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Rep. E. Clay Shaw Jr., Chairman

Hearing on

Efforts to Inform the Public about Social Security

Testimony Presented
By

Ron Gebhardtsbauer, MAAA, FSA
Senior Pension Fellow
American Academy of Actuaries

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The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear, objective analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.

Chairman Shaw, committee members, staff, and fellow panelists, Good Afternoon. My name is Ron Gebhardtsbauer and I am the Senior Pension Fellow at the American Academy of Actuaries. The Academy is the nonpartisan, public policy professional organization for actuaries in the United States. We at the Academy thank you for inviting us to speak at this hearing on “Efforts to Inform the Public about Social Security.”

In the interest of time, I have provided the subcommittee with copies of my full testimony on this subject, so that I can focus on my most important points. I’ve been asked to discuss two proposed bills that recommend adding information to the Trustees Report. These are H.R. 3578 and S.2249. I also will comment on the 1999 Social Security Advisory Board Technical Panel recommendations for expanding the data included in the Trustees Report.

What Issues about Social Security Are of most Concern to the Public?
One of the more interesting parts of my job over the past 4 years was to serve as the Social Security expert at many Town Hall forums across the country sponsored by Members of Congress, the White House, and several non-partisan organizations.

At the Town Hall forums, the most frequent questions were:
- Did Congress really spend our Social Security money?
- Are Social Security’s bonds real money, or not?
- Will Social Security be there for me when I need it?
- Are we getting a good return on our contributions?

The Questions are Really for Congress: Unfortunately, these questions ultimately cannot be answered by a Trustees’ Report or a Benefit Statement from Social Security. They can really only be answered by Congress. It will be difficult for Social Security to answer these questions fully until Congress puts Social Security back into balance. Nevertheless, the American public can find much valuable information in the annual report of the Social Security trustees.

The Trustees’ Report
In preparation for this testimony, I reviewed Social Security’s web sites and was fascinated by how extensive they were. For example, they have all the Trustees’ Reports back to the first one in 1941. The first one was only 12 pages. The past was so much simpler. Yet it had many familiar items, such as graphs and charts, optimistic and pessimistic assumptions, caveats about how hard it is to forecast the future, and important dates (e.g., when benefits would exceed taxes and funds would be exhausted). Over the past 6 decades, Social Security has responded to the needs of the public and Congress by including many more items. Current reports are around 220 pages.

Suggestions for additional information in the Report: However, various experts and recent advisory panels have suggested including still more information in the Trustees’ Report. See the attached recommendations from the 1999 Technical Panel. Many of their suggestions are valuable. I will discuss the controversial ones and provide advantages and disadvantages, so that you can decide if you want to require them.

For Comparing Reform Proposals: Some items would be very helpful for comparing specific proposals (**e.g., projections of poverty rates and budget deficits**). For example, some reform proposals use Individual Accounts, which could increase poverty rates among the elderly. Other proposals fix this by subsidizing small accounts or coupling them with a flat universal benefit. That could reduce poverty rates. Thus, you may want poverty projections for comparing these proposals before voting on them. Other reform proposals from both sides of the aisle use General Revenues. Again, you may want a projection of future budget deficits (such as those found in the recent GAO Report HEHS-00-29) to compare these reforms. Thus, some items may only be needed in certain circumstances, and may not be needed forever, especially after you put Social Security back in balance. Therefore, instead of requiring them in the Trustees' Report, you may want to just encourage Social Security to put them in a separate report and/or on their web site. You may find that they would be happy to do that. The Trustees have taken prior Technical Panel reports seriously and generally respond to their suggestions. In addition, you might give them some time to determine how best to provide them or display them, so it may be preferable not to be too specific in your requirements.

The Academy has also released today, *Quantitative Measures for Evaluating Social Security Reform Proposals*, which provides policy makers with a framework to evaluate the financial effect of competing reform proposals on the program's long-term solvency and the impact of proposed changes on the financial needs and expectations of current and future workers. A copy of the issue brief is attached to my testimony.

Budget Projections: There are difficulties in calculating some of the numbers (e.g., the budget projections). The Trustees would need to reproduce the extensive budget projections from OMB, and would have to convert them to the Trustees' assumptions, so that the projections are consistent. In addition, they would have to project OMB's numbers beyond the typical 10 years that they project them, and decisions would have to be made on whether dynamic scoring should be used. But this is not an insurmountable problem. GAO has made such a projection (GAO Report: Evaluating Reform Proposals HEHS-00-29). There may be an **unintended consequence** though. The administration might push for using the OMB assumptions instead. In the past, the actuaries strenuously objected to using OMB's or CBO's assumptions for fear that they might be politically motivated (however slight it might be). If the actuaries are forced to calculate budget numbers using OMB's or CBO's assumptions, it could harm the independence of their work. Possible solutions would be for the bill to require using the actuaries' assumptions, or require CBO to perform the budget projections.

Stochastic valuations: The current report provides the Trustees' best estimate of what they think will happen in the future, along with an optimistic and a pessimistic projection. A stochastic projection will estimate the probability that the system will fail in 75 years. You may find this an interesting piece of information and helpful if you want to quantify when a certain reform proposal is more risky, such as a reform that would invest in stocks. On the other hand, **it can have some drawbacks besides being complex and expensive. It can be confusing and have unintended consequences on policy.** Congress really wants only one answer, but stochastic valuations will provide multiple answers, and they may not be the answers you want. For example, suppose Congress puts Social Security back in balance the usual way using our best estimates of the future. The next day's headline, using a stochastic valuation, might say "Social Security's probability of failure is now only 50%." I'm not sure that is a message Congress would like. On one hand, that is reality. On the other, it could make Congress look bad. Would it push Congress to raise taxes further in order to assure a lower level of failure? Thus, using the stochastic measure could make Social Security more expensive. In addition, arguments about the assumptions will escalate, because the Trustees would have to determine the shape of the distribution for each assumption, the standard deviation from the mean, and the covariance with all the other assumptions. If you think people are arguing about the assumptions now, wait until you have stochastic valuations.

Money's Worth Tables: Some additions are **voluminous** and would dramatically increase the size of the report with tables of many numbers and graphs (such as money's worth tables). As the 1999 Technical Panel suggested, this item can be shortened by just doing prospective money's worth calculations for small number of age and income cohorts. Retrospective returns depending on how long you lived, whether you received a disability benefit or survivor benefit, etc., can produce a voluminous amount of results.

Money's Worth numbers can be **misused and misleading**. For example, Social Security's assets had a yield of 7% this past year. People are pleasantly surprised when they hear that. They think it is lower, due to what other people say the returns are using money's worth calculations. These implicit rate of returns should not be compared with market returns. They can even be negative for some people. But that's the nature of insurance - you don't mind it when your insurance policy doesn't pay off (e.g., you didn't get in a car accident). In that situation, your rate of return is more than a little negative; it's negative 100%. You didn't get any money back on your insurance premium. You can also get negative returns on social welfare programs and taxes, because some people pay in more than they get back. Thus, this rate of return *cannot, should not*, be compared to the yields you get on your assets. If we decide to privatize Social Security, we will still have to pay benefits to our parents. Thus, at least some, maybe all, of our contributions are going to someone else. A money's worth analysis forgets that we can't get out of that promise to our parent's generation. In addition, in Social Security, single people are paying taxes that help married people, and high-income people are paying in for lower earners. If they have a low return, it may be because their contributions are going to others. This wasn't a problem in the past, because they would get more from the next generation. But now the system is mature, that won't happen again (unless fertility rates increase dramatically or our current huge productivity gains last forever). As you can see, individual money's worth analysis, gets more to the question of distribution among classes. If we want the system to have a better return, we can invest in stocks or just increase the bond yields by Congressional action. (Since it is Congress that keeps Social Security from investing in stocks and corporate bonds, they could compensate by giving them a return of 10% will just raise our income taxes and it will add an element of politics into the system.) There is another concern with rates of return analysis. One way to fix Social Security would be to give it $5 trillion of General Revenues. The rates of return would look great, but that wouldn't be fair. All sources of contributions must be included in the calculation, so that the comparison is not manipulated. This is not as easy as it sounds however. For example, how would you calculate it if Congress gave Social Security's bonds a slightly better rate of return? (Should some of the additional investment return be included in contributions?)

Thus, providing each individual's rate of return can be misleading, so we need to be careful, before we require them.

One last concern for individual rates of return for Social Security is that they depend on how Social Security will be fixed, and who will be affected. So again, Social Security can not adequately answer this question - only Congress can.

Social Security could just provide some of the extensive recommendations on their Web site, not the Trustees' Reports or benefit statements, unless you think they would be misleading even on the web site.

Recent proposed legislation, H.R. 3578, would require certain additional items in the Trustees' Report. We discuss the advantages and disadvantages, so that you can assess them.

The Unfunded Liability (and Change since Prior Year): This number is useful for reform proposals that want to move to an advance-funded system. It is sometimes referred to as the closed group obligation, the transition cost, or the unfunded termination liability, and would be around $9 trillion today. Private-sector pension plans are required to display their unfunded termination liability prominently. However, some people contend that it is not a relevant number for an ongoing Social Security system, which is just a transfer system from workers to retirees. They contend it should not appear in the Report, because it will be confused with the open-group unfunded number (approximately $3 trillion today). When the system gets back in balance the open-group number will be zero, but the closed-group number will still be around $9 trillion. Will this confuse people? Advocates of this number say it is important for us to acknowledge that Social Security is not advance funded and that we have made these promises without funding for them. I can only give the advantages and disadvantages on this, not take a position. It is a political issue for you to decide if you want to require it and how prominent it should be - whether it should be in the Summary, the Report, or just available on a website. The number is calculated annually already, so it won't add any administrative costs. H.R. 3578 would have to define it better. For example, is it the number that private-sector plans must provide - the closed group unfunded termination liability or is it the on-going unfunded accrued liability? Is it a calculation closed to just the people paying into the system today, or is the calculation open to new workers coming into the system in the future. If open, is it open forever or limited to 75 years? H.R. 3578 has 3 versions. Only the present value calculation is meaningful. Another would just add up nominal dollar unfunded amounts from the future. Another uses CPI-adjusted numbers. These two numbers are misleading and should not be used. They can increase dramatically even in good years (e.g., if productivity improves), which is a not a helpful result.

The Deficit in the Last Year of the Projection: This amount is helpful for understanding the sustainability of the system and already appears in Table III.B4 on page 183 ($7 trillion in 2075 dollars). H.R. 3578 also wants the inflation-adjusted amount displayed more prominently. Relating it to pay or GDP would be preferable. Chart C in the Summary shows the 2075 deficit is 6% of taxable payroll. This is more meaningful than the $7 trillion number or even the $300 billion number which is inflation-adjusted, because benefits and taxes increase at rates more closely tied to pay. The further out in years, the more the numbers become misleading by the additional compounding over the inflation rate. This deficit is also discussed in the Summary, which states that the benefit outgo is 1 ½ times as large as the tax income in that year.

The Economic Model, Relevant Data, and Changes: We agree that all of these items should be in an actuarial valuation. In fact, actuarial standards of practice require that actuarial valuations be sufficiently documented so that another actuary can assess whether the results are reasonable. If the sponsors are encouraging more details, I note that page 144 refers the reader to a web site and some Actuarial Studies (which are listed on the web) that can be requested from the Office of the Actuary.

Quality of Trust Funds' Assets: H.R.3578 also requires the Trustees' Report to explain that the Trust Fund balances are not real economic assets. This hints at the very controversial debate on whether the money is real or not. However, I don't know if Congress can do this without contradicting its full faith and credit backing of the bonds. I think I know what the sponsor wants. Prior Trustees' Reports gently expressed a concern about how the bonds would be redeemed, which might be acceptable. Maybe people can work together to finesse this difference without the law getting into this controversy. The proposed bill requires the Report to state that Congress will need to raise taxes, increase the debt, or cut benefits to redeem the bonds. This is a reasonable factual statement.

Technical Panel: Another bill (S.2249) says it's the Sense of the Senate to implement the recommendations in the 1999 Technical Panel's report. Many of them have value, and we have discussed some of their advantages and disadvantages already. However, some people are concerned about an unintended consequence of referencing the 1999 Panel in the bill. You may prefer that a bill just state its specific requirements without referencing the Panel. Citing the Panel elevates them above the Trustees (which includes their bosses' boss - the Commissioner of Social Security, and also the Secretaries of Treasury, HHS, and Labor). In addition it could give future Panels (which might have very different ideas) more importance than you might want, or it could give some items in the 1999 Report more authority than you wanted. **Do you agree with all of the recommendations?** How important are they? Are their benefits worth the cost to provide them? If some of them take an inordinate amount of space, could they be on the web instead and referenced? Since the suggestions are from a panel of experts, we doubt that any of their requirements would be misleading to knowledgeable readers, but some people are concerned that items, such as stochastic valuations and internal rates of return, could confuse and mislead some people. There are lots of items in those 100 pages of their report. Some additional advantages and disadvantages of S.2249 follow:

Emphasize income and cost rates and balances for all 75 years with the same emphasis as the actuarial solvency numbers. It appears that all 225 numbers are being required in all the places the solvency number appears. Since this would take a lot of space, maybe the intent is to just have it appear up front, prominently. Since the intent is to present measures of long-term sustainability, maybe only the 75th year is needed, as suggested in H.R. 3578.

Percentage Increase in Taxes/Decrease in Benefits Needed for Solvency in all 75 years: These percentages can be determined by a quick division from numbers in the Report (e.g., Table

II.F.13 or III.B2, or B3, or B4, or C1). They will add to the length of the report, but can be helpful.

Effects on National Savings: These numbers can be important when comparing certain reform proposals. For example, if contributions are increased (whether for the Trust Fund or for Individual Accounts) and/or benefits cut, National Savings could increase, which could have other beneficial affects on productivity and the economy. However, there is strong disagreement on whether savings will increase a lot or a little. Some would say they are **unknowable**. In fact, there are disagreements even on how to measure savings (e.g., whether to include capital gains). In addition, these numbers are primarily of value in comparing proposals.

Effects on the Budget: Again, these numbers are valuable when comparing certain reform proposals. For example, some reform proposals use General Revenues, which can increase future budget deficits. Members will want projections of these deficits (such as those found in the recent GAO Report HEHS-00-29) to compare these reforms. Thus, this item may only be needed in certain circumstances, and may not be needed forever, especially after you put Social Security back in balance.

Average Lifetime Values of Benefits (by age, income, gender, and type of benefit): As the 1999 Technical Panel noted, this will show that the value of *lifetime* benefits received from Social Security is increasing as people live longer. Life expectancies also show this. The panel also noted that the lifetime values can help us compare lifetime benefits from reform proposals that distribute benefits in different patterns. The panel however, recommended fewer numbers for the Trustees' Report. They suggested the larger group of numbers be available electronically. Some panel members also suggested that the lifetime value of taxes paid also be provided. This would help the reader determine their money worth, the advantages and disadvantages of which were discussed earlier.

Conclusion

Experts and panels have recommended new items for the Trustees' Reports, many of which are valuable. **Social Security may over time accept many of them, as they have in the past.** However, if Congress chooses to mandate certain items, I would suggest it study them thoroughly. Some recommendations may be costly and you may want to do a cost-benefit analysis before requiring them. Some are voluminous, so you may decide that they are important enough to have somewhere, but not necessarily in the Trustees' Reports. Some items are good but they need to be defined better and clarified, so that they are not misleading. Some items are only needed for today's reform proposals, which is why they are not in the annual Trustees' Report. They may not be needed in the future. However, they may be needed as a base number from which to compare the proposals. Thus, they can go on the web site if necessary, but they don't have to be in the Report. Some may cause confusion or be misleading, so you will want to be careful before adding them. Some proposals just want more prominence for certain items, which shouldn't be a problem, unless you think the prominence over-emphasizes them to unwary readers. Some have **unintended consequences**. For example, the 1999 Technical Panel's recommendation for stochastic valuations could raise Social Security taxes.

Hopefully by providing these advantages and disadvantages, you will be able to decide which additions are important enough to require by law.

Finally, my experience listening to participants at Town Hall forums around the country has revealed that the public's most important questions can not be answered by the Trustees' Report, only by Congressional action. We at the Academy are available now and any time in the future if you have more questions. Thank you for inviting us to speak at this hearing.

1999 TECHNICAL PANEL Table of Recommendations

Presentation Issues (for the Trustees Report and elsewhere)

! The format can be improved to allow easier access and understanding.

! The uncertainty of projections should be displayed more clearly and in ways that reflect better the relationship of that uncertainty to the design of the law.

! Cohort life expectancy should be shown (period life expectancy, as now shown, is easily misunderstood).

! The lifetime value of benefits (and possibly taxes) for various types of workers over time should be displayed.

! Alternative estimates of the unfunded obligations of the Social Security system should be presented in the Trustees Report.

! Traditional definitions of “typical workers”—low and average earners—result in an overstatement of the lifetime income and benefits of the typical low-income and average-income worker and should be revised.

! Less emphasis should be placed on the 75-year actuarial balance and more on long-term sustainability (as reflected, for instance, in balance during the last part of the projection period).

! Benefits under existing tax rates and taxes under existing benefit rates should be presented to better reflect consequences of current law.

! Prevalence rates for Disability Insurance, not just incidence rates of new awards, should be displayed.

Methodology and Models

! A published consistent set of criteria is recommended for comparing reform proposals and current law.

! General equilibrium modeling is necessary for consistency and to understand interactions.

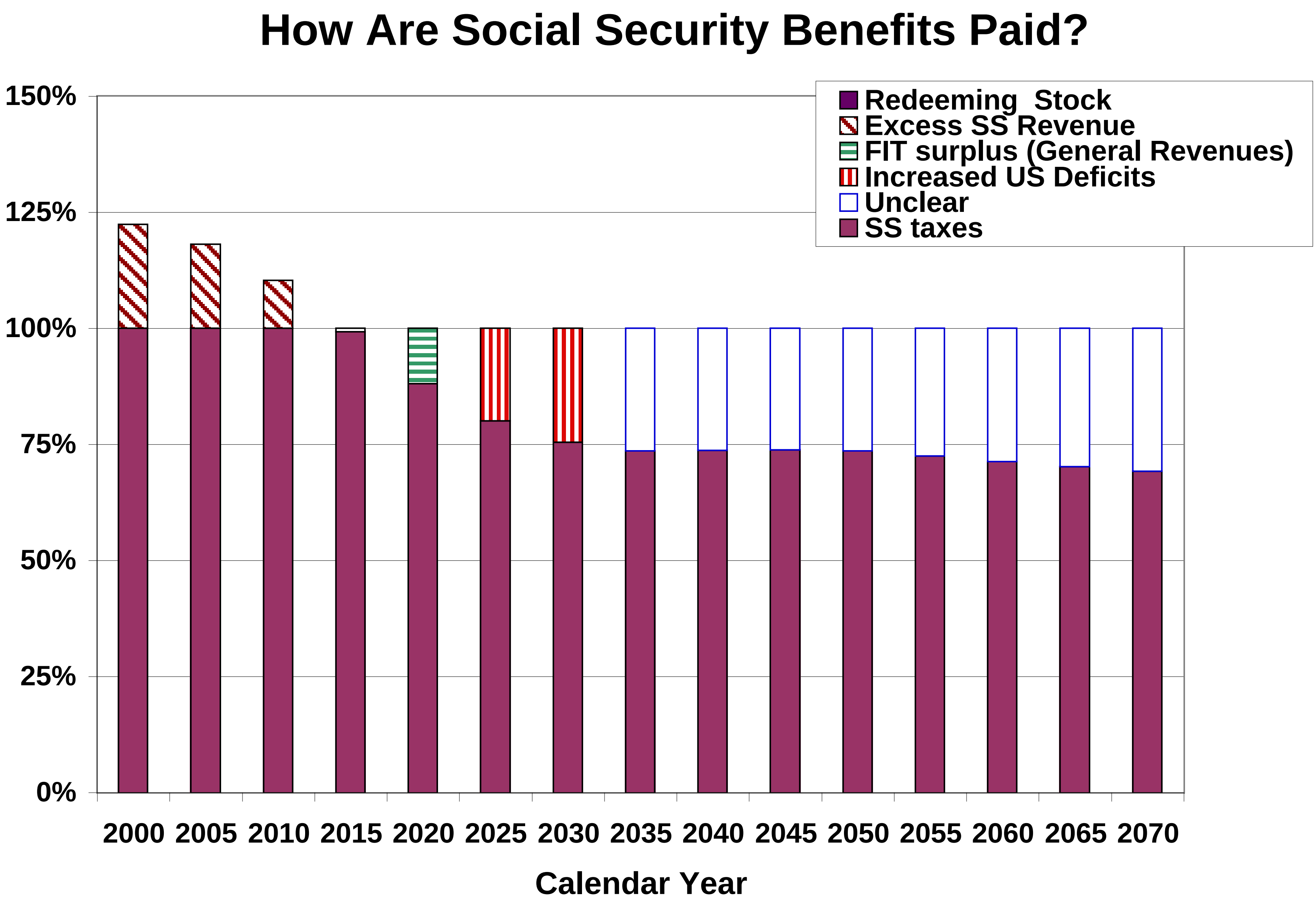
! Models (micro simulation) to demonstrate distributional effects, as well as to estimate better those features influenced heavily by distributional factors, are necessary and must be enhanced significantly.

! Greater public access to Social Security information should be encouraged.

! Ongoing technical review of several issues is necessary.

! Modeling capabilities (stochastic modeling) are necessary to display uncertainty and the effect of policy on that uncertainty.

! Estimation methodology would benefit from new techniques to reflect consistency among variables



Redeeming SSA Treasuries requires General Revenue (surplus income taxes) or more Deficits
Future surpluses depend on debt repayment, no tax cuts or increased govt programs, good economy
Increased deficits or stock redemption increases borrowing costs