the benefit earned while not disabled.

The Task Force's method could be designed to produce essentially the same effect as any particular change to the full retirement age and thus may have a similar financial benefit. However, it does not provide similar signaling to American workers as an increased retirement age. An increased retirement age signals American workers that they can and should continue to

⁵ http://www.actuary.org/files/publications/IB_Auto_Adjustments_FINAL.pdf

participate in the workforce, thereby having greater opportunity to save more for retirement and earn a greater Social Security benefit.

Mitigating the Effect of a Higher Retirement Age

There are ways to lessen the impact on working Americans and certain segments of the workforce who could be particularly affected by any increase in the Social Security retirement age:

- Gradually phase in any change over an extended period of years, even decades, to allow for more time for society to adapt to the new work-life reality.
- Modify the progressivity of the benefit formula in conjunction with retirement age changes or introduce progressivity into the early retirement reduction factors. This may address the disparate distribution of longevity gains across the population—with wealthier socioeconomic groups recently showing more longevity improvements than poorer socioeconomic groups.
- Additional occupational bridge pensions, perhaps combined with revisions to existing disability programs, could address people having difficulty in continuing to work in occupations that involve physical labor.
- Measures that facilitate employment at older ages (such as reductions to the payroll tax at older ages) to address the greater difficulties that older workers sometimes face in finding jobs.

Early Eligibility Age

The Early Eligibility Age for Social Security has been age 62 since 1956 for women and 1961 for men. The 1983 amendments that raised the full retirement age did not change the early eligibility age, but the amount of benefit at the early eligibility age was further reduced for those workers with a full retirement age above 65. Early benefits are reduced 30 percent at age 62; that is 6.7 percent per year for the first three years and 5 percent for the remaining years to full retirement age (for persons born in 1960 or later). Some proposals to change the full retirement age also suggest changing the early eligibility age, for example to keep the earliest eligibility age five years before the full retirement age.

From a financial as well as societal perspective, raising the early eligibility age has the beneficial result of encouraging most individuals to work longer. Individuals who remain in the labor force are a productive part of our economy and are able to save more for their deferred retirement.

Raising the early eligibility age also helps prevent payment of benefits that may prove inadequate. The 1983 amendments increased the maximum number of years one can retire early and draw early benefits from three to five years prior to full retirement age, and increased the reduction in the benefit from 20 percent at three years to 30 percent at five years. Increasing the

full retirement age beyond age 67 without also raising the early eligibility age would mean that benefits at the early eligibility age would be reduced more than the current 30 percent. This reduction applies to the benefits over the full lifetime of the individual and may as a result prove to be inadequate, potentially causing pressure for benefit increases. Raising the early eligibility age in concert with the full retirement age would maintain the maximum reduction at 30 percent.

Raising the early eligibility age does not significantly change Social Security's financial position because early retirement benefits are already reduced to the approximate actuarial equivalent payments.

Partial Claiming of Benefits at Age 62

Another proposal that mitigates the effect of higher early eligibility age is to allow individuals to claim a portion of their benefit, say up to 50 percent, at age 62 or later, even if before early eligibility age. This portion of the Primary Insurance Amount would be reduced for early commencement accordingly. This proposal would provide partial income to individuals who have difficulty working but do not qualify for disability benefits. Again, because early retirement benefits are approximate actuarial reductions, there would be relatively small effects on the financial status of Social Security.

Currently, the age 62 early retirement age is the single most popular age for electing receipt of benefits. Despite the larger benefits that are available at later ages, many people continue to elect to receive benefits at their first opportunity. Retaining age 62 as the early retirement age or allowing partial benefits at age 62 is likely to result in many people selecting commencement at this early age with a smaller lifetime benefit. This may result in lifetime benefits that prove to be inadequate.

Studies indicate the proportion of jobs that are physically demanding has shrunk to less than 8%, and less than 20 percent of workers who retire early do so for health reasons⁶. Perhaps programs other than Social Security's OASI could be designed to provide adequate lifetime retirement income for the percentage of workers needing such assistance.

Summary

In closing, I again thank the subcommittee for the opportunity to present some ideas on behalf of the American Academy of Actuaries on these important issues facing Social Security. The increased longevity of Americans is a benefit to us in many ways, but it also increases the cost of financing a secure retirement. Delaying action to fix Social Security can only reduce the options available to us. By dealing with this issue sooner rather than later, we can ensure that the system that has benefited several past generations will continue to provide retirement security for generations to come. Thank you. I would be happy to answer any questions you might have at the appropriate time.

⁶ Munnell and Sass, "Working Longer," and Lakdawalla, Bhattacharya and Goldman, "Are The Young Becoming More Disabled."

Appendix

Life Expectancy at Age 65

| Year (age 65) | Male | Female |
|----------------------|-------------|---------------|
| 1940 | 12.7 | 14.7 |
| 1950 | 13.1 | 16.2 |
| 1960 | 13.2 | 17.4 |
| 1970 | 13.8 | 18.5 |
| 1980 | 14.7 | 18.8 |
| 1990 | 16.0 | 19.3 |
| 2000 | 17.5 | 20.0 |
| 2010 | 18.6 | 20.7 |
| 2011 | 18.7 | 20.7 |
| 2035 | 20.3 | 22.3 |
| 2060 | 21.7 | 23.4 |
| 2085 | 22.9 | 24.6 |

Source: 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds
<http://www.ssa.gov/oact/tr/2012/tr2012.pdf>

Chairman JOHNSON. Mr. Steuerle, welcome again. Please go ahead.

**STATEMENT OF C. EUGENE STEUERLE, PH.D., INSTITUTE
FELLOW, URBAN INSTITUTE**

Mr. STEUERLE. Chairman Johnson, Members of the Committee, subcommittee, thank you for this opportunity to testify before you. In my testimony, I provide a fairly lengthy set of proposals that follow principles that I believe apply to Social Security, but I don't want to spend my brief 5 minutes here talking about them so much as to make a pitch with you that we want to do Social Security benefit reform, that is the subject of this hearing, regardless of the level of taxes you collect, regardless of the imbalances of the system, and that is because Social Security has increasingly failed to target its money towards, I think, needs that we would all agree are most important or even meet various principles such as equal justice under the law.

So let me give you an example just in terms of lifetime benefits. A newly retiring average wage couple today will receive about \$580,000 in Social Security benefits. That is what they would need in a bank account if it was to earn, which it won't earn today, but it would earn about 2 percent in real interest rates. And if you add in Medicare, they are scheduled to get about \$1 million in Social Security and Medicare benefits. That largely derives from the large number of years of benefits that are paid.

But even if we thought that that was a level we had to maintain, mind you that in the budget as a whole, we are now cutting benefits in other programs for children, we are cutting programs for middle-income families, but in Social Security and Medicare, every year we bump up these lifetime benefits by about \$20,000, so that if we take a couple retiring, say a couple that is in their 40s today, they are scheduled to get about \$1.4 million in the Social Security and Medicare benefits versus the \$1 million for the couple retiring today. That is where all the growth in government is going, even while we derail almost everything else that government is about.

Now, there are other problems in Social Security. Social Security has really morphed into a middle-age retirement system. Typical couples now retire for close to three decades in terms of getting benefits, that is the longer living of the two. If people retired today for the same number of years as they did when physical demands of work were larger, that is, the retirement age of 68 that they retired on average in 1940, today they would be retiring at about age 76.

Meanwhile, all this pushing of more and more benefits to younger and younger ages relative to death means that fewer benefits, a smaller and smaller share of benefits are going to people who are truly old, which is the purpose of the program, and so soon close to one-third of adults will be on Social Security, retiring on average for about one-third of their adult lives.

Now, Social Security did do a good job in reducing poverty in its early years, but in recent years, despite spending hundreds of billions of dollars more every year, it has only made very modest progress on this front. Meanwhile, in the midst of a recession, when we are worried about the nonemployment rate going up, the

Social Security system encourages an increase in this nonemployment rate at the very time when our older members of our society are perhaps the most underused source of human capital in our economy and a group of people that we should be encouraging to work.

And then, finally, along with this long list of failures, the failure to provide equal justice just permeates the system. It discriminates against single heads of households, often abandoned mothers, it discriminates against spouses with relatively low earnings, it discriminates against those who bear their children before age 40, which is when most people bear their children, it discriminates against long-term workers and many, many others for which I provide details.

And then finally, as a couple other members of this panel have mentioned, the private retirement system also needs addressing because it leaves most elderly households very vulnerable.

Unfortunately, the Social Security debate has largely proceeded on the basis of being for the box or against the box. We have to sort of be for Social Security or against Social Security. The contents of the box, as I say, deserve scrutiny regardless of the size of the system overall.

So how might one break through this stalemate in a political way? While I applaud the efforts of the Simpson-Bowles Commission and the Bipartisan Policy Commission, I think we can go much further if we start with a basic set of principles and we just see where they lead us. Now some changes, by the way, would lead to an increase in benefits. Some changes might lead to a decrease in benefits, but we don't want to decide them one at a time. We want to see how the aggregate pulls together. So inevitably balancing my way should proceed in the following order.

So first consider reforms aimed at meeting Social Security's primary purposes, let's provide greater protections for those who are truly needy and for those who are truly old, let's support the work and saving base that is necessary to undergird the system and provide the taxes we need, that means we have to encourage work, and let's provide more equal justice for those suffering needless discrimination in the system. So some of the changes cost money, some raise money, but we shouldn't address them one at a time. After we do these changes, then we should come in and adjust minimum benefits even further, I have some suggestions in, adjust the rate schedules, adjust the indexing of benefits, so then we hit our targets for distribution and our targets for final cost.

Now, if you do what I say, we could work together across the aisle to fix up the system for the bottom half of the distribution and save, if you want to, that fight over whether higher income taxpayers are going to pay more taxes or if they are going to get reduced benefits, which is where the fight really leads.

So my testimony, as I say, provides a detailed way of engaging this type of reform process. It is largely the logic that I followed when I served as economic coordinator of the Tax Reform Act of 1986. I get called to testify all the time on how did we get this to work? Well, we started off to see where our principles led us, then we came back in, then we came back in and adjusted things like rate schedules, minimum benefits, things like that, to hit our dis-

tributational and revenue targets. It is the same type of suggestion I made to the Simpson-Bowles Commission on taxes.

Chairman JOHNSON. Your time has expired, can you close?

Mr. STEUERLE. That is the end of my recommendations. Thank you, Mr. Chairman.

[The prepared statement of Mr. Steuerle follows:]

In this testimony, I would like to focus mainly on one essential point: Social Security benefit reform is required, regardless of the current imbalances in the system and the level of taxes that are eventually raised to support the system.

Why? Despite Social Security's great success, its growth in lifetime benefits and taxes over time has been decreasingly targeted at its four major goals:

- financial support for those with limited resources,
- financial protection against the risks of old age,
- incentives for the work and saving that provide the revenues undergirding the system, and
- equal justice under the law.

Simply put, the benefit side of Social Security was designed for a different era, a period when many new workers were entering, not leaving, the workforce, and when there was a different (though, even then, stereotyped) view of the family. Many of these issues stretch well beyond Social Security. In particular, putting close to a third of all adults on Social Security reduces personal income, the growth rate of GDP, the ability of the elderly to support themselves when they are truly old, and the income tax and other revenues that support all government programs (not just Social Security). It also adds to the decreasing ability of our failed private retirement systems to provide an adequate additional leg of support for Americans.

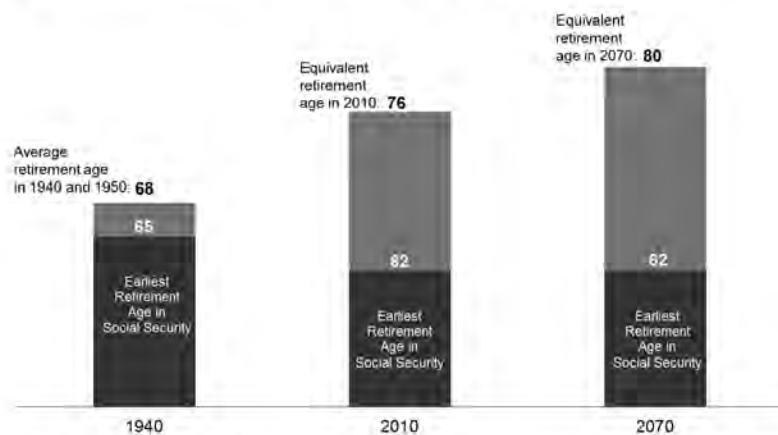
Especially in Social Security's early history, many people thought the program was highly progressive, in large part because its benefit formula provided higher replacement wages for those with lower lifetime incomes and then, a bit later, because it provided disability insurance. Over time, however, the system has been found to have many forms of redistribution, some of which are fairly regressive. Many features violate basic equity and efficiency principles without serving any fundamental purpose well.

To give you some examples of how far the system has moved from its fundamental purposes, consider the following:

Social Security now provides about \$579,000 worth of benefits (\$966,000 if one includes Medicare) to the newly retiring average-wage couple in 2013. Benefits will rise toward \$700,000 (\$1.4 million) for couples in their mid-40s today, even while programs for their children are scheduled to be cut.

Social Security has morphed into a middle-age retirement system. Typical couples are receiving close to three decades of benefits, while individuals retire on average at least a decade longer than they did when the system was first established. For a couple retiring today at age 62, benefits are expected to last about 28 years.

In 1940 and 1950, the average worker retired at about age 68. To live for an equivalent number of years on Social Security, a person would retire at age 76 today and age 80 in 2070 (figure 1). Instead, the average worker today retires at age 63 to 64.

Figure 1: Equivalent Retirement Ages in Social Security

Source: The Urban Institute, 2013. Based on data from the Social Security Administration, Birth Cohort Tables.

By constantly increasing benefits to middle-age retirees, at least as defined by life expectancy, smaller and smaller shares of Social Security benefits are being devoted to the elderly (figure 2). This threatens the well-being of the truly elderly by encouraging them to spend their retirement income too soon.

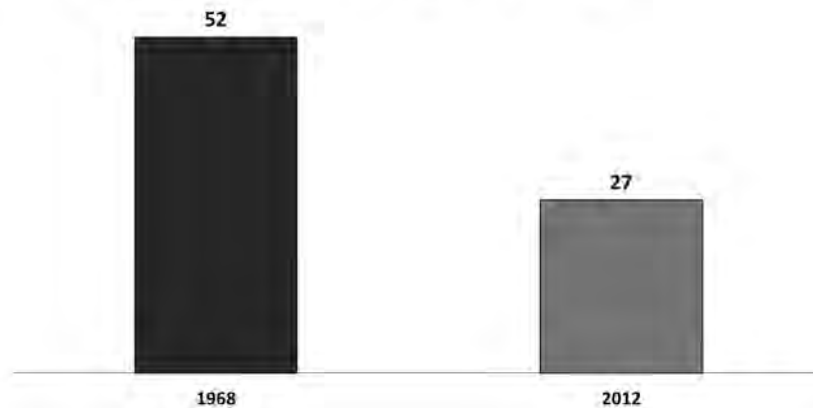
Soon close to a third of adults will be on Social Security, retiring on average for a third of their adult lives. This simply is not sustainable, no matter how well intentioned.

While Social Security did a good job reducing poverty in its early years, it has made only modest progress recently, despite spending hundreds of billions of dollars more over that time.

The program discourages work among older Americans at the very time they have become a highly underused source of human capital in the economy. Those work implications for national income and other revenue collections should be included when future Social Security reforms are undertaken. The failure to provide equal justice permeates the system. The existing structure discriminates against the working single head of household, the couple with relatively equal earnings between spouses, the long-term worker, and parents who start child-bearing in their 20s or 30s, among others. How can one engage in reform while perpetuating for all eternity a system that requires abandoned mothers to support spousal and survivor benefits for which they do not qualify, while providing differentials—often of hundreds of thousands of dollars of lifetime benefits—to families based solely on the age separation of the spouses, the age at which workers have children, whether a divorcee gets a divorce decree after nine years and 11 months or ten years and one month, the number of spouses a spouse has, or whether spouses' incomes are evenly or unevenly split?

At the same time, the lack of private retirement assets leaves many households quite vulnerable, especially as they approach truly old age. Many of these problems overlap. Saving declines because people retire in what used to be among their peak saving years. For instance, when a person retires for 20 years versus 15, he spends both five fewer years saving and five more years spending down his or society's savings.

Figure 2: Percentage of Men's Social Security Benefits Going to Men With Less Than 10 Years Remaining Life Expectancy



Notes: Calculations from the Social Security Administration's 2012 Annual Statistical Supplement. C.E. Steuerle and Caleb Quakenbush, The Urban Institute, 2013.

A Bipartisan Way Forward: Beyond Debating the "Box"

Those limitations lead logically to four types of benefit reforms:

- improving benefits for those with fewer means while restricting automatic growth in benefits where needs are least;
- adjusting benefits so they are more concentrated in older ages, both to improve protections and to encourage employment;
- removing many sources of inequity and inefficiency in the system that penalize beneficiaries ranging from low-income abandoned mothers to long-term workers; and
- reforming private pensions so they better protect the majority of workers who today end up with little in private retirement benefits.

Unfortunately, benefit design has been hard to interject into a Social Security debate largely proceeding on the basis of being "for the box" or "against the box," without regard to its

contents or size. The contents themselves deserve scrutiny to see how well each piece adheres to various principles of public policy and finance.

How might one break through the stalemate to try to find areas of mutual agreement? While I applaud the efforts of the Simpson/Bowles Commission and the Bipartisan Policy Commission and generally would favor their compromises over current law, I believe we can go much further in fixing this system if we start with a basic set of principles and follow them to their logical conclusion.

In particular, I very much encourage you to engage Social Security reform in a way that goes beyond what former presidential press secretary James Brady, among others, called the BOGGSAT method—a “bunch of guys and gals sitting around a table” [extended definition mine].

Looking through the political veil, it appears that disagreement centers largely on whether restoring balance is achieved through tax increases or a slowdown in benefit growth. Whether benefit cut or tax increase, those costs inevitably will be assessed mainly on above-average-income individuals, who pay most of the taxes and get most of the benefits. Therefore, that debate should not prevent proceeding in the following order:

First, consider reforms aimed at meeting Social Security’s primary purposes: providing greater protections for those truly old or with limited resources; supporting the work and saving base that undergird the system; and providing more equal justice for those suffering needless discrimination in the system, like single heads of household and longer-term workers. Some of those fixes cost money, and some raise money, don’t try to address trust fund and distributional consequences in each and every change.

Second, further adjust minimum benefits and the rate schedule and indexing of that schedule over time to achieve final cost and distributional goals. For instance, for those with higher incomes, cap benefits or use limited wage indexing; for middle-income workers, add another rate or extend the length of a rate bracket. The extent of these adjustments will also depend upon the tax rate and base structure agreed upon.

In table 2, I offer a combination of reforms that, if followed in steps, would much better meet the various goals of increasing progressivity, providing better protections for the old and those with lower lifetime incomes, providing better incentives for work and saving, and removing many of the ways in which the system provides unequal justice.

Background on Lifetime Benefits

In considering reform, I suggest examining the extent of benefits (and taxes) within Social Security—or, more broadly, within Social Security and Medicare—on the basis of lifetime benefits (and taxes), as opposed to making tradeoffs that would not be obvious when decisions about annual benefits, retirement age, indexing of benefits, premium cost for Medicare, and other features are considered separately.

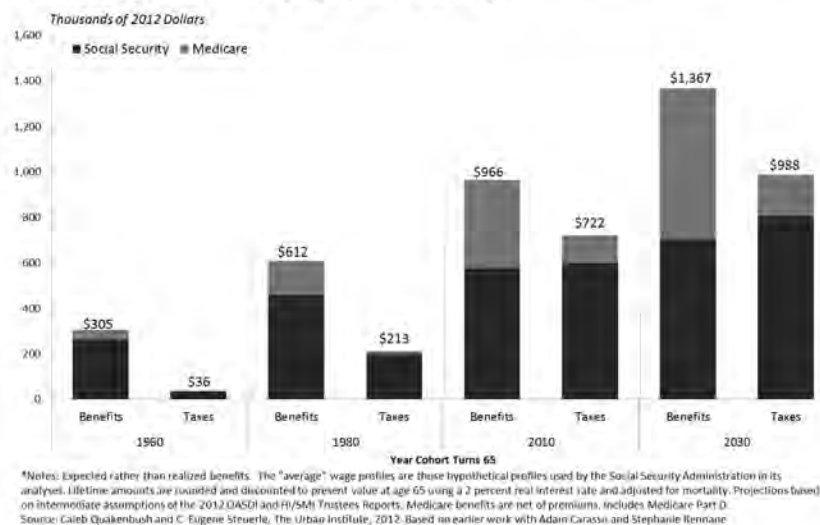
Here I define “lifetime benefits” as the value, at age 65, of Social Security and Medicare benefits as if the necessary monies were sitting in a 401(k) account that would earn interest but be drawn upon over retirement years. In today’s dollars, lifetime benefits for an average-income couple have risen from about \$305,000 in 1960 to \$966,000 today (\$579,000 in Social Security and \$387,000 in Medicare; see figure 3). Add in the backup insurance most of us have if we go

into a nursing home for any extended period, and the total approaches \$1 million per couple. Over the next two decades, the benefits grow by about \$401,000, or an average of more than \$20,000 a year.¹

Note that this automatic benefit growth occurs at the same time that the spending on children and on the nonelderly is largely scheduled to stagnate or decline.

When looked at from this perspective, it is not hard to conclude that we simply cannot provide a very large portion of the population significant growth in packages of benefits that for many already are at the \$1 million level or more, without severe consequences for our children and working families. These pressures play out on the broader budget not just because of the allocation of total spending but because Social Security (and government health insurance) in its present form encourages an increase in adult nonemployment (by encouraging an ever larger percentage of adults to retire) at the very time when the country is looking to increase the employment rate.

Figure 3: Social Security and Expected* Medicare Benefits and Taxes
Average Wage, Two-Earner Couple (\$44,600 each in 2012)



¹ C. Eugene Steuerle and Caleb Quakenbush, "Social Security and Medicare Taxes and Benefits Over a Lifetime: 2012 Update," <http://www.urban.org/publications/412660.html>. Based on earlier work done with Stephanie Rennane.

Conclusion

Reform of the Social Security benefit structure should be proceed on the basis of principles and goals related to adequacy, protections in old age, encouragement of work to protect the tax base on which programs like this depend, and equal justice under the law for those equally situated. Many features of current law violate basic principles of public finance without promoting other worthy goals in an effective or well-targeted manner.

Without being wedded to exact details, I have laid out in some detail how to go beyond the types of options put forward by the various commissions constrained in various ways, including staffing. In particular, I warn against the problems created when evaluating each design feature based on its budgetary or distributional effect. One should not support a provision throwing money off a roof in a poor part of a city just because it is progressive nor oppose an increase in benefits for the poor because by itself it would increase spending. After deciding the basic benefit base, one can go back through and achieve budgetary and distributional targets by further adjusting items, such as the benefit rate structure and minimum benefits.

In many ways, the process I am suggesting to you today largely follows the logic I applied to taxation when serving as the economic coordinator of the Treasury effort that led to the bipartisan-supported Tax Reform Act of 1986, and my testimony before the Simpson/Bowles Commission on how to engage tax reform as part of its broader budgetary reform.²

² Both the author and various researchers at the Urban Institute have over time advised and testified to these commissions on design of options and on various budgetary effects of both spending and tax proposals.

Table 1: Examples of Social Security's Redistributive Features

| Feature | Redistribution |
|--|---|
| Progressive benefit formula | High earners to low earners (Higher replacement rates for workers with lower lifetime earnings) |
| PAYGO financing | Younger to older generations and larger families to smaller families (Benefits based on earnings history, not contributions; tax rate has increased over time, shifting burden disproportionately to younger families and families with disproportionate numbers in younger generations) |
| Forced annuitization | Short-lived to long-lived (Those with shorter life expectancies will pay into the system but receive benefits for fewer or no years) |
| Disability Insurance | Healthy to unhealthy |
| Spousal and survivor benefits | Unmarried to married (Spouses pay no additional taxes for these benefits; single workers do not pay lower taxes and are not entitled to these benefits) |
| Dependent benefits | Smaller families to larger families |
| Crediting only limited number of years of contributions towards benefits | Long careers to shorter careers (Adults who work more than 35 years are not compensated for more years of contributions) |

Table 2: Steps to Reform Social Security
Stage One

Improve Adequacy for the Poorest and Most Vulnerable

- Provide a solid wage-indexed minimum benefit (not just the token one in many bills), indexed for inflation. The minimum should provide something like one that scales up by 2 percentage points per year of work from 80 percent of an individual wage-indexed poverty-level income at 10 years of work, to 100 percent with 20 or so years of work, to 140 percent with 40 or more years of work.
- Give minimum “earnings” credit and “years of work” credit for child-raising years—for example, an additional credit of \$10,000 of earnings for years spent raising a child under age 10. (This has been found to be a primary way of protecting the spouses for whom spousal and survivor benefits were intended but were unfairly and poorly targeted.)
- Back up this system by restoring the asset limits that used to apply in SSI (though, because assets and income are easy to transfer, do not depend upon SSI to deal with most distributional issues.)

Remove Impediments to Work and Threats to Adequacy in Old Age

- Over and above retirement-age adjustments already scheduled, index the retirement ages (in my example) or ages (in current law) so that the number of years of support does not automatically increase as life expectancy increases. Similarly, index various age-70 cutoffs in the system. (This is a stricter index than applied in other reform proposals, which continue to increase years of support over time, benefiting higher-income individuals more than lower-income ones.)
- Further increase the earliest retirement age by an additional 1 month a year for 36 years. (On net, this does not reduce lifetime benefits, and it moves the system back toward old-age rather than middle-age insurance.)
- Further backload to later ages whatever lifetime benefits are provided by lowering up-front benefits in exchange for higher benefits later. Such backloading is even more required if the COLA adjustment is lowered and problems like dementia continue to arise. One way to do this is to wage index benefits post retirement but then provide an equivalent actuarial reduction in the initial benefit level. Alternatively, provide periodic adjustments along the same order of magnitude. (Though this is meant to be roughly actuarially neutral; the goal is to protect better the very old, provide more resources when problems like dementia increase, and to further encourage the work required to support Social Security and other government programs.)
- Make clearer the option to get a better annuity, for instance, by declaring the retirement age at which maximum benefits are attained as age 70 (indexed), with appropriate actuarial reductions (similar to what is achieved through delayed retirement credits) for

those who take their benefits before then. (This is basically current law, but better understood.)

- Offer partial retirement options, as well as options to exchange money for a higher annuity to the extent already allowed in current law. (Workers now can buy the higher annuity by deferring Social Security receipt, but the relationship is poorly understood.)
- Eliminate the earnings test. (This test sends very confused signals to beneficiaries and discourages work for many who view it incorrectly as a tax.)
- If the full retirement age and gradual increase in the earliest retirement age are accepted, drop all reference to a “normal” retirement age.

Improve Equity and Efficiency

- Over a 30-year period, gradually adopt private pension equity rules on treatment of spouses and survivors.
 - A mandated survivors annuity is paid for out of the worker’s annuity. The survivor’s annuity must be at least 75 percent of the worker’s annuity.
 - Benefit sharing is required upon divorce, based on years of marriage.
- As in the private pension system, whatever spousal or survivor’s benefit is provided, make an actuarial age adjustments to account for the different ages of the spouses. (This provision’s purpose holds even in absence of the previous reform and is intended to remove the sources of discrimination against those who marry someone near to their own age.)
- Over the same 30-year period, gradually cap the level of existing free spousal and survivor benefits—those not paid for through actuarial adjustment. (The monies saved from these reforms are spent to partly support a better minimum benefit system and improvements through possible rate restructuring to help those below median benefit levels, as discussed below, and generally have been found to significantly reduce old-age poverty.)
- Change the benefit formula so it counts all years of work. (This removes some of the discrimination against long-term workers, adds to work incentives, and removes some of the discrimination, for those who delay benefit receipt, between those who work and pay taxes and those who do not.)
- Eliminate dependent benefits associated with old-age insurance, which go only to those (usually men) who decide to have children late in life, an unintended purpose of the system.

Stage Two

Re-examine Package to Insure Adequacy Goals

- Ensure that this combination of changes increases average benefits in all lifetime income ranges below the median by readjusting the minimum benefit (and first rates and

brackets) in the benefit formula. This could require some rate changes in existing brackets, a new fourth rate, or a lengthening or shortening of a middle bracket. It may also require more than one adjustment over time, depending upon how changes are phased in. For instance, it was my intent to use the gradual changes in spousal and survivor benefits to help pay for this more progressive overall system.

Achieve and Guarantee Long-Term Balance

- Maintain long-term balance even after any reform is enacted through automatic adjustments in retirement age, maximum benefits, or reduced wage indexing above median benefit levels whenever the system is projected to be out of long-term balance in more than five straight annual reports. For instance, cap all growth in expected lifetime benefits for a couple with combined Social Security and Medicare benefits of more than \$1 million or, say, \$700,000 in Social Security.

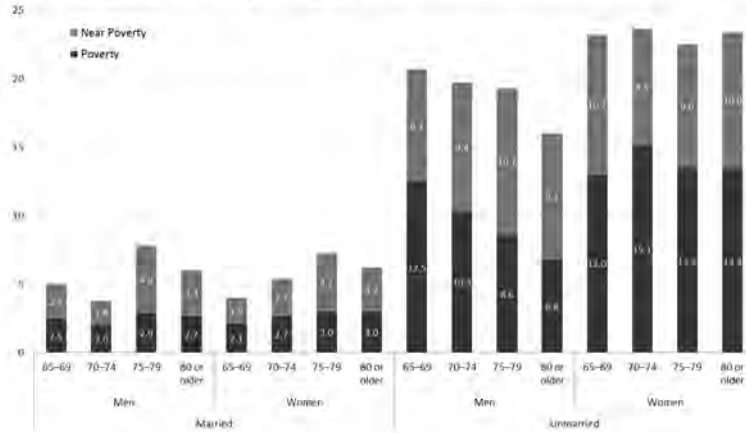
Relationship to Revenues

- The benefit package here suggested would add to revenues because of the additional work the reforms would generate.
- The extent to which overall benefit growth rates are slowed will depend upon what tax changes are also implemented. That is, these benefit changes would create a much fairer, progressive, and efficient system regardless of whether it becomes larger, smaller, or the same overall size as now. For instance, I also favor an increase in the share of compensation subject to tax because of continual expansion in both the employee benefits avoiding Social Security tax and in the share of earnings above a taxable maximum. Thus, this type of benefit reform analysis could be done at different revenue levels.

Private Pension Reform

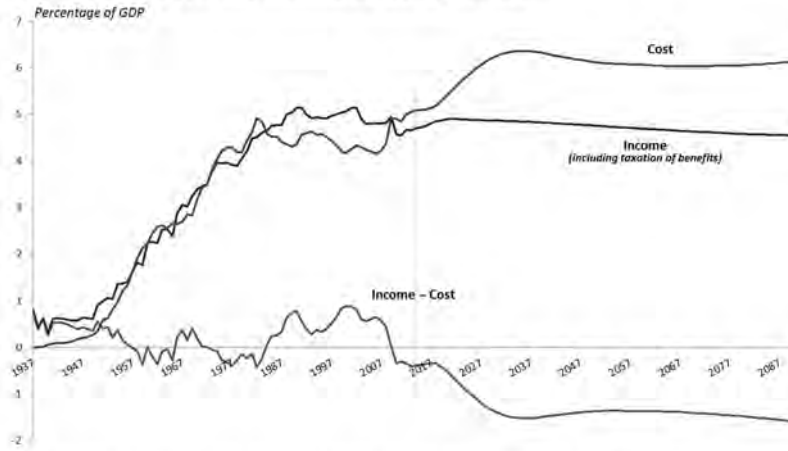
- Back up the Social Security reform with a private pension reform that makes receipt of many types of pension benefits dependent upon some minimum employer contribution for almost all workers, along with a higher savers' credit and an opt-out provision for employee contributions (like the SIMPLE Plan, only with more teeth). Provide additional incentives for private pension and retirement plans that set a minimum contribution level for each worker, and provide additional disincentives for those plans that do not set such a minimum. Among the incentives that can be considered are enhanced savers' credit and removal of complicated discrimination rules for plans providing such a minimum. Among the disincentives would be a lower or unindexed level of maximum contribution for plans not meeting the new standards.
-

Share of Aged Social Security Beneficiaries with Low Income, by Gender, Marital Status, and Age, 2010



Social Security Administration, 2010, "Income of the Population 55 or Older" Table 11.3.

Social Security Cost and Income, Excluding Interest



Source: Data from 2012 OASDI Trustees' Report and Statistical Supplement. Projections assume intermediate Cost Scenario. Yearly income only. Caleb Quakenbush and C. Eugene Steuerle, The Urban Institute, 2012. Based on earlier work with Stephanie Remane.

Chairman JOHNSON. Mr. Lorenzen, thank you for braving the traffic in Washington today. I had the same problem, so I understand it. Thank you, you are recognized.

**STATEMENT OF ED LORENZEN, EXECUTIVE DIRECTOR, THE
MOMENT OF TRUTH PROJECT, COMMITTEE FOR A RESPONSIBLE
FEDERAL BUDGET**

Mr. LORENZEN. Thank you. Good morning, Mr. Chairman, Members of the subcommittee, it is a pleasure to be before you again to talk about the recommendations of the final report of the Simpson-Bowles Commission regarding Social Security, particularly those regarding benefit formula and retirement age. I would also like to associate myself with all the comments of Mr. Steuerle, whose advice and writings had a major impact on the work of the Commission, even if we were not as aggressive as he would like.

The executive order that created the Fiscal Commission charged the Commission with two mandates, one to identify policies to improve the fiscal situation in the medium term, but also to achieve fiscal sustainability over the long term. Commission members had differences of opinion of the role of Social Security in the medium-term fiscal outlook, but there was a general consensus among Commission members that meeting the mandate of improving the long-term fiscal sustainability required looking at the Social Security system and making the Social Security program sustainably solvent.

Therefore, the recommendations in that count Social Security reform in meeting deficit reduction in the near term but were important for long-term recommendations. In the report, we outlined the approach the Commission took this way: To save Social Security for the long haul, all of us must do our part. The most fortunate will have to contribute the most by taking lower benefits than scheduled and paying more in payroll taxes. Middle-income earners who are able to work will need to do so a little longer. At the same time, Social Security must do more to help reduce poverty among the very poor and the very old who need help the most.

The provisions in the Commission's report directly affecting benefits, including changes in the benefit formula, retirement age, and cost of living adjustments, among other changes were responsible for approximately 60 percent of the savings over 75 years, and the provisions related to revenues, increasing the taxable maximum faster than current law and requiring State and local workers to pay into the system were responsible for approximately 40 percent of the savings over 75 years, but if you look in the 75th year, the net increase in revenues would be—just 22 percent of the shortfall in the 75th year, and that is why we felt it was necessary to include changes in the benefit formula in the retirement age to make the program sustainably solvent.

So the first area of benefit changes we recommended were gradually moving to a more progressive benefit formula, which would slow the benefit growth relative to the current law, particularly for workers with incomes above the median. Specifically, the plan would gradually phase in changes and replacement rates of 90, 32, and 15 percent under current law to 90, 30, 10, and 5 percent by 2050, phased in over a 30-year period. The current 32 percent

bracket would be split at the median income level and ultimately reduced to 30 percent, so there would be only a very modest change in the benefit formula for workers with incomes below the median level.

Future retirees would receive higher benefits than can be provided under current law for most seniors, except for the highest earning workers. Because the bend point factors would continue to be wage indexed, full benefits would continue to grow faster than inflation for nearly all beneficiaries and grow nearly as fast as wages for those in the bottom 50 percent of income distribution.

One of the Commission's key principles was that Social Security must ensure the program will meet its basic mission to prevent people who can no longer work from falling into poverty. In order to achieve this goal, the Commission recommended creating a new minimum benefit, which would provide stronger poverty protections than current law, and reduce poverty among seniors relative both to current law scheduled benefits and payable benefits.

The minimum benefit would provide a full career minimum wage worker with a benefit equal to 125 percent of poverty, and the minimum benefit would then be indexed to wages, which would provide substantially stronger poverty protection over time.

Although the plan in the final report of the Commission would provide substantially higher benefits for most low-income workers, we did find that there were unintended consequences with a slight reduction in median benefit for workers in the bottom quintile, and the Commission cochairs committed to the members of the Commission to identifying changes to address that concern, and we spent a great deal of time over the last couple of years looking at ways to tweak the minimum benefit and the benefit formula in order to do so.

I have outlined those changes in my testimony, and I would say that with those changes, we would have substantially stronger poverty protections than current law, and relative to payable benefits would have 50 percent reduction in poverty and relative to scheduled benefits a 10 percent reduction. One of the key lessons I also learned in this process was the importance of looking at workers with intermittent work histories who often have—were most likely to fall short of the adequate benefits and not always protected by minimum benefit provisions, but in doing so, it is important to distinguish between those who truly are low-income workers and those who simply look like they are a low-income worker based on the Social Security income calculations, but in fact, were relatively affluent because they had a great deal of earnings over their lifetime that were not covered by Social Security for working abroad, uncovered employment, and the like.

Chairman JOHNSON. Can you close it down?

Mr. LORENZEN. Certainly. Finally, we had increases in the retirement age, we indexed the retirement age to longevity. Both the early retirement age and the normal retirement age under the current projections would be growing by 1 month every 2 years. However, it is—would actually be based off the increases in longevity, therefore if longevity is growing faster than currently projected, the age would increase more rapidly, but conversely if the longevity

grows more slowly, the retirement age would grow less aggressively.

Chairman JOHNSON. Thank you.

[The prepared statement of Mr. Lorenzen follows:]

Testimony of Ed Lorenzen
 Executive Director, The Moment of Truth Project
 Senior Advisor, Committee for a Responsible Federal Budget
 Before the Subcommittee on Social Security
 Committee on Ways and Means
 U.S. House of Representatives
 May 23, 2013

Introduction

Mr. Chairman, Ranking Member Becerra, and members of the subcommittee, I appreciate the invitation to appear before you today to discuss the recommendations in the final report of the National Commission on Fiscal Responsibility and Reform regarding the Social Security program, specifically the recommendations related to the benefit formula and eligibility age.

I am the Executive Director of the Moment of Truth Project, a project of the Committee for a Responsible Federal Budget that was created to build on and continue the work of the National Commission on Fiscal Responsibility and Reform (also known as the Simpson-Bowles Commission) and which is co-chaired by Fiscal Commission Co-chairs Erskine Bowles and Alan Simpson. I was a staff member on the Fiscal Commission and was involved in development of all policies in the final report, including the Social Security reform recommendations.

The Executive Order establishing The National Commission on Fiscal Responsibility and Reform charged the Commission with “identifying policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run” and “proposing recommendations that meaningfully improve the long-run fiscal outlook.”¹ Commission members had differences of opinion regarding the role of Social Security in the medium term fiscal outlook, and the final report did not use savings from Social Security to meet the medium term goal set out in the executive order of achieving primary balance and stabilizing the debt. However, the overwhelming majority of Commission members agreed that reforming the Social Security system to make the program sustainably solvent was an essential part of meeting the mandate in the executive order of achieving fiscally sustainability over the long run.

The Commission proposed a balanced plan that would eliminate the 75-year Social Security shortfall and put the program on a sustainable path thereafter. The report outlined the overall approach the Commission took in developing the recommendations to make Social Security sustainably solvent this way:

“To save Social Security for the long haul, all of us must do our part. The most fortunate will have to contribute the most, by taking lower benefits than scheduled and paying more in payroll taxes. Middle-income earners who are able to work will need to do so a little longer. At the same time, Social Security must do more to reduce poverty among the very poor and very old who need help the most.”²

¹ Executive Order 13531 -- National Commission on Fiscal Responsibility and Reform, February 18, 2010

² National Commission on Fiscal Responsibility and Reform. (December 2010): http://www.momentoftruthproject.org/sites/default/files/TheMomentofTruth12_1_2010.pdf

The Commission's Social Security plan included a number of changes to benefits as well as taxes. Specifically, the Fiscal Commission plan would have modified the benefit formula to make it more progressive, established a new "minimum benefit" for low income workers, increased the taxable maximum, switch to the chained CPI for cost-of-living adjustments, provide a progressive benefit bump-up for beneficiaries who have been receiving benefits for twenty years, including all newly-hired state and local workers in the program and make other changes and improvements in the program.

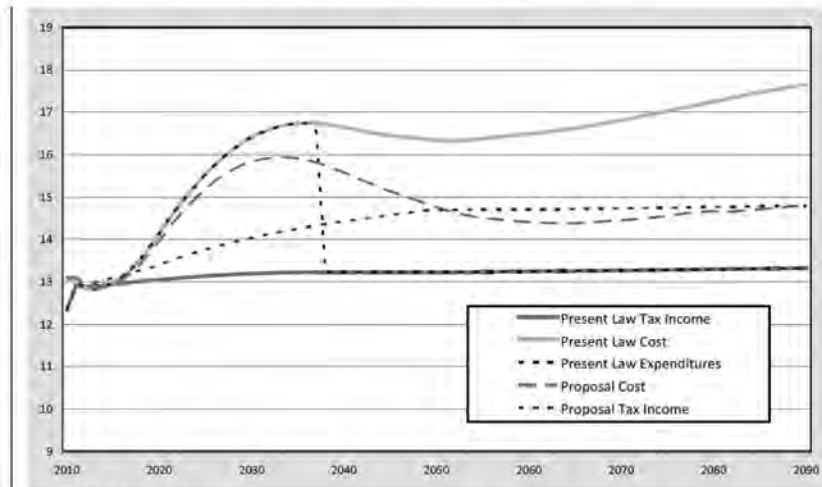
Figure 1 Fiscal Commission Social Security Plan

| | 75- Year | 75th Year |
|---|-------------|--------------|
| Gradually phase in progressive changes to benefit formula, modifying PIA factors to 90% 30% 10% 5% by 2050 | 45% | 51% |
| Offer minimum benefit of 125% of poverty for an individual with 25 years of work; index minimum benefit level to wage growth | -5% | -6% |
| Index normal retirement age (NRA) and earliest eligibility age to longevity so that they grow about 1 month every two years; include a "hardship exemption" | 18% | 30% |
| Provide benefit enhancement of 5% of the average benefit (over 5 years) for individuals who have been eligible for benefits for 20 years | -8% | -6% |
| Gradually increase taxable maximum to cover 90% of earnings by 2050 | 35% | 22% |
| Apply refined cost of living measure (chained-CPI) to COLA | 26% | 17% |
| Cover newly hired state and local workers after 2020 | 8% | 0% |
| Share of Existing Shortfall Closed (2010 Trustees Projections) | 112% | 102% |

As shown above, the plan relied on a mix of changes in benefits and revenues to restore solvency, with the net reduction in costs from benefit changes responsible for slightly over 60 percent (61.6%) of the savings over seventy five years and net increase in revenues responsible for just under 40 percent (38.4%) of the savings.

However, the net increase in revenues would close a declining portion of the shortfall over time, closing just 22 percent of the shortfall in the 75th year, while the portion of the shortfall closed by benefit changes were greater over time. These numbers underscore why changes in the benefit formula and retirement age were essential to achieving the goal of making the program fiscally sustainable over the long term, as opposed to simply achieving actuarial balance over a seventy five year period while leaving the program on a path where costs will once again exceed revenues by ever larger amounts in the future. As you can see from the graph in Figure 2, the Commission plan would reduce the annual cash shortfalls facing the Social Security system substantially over the next four decades, bringing annual costs in line with revenues by 2050 and keeping costs and revenues roughly in line for the remainder of the evaluation period.

Figure 2: Commission Plan and Present Law Cost and Tax Income as Percent of Taxable Payroll: 2010 Trustees Report Intermediate Assumptions



Source: SSA Actuaries

Progressive Changes in Benefit Formula

Because the costs of providing the benefit levels promised under current law will grow more rapidly than projected revenues, the Commission recommended gradually moving to a more progressive benefit formula that slows future benefit growth relative to current law, particularly for higher earners. Under the Commission recommendations, future retirees would receive higher initial benefits than can be provided under current law (since benefits are limited to payroll tax revenue) for most seniors, except the highest earning workers.

Under current law, initial benefits are calculated using a progressive three-bracket formula that offers individuals 90 percent of their first \$9,000 of (wage-indexed) average lifetime income, 32 percent of their next \$55,000, and 15 percent of their remaining income, up to the taxable maximum. Under the Commission proposal, the current formula would gradually transition to a four-bracket formula that would split the middle bracket in two at the median income level and beginning in 2017 very gradually change the replacement rates from 90 percent, 32 percent, and 15 percent to 90 percent, 30 percent, 10 percent, and 5 percent by 2050. By splitting the middle bracket at the median income level, the plan would limit the change in the benefit formula for workers with incomes below the median benefit level to the modest reduction in the 32 percent factor under current. Additionally, because the bend point factors would continue to be wage-indexed, full benefits would continue to grow faster than inflation for nearly all beneficiaries – growing nearly as fast as wages for those in the bottom 50 percent of the income distribution.

Figure 3: Changes to Social Security Bend Points

| Bend Point Locations in 2013 | Current Law (2013) | FC Report (2050) | Projected Bend Point Locations in 2050 (in 2013 Dollars) |
|------------------------------|--------------------|------------------|--|
| \$0 to \$9,500 | 90% | 90% | \$0 to \$15,500 |
| \$9,500 to \$43,000 | 32% | 30% | \$15,500 to \$70,000 |
| \$43,000 to \$57,000 | | 10% | \$70,000 to \$93,000 |
| \$57,000 to \$114,000 | 15% | 5% | \$93,000 to \$173,000 |
| >\$114,000 | n/a | | \$173,000 to new tax max |

Note: All numbers are staff estimates and rounded to the nearest \$1000.

Enhanced Benefits for Low-Wage Workers

One of the Commission's key principles was that Social Security reform must ensure the program will continue to meet its basic mission: to prevent people who can no longer work from falling into poverty. In order to more effectively achieve this goal, the Commission recommended creating a new special minimum benefit which would provide stronger poverty protections than current law, and reduce poverty among seniors relative both to current law scheduled benefits and payable benefits.

The minimum benefit recommended by the Commission would provide a full-career (30-year) minimum wage worker with a benefit equivalent to 125 percent of the poverty line in 2017 and wage-indexed thereafter. For workers with 10 to 30 years of earnings, the minimum benefit would be phased down. Additionally, the work requirement in the minimum benefit is scaled down for disabled workers, to account for their shorter work histories. Because the minimum benefit would be *wage-indexed*, it ensures the initial benefit levels for low-income workers will grow as fast as or faster than benefits for middle- and high-income workers. Meanwhile, it would provide substantially stronger poverty protection over time, since wages grow faster than the poverty level, which is indexed to price inflation. By 2050 (when reductions in the benefit formula are fully phased in) an individual with 30 years of work would be guaranteed a benefit closer to 200 percent of the poverty line, and someone with 20 years closer to 100 percent. By the end of the 75 year window, these guarantees would be approximately 300 percent and 150 percent of the poverty line, respectively.

While the Commission plan would improve the progressivity and equity of the Social Security system and provide greater protections for vulnerable populations than current law, particularly with the modifications outlined below, Congress should consider further reforms to advance these goals. In doing so, policymakers should give special consideration to individuals with an intermittent or limited work history, who are especially likely to receive an inadequate Social Security benefit under current law.

However, when considering additional protections for individuals classified as low-earners for purposes of Social Security with limited work histories, Congress should take care to target assistance to individuals who truly are indeed low income – a difficult task considering that

current measures identify some relatively affluent individuals (such as those who spent much of their lives in non-covered employment, as spouses of high-earners, or who receive substantial earnings from investment income).

The Commission also advised that as lawmakers design the details of the new special minimum benefit, special consideration should be given to individuals with intermittent work histories and workers with low lifetime earnings who have limited work histories. To ensure that individuals are not made worse off overall by losing eligibility for other benefits, the Commission recommended the new minimum benefit be accompanied by changes in eligibility rules for Medicaid and Supplemental Security Income (SSI).

Modifications to Achieve Commission Goal of Protecting Bottom Quintile

While the minimum benefit and other provisions would provide improvements in poverty, Although the plan outlined in the final report would increase benefits for many low-income workers and reduce poverty among seniors, some tweaks of the minimum benefit and benefit formula outlined in the Commission's report will be necessary in order to fully achieve the intent of Commission members who supported the final recommendations regarding protecting benefits for workers in the bottom quintile.

Subsequent analysis of the original plan found that the plan would result in a slight reduction in scheduled benefits for the median retiree in the bottom quintile, primarily because a number of future retirees with short or intermittent work histories would not be adequately protected by the new minimum benefit which was targeted toward full-career workers. Upon learning of this unintended consequence, the Commission co-chairs reiterated their commitment to the members of the commission and asked staff to eliminate the benefit reduction in the bottom quintile.

In order to fulfill this commitment, Moment of Truth Project staff worked with the Urban Institute to identify two modifications which together would achieve the goal of avoiding a reduction for the median retiree in the bottom quintile. The first modification would make the formula change even more progressive by increasing the bottom replacement factor from 90 percent to 95 percent and establishing the 10 percent bend point at the 40th percentile (the Commission's 2010 report put it at the 50th percentile). The second modification would phase-up the minimum benefit more rapidly for retirees with less work history –from 0 to 110 percent of poverty between 10 and 20 years of work history, then to 125 percent for 30 years and 140 percent for 40 years – and credit workers for quarters of coverage toward the minimum benefits in years with less than four quarters of coverage. In addition, several anti-abuse measures would be added to the minimum benefit to prevent certain wealthier individuals with substantial retirement income from outside Social Security from over-collecting.

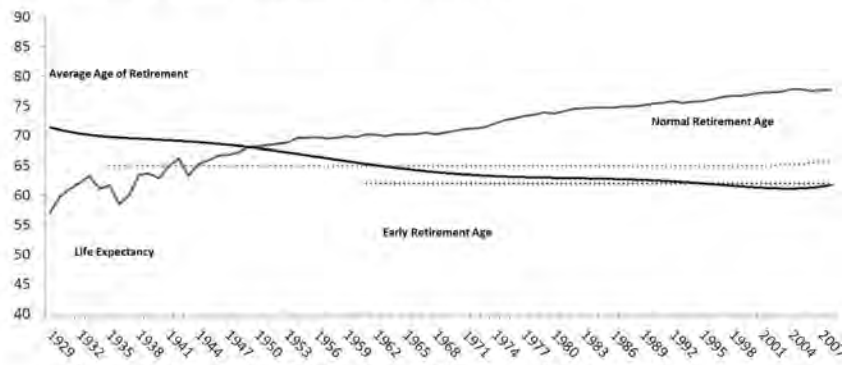
With the appropriate design details, these two changes would be roughly cost-neutral, but would offer far more robust benefits for those in the bottom quintile and far better poverty protections than was provided either in the original Commission plan or under the current system.³

³ In this particular formulation, the minimum benefit would be phased in between 2017 and 2023 to avoid benefit notches and would be calculated based on the poverty line through 2023, after which it would be indexed to wage growth.

Indexing the Social Security Normal Retirement Age (NRA) and Earliest Eligibility Age to Increases in Longevity

Since Social Security was established, there have been tremendous gains in life expectancy at birth – yet the average retirement age has continued to fall. Today, the average retirement age is about 61 -- (not so) coincidentally the almost the same time that Social Security begins offering benefits – with the Earliest Eligibility Age (EEA) currently at age 62.⁴ Meanwhile, life expectancy at age 65 has increased by 5 years since 1940, and continues to rise annually.⁵

Figure 4: Life Expectancy and Retirement Ages over Time



Source: Social Security Administration and U.S. Census Bureau

Moreover, there is no reason to believe that the trend toward retiring at an early age and spending more years in retirement is due to physical hardships that would be exacerbated by an increase in the retirement age. As Social Security Trustee Charles Blahous explains, “physical inability to work is not the sole or even the primary determinant of workforce participation rates for those in their 60s. In 1955, 57% of American males aged 65-69 were in paid employment. By 1975, this had declined to 32%. This wasn’t because American workers in 1975 were suddenly breaking down where those in 1955 had been leading comfortable, sedentary lives.”⁶

To account for increasing life expectancy, the Commission recommended indexing the retirement age to gains in longevity. Under the Social Security Trustees current longevity assumptions, this would result in to increasing the retirement ages by one month every two years after the NRA reaches age 67 under current law. At this pace, the NRA would reach 68 around

⁴Gallup, (May 2013): <http://www.gallup.com/poll/162560/average-retirement-age.aspx>

⁵ Social Security Administration: <http://www.ssa.gov/history/lifeexpect.html>

⁶ Charles Blahous, *Slowing Down Social Security’s Retirement Age Increase* (e21, November 2010): <http://economics21.org/commentary/slowing-down-social-security-retirement-age-increase>

2050 and 69 by around 2075. The EEA would increase at the same rate, reaching 63 around 2050 and 64 by 2075. The exact rate of increase in the retirement age would depend on future increases in longevity. The slow phase-in of the benefit formula reduction and retirement age increase were specifically designed to minimize the effect on those in or near retirement while giving time for younger generations to better plan for their retirement.

Indexing the retirement age to longevity as opposed to setting a fixed schedule for increasing the retirement age provides additional robustness to ensure that the program remains on a fiscally sustainable course even if actual outcomes differ from projections. If medical breakthroughs or other factors cause life expectancy to increase faster than currently projected, the increase in the retirement age would be accelerated by a corresponding amount to offset most, but not all, of the increased costs from beneficiaries spending more years in retirement. At the same time, if current projections overstate the growth in beneficiaries from increasing life expectancy (which is one of the primary differences between the Trustees "low cost" projections which show a smaller shortfall and the "intermediate" projections that are commonly used), the increases in the retirement age would be smaller.

The Commission's approach would maintain a constant ratio of years in retirement to years in adulthood. As life expectancy grows by one year, individuals will still be able to spend an additional 4 months in retirement, as compared to today. The American Academy of Actuaries noted in a letter sent to the Commission that for all the years that the retirement age remained fixed (and even after adjustments included in 1983 legislation), retirees have been getting a de facto benefit increase, since they will spend more years collecting benefits in the system than previous generations.⁷ Moreover, the Academy argued this increase comes on top of the fact that initial benefits grow with wage inflation and retirees have (for the most part) received annual cost-of-living adjustments. In other words, just as the changes in the benefit formula in the Commission plan would still result in initial benefits for future retirees that are higher than the initial benefits for current retirees for all but the highest income workers, the increase in the retirement age recommended in the plan would still allow future retirees to receive benefits for more years than current retirees.

Hardship Exemptions

The Commission recognized that increasing the retirement age could pose a hardship for those who may not qualify for disability benefits, but are physically unable to work beyond the current EEA. To protect this population, the Commission recommended that the Social Security Commissioner design a hardship exemption to allow up to 20 percent of retirees to claim benefits at age 62 as the EEA and NRA increase, and be held harmless from additional actuarial reduction resulting from increased NRA. The decision to set aside resources for a hardship exemption for up to 20 percent of retirees was based on an analysis conducted by the RAND Corporation for AARP, which found that that 19 percent of early retirees reported a work-limiting health condition that would have prevented them from participating in the labor force.

⁷ American Academy of Actuaries, (October, 2010):
http://www.actuary.org/pdf/Fiscal_Commission_Retirement_Age_102510.pdf

The Commission recommended charging the Social Security Administration with designing a policy over the next ten years that best targets this population, and directing the Commission to consider relevant factors such as the physical demands of labor and lifetime earnings in developing eligibility criteria, instead of specifying the criteria for the hardship exemption. There is limited data about the reasons workers retire early and analysis about which workers who retire before Normal Retirement Age do so for reasons of convenience as opposed to those for whom delaying retirement would pose a hardship. The Commission decided that further research and analysis is necessary to accurately identify the workers for whom an increase in age would pose a hardship and develop appropriate criteria for determining hardship. In addition, there would be time for SSA to conduct research and properly design a hardship exemption before the increases in retirement age began.

Economic Benefits of Increasing the National Retirement Age

Over the next several decades, population aging will not only drive up entitlement costs by creating new retirees, but it will crowd out other important investments. A study from the Third Way found that in 1962, about 32 cents of every federal dollar, excluding interest payments, was spent on investments, while only 14 percent was spent on entitlements. Today, we spend less than 15 cents on investment and roughly 46 cents on entitlements. By 2030, when the last of the baby boomers have surged onto the Social Security rolls, entitlements will consume 61 cents of every federal dollar, starving our already neglected investment and leaving us, in the words of the study, with “a less-skilled work force, lower rates of job creation and an infrastructure unfit for a 21st-century economy.”⁸

Population aging will also undermine the revenue base by decreasing the relative number of tax-paying workers. An older society is also a slower growing society, as there are fewer workers and less net savers in the economy. But it is possible to change the dependency ratio by getting people to work longer. In this way, we could turn would-be retirees into workers, improving income tax revenue, labor supply, savings and investments (and therefore capital stock), and individual retirement security.

The Social Security Normal Retirement Age serves as a powerful signal for retirement, and gradually increasing it would likely encourage those who can to work longer, thereby helping to reduce Social Security's shortfalls. Even more powerful is the Earliest Eligibility Age. Raising this age would not only encourage longer working lives, it would protect retirees from receiving permanently lower benefits by accepting the full downward actuarial adjustment that comes with retiring early. (Of course policymakers would need to think through how to protect those who truly cannot work beyond 62 – perhaps by strengthening the disability system.)

According to a report issued by the Congressional Budget Office last year, raising the normal retirement age by 3 years would increase the size of the economy by 1 percent by 2035 as a result of people working longer.⁹ Raising the early retirement age by 2 years would have a similar effect. And this is before accounting for any potential growth from increased savings or from smaller deficits.

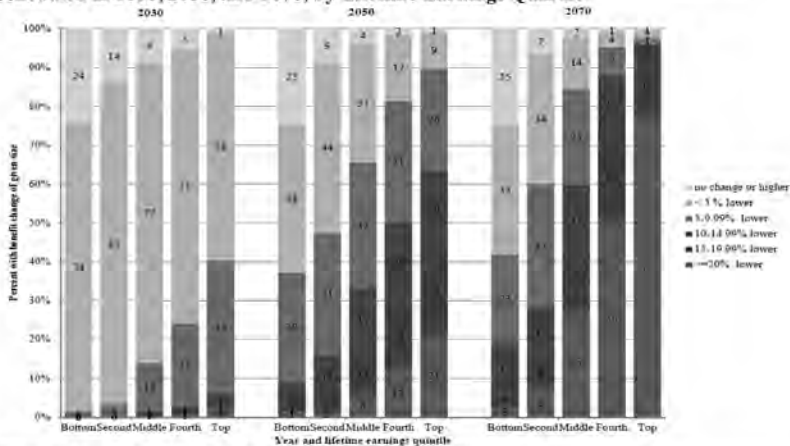
⁸ Third Way (July 2012): <http://www.thirdway.org/publications/564>

⁹ CBO, (January 2012): *Raising the Ages of Eligibility for Medicare and Social Security*. <http://cbo.gov/publication/42683>

Distributional Impact of Increasing the National Retirement Age

Some have argued that raising the retirement age is regressive because wealthier recipients tend to live longer. That fact alone does not make raising the NRA regressive, it makes the Social Security program regressive as is. However, this is offset by the progressive benefit formula. Increases in the retirement age would result in a roughly equal reduction in lifetime benefits for all beneficiaries who first collect through the retirement program. As a technical matter, raising the NRA leads to a reduction in benefits at any given age. For example, someone retiring at age 62 might see their benefits reduced to 25 percent lower than if they retired at 65, rather than 20 percent. As a result, raising the normal retirement age affects people of all income roughly equally and is in fact slightly progressive. The actual effects of an increase in the retirement ages are slightly progressive because it is a benefit cut that *exempts* those who first collect through the disability system – who tend to be lower income.

Figure 5: Projected Adult Social Security Benefit Changes Relative to Current Law Scheduled in 2030, 2050, and 2070, by Lifetime Earnings Quintile



Source: Urban Institute Retirement Policy Program, based on DYNASIM3 (run 810).
 Notes: Shared lifetime earnings are defined as the average of indexed earnings from ages 22 through 62 (or year of disability, whichever is first). (The index used is Social Security's Average Wage Index.) Quintiles are defined for the Social Security beneficiary population in the selected year by cohort, not the overall population.

Options for Phased Retirement

In recognition of the diverse retirement experiences and needs, the Commission's proposal introduced significant new flexibilities and protections in addition to an indexed retirement age. They suggested the option of allowing beneficiaries to collect up to half of their benefits as early as age 62, with applicable actuarial reduction, and the other half at a later age (therefore incurring a smaller actuarial reduction).

While designing such an option presents challenges, policymakers should consider options such as this to provide increased flexibility for a smoother transition for those interested in phased retirement, or for households where one member has retired and another continues to work.

Impact of the Simpson-Bowles Plan on Benefits

Under the Fiscal Commission plan, initial benefits would continue to grow faster than inflation for all income groups – meaning workers today will receive higher benefits than current retirees. By making the program sustainably solvent, Simpson-Bowles prevents a 25 percent across-the-board benefit reduction in 2033. As a result, all but the highest earning workers would receive higher benefits under Simpson-Bowles than under current law. Importantly, benefits for the lowest earning workers would be greater than they would be under both current law scheduled benefits and payable benefits, resulting in a reduction in elderly poverty of more than ten percent relative to a baseline which assumes current law scheduled benefits and by fifty percent relative to a baseline which assumes the reduction in benefits under current law when the trust fund is exhausted.

Figure five shows the Social Security Administration's Chief Actuary's estimates of benefit levels under the Commission plan and current benefit projections various scenarios in 2050 – when today's 30 year olds would be reaching the normal retirement age under Simpson-Bowles.¹⁰ It is important to note that these estimates look at *initial benefits* at the *normal retirement age* – meaning they separately account for the fact that individuals would need to work a year longer under the Commission's plan (first row)

Figure 6: Simpson-Bowles Impact on Initial Benefits at Normal Retirement Age

| Initial Benefits at Normal Retirement Age (2012 Dollars) | | | | | | |
|---|-------------|-------------|---------------------------|-------------------------|----------------------|---------------------------------|
| | 1990 | 2010 | 2050 Scheduled | 2050 Payable | 2050 S.B. | S.B. as % of Payable |
| Normal Retirement Age | 65 | 66 | 67 | 67 | 68 | +1 |
| Very Low Earner | \$7,100 | \$8,500 | \$13,700 | \$10,400 | \$19,200 | 184% |
| Low Earner | \$9,300 | \$11,100 | \$18,000 | \$13,600 | \$19,200 | 141% |
| Medium Earner | \$15,300 | \$18,400 | \$29,600 | \$22,500 | \$27,700 | 123% |
| High Earner | \$19,000 | \$24,400 | \$39,200 | \$29,900 | \$32,000 | 107% |
| Maximum Earner | \$20,600 | \$29,000 | \$48,300 | \$37,000 | \$36,000 | 98% |

Source: SSA

¹⁰SSA, (December 2012): http://www.ssa.gov/oact/solvency/FiscalCommission_20101201.pdf

For most beneficiaries retiring in 2050, the Commission's plan would be more beneficial than the status quo, and in some cases much better. Those classified as "very low earners" would receive annual benefits of \$19,200 per year if they retired at the normal age – compared to the \$10,400 they would receive (retiring a year earlier) under current law and the \$8,500 they receive today. Even those classified as "high earners" would still receive more than is payable at the normal retirement age and almost as much as payable at age 65.

While most earners would receive far more under the Commission's proposal than under current law, the very highest earners would not only receive less in benefits, but would also pay more in taxes than what is currently scheduled. This highlights one of the Commission's key principles – to make the benefit formula more progressive. At the same time, most workers would be asked to work modestly longer under – about one year more than scheduled by 2050 and two years more by 2075 (though about 20 percent would receive a "hardship exemption").

Conclusion

Arthur Altmeyer, one of the architects of the original Social Security Act, famously said: "Social security will always be a goal, never a finished thing, because human aspirations are infinitely expandable--just as human nature is infinitely perfectible."

The Commission's recommendations would strengthen Social Security and would have made it financially sound for the next seventy five years and beyond, but further reforms beyond those recommended in the commission report should be considered. Unfortunately, since the Fiscal Commission proposal was released, the 75-year actuarial shortfall has increased substantially – from 1.92 percent of taxable payroll back in 2010 to 2.67 percent today.

In addition, as more sophisticated analysis by the Social Security Administration and others becomes available, policymakers are able to identify inequities in the system and better refine policy changes to achieve the desired results. I would strongly encourage Congress to continue to support the important ongoing research and analysis being conducted by the Social Security Administration.

The Social Security proposal included in the Fiscal Commission report is certainly not a free lunch, nor is it by any means the only approach to fixing Social Security. Numerous options exist to fix Social Security. In fact, the Committee for a Responsible Federal Budget is currently developing an interactive tool called "The Reformer" to enable policymakers and the public to estimate the effects of a range of Social Security reforms on the solvency of the program. Still, the Commission's plan is sensible, one which balances the needs of current and future generations. There is no question that it is better to schedule modest, gradual, and targeted changes today than to allow a sudden 25 percent cut hit all current and future workers tomorrow.

Chairman JOHNSON. We are going to do something a little different here. I appreciate the testimony of all of you, and I am going to ask you this question: How soon should we act to fix Social Security? I would like each one of you to tell me. Mr. Lorenzen?

Mr. LORENZEN. I would say that the sooner that Congress can act, it would be better. I can say this as someone who has been working on Social Security reform for much longer than I like to admit, that at each successive time, I have gone through the process of looking at the options of what you have to do on benefits and on revenues and the level of benefits you can provide at a certain level of taxes, that the choices become substantially more difficult each time I have gone through this process.

Chairman JOHNSON. The question is how soon should we start?

Mr. LORENZEN. And so, I think it needs to be starting soon. I think we have already waited too long.

Chairman JOHNSON. Okay. Mr. Hoagland?

Mr. HOAGLAND. You should start now, I agree that you should not hold up on this exercise.

Chairman JOHNSON. Mr. Fichtner.

Mr. FICHTNER. Congressman, 10 years ago. In some ways we are already too late. They are saying act now. We should have done this a long time ago. I used to go around saying that we could change benefits and hold current retirees harmless, we are getting closer to not being able to do that, so we are late, but definitely now.

Chairman JOHNSON. I agree with you. I have been on this committee a long time myself and, you know, we can work. This is one thing we can work.

Mr. THOMPSON. Look at me, I just got on this subcommittee.

Chairman JOHNSON. Well, do you want to wait a while? Ms. Miranda?

Ms. MIRANDA. The sooner the better.

Chairman JOHNSON. Thank you. Mr. Fuerst?

Mr. FUERST. Acting sooner enables more options of a less drastic nature and allows changes to be phased in gradually. The 113th Congress should act to implement sustainable solvency. So I will give you to the end of next year.

Chairman JOHNSON. How about the end of this year?

Mr. FUERST. That would be even better.

Chairman JOHNSON. We are working on it, let me tell you. Mr. Becerra and I have been working on it a long time together, and I think I agree with you. Mr. Steuerle?

Mr. STEUERLE. Mr. Chairman, it is yesterday. Every year we wait, we put more and more of the burden on the young, and we who are a little bit older bear less and less of the burden, and that is simply unfair.

Chairman JOHNSON. Yeah, I know. You and I are worried about it, aren't we?

Mr. STEUERLE. Yes, I think you and I should pay—I mean, it is hard to adjust—everybody keeps saying we shouldn't pay any of the costs, but in point of fact, I think we should bear some of it, too.

Chairman JOHNSON. You know, in your testimony, Mr. Steuerle, you say Social Security was designed for a different era.

I agree. What are the impacts of putting close to a third of all adults on Social Security and the impact of the current law retirement age on workers, beneficiaries, and the economy?

Mr. STEUERLE. Well, it simply means with a smaller work base to support the system, no matter what tax rate we agree upon, whether it is a higher rate or a lower rate, with fewer workers, we have got less money coming into the system, so in point of fact, although we are talking about benefit adjustments today, to the extent we can encourage more work through changes in the retirement age, through adjustments, backloading the system so a few more benefits are paid at old age, if we encourage work, we get more revenues at any tax rate. And, by the way, I should comment at the same time that given that our economy is now in a state of still high unemployment, we should really be looking at the non-employment rate, and one of the major factors on the nonemployment rate is the encouragement of older people to retire.

Chairman JOHNSON. Well, thank you for your comments, all of you. I appreciate your testimony. Is Xavier coming back?

Mr. DOGGETT. He is coming back eventually, but he has a conflicting meeting.

Chairman JOHNSON. Okay. Then Mr. Doggett, I am going to recognize you for 5 minutes.

Mr. DOGGETT. Well, thank you very much. Dr. Steuerle, I understand your testimony to be that whatever the committee might recommend on revenue changes, there must be some benefit changes?

Mr. STEUERLE. [Nonverbal response.]

Mr. DOGGETT. Is the converse also true? Because I understood that to be Mr. Hoagland's findings of the Bipartisan Policy Committee and also on the Bowles-Simpson, that it is impossible to resolve this problem equitably unless there are additional revenues?

Mr. STEUERLE. Well, personally I do support additional revenues for the system. I do have a problem, however, which goes beyond the Social Security issue is that for the most part, if I am going to raise additional revenues, particularly if I am going to raise additional revenues on higher income people, I don't want that money to keep going for these elderly programs, they are absorbing all of the growth in government. So I have this dilemma. While I think revenues is part of our broader budgetary issues, I don't know that I want to keep devoting additional taxes and revenues to supporting elderly programs at the cost of programs for younger people.

So I, therefore, confine the extent to which I would have tax increases in Social Security, which is not the same thing as the extent to which I would confine tax increases outside of Social Security.

Mr. DOGGETT. So you are basically agreeing with the Simpson-Bowles and the bipartisan policy recommendations that we will not get our national debt in shape unless we have some additional revenues to go along with this, but you don't necessarily support additional revenues for Social Security specifically?

Mr. STEUERLE. I do support some additional revenues for Social Security. I actually—like the Commission's, I would bump up

the taxable maximum back up to approximately 90 percent of wages, so I do actually support that type of change.

Mr. DOGGETT. I got the impression from your testimony that to some extent, looking at Social Security changes is an all-or-nothing proposition, that there has to be broad comprehensive change along the lines of your policy objectives, not doing it a single item at a time, such as cost of living or retirement age. Is that your position?

Mr. STEUERLE. Yes, Mr. Doggett. Let me give you an example with the retirement age. The simple fact that we all get now about, say, 6 more years of benefits than—that is actually we take about 11 or 12 because we retire earlier, but if we didn't retire earlier, we get about 6 or 7 more years of benefits. That has inured mainly to the benefit of higher income people because we get a higher benefit to begin with, and in fact, if I don't live to 62, I don't get anything out of all those additional years of benefits, and if I am disabled I don't get anything, so a lot of, most of the benefits from not indexing the retirement age over its history has inured to the benefit of higher income people. So if you cut back on that, we still have to worry about other distributional effects. You know, as I say, for people who are disabled, for people who don't make it to 62, for people who have trouble working, we have to worry about that. But not adjusting the retirement age is like throwing the money off the roof in a poor area of the city and hoping some of the poor get it. It is just not very target effective.

So, yes, I would increase the retirement age and then I would try to come back into other provisions like minimum benefits and other things to make a system that, in my view, should be more progressive than it was. I think the system is less progressive than people think it is because it has a lot of regressive features that people didn't pay attention to in the beginning, and so my goal is to make the system more progressive, better at the bottom, say the bottom half of the distribution, recognizing that because it is out of balance, people at the top are either going to have to take benefit cuts or tax increases, one or the other, to pay for it.

Mr. DOGGETT. Ms. Miranda, what do you think the effect of the changes you have heard the other witnesses testify that they feel must be made in Social Security will have on working families?

The changes that you have heard recommended, they have indicated they want to compensate for some of those changes with other adjustments and that the current program, they believe, does not adequately address the needs of poorer retirees. What is your reaction to their recommendations?

Ms. MIRANDA. Well, we agree that the system does not adequate—provide adequate benefits for low-income retirees and others. However—and we are very much in favor of a lot of the ideas to improve benefits for the low income. However, these ideas are often coupled with a benefit cut, so there is no net improvement for low income. I did the math for Hispanic men and women. Hispanic women have the lowest average Social Security benefit for any gender or race or ethnicity, so their average benefit is below the poverty line. It is \$10,438. And I did do the math on the chained CPI plus the age bump-up, and it is still a loss. It is still about a 1½ percent loss to these low-income women already.

So there is no net gain from doing it if you couple it with a benefit cut. So we are in favor of things like the bump-up for the age, but we are not in favor of it being coupled with a cut. So we like some of those ideas. However, I would like to say with the special minimum benefit, I have also looked into it, including Dr. Steuerle's research from the Urban Institute, and you see that low-income people, the lowest income people have the shortest career histories in covered earnings, so something like 80 to 95 percent of low-income workers would not meet the requirements to get the full special minimum benefit. The requirement is 30 years in covered earnings, and only something like 3 to, at the most, 20 percent of low-income workers would meet that requirement. So you are excluding almost everybody. It is practically the null set. So I don't know. I mean, every proposal seems to have that in there, and it doesn't do much good—

Chairman JOHNSON. We have already heard your testimony, and his time has expired.

Ms. MIRANDA. Oh, sorry.

Mr. DOGGETT. Thank you very much.

Chairman JOHNSON. Thank you, Lloyd. Mr. Renacci, you are recognized.

Mr. RENACCI. Thank you, Mr. Chairman. I want to thank all the witnesses and thank you for all your testimony. It is interesting because prior to coming to Congress I was a CPA and was brought into businesses in many cases that were failing, and when you looked at their failures, it was many times the owners would say, well, you know, we were doing fine, and we shouldn't touch anything, and we shouldn't have done anything, and what they really ignored was the trend in the future, and so I am appreciative that we are looking at the trends in the future here because that is the key. We can sit and just bury our head, but the trends are showing that we have got some problems.

Mr. Steuerle, you made a comment where there is two sides, you are either for the box or against the box. It is kind of interesting because I would agree that some people when you say something, they would say you are against the box or you are for the box. I think everybody up here is making sure that Social Security is solvent for the future. I know as a father of three children, I want to make sure that the benefits are available to them, too.

So when I look at things, I try and look at systemic issues, and I would like to ask—in reading your testimony, I see a couple things that have been brought out of your testimony, several of you. The system does not encourage savings, our current system, and the other thing is the system encourages retirement before the full retirement age.

Those seem to be two real systemic problems within the current system which aren't benefits, aren't revenue raisers, aren't any of those. These are actual systemic problems that—you know, I would like Mr. Steuerle or Mr. Fichtner if you could address, what are some of the ways Congress, and even the Social Security Administration can incentivize savings and also we can encourage older Americans to remain in the workforce? So I start with Mr. Steuerle.

Mr. STEUERLE. I have a number of suggestions in my testimony. I won't go into all the details, but the basic suggestions are to bump up the retirement age. As it actually turns out, I would also increase the early retirement age because it actually turns out that the people who are hurt the worst are the lower income people who can work but don't, that is their proportional loss in income over their retirement is actually worse than it is for higher income people who might have capital income on their side. And then, as I say, I would try to make a lot of other adjustments to make sure that that net change is more progressive. I would try to backload benefits more, that is to the extent we can make it more of an old age system rather than a system that is really a middle age retirement system, that is going to encourage work by not providing so much in the way of benefits up front. I would also offer people partial retirement options that Social Security doesn't offer, so that people don't have to think it is an all-or-nothing choice, which many of them do.

On the savings front, I have suggested a number of times that we follow Britain's example when they did Social Security reform, and we back up Social Security reform with a private pension reform that is aimed, by the way, at providing substantial coverage for the vast majority of people who get very little in private retirement benefits.

Mr. RENACCI. Before I move to Mr. Fichtner, I would just ask you this question, instead of raising the age, how about changing the system? I have friends back home that are retiring because it makes no sense for them; if they work longer, they don't get any additional benefit, and at the same time, there is no incentive to continue to work because they get their retirement benefits cut if they do, and they can't work and get those benefits.

Mr. STEUERLE. The current system has something called an earnings test, which technically doesn't reduce benefits, but people think of as a huge tax rate on their benefits. Because technically what happens when those benefits get reduced, Social Security gives them an actuarial adjustment for higher benefits later. I want to make that explicit, they recognize by working longer that they could make that work to their advantage in a much more explicit way. But also the suggestion I made, and I think Mr. Fichtner made, to actually drop this notion of only counting 35 years of work means if I work more than 35 years, I work past 62, that can also add to my benefits. So I make a number of adjustments along those lines.

Mr. RENACCI. Mr. Fichtner.

Mr. FICHTNER. Thank you for the question, Congressman. I realize your time is short, so I will second everything that Dr. Steuerle said, and then sort of add what can the Social Security Administration do to help encourage people to maybe delay claiming. Because those who take early retirement basically are behind, and the monthly benefit is lower than they would otherwise be when they get into their 80s or 90s, then behind for the rest of their lives. Part of it is financial literacy, which both of the Commission plans actually endorse, which we did show the benefits and the risks and costs of claiming early versus claiming later. And I think we should look at raising the early retirement age.

Right now, as we said, 40 percent take it at 62, 70 percent are taking it before normal retirement age. That means that is actually increasing poverty in older ages. If we increased it, but did like a hardship benefit or a special minimum benefit bump up, that would keep lower people out of poverty, but still give the incentive for those who continue to work.

Mr. RENACCI. Mr. Chairman, I yield back.

Chairman JOHNSON. Thank you. Mr. Tiberi, you are recognized for 5 minutes.

Mr. TIBERI. Thank you. Thank you all. Great testimony. I got to tell you this should be easier to get done than it is after listening to you all. But let me tell you just a couple stories. I was at a senior center in my district 10 years ago. I was supposed to give a congressional update. And there were seniors there from 62 to in the 90s. Before I could even get a word out about my congressional update, this lady in the back of the room wanted to know why I was on the Bush privatization of Social Security. And I answered there was not a piece of legislation yet, but we have to fix Social Security, maybe not for you all, but for your kids and certainly your grandkids.

Another lady said, "My grandkids are spoiled. Don't touch Social Security, because I paid into it just like I paid into Medicare." I have noticed over the last 10 years, and I think it has to do with organizations like yours and yours, that seniors are tending to understand more that they didn't pay into Medicare every benefit they are getting out. That is been a real struggle, by the way, a real struggle.

So I think education is the key. And you talked about the progressivity. Dead on. But the lack of education even among some Members is striking to me. I have a senior population who still believes that we should fix the notch years, right? The notch years. And I try to tell them, you know, you got a better deal than my dad, who is going to be 80. And my dad retired at 65. You know, maybe I should be mad that somebody here changed the retirement age and requires me to retire at 67. But I got to tell you, my sister, who is in her 30s, doesn't even think that even matters because she doesn't believe she is going to get Social Security. And to say, and some in this town say, well, this isn't a problem, they should go look at their Social Security benefit package if they are under 50.

Here is my question to you: How do we get just Members of Congress to understand the severity of the problem in the system? Because I think you are absolutely right, Mr. Steuerle, and Mr. Fuerst, you are on the same page, we can't fix these systems that benefit us if we get there by raising more revenue to put into those systems, because it is tragic what we are doing to little girls and little boys who are trying to get an education. My parents were immigrants. They never had great jobs. They are now concerned about their grandkids.

So this shouldn't be about CEOs and NBA basketball players and them paying their fair share. This should be about fundamentally fixing two vitally important programs for the future. And you have all made some really great suggestions. But the politics of this aren't quite there yet. Mr. Lorenzen.

Mr. LORENZEN. I want to say a couple of things. First, I think it is important to talk not only about the importance that those programs are strong for future generations, for future children and my soon-to-be-born child, but also to talk about what it means for the resources for other priorities that Dr. Steuerle was talking about, that if tax revenues are going to those programs, those are tax revenues that are not available for other priorities. I think that is an equally important point to remind people.

And I would just use this opportunity to make a shameless plug. The Committee for Responsible Federal Budget, which hosts the Moment of Truth Project, will be coming out shortly with The Reformer, which will be an interactive online tool that will allow people to look at the different options for changing benefits and revenues. And you will see what it means over 75 years and the period, and so people can see the choices and trade-offs.

Mr. TIBERI. And let me tell you what I support. I had a debate with a smart guy who argued with me that taking it at 62 was better because life expectancy is longer now. So there are smart people who do that. But I got to tell you, in this town if I say I am for fixing Social Security and Medicare, somebody might say, well—someone has said, well, it is because you want to do that, you want to cut benefits, you want to hurt the program. Let me tell you, I mean, I would like to cut the retirement age to 55, you know, as a selfish person. That is not what this is about. I don't want to cut anybody's benefits. I want to make sure that people who, like my mom and dad, who depend on this program, get it, and that we don't rob future generations to get there. So Mr. Steuerle, any final comments on the politics of this?

Mr. STEUERLE. Yes, I don't know what else we can do here. I am actually, and every person at this table, we all work on trying to give you data you can use. If you look, for instance, at the last graph in my testimony, that is the one I use when people want to argue the trust fund balances. Because it basically shows that when you get to about 2035, we are going to be paying maybe 30 percent more than we got in the way of revenues. So regardless of what you think about the trust funds, show them that type of data. I do lifetime value of and benefits and taxes. I keep pointing out that the package of benefits in Social Security and Medicare is now approaching \$1 million. When I say that to people, they don't say, gee, it has got to be higher, you know, once they know the real numbers. And then finally on the retirement age, one I strongly suggest, and Mr. Lorenzen and I have talked about this, in their Commission they debated how to announce it in terms of the increase in the retirement age, this is the normal retirement age, but if you look at their package, they actually keep giving more and more years—which I would not do by the way—keep giving more and more years of benefits to people as they live longer, just less than they get now. If you go to the public and say should it be a priority of Social Security to continually provide more years of benefits to people or should we have other priorities, they will usually accept—they won't accept that as an option. And yet that is the system we have. So that is different than saying you are increasing the retirement age.

Mr. TIBERI. Thank you.

Chairman JOHNSON. I want to thank each of you for being here. And we appreciate your testimony. We have got votes on the floor. And I don't want to try to hold you during that time. We are adjourning today for Memorial Day. How about that? So I want to thank each and every one of you for being here, and thank our panel for their questions, and thank you, Lloyd. So we will stand adjourned.

[Whereupon, at 10:33 a.m., the subcommittee was adjourned.]

[Questions for the record follow:]

Donald Fuerst

 AMERICAN ACADEMY *of* ACTUARIES

July 31, 2013

Representative Sam Johnson
 Chairman, Social Security Subcommittee
 Committee on Ways and Means
 U.S. House of Representatives
 1101 Longworth House Office Building
 Washington, D.C. 20515

Representative Xavier Becerra
 Ranking Member, Social Security
 Subcommittee
 Committee on Ways and Means
 U.S. House of Representatives
 1101 Longworth House Office Building
 Washington, D.C. 20515

Re: May 23, 2013 Hearing on Social Security

Dear Chairman Johnson and Ranking Member Becerra:

I am pleased to respond to your request for further comments regarding my May 23 testimony on increasing the Social Security retirement age. I testified to how the Social Security system could better reflect longevity improvements, including alternatives to increasing the retirement age. The American Academy of Actuaries¹ has advocated, for purposes of sustaining the financial solvency of the system, increasing the retirement age to reflect increases in life expectancy among American workers. Adjusting Social Security benefits for life expectancy should be a critical part of any changes to resolve the deficit between future benefits and future income.

You have asked me to address three questions:

- 1. In your testimony, you discuss the fact that Social Security's retirement age influences when someone decides to stop working. What are your views regarding addressing longevity through increasing the retirement age versus changing the benefit?**

A change to the benefit formula can provide the same amount of benefit as results from increasing the full retirement age, but it sends a far different message to the American worker. Workers look to both the earliest eligibility age and the full retirement age as goals or milestones. Experience points out how significant these milestones are: approximately 44 percent claim at the earliest eligibility age and almost 95 percent claim by the full retirement age.

Changing the formula but not the earliest and full retirement ages would have less influence on the retirement age selected by workers because of the signal that the eligibility ages provide. With a reduced benefit formula, many retirees would receive smaller payments because they claimed at the full retirement age, rather than working

¹ The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

longer and receiving a larger benefit. This change would be detrimental to the financial security of our elderly.

2. Should the early eligibility age (EEA) of 62 be increased? What is the effect on the claiming age if the EEA is or is not increased?

Increasing the early eligibility age has the beneficial result of encouraging most individuals to work longer. Individuals who remain in the labor force are a productive part of our economy and able to save more for their deferred retirement.

Increasing the EEA also helps prevent payment of benefits that may prove inadequate. The 1983 amendments changed the full retirement age (FRA) but not the EEA, allowing workers to retire up to five years prior to full retirement age. This increased the early retirement reduction in the benefit from 20 percent at three years to 30 percent at five years. Increasing the full retirement age beyond age 67 without also raising the EEA would mean that benefits at the early eligibility age would be reduced more than the current 30 percent. This reduction applies to the benefits over the full lifetime of individuals and may as a result prove to be inadequate to retirees' needs, potentially causing pressure for benefit increases. Raising the EEA in concert with the FRA would maintain the maximum reduction at 30 percent.

If the EEA is not changed, initial claims at age 62 (currently about 44 percent) will continue to be high. If the EEA is increased, more individuals will work longer and ultimately receive larger benefits.

Increasing the EEA does not significantly change Social Security's financial position because early retirement benefits are already reduced to the approximate actuarial equivalent payments.

3. If the full retirement age (FRA) is increased but the EEA is not, an individual who claims at 62 would see a larger benefit reduction. For example, if the FRA is increased to age 70, the actuarial reduction at age 62 would be 43 percent. What is the impact of changing the size of the reductions so they are not actuarially neutral?

Changing the reduction factors so that they are not actuarially neutral would increase the cost of Social Security and undermine the beneficial aspects of increasing the full retirement age (FRA).

Increasing the FRA brings with it a retirement signaling effect that sends a message to American workers encouraging longer work careers. At the same time, providing subsidies that facilitate early retirement encourages shorter work careers. These two messages are at odds.

The American Academy of Actuaries appreciates the opportunity to provide the subcommittee with these comments and would welcome the opportunity to assist in any further exploration of these issues. Please contact David Goldfarb, the Academy's pension policy analyst (202-785-7868; goldfarb@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

Donald E. Fuerst, MAAA, FSA, FCA, EA
Senior Pension Fellow
American Academy of Actuaries

Cc: Members, Subcommittee on Social Security
House Ways & Means Committee

Eugene Steuerle

Committee on Ways and Means
 Subcommittee on Social Security
 Questions for the Record

Hearing on "The President's and Other Bipartisan Entitlement Reform Proposals"

Eugene Steuerle

July 31, 2013

1. **If the full retirement age (FRA) is increased but the EEA is not, people who claim at 62 would see larger reductions. For example, if the FRA is increased to age 70, the actuarial reduction at age 62 would be 43 percent. What is the impact of changing the size of the reductions so they are not actuarially neutral?**

Social Security has expanded years of retirement enormously by not changing the early retirement age and only adjusting the "normal" retirement age by two years from 65 to 67. If future reform merely responds by gradually adjusting the normal retirement age, but not the early retirement age, it effectively reduces annual benefits for those who continue to retire at the earliest age possible (again, for ever more years of support). This provides a threat to those retiring early, who often are unprepared for the costs of old age. Among married couples today, at least one spouse is likely to live to age 90 or so, in effect providing close to three decades of benefits for those who retire at age 62.

In effect, whether or not the normal retirement age is adjusted, the maintenance of the same minimum chronological age (62) for receipt of benefits continually "front loads" the system in the sense that greater and greater shares of benefits are provided further and further from old age—that is, further and further from years closer to death when impairments are more likely.

2. **What percentage of the workforce really can't work longer and would be adversely affected by an increase in the retirement age? Do you believe some type of hardship exemption should be included? If so, how would you design it to ensure it was well targeted?**

It would be difficult to put a precise figure on the percentage of those who cannot work at any given age. As health care improves in general and people live longer, most analyses support the notion that people can also work longer. Some evidence is provided by self-reports on health status. Today, for instance, close to 95 percent of those between the ages of 65 and 70 report being in at least fair health, and about 80 percent say they are in good or excellent health.

No one has come up yet with a good or administrable design of a hardship exemption, which relates closely to trying to measure disability. Then there are the equal justice issues. For instance, if hardship

is defined by type of job, should a middle income worker who can no longer work in a manufacturing job be favored over a retail firm worker with equal or lower lifetime earnings? And, unfortunately, those most threatened in true old age by retiring several decades before probable death tend to be those who are poorer to begin with and cannot rely upon other sources of income. As a consequence, their incomes in late old age are most threatened by the actuarial reductions that come from earlier retirement. The Social Security disability system remains our primary hardship-based system, backed up by the Supplemental Security Insurance program that needs to be better indexed for the future.

In my view, money should be spent on increasing benefits where they can be well targeted and not spent on those who are relatively well off. Such improvements include: minimum benefits, allowances for raising children, and other efforts to distribute a larger share of benefits to those with lower incomes. I also favor increasing benefits for long-term workers rather than cutting off credit for work at 35 years. I would also consider some minimum "life certainty" for some of those who die young and haven't received disability benefits.

3. Your testimony talks more broadly about benefit adequacy. As we consider changes to the program, please discuss how you would address benefit adequacy. Whose benefits should be adjusted, how and why?

Many of our elderly have fairly low annual cash benefits despite a system that provide a typical newly retirement couple with close to \$1 million in lifetime Social Security and health benefits. Much of the differential derives from spending close to one-third of an adult life on Social Security. I believe an adequate annual cash benefit should be well above the federal poverty line, adjusted for wage growth in the economy (that is, keeping up relatively with the wages of workers). The benefit formula, minimum benefits, and adjustments for years of child rearing can all help in this respect. At higher income levels, at least above median, the annual benefit growth rate can be pared as long as the system is out of balance. Finally, I would encourage private pension reform as a supplement to Social Security for those with low- and middle-incomes, since so many retired individuals have little or nothing in the way of retirement support.

4. How do we design a program that suits today's workers? Who will be most disadvantaged by sticking to the old system and forgoing the chance to give our country a new Social Security program that protects the vulnerable but also lets our younger workers prosper?

Social Security's current structure was designed for a very different age. Why should we continue to have a system based essentially on the assumption of stay-at-home mothers with no incomes of their own? As one consequence, this system discriminates against single heads of household—many of whom are abandoned mothers—by making them pay for spousal and survivor benefits they cannot receive. Why should we count taxes or contributions for only 35 years, discriminating against longer-term workers? These are among the disfavored groups in the current system.

Also, why should we support middle-age retirement when a higher non-employment rate in the economy slows down overall growth and makes recovery from recession more difficult? Relative to their life expectancy, people on average today retire for in excess of a decade more than they did in 1940, when benefits were first paid. This provides a major threat to well-being in true old age, even if it did not also add to the imbalances in Social Security and the budget as a whole (partly through lower income tax collections). Higher non-employment also reduces personal income and GDP because of lower national output.

- 5. In your testimony, you noted that close to one third of adults will be receiving benefits for one third of their lives. Do you have concerns with the President's proposal that starts a long time beneficiary increase at age 76?**

The adjustment suggested by the President for those living longer was proposed as a partial offset to the impact of a reduced COLA, which would reduce benefits for someone aged, say, 90, by close to 10 percent, but by almost nothing for those in their early 60s. Over the years, Social Security has provided smaller and smaller shares of total benefits to those truly old, for example, those in the last ten years of life as measured by life expectancy. To better protect for true old age, we should be increasing benefits more in older ages and decreasing them in younger ages, particularly at ages when people on average have fifteen or more years of life expectancy. "Backloading" the system in this way, even if lifetime benefits were held constant, would increase work incentives and add to revenues through that additional work.

- 6. Social Security has long included a benefit for nonworking spouses. In your testimony you discussed the varying amount of benefits a woman might receive depending on whether she is married and how much her spouse earns. For a married woman who earns less than her husband, the effective tax rate for her Social Security taxes could be 100% if she would end up with the same benefits regardless of her work history. The current program is not doing a good job of rewarding women who contribute to Social Security through their hard earned wages. How do we make the program work better for women?**

The trick, I believe, is to recognize the multiple goals at hand and to target provisions to those goals. The archaic Social Security provision of additional spousal and survivor benefits without regard to any additional contribution is outlawed in the private pension system. The legitimate goal, badly designed in practice, was to protect survivors and to insure some minimum level of support to couples. Such can be achieved much more efficiently—and the well-being of the average woman and lower-income man—improved by providing minimum benefits and minimum credits for child-rearing years, along with a requirement that the worker provide and pay for survivor benefits through a lower up-front worker benefit. Further tweaks to the benefit formula can then insure better protection to those with low and moderate incomes, including typical but not all spouses and survivors. In the end, these goals can be

achieved even as legislation achieves long-term balance through other benefit and tax adjustments, most of which will be paid for one way or the other by those with lifetime incomes above median.



Jason Fichtner



July 30, 2013

Jason J. Fichtner, PhD
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Responses to Questions for the Record

Testimony before the Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
May 23, 2013

Attention: Kim Hildred

Staff Director
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
B-317 Rayburn House Office Building
Washington, DC 20515
cc: [Jessica Cameron](#) via email

Question 1:

In your testimony, you discuss the fact that Social Security's retirement age influences when someone decides to stop working. What are your views regarding addressing longevity through increasing the retirement age versus changing the benefit formula?

I prefer to address longevity issues through raising the retirement age to more accurately reflect that Americans are living longer, leading healthier lives, and, naturally, working longer. This approach would be more efficient and more equitable than changing the benefit formula, which could result in lower benefits later in life—often when beneficiaries face higher health-related costs.

If Congress chooses to address longevity issues through changes in the benefit formula, I would recommend the reform be accompanied by an increase in benefits for those in their mid-80s and older, as suggested by many of the reform plans discussed during the hearing.

Question 2:

Should the early eligibility age (EEA) of 62 be increased? What is the effect on the claiming age if the EEA is or is not increased?

The EEA should be raised because it would greatly increase incentives for seniors to remain in the labor force. Working longer and delaying taking benefits would help alleviate poverty among seniors later in their golden years.

Raising the EEA would also help the economy by keeping experienced workers in the labor force. With age 62 now the most popular age to claim benefits, raising the EEA would necessarily delay many claims and would likely correlate with continued employment. Research estimates that raising the EEA to 65 would lead to a long-run increase in GDP of 3-4 percent.

I share the concerns of my fellow panelists that an increase in the EEA would be a financial hardship for individuals who truly cannot work past 62. To address this, I would recommend some sort of hardship exemption.

Question 3:

If the full retirement age (FRA) is increased but the EEA is not, an individual who claims at 62 would see a larger benefit reduction. For example, if the FRA is increased to age 70, the actuarial reduction at age 62 would be 43 percent. What is the impact of changing the size of the reductions so they are not actuarially neutral?

I prefer to keep the actuarial adjustment "neutral," otherwise the current incentives to retire early at age 62 would be maintained or possibly even increased. To address concerns that some may receive inadequate benefits if the FRA is increased but not the EEA, I prefer a better special-minimum benefit and/or a hardship exemption.

I do not recommend changing the relative benefits so they are not actuarially neutral under a plan that would increase the FRA but not the EEA. To do so would exacerbate the perverse incentives in Social Security's current structure that discourage saving, and encourage early retirement and discontinuing work.

Question 4:

Since the Social Security Administration only has wage information, do you think it could administer a minimum benefit that includes child care credits?

It would be very difficult for SSA to implement such a proposal. With wage data from a W2 tax form, SSA can only determine whether an individual was employed, how much he/she earned, and whether any income came from self-employment. SSA cannot determine whether an individual was employed full- or part-time, or whether he or she left the labor force voluntarily for reasons such as childrearing, vacation, or sabbatical.

Implementing such a proposal would require new forms and processes, and may require different data-sharing agreements with the Internal Revenue Service. W2 information would need to show whether dependent care benefits were provided by an employer. This

would require the creation of a separate reporting form. This would also add new administrative costs for monitoring and enforcing compliance.

Question 5:

The Bipartisan Policy Center Debt Reduction Task Force's plan highlighted the need for Social Security to improve its communications to better show how early claiming affects benefits. How can Social Security help people better understand the long-term impacts of their choices? Are there ways we should think about changing benefits or even the rules to make Social Security easier to understand and less about knowing which strategy will work best?

As a teacher, I see the benefits of education and knowledge daily. The SSA should do as much as possible to promote financial literacy and help people better understand the long-term effect of their choices. The cost of increasing SSA communications with the public would be marginal and should be done regardless of how Social Security is otherwise reformed.

As I pointed out in my written testimony, research links financial literacy and savings behavior, indicating that less financially literate individuals are less likely to adequately save for retirement. Research also finds that individuals expect to receive more in Social Security retirement benefits than what they actually receive.

Individuals who are better informed about the full costs of claiming benefits early may be more likely to delay claiming until full retirement age, or longer. This could improve labor-force participation, reduce poverty among seniors, and help the overall economy.

Finally, a better-informed public would be better equipped to assess the various "schemes" for maximizing Social Security benefits that are being promoted by some experts and financial planners. However well-intended these various claiming strategies may or may not be, the advice could lead to financially harmful decisions by those in society least able to bear them. As an immediate counter, SSA should continue to promote and distribute the two-page publication "[When to Start Receiving Retirement Benefits](#)" (attached).

With respect to benefit rules for a nonworking spouse, I recommend changing these rules to incentivize work and reduce the negative impact of the benefit-enhancement schemes noted above. The nonworking spouse benefit plays a useful role within Social Security by recognizing the value of stay-at-home work and of raising the next generation of wage earners. It is, however, inefficiently designed in that it is both regressive and a significant disincentive to paid employment.

It is not necessary to eliminate the nonworking spouse benefit to address these inequities. One option is simply to constrain its growth so that no future nonworking spouse can receive a benefit exceeding the inflation-adjusted value of the benefits that today's low-wage workers receive based on a full career of payroll tax contributions.

Another potentially important work-incentive reform is to redesign the basic benefit formula so it is based on each separate year of earnings, rather than on career-average earnings. The current progressive-benefit formula causes Social Security returns to drop with extended work, as career-average earnings rise. This causes problems in the

treatment of those who move in and out of Social Security coverage. For example, the formula mistakes higher-wage state and local employees and immigrants for needy low-wage workers, necessitating complex fixes such as the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). Such controversial complexities would be unnecessary if Social Security simply accrued proportional benefits with each additional year of taxpaying work, since all intermittent workers would be treated identically.

Question 6:

How does the replacement rate of Social Security benefits differ by generation? Does the current measure adequately reflect the contribution of Social Security towards an individual's retirement security?

The formula used to calculate initial Social Security benefits upon retirement is indexed so that benefits from one birth cohort to the next rise in proportion to growth in the national Average Wage Index (AWI). Because national-average wages tend to rise faster than price inflation over time, Social Security replacement rates also tend to rise for a given level of real (price-inflation indexed) wages. As my Mercatus colleague Charles Blahous showed in his paper "[Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates](#)," a worker retiring in 2055 with lifetime-average wages equal to roughly \$43,800 in today's dollars would expect a replacement rate of 48.7 percent if claiming benefits at the normal retirement age. This is substantially higher than the 42.9 percent replacement rate a \$43,800 worker retiring last year at the normal retirement age will receive. This indexation of benefits such that replacement rates continually rise for a given level of real wages is a key factor driving up Social Security costs over time.

It is unlikely that the replacement rates currently reported in the Social Security trustees' report accurately reflect Social Security's role in broader retirement security planning as most readers would interpret them. A primary reason for this is that replacement rates are not calculated in a way that relates individuals' Social Security benefit levels to their own prior earnings levels. Rather, they are calculated relative to those in the workforce at the time the individual claims benefits. This occurs because the calculation indexes the worker's prior earnings record for subsequent growth in the national AWI.

As Andrew Biggs and Glenn Springstead pointed out in their paper "[Alternate Measures of Social Security Replacement Rates](#)," replacement rates calculated on the basis of the AWI in the manner of the Social Security trustees will appear to be substantially lower than those that would be calculated based either on the nominal or the inflation-adjusted value of a worker's preretirement earnings. The Social Security trustees are aware of this issue, and wrote in this year's report that they are "exploring whether to expand or otherwise modify this presentation in the 2014 Trustees Report" (2013 annual Social Security Trustees report, p. 143).

Jason Fichtner, attachment

When To Start Receiving Retirement Benefits



At Social Security, we're often asked, "What is the best age to start receiving retirement benefits?" The answer is that there is no one "best age" for everyone and, ultimately, it is your choice. You should make an informed decision about when to apply for benefits based on your individual and family circumstances. We hope the following information will help you understand how Social Security can fit into your retirement decision.

Your decision is a personal one

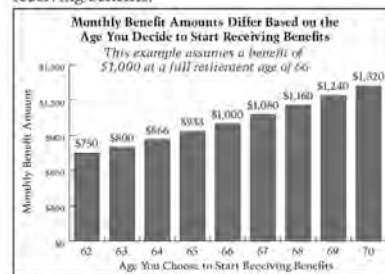
Would it be better for you to begin receiving benefits early with a smaller monthly amount or wait for a larger monthly payment later that you may not receive as long? The answer is highly personal and depends on a number of factors, such as your current cash needs, your health and family longevity, whether you plan to work in retirement, whether you have other retirement income sources, your anticipated future financial needs and obligations, and, of course, the amount of your future Social Security benefit. We hope you will weigh all the facts carefully and consider your own circumstances before making the important decision about when to begin receiving Social Security benefits.

Monthly payments differ substantially based on when you start receiving benefits

If you live to the average life expectancy for someone your age, you will receive about the same amount in lifetime benefits no matter whether you choose to start receiving benefits at age 62, full retirement age, age 70 or any age in between. However, monthly benefit amounts can differ substantially based on your retirement age. Basically, you can get lower monthly payments for a longer period of time or higher monthly payments over a shorter period of time. The amount you receive when you first get benefits sets the base for the amount you will receive for the rest of your life, though you do receive annual cost-of-living adjustments and, depending on your

work history, may receive higher benefits if you continue to work.

The following chart provides an example of how your monthly benefit amount can differ based on the age at which you decide to start receiving benefits.



Let's say your full retirement age is 66 and your monthly benefit starting at that age is \$1,000. If you choose to start getting benefits at age 62, your monthly benefit will be reduced by 25 percent to \$750 to account for the longer period of time you receive benefits. This is generally a permanent reduction in your monthly benefit.

If you choose to not receive benefits until age 70, you would increase your monthly benefit amount to \$1,320. This increase is from delayed retirement credits you get for your decision to postpone receiving benefits past your full retirement age. The benefit amount at age 70 in this example is 32 percent more than you would receive per month if you chose to start getting benefits at full retirement age.

Retirement may be longer than you think

When thinking about retirement, be sure to plan for the long term. Many of us will live much longer than the "average" retiree, and, generally, women tend to live longer than men. About one out of every four 65-year-olds today will live past age 90, and one out of 10

(over)

will live past age 95. Social Security benefits, which last as long as you live, provide valuable protection against outliving savings and other sources of retirement income. Again, you will want to choose a retirement age based on your circumstances so you will have sufficient income when you need it.

Your decision could affect your family

Your spouse may be eligible for a benefit based on your work record (spouse benefits are reduced if claimed before the spouse's full retirement age). If you die before your spouse, he or she may be eligible for a survivor benefit based on your work record, particularly if you have earned more than your spouse over your lifetime. If you begin receiving Social Security benefits early, we cannot pay your surviving spouse a full benefit from your record. Also, if you wait until after the full retirement age to get benefits, your surviving spouse—if he or she is at least full retirement age—generally will receive the same benefit amount that you would have received.

Your children also may be eligible for a benefit on your work record if they are under age 18 or if they have a disability that began before age 22. For them to receive benefits, you must be getting benefits, too.

You can keep working

When you reach your full retirement age, you can work and earn as much as you want and still receive your full Social Security benefit payment. If you are younger than full retirement age and if your earnings exceed certain dollar amounts, some of your benefit payments during the year will be withheld.

This does not mean you must try to limit your earnings. If we withhold some of your benefits because you continue to work, we will pay you a higher monthly benefit amount when you reach your full retirement age. In other words, if you would like to work and earn more than the exempt amount, you should know that it will not, on average, reduce the total value of lifetime benefits you receive from Social Security—and may actually increase them.

Here is how this works: after you reach full retirement age, we will recalculate your benefit amount to give you credit for any months

in which you did not receive some benefit because of your earnings. In addition, as long as you continue to work and receive benefits, we will check your record every year to see whether the additional earnings will increase your monthly benefit.

Don't forget Medicare

If you plan to delay receiving benefits because you are working, you should sign up for Medicare three months before reaching age 65, regardless of when you reach full retirement age. Otherwise, your Medicare medical insurance, as well as prescription drug coverage, could be delayed, and you could be charged higher premiums.

Additional resources

You can estimate benefit amounts and find more information to help you decide when to start receiving retirement benefits by using our Benefits Planners online at www.socialsecurity.gov/planners. You also can use our Retirement Estimator at www.socialsecurity.gov/estimator or create an account and get your *Social Security Statement* at www.socialsecurity.gov/mystatement. Both provide retirement benefit estimates based on your actual earnings record.

When you are ready for benefits, you also can apply online at www.socialsecurity.gov/applyforbenefits. Many people can continue to work and still receive retirement benefits. If you want more information on how earnings affect your retirement benefits, ask for *How Work Affects Your Benefits* (Publication No. 05-10069), which has current annual and monthly earnings limits.

A wealth of other information—including copies of our publications—is available on our website at www.socialsecurity.gov. You also can call our toll-free number, **1-800-772-1213** (for the deaf or hard of hearing, call our TTY number, **1-800-325-0778**). We can answer specific questions from 7 a.m. to 7 p.m., Monday through Friday. Generally, you'll have a shorter wait time if you call during the week after Tuesday. We can provide information by automated phone service 24 hours a day.

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William Hoagland

- 1) **The plans offered by the Simpson-Bowles Commission and the Bipartisan Policy Center's Debt Reduction Task Force addressed increases in life expectancy, but in different ways. You and your members chose to address longevity through the benefit formula. Please discuss your approach and how your members decided this was the best way to go.**

Any comprehensive Social Security reform must account for increased life expectancies – one of the primary drivers of the program's cost increases over time. The Bipartisan Policy Center's (BPC) Debt Reduction Task Force deliberated extensively over the policy options to accomplish this goal. Ultimately, we did not recommend increasing the program's early or full retirement ages beyond where they are currently scheduled to reach, but instead proposed to modestly reduce monthly benefits over time for those who continue to retire at those ages. A future retiree, however, could fully avoid those reductions by slightly postponing his or her scheduled retirement. (The reductions would not affect career low-income workers.) Furthermore, we called on the Social Security Administration to educate beneficiaries about the advantages of waiting to claim benefits – primarily, larger monthly checks for the duration of their retirement.

In its plan, the Task Force chose to "index the benefit formula" to account for increasing longevity instead of increase the retirement ages because many of us felt strongly that individuals should retain the option of retiring at age 62, as there are some individuals who, for physical or other reasons, simply cannot delay that decision. When our Social Security reform package was scored by the Chief Actuary of the program, he found that our longevity policy alone would close more than 40 percent of the Trust Fund's projected shortfall in the 75th year.

- 2) **How did your members decide which earners would be held harmless from the Task Force's benefit changes?**

Rather than holding a particular group "harmless," the Task Force actually decided to boost benefits for individuals who worked long careers but had low earnings. These are people who contributed decades to the American workforce and deserve to live their later years without fear of poverty. This updated special minimum benefit would apply to approximately 35 percent of retirees who work full careers.

Those with average career incomes above that level would have their projected scheduled benefits impacted in a progressive manner, with the largest reductions applying to those with average career earnings above the taxable maximum (currently \$113,700). Importantly, even after our reforms are implemented, all beneficiaries (including those with high career incomes) would see larger monthly benefit checks than they would receive under current law after 2033, as the Social Security Trust Fund is on track to be exhausted in that year and benefits cut across the board by almost 25 percent. Additionally, as mentioned above, beneficiaries have the option to fully offset the adjustments associated with longevity by slightly postponing their retirements.

- 3) **The Task Force's eligibility for an increased minimum benefit for low earners includes the time spent taking care of children. Why did the Task Force believe it was important to include child care credits and were you concerned about whether the Social Security Administration would be able to effectively administer such a program?**

The Task Force felt that parents who spend years out of the workforce raising their children should not be disadvantaged when determining qualification for the special minimum benefit. Penalizing parents who stay at home would send the wrong message. Therefore, we proposed allowing up to eight years of caring for children under the age of six to count towards years of qualified earnings. We envisioned the Social Security Administration working with the Internal Revenue Service to administer the allowance, but we welcome adjustments to make the proposal easier to carry out.

- 4) **The Task Force, Simpson-Bowles and the President all have slightly different approaches to a benefit increase for long time beneficiaries that would be implemented if the chained consumer price index were to be adopted. Why did the Task Force use an age-based approach?**

In order to help ensure that retirees do not outlive their savings, the Task Force proposed a benefit bump for beneficiaries between the ages of 81 and 85. For each year between those ages, beneficiaries would receive an increase in their monthly benefits equal to 1 percent of the average worker's monthly benefit amount.

We formulated the bump to occur at particular ages – rather than, for example, after a certain number of years of collecting benefits – because one of our primary goals was to protect retirees against the increasing healthcare costs and eroding savings that often confront this demographic. With that in mind, however, the differences are relatively small between the various benefit bump proposals. The fact that many comprehensive Social Security reform packages include this type of bump reflects the importance of providing an adequate benefit to some of the most vulnerable retirees.

Ed Lorenzen

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Congress of the United States
House of Representatives

COMMITTEE ON WAYS AND MEANS
WASHINGTON, DC 20515

SUBCOMMITTEE ON SOCIAL SECURITY

July 17, 2013

Ed Lorenzen
Executive Director
The Moment of Truth Project
Committee for a Responsible Federal Budget
1225 Eye Street, NW Suite 1000
Washington, DC 20005

Dear Mr. Lorenzen:

Thank you for your testimony before the Committee on Ways and Means Subcommittee on Social Security at the May 23, 2013 hearing on proposed adjustments to Social Security benefits, the third hearing in a series on "The President's and Other Bipartisan Entitlement Reform Proposals." In order to complete our hearing record, we would appreciate your response to the following question:

1. Plans offered by the Simpson-Bowles Commission and the Bipartisan Policy Center's Debt Reduction Task Force addressed increases in life expectancy, but in different ways. Your members decided to increase both the early eligibility age (EEA) and full retirement age (FRA) and you also included a hardship exemption for those who may not qualify for disability benefits but who are physically unable to work beyond age 62. Please discuss your approach and how your members decided this was the right way to go.
2. Under your plan, the Commissioner of Social Security would be asked to develop the hardship exemption. The plan noted that establishing a hardship exemption would be complicated to do. Why was this important to include and why didn't the plan include details beyond directions to the Commissioner?
3. How did your Members decide which earners would be held harmless from the Commission's benefit formula change?

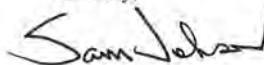
Committee on Ways and Means
Subcommittee on Social Security
July 17, 2013
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4. Why did the Simpson-Bowles Commission use a years-based approach for the long time beneficiary increase? How would you recommend constructing a long time beneficiary increase?
5. Based on the principles used to develop your plan, if changes to the benefit formula were being made today, would you still hold those 55 and older harmless to benefit changes or is it more important to begin the changes in 2017?

We would appreciate your responses to these questions by **July 31 2013**. Please send your response to the attention of Kim Hildred, Staff Director, Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, B-317 Rayburn House Office Building, Washington, DC 20515. In addition to a hard copy, please submit an electronic copy of your response in Microsoft Word format to jessica.cameron@mail.house.gov.

Thank you for taking the time to answer these questions for the record. If you have any questions concerning this request, you may reach Kim at (202) 225-9263.

Sincerely,



SAM JOHNSON
Chairman

Response to Questions for the Record

- 1) The Commission chose to address increases in life expectancy through an increase in the Full Retirement Age and Early Eligibility Age because increasing the eligibility age provides a valuable incentive to encourage longer work lives as life expectancy increases. This incentive has multiple policy benefits, including stronger economic growth.

The Social Security Normal Retirement Age serves as a powerful signal for retirement, and gradually increasing it would likely encourage those who can to work longer, thereby helping to reduce Social Security's shortfalls. According to a report issued by the Congressional Budget Office last year, raising the normal retirement age by 3 years would increase the size of the economy by 1 percent by 2035 as a result of people working longer.¹ Raising the early retirement age by 2 years would have a similar effect.

By contrast, the approach taken in the Domenci-Rivlin proposal of adjusting benefits to reflect increased life expectancy would encourage workers to accept lower initial benefits in order to retire at current eligibility ages even if they are physically able to work longer. This would both deprive the economy of quality workers as we face labor shortages in the future and risk retirees receiving inadequate benefit levels in the latter part of retirement when they no longer have other sources of income. The approach taken in the Simpson-Bowles Commission would encourage workers to continue working and maximize benefit levels, while creating a hardship exemption which w

- 2) The Commission recommended charging the Social Security Administration with designing a policy over the next ten years that best targets this population, and directing the Commission to consider relevant factors such as the physical demands of labor and lifetime earnings in developing eligibility criteria, instead of specifying the criteria for the hardship exemption. There is limited data about the reasons workers retire early and analysis about which workers who retire before Normal Retirement Age do so for reasons of convenience as opposed to those for whom delaying retirement would pose a hardship. The best analysis we were able to find was a study conducted by the Rand Corporation for AARP which found that nineteen percent of individuals who retired at the early eligibility age self-reported doing so for health reasons.

The Commission decided that further research and analysis is necessary to accurately identify the workers for whom an increase in age would pose a hardship and develop appropriate criteria for determining hardship. In addition, there would be time for SSA to conduct research and properly design a hardship exemption before the increases in retirement age began.

- 3) The Commission members only explicated decided to hold the lowest income workers harmless from changes in the benefit formula. Few were held harmless from the formula changes – only those with *very* low income (PIA all in the 90% factor) or those with an offsetting minimum benefit – but Commission members did want the benefit formula to be

¹CBO, (January 2012): *Raising the Ages of Eligibility for Medicare and Social Security*. <http://cbo.gov/publication/42683>

progressive with the greatest reductions focused on the upper half of the income scale. For the bottom half of the population, the 32 factor was gradually reduced to 30. For the top half, factors of 10 and 5 would eventually replace the current factors of 32 and 15. Recognizing that resources are limited, there was near universal consensus on the commission that those most able to afford their retirement should contribute the most toward solvency by accepting slower growth in their overall benefits. Though all beneficiaries in the top half would experience somewhat slower growth than current law, those at the very top would see the biggest change.

It was important for our commissioners that those in the bottom quintile not experience a decrease in their scheduled benefit levels. While the minimum benefit and other provisions would provide improvements in poverty and the plan outlined in the final report would increase benefits for many low-income workers and reduce poverty among seniors, tweaks of the minimum benefit and benefit formula outlined in the Commission's report will be necessary in order to fully achieve the intent of Commission members who supported the final recommendations regarding protecting benefits for workers in the bottom quintile. Subsequent analysis of the original plan found that the plan would result in a slight reduction in scheduled benefits for the median retiree in the bottom quintile. This is primarily a result of a number of future retirees with short or intermittent work histories would not be adequately protected by the new minimum benefit which was targeted toward full-career workers.

Upon learning of this unintended consequence, the Commission co-chairs reiterated their commitment to the members of the commission and asked staff to eliminate the benefit reduction in the bottom quintile. In order to fulfill this commitment, Moment of Truth Project staff worked with the Urban Institute to identify two modifications which together would achieve the goal of avoiding a reduction for the median retiree in the bottom quintile.

The first modification would make the formula change even more progressive by increasing the bottom replacement factor from 90 percent to 95 percent and establishing the 10 percent bend point at the 40th percentile (the Commission's 2010 report put it at the 50th percentile). The second modification would phase-up the minimum benefit more rapidly for retirees with less work history – from 0 to 110 percent of poverty between 10 and 20 years of work history, then to 125 percent for 30 years and 140 percent for 40 years – and credit workers for quarters of coverage toward the minimum benefits in years with less than four quarters of coverage. In addition, several anti-abuse measures would be added to the minimum benefit to prevent certain wealthier individuals with substantial retirement income from outside Social Security from over-collecting.

With the appropriate design details, these two changes would be roughly cost-neutral, but would offer far more robust benefits for those in the bottom quintile and far better poverty protections than was provided either in the original Commission plan or under the current system.²

² In this particular formulation, the minimum benefit would be phased in between 2017 and 2023 to avoid benefit notches and would be calculated based on the poverty line through 2023, after which it would be indexed to wage growth.

- 4) The year-based approach had two advantages over the age-based approach. First, it allowed us to provide the same protections to long-time disabled as long-time retired beneficiaries. For both groups the more time out of the labor force the greater chance savings will be depleted. A uniform bump-up seemed like the best approach to deal with this. The second advantage of the year-based approach is that, when combined with an increase in the EEA, it reflects improvements in life expectancy by increasing as people are living longer.
- 5) There was no hold harmless principle for workers above a certain age in the Fiscal Commission recommendations. We wanted to apply benefit formula changes to new beneficiaries only, and we wanted to make changes gradually to give workers time to plan.

Given the current state of Social Security finances, delaying the implementation date of benefit changes would require the benefit changes to be greater for the age cohorts who are subject to changes as more workers would be exempt from changes and the necessary savings would be spread out among a smaller number of beneficiaries. This underscores the importance of acting sooner than later in addressing the shortfalls facing Social Security. Delaying action will require policymakers to choose between implementing benefit changes on workers close to retirement or imposing greater benefit changes on other beneficiaries. Given our desire to spread the burden of changes fairly across age cohorts and phase in changes gradually, we would likely choose to keep implementation of benefit changes in 2017 or shortly thereafter.



[Submission for the record follows:]

RetireSafe, statement

RetireSafe

Standing Up For America's Seniors!

May 22nd, 2013

The Honorable Sam Johnson
Chairman of the House Committee on Ways and Means Subcommittee on Social Security

Chairman Johnson;

I submit this statement as a spokesman for RetireSafe's 400,000 supporters nationwide to voice our continued concern with the many discussions concerning our Nation's debt and the focus on cutting older Americans' benefits as a solution for that debt. The issues regarding Social Security and Medicare reform are numerous and RetireSafe has taken strong stances in the past and will continue to be involved as these discussions go forward. Today, however, on the eve of this hearing on "Bipartisan Entitlement Reform", we want to focus on one important aspect of reform that has been discussed lately and has found some favorable acceptance by the Administration and by both Democrats and Republicans. I speak of the chained CPI and its perceived impact on Social Security and the national debt.

The consumer price index (CPI) is a method used to calculate the cost-of-living-adjustment (COLA) for Social Security and many other programs. The COLA was initiated to ensure that the purchasing power of everyone's Social Security benefit was not eroded by inflation. To ensure that the benefit check they got this year buys the same amount of goods and services that it bought last year. The chained CPI's acceptance has been driven by some economist's calculation that a COLA based on the chained CPI would be smaller, reducing benefit payments and subsequently lowering the national debt. I think it would be fair to conjecture that if the chained CPI would have been estimated to result in an increase in the COLA rather than a decrease we would not be having this discussion about the CPI at all. The point I want to make is that the chained CPI, or any CPI, should not be used as a method to reduce the debt or to "preserve" Social Security by cutting benefits. The CPI used for the calculation of the Social Security COLA should have only one purpose, to preserve the value of the Social Security benefit. That should be its only job. Trying to use it for anything else is disingenuous and a trick to hide benefit reduction.

I have written numerous times about how and why the CPI that is used today to calculate the COLA is flawed; that it uses data for young urban wage earners and clerical workers and doesn't reflect the spending patterns or expense requirements of seniors. We have vigorously supported a bill that would calculate an accurate CPI, the CPI for Seniors Act, which will mandate a fair and correct CPI for seniors, and thus a fair annual Social Security COLA. That's all it does, it doesn't "fix" anything, and it doesn't reduce anything. It just preserves the purchasing power of that Social Security check that seniors count on each and every month.

It is also important to remember that other entitlement reforms that have been put forth to date would only affect future Social Security beneficiaries. The instigation of the chained CPI and the ensuing reduction in benefits will affect all seniors **right now** and the compounding affect will increase that impact more and more each year.

An option that deserves serious consideration is the creation of an accurate and fair CPI for seniors to ensure it does its simple and singular job of protecting the purchasing power of the Social Security checks that come each month. Entitlement reform and debt reduction should be dealt with in a clear and forthright manner, not hidden behind a chained CPI.



Thair Phillips
President, RetireSafe

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