Committee On Finance

Max Baucus, Ranking Member

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Contact: Russ Sullivan/Wendy Carey
202-224-4515

Statement of U.S. Senator Max Baucus
United States Senate Finance Committee Hearing
"Social Security: Achieving Sustainable Solvency"

Thank you, Chairman Grassley, for calling this hearing, focused on extending the life of Social Security, without private accounts.

And Mr. Chairman, that last part is key. For if we are to have any hope of enacting legislation this Congress to strengthen Social Security, then the President needs to leave his effort to privatize Social Security behind. Once the President disavows private accounts in Social Security, then he will find Democrats willing and able to join him in an effort to strengthen Social Security for the century to come.

Social Security is America's most important domestic program. If Social Security did not exist, most of our seniors would live in poverty. With Social Security, just 1 in 10 seniors do.

Under current law, the Congressional Budget Office projects that Social Security can pay full benefits until 2052. In the year after that, Social Security will be able to pay about 80 percent of benefits. We need to improve Social Security's finances so that it will be able to pay full benefits after 2052. But we do not need to make drastic changes.

Unfortunately, we are going to be hearing about drastic changes today. The testimony of the Director of the Congressional Budget Office will provide data on three options to achieve sustainable solvency of the Social Security program. Unfortunately, however, each option results in deep benefit cuts for both middle-class and low-income Social Security beneficiaries. I do not think these deep cuts would be acceptable to most of the American public.

Let me be more specific:

- The first option put forward is "price-indexing," just as in Model 2 of the President's Social Security Commission. The President's advisors suggested in January that the President liked this option, although they have backtracked since. CBO's testimony indicates that this option reduces all benefits by about 50 percent after 63 years. These are huge benefit cuts. Moreover, these big cuts would also apply to disability benefits, and to survivors' benefits when workers die during their working years.

- The second option being put forward is similar to the President's "partial price-indexing" plan. He endorsed this plan in his press conference a few weeks ago. Like the President's proposal, this option has deep benefit cuts for the middle-class and deep benefit cuts for survivors. For example, workers with average earnings who are born today and retire at age 65 would have their benefits cuts by 31 percent.

But this option also cuts benefits for some low-income workers who were protected under the President's plan. For example, all low-income workers with average career earnings as low as $15,000 in today's dollars would receive benefit cuts under this newest option. Moreover, the new option would also make deeper cuts in benefits for the disabled than the President's proposal would.

- The third option put forward today would raise the retirement age to about 70 years for all workers who are born ten years from now. Currently, the retirement age will rise to 67. This is a big increase. As if that were not enough, the option would also cut benefits by changing the way benefits are indexed. This would reduce benefits by 27 percent for earners in the middle of the income distribution who are born this year and retire at age 65. Even worse, it would cut benefits for workers in the lowest fifth of the income distribution by 33 percent. And these deep benefit cuts would apply to survivors of deceased workers and to disabled workers as well.

Once you look at the details, I think it becomes clear that these three new options cut benefits for Social Security beneficiaries far too deeply. We need to scour all other ideas for improving Social Security's long-run finances.

Unfortunately, the President's privatization plan would also cut benefits for Social Security beneficiaries far too deeply. And it would also add massively to our federal debt.

The President's plan has two basic parts. The President's first proposal is to privatize Social Security. The President wants to allow workers to divert some of their payroll taxes out of the Social Security Trust Fund and into private savings accounts. He also proposes that when these workers retire, they must pay back the federal government all of the money that had been diverted, plus interest, compounded at a rate of 3 percent above the inflation rate. The President would dock retirees' Social Security checks to collect the repayment. This privatization proposal is a bad idea, for several reasons.

First, this proposal makes Social Security's solvency worse, not better. Suppose we consider Social Security's health over the next 75 years, as has been traditional. The diversion of funds from the Social Security Trust Fund takes place during the working years of the individual, but the repayments of the funds first begin after the worker retires. So for some workers, the repayment occurs outside the 75-year window. This timing gap worsens Social Security's 75-year solvency.

Coping with this increase in insolvency would cause pain. To make up for this added insolvency with benefit reductions for retirees -- while protecting the benefits of survivors and the disabled -- the federal government would need to cut retirement benefits across-the board by more than nine percent. I would further note that the average benefit for a retiree today is about $11,000. A benefit cut of nine percent would mean a loss of about $1000 a year to that average retiree. So privatization is a self-inflicted wound to solvency. It just does not make sense.

The second problem with privatization is that it would cause a massive increase in federal debt. The debt would go up by about $5 trillion during the first 20 years. That is because the federal government would have to borrow money to buy the stocks and bonds that it would put into each worker's private account.

The $5 trillion of new debt would more than double the size of federal debt held by the public today. At some point, all of this extra debt would drive up long-term interest rates in the U.S. This would slow economic growth and reduce our standard of living. And this added debt would result in foreigners owning a lot more of our financial assets. This means that the earnings on these assets would benefit foreigners, not U.S. residents. Foreigners already own almost $2 trillion of our debt. Privatization would probably double that amount.

Moreover, much of our debt is currently owned by the central banks of foreign countries such as China, Japan and South Korea. If the dollar were to start dropping even more in value than it already has, these banks might fear that the U.S. debt they owed would start plunging in value. They might feel compelled to sell that debt. This would cause interest rates here to spike. And that could bring on a recession.

The third problem with privatization is that it could cause many workers to lose money. Under the President's proposal, if your earnings do not average at least 3 percent above inflation for your working years, you will lose money. But the Congressional Budget Office projects just that. If you make even slightly less than that rate of return, you will suffer a loss.

Unfortunately, the President has also endorsed a second bad idea. That is cutting benefits by changing the "indexing" of initial benefits. The President's plan would severely cut Social Security benefits for middle-income retirees, as I discussed earlier. And these cuts would occur regardless of whether the worker opts for private accounts.

But that's not the end of it. The President's chief economic advisor, Allen Hubbard, said last week that the President's plan would cut Social Security survivors' benefits too. Mr. Hubbard also admitted that under the President's proposal, disability benefits for workers and their families would not be fully protected from cuts.

But as bad as privatization is by itself, and as bad as the middle-class benefit cuts are standing alone, they are even worse when they are combined together. Yet that is what the President is proposing. As noted earlier, workers who opt for private accounts will have their Social Security benefits reduced when they retire. Also, as noted earlier, the President's plan would cut benefits of middle-class beneficiaries, regardless of whether they had opted for private accounts. The combination of these two benefit cuts for a worker born 5 years from now with career average earnings of $59,000 who retires at age 65 would be a cut of 97 percent. For a worker with career average earnings of $90,000, the benefit cut would be 100 percent.

Yet even with these cuts, the President's plan would not come close to eliminating Social Security's insolvency. Under the projections of the Social Security Actuaries – which the President is using – this combination would eliminate only about 30 percent of Social Security's financing shortfall over 75 years. The President would have to propose a lot more savings, probably huge benefit cuts beyond those he has already proposed.

The disadvantages of the President's two proposals – in combination or separate -- greatly outweigh any advantages. We need to leave the President's plan behind. Rather, we must scour all of the options available to us to eliminate Social Security's 75-year solvency shortfall. For example, we need to look at tax compliance for Social Security employment taxes.

The Joint Committee on Taxation and the Treasury Inspector General for Tax Administration each have made recommendations for improving compliance with employment tax law. The changes that they are recommending would increase income to the Social Security Trust Fund. We should not cut the benefits of any law- abiding retiree by one dime or raise the taxes of any law-abiding worker by one dime, until we have done our best to ensure that all taxpayers are complying with the current tax law. And the same holds true with respect to any improper payments that are being received on the benefits side of the program.

I look forward to hearing the testimony and the discussion from our fine panel of witnesses. The sooner that we get the President's plan behind us, the sooner we can turn to the real business of improving Social Security's finances for the long run.

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