



U.S. REPRESENTATIVE • 4TH CONGRESSIONAL DISTRICT • OREGON

# PETER DeFAZIO

## R E P O R T S



### Memo

**Da:** January 2005  
**To:** Oregonians in the 4th Congressional District  
**Fr:** Peter DeFazio  
**Re:** Social Security

Social Security reform is a major issue in Congress this year, so I'd like to offer you some background information as we begin the debate.

Social Security is a critical program that provides retirement, disability, and survivor's benefits to 47 million seniors, widows and widowers, disabled workers, families and children. **Contrary to what you often hear, Social Security is not in crisis.** It is fundamentally sound and can remain so forever with only moderate changes.

Nonetheless, the President intends to partially privatize the program, which will make Social Security's financial situation worse, not better, and lead to large benefit cuts.

For more information, visit my web site at: <http://defazio.house.gov>.

## Social Security and Gen X

There are two familiar refrains from young people about Social Security: (1) it's only for old people, (2) it won't be there for me when I retire. Both are wrong. Changes made to the system today will have the greatest impact on people age 35 and younger.

Social Security isn't just for retirees. It also provides death and disability insurance for families.

**More than 3.5 million Americans under age 18 currently receive Social Security benefits because a parent died or became disabled.** The survivor and disability benefits available to young people can help them or their family overcome life-changing tragedies by providing financial resources to get back on track (see *Benefits* under FAQ).

Wages have been declining for young people since the 1970s, which makes it harder to save. **Social Security provides a safety net for young people who don't earn enough to build their own nest egg for retirement or disability.**

Previous generations enjoyed pensions from their employers. Today, less than 21 percent of workers have guaranteed pensions. **Social Security provides a guaranteed pension**, adjusted for inflation, and is not vulnerable to stock market downturns.

Social Security lifts millions of seniors out of poverty, which means that young people don't have to support their parents or grandparents.

**But will it exist without being changed when Gen X retires? Yes.**

Social Security will be able to pay 100 percent of promised benefits through 2042 or 2052, depending on who you ask. Even after that, because future workers will still be paying payroll taxes into the system, **Social Security will be able to pay at least 75 percent of promised benefits without any changes whatsoever.** The projected shortfall can be fixed with only modest changes. Young people need to know that Social Security will never be "bankrupt" in the sense that it couldn't pay any benefits at all to future recipients.

## SOCIAL SECURITY FAQs

### GENERAL BACKGROUND

**When was Social Security created and why?**

Social Security was established in 1935. **The law created a guaranteed, no-risk retirement pension in an effort to reduce poverty among seniors.** The hope was that Social Security would serve as one leg of a three-legged stool for a secure retirement—private savings and employer-provided pensions, the other two.

Before Social Security, more than half of seniors lived in poverty. Today, fewer than 11 percent fall below the poverty line.

Benefits for survivors of deceased workers were added in 1939 and for the disabled in 1956.

**Who receives benefits?**

Social Security is a family protection plan that provides retirement, life and disability insurance to all wage earners. Today, more than 47 million Americans are collecting benefits. Nearly one-third of beneficiaries are children, disabled workers, and survivors of deceased workers, not seniors.

**What do the benefits mean to the average family?**

It's a guaranteed insurance plan for your family.

**In old age:** Average seniors (those with a median income of \$19,000/year) rely on Social Security for two-thirds of their income. It's the only source of income for nearly 20 percent of retirees.

**If you become disabled:** Social Security provides the equivalent of a \$353,000 disability insurance policy, replacing around 65 percent of earnings in the event of a disability. Workers have a 3-in-10 chance of becoming disabled during their life.

**If you die:** Social Security provides the equivalent of a \$403,000 life insurance policy, replacing up to 80 percent of earnings. A 20-year-old has a 1-in-5 chance of dying before reaching retirement.

### A PRIMER—HOW IT WORKS

**How is Social Security financed?**

Social Security is primarily financed by a mandatory 12.4 percent tax on wages up to \$90,000 a year, divided evenly between employers and employees. Around 70 cents of every dollar paid into Social Security goes out immediately to pay benefits for current recipients.

**What is the Social Security Trust Fund?**

In 1983, President Reagan signed a large payroll tax increase into law to prepare for the retirement of the so-called Baby Boom generation. **This year, Social Security will collect \$180 billion more in payroll taxes than is needed to fund benefits for current recipients.** This surplus is credited to the Social Security Trust Fund and then invested in government bonds that pay interest to the Trust Fund. The Trust Fund already has assets of more than \$1 trillion, which will grow to \$6.6 trillion by 2027.

[FAQ continued on page 2](#)

# Social Security and Small Businesses

**Partial privatization of Social Security will result in a massive new burden on millions of small businesses.** Under current law, the 25,000 largest employers in the country file daily wage reports with the IRS, which then transfers revenue to Social Security. Small businesses report to the IRS every two weeks, every month or every quarter, depending on the number of employees.

Under a partially privatized system, the accumulation in an individual's account will be sensitive to the timing of deposits and investment choices, requiring small businesses and the self-employed to regularly report wages to the government, perhaps weekly or daily. Otherwise, employees could miss out on stock market runs.

In addition, 30 percent of employers still make paper filings with the government. This can delay reporting and lead to errors that would be unacceptable under a system with individual accounts where contributions and investments must be precisely tracked.

Under the President's plan, it is likely small businesses, even those that don't currently offer a pension plan, will be forced to make expensive investments in computerized reporting systems to meet the requirements of partial privatization.

## Partial Privatization & Tradeoffs

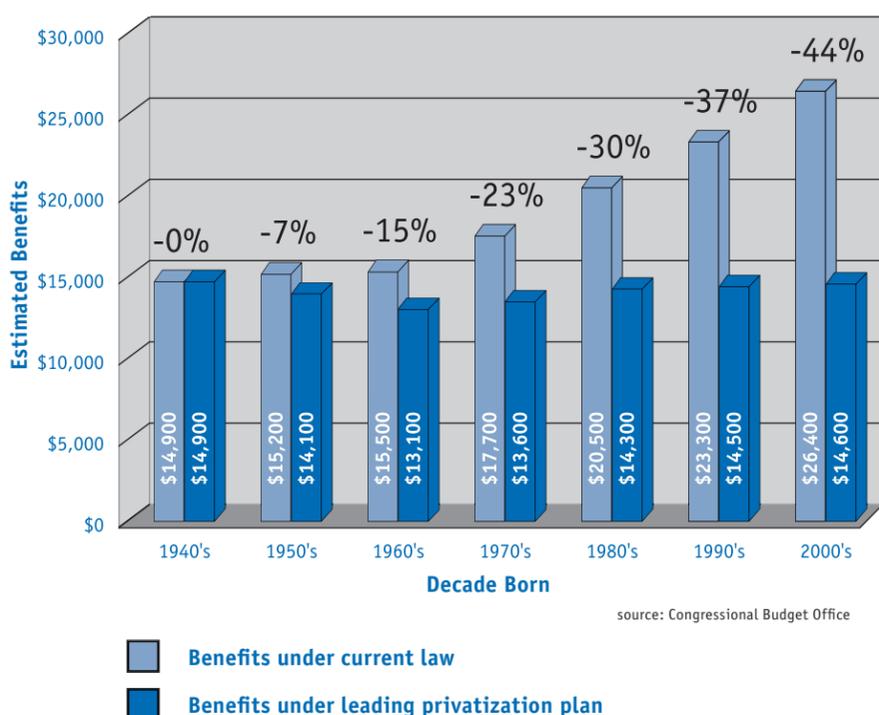
**Social Security is not in crisis.** Under conservative estimates, the program will be able to pay 100 percent of promised benefits for at least the next 40 years, if not longer. And if no changes are made to the program, Social Security will still be able to pay at least 75 percent of promised benefits after 2042.

Despite the claims, partial privatization doesn't fix that potential future financial shortfall, it makes it worse.

Diverting payroll taxes to establish private accounts creates an even bigger financial gap. To cut the gap, the leading partial privatization plan cuts benefits. According to the CBO, workers currently in their 20's will see an average benefit cut of 30 percent under partial privatization. Workers born in 2005, will see cuts of 44 percent or more (see chart below).

Under my plan, promised benefits are maintained. In fact, working Americans would receive a tax cut. Too good to be true? See page 3.

### Cuts to Guaranteed Benefits Under Partial Privatization



## FAQ continued from page 1

### Is money being borrowed from the Trust Fund?

The Trust Fund operates much like your local bank or credit union. When you deposit money in your bank, the money doesn't just sit in a box waiting for you to return and claim it. Rather, your bank lends the money out to other customers, who then repay it with interest. However, the bank must maintain enough cash on hand so when you choose to withdraw your money, the bank has the resources to cover the transaction.

The excess payroll taxes deposited into the Social Security Trust Fund are invested in government bonds, which are owned by the Trust Fund and backed by the full faith and credit of the United States government. The actual dollars are then available for other purposes.

### What should the government do with Trust Fund money?

In the late 1990s, a group of us tried several times to stop Congress from borrowing and spending surplus Social Security revenue on current government programs. We were successful in protecting the surplus in 1999 and 2000 with something called the "lock box." Under the lock box, surplus Social Security revenue was used to pay down federal debt rather than spending it on other government programs.

Unfortunately, the "lock box" protection for these surpluses ended in 2001. Most recently, in his fiscal year 2005 budget, the President proposed borrowing \$180 billion from Social Security in 2005, and \$1.1 trillion over five years to pay for other government spending and tax cuts.

### Are the bonds (IOUs) held by the Trust Fund worthless?

The U.S. Treasury bonds issued to Social Security are financial assets in the same way that stocks, corporate bonds, or U.S. Treasury bonds purchased by foreign investors are assets. **They represent a legal claim on revenue, and are backed by the full faith and credit of the United States.** The federal government must honor the debt to the Trust Fund when it comes time to redeem the bonds.

## THE FUTURE: SOCIAL SECURITY IS NOT IN CRISIS

### What does the long-term future look like?

To get a sense of Social Security's long-term financial picture, the Social Security actuaries make projections over a 75-year time period, using economic and demographic information like: life expectancy, the ratio of workers to retirees, economic growth, immigration, productivity, wages, and birth rates, among others. Obviously, the idea that someone today can predict with certainty what the U.S. economy will look like in 2080 is sheer fantasy. Just imagine what people in 1930 would have predicted for 2005. Would projections made at that time have captured the impacts of the Great Depression? World War II? The Cold War? Inflation in the late 1970s-early 1980s? The recent dot-com boom and bust? Not likely.

### Is Social Security in crisis and going bankrupt?

No. Even if the actuaries' projections were exactly right for the next seven decades, Social Security's finances are not nearly as dire as proponents of partial privatization want you to believe. **The bottom line is that payroll taxes, in combination with the Trust Fund, are sufficient to pay 100 percent of promised benefits through at least 2042**, nearly four decades from now. Even after 2042, Social Security will not be "bankrupt" and unable to pay any benefits at all, as some imply. Even if Congress makes no changes to Social Security at all, **the program will still be able to pay at least 75 percent of promised benefits after 2042** because of the payroll taxes being paid in by future workers.

### How reliable are the projections?

Even the 25 percent shortfall mentioned above is an educated guess. For example, the Social Security actuaries project economic growth will average a dismal 1.5 percent over the next 75 years. However, economic growth over the prior 75 years (including the Great Depression) was more than double that—3.5 percent. If the economy grows at the same rate as it has

in the past, then Social Security will be able to pay 100 percent of guaranteed benefits for at least 75 years.

Projections are very sensitive to changes in such things as the economy and population. Slight changes in those assumptions can effect future projections dramatically. For example, **because the Congressional Budget Office (CBO) assumes the economy will grow slightly faster, it projects that Social Security is financially sound until 2052, a decade longer than the Social Security Trustees.**

[Why do some claim Social Security faces a \\$10-12 trillion shortfall?](#)

This is a newly created estimate of the Social Security shortfall when measured forever (commonly referred to as the “infinite horizon”). It’s a radical and dubious departure from the traditional 75-year period used by the actuaries. The American Academy of Actuaries, the nation’s leading professional organization of actuaries, has stated that infinite horizon projections are essentially meaningless and were recently created to scare people into believing a program is in worse financial shape than it really is.

Measured over 75 years, Social Security’s financial shortfall is \$3.7 trillion. This happens to be equal to the 75 year cost of recent tax cuts given to those who earn \$311,000 a year or more. I think providing promised Social Security benefits for *all working Americans* should be a priority over giving tax cuts to the top one percent.

## THE PARTIAL PRIVATIZATION “SOLUTION”

[How will private accounts be financed?](#)

Most leading privatization plans allow individuals to divert one-third or more of their existing payroll tax revenues out of the existing system to a form of private account. However, because payroll taxes are used to pay current benefits and build the Trust Fund, **diverting a portion of payroll taxes into private accounts creates a huge gap in financing of at least \$1 trillion over the next ten years, \$3 trillion over the next twenty.**

There are three ways to fill the gap. **1)** Cut benefits as recommended by the President’s Commission. **2)** Increase taxes (double-taxing young people: once to fund benefits for current retirees and once to fund their individual accounts). **3)** Borrow trillions of dollars to finance partial privatization (taxing young people to pay for the borrowed funds). Further, **diverting payroll tax revenue to private accounts actually accelerates the financial challenges facing Social Security**, emptying the Trust Fund by 2021—two decades sooner than projected under the current program.

[Will benefits have to be cut under a partially privatized system? Will returns from private accounts make up for those cuts?](#)

**The leading partial privatization plan would cut guaranteed benefits by as much as 50 percent.** Private accounts may offset some of these devastating cuts if the investments perform well, **but experts believe the total benefit cut would still be at least 20-40 percent.**

[Would the cuts impact everybody?](#)

Under the leading partial privatization plans, **benefit cuts would apply to retirees, survivor and disability beneficiaries, and all other recipients, not just those who opt for individual accounts.**

[Will private accounts solve the possible financial shortfall in Social Security?](#)

Private accounts, by themselves, actually worsen the financial status of Social Security by diverting money from the existing system to fund the accounts. Private account plans rely on benefit cuts or borrowing to close the projected gap.

[The President talks about altering benefits, tying them to changes in prices rather than changes in wages. What does this mean?](#)

Because wage levels have historically risen faster than prices, tying initial benefit levels to prices will mean a benefit cut of 25-40 percent. Also, your check will replace a smaller percentage of your wages and salary over time,

## The DeFazio Plan

What if someone said you could receive both a tax cut and 100 percent of your promised benefits? Too good to be true? Think again.

With a few minor adjustments we can do both. I have offered a plan to stabilize and enhance the existing system. My plan has been certified by the Social Security actuaries as restoring 75-year solvency to the program. It would:

**Make the payroll tax more equitable.** Currently, wages above \$90,000 are not subject to the Social Security payroll tax. My plan eliminates this cap so, like Medicare, income above \$90,000 is taxed to support Social Security. Millionaires would pay the same percentage of their income to support Social Security as average Oregonians.

**Exempt the first \$4,000 in income from the Social Security payroll tax**, so everyone earning \$94,000 a year or less gets a payroll tax cut.

To increase returns to the system and to keep Social Security surpluses from being spent on other government programs, **allow a portion of the Social Security Trust Fund to be invested** on an aggregate basis by a private board in equities like stocks and corporate bonds.

**Improve the finances of widows and widowers**, by raising their Social Security benefit to 75 percent of their deceased spouses benefit.

## Privatization Overseas

Proponents of partial privatization point to Chile and Great Britain as successful models, despite problems with increased expenses and decreased benefits.

In 1981, the military dictatorship in Chile privatized the government-sponsored pension system. **The new system is less efficient than the system it replaced, costing three times more.**

While early returns on private accounts looked high, they were artificially inflated due to one-time events like selling off state-owned companies. A recent study found that the average worker would have gotten better returns just by placing their pension in a savings account. Because the private accounts have been smaller than expected, the Chilean government must supplement the accounts of more than 40 percent of recipients. The World Bank found that half of the pension contributions to the average account goes to management fees.

In 1986, Britain moved toward partial privatization. **Administrative fees have consumed up to 20 percent of a worker’s contributions**, with profits of financial firms exceeding 22 percent. Hundreds of thousands of workers lost money due to deceptive sales practices, leading to pressure for an \$18 billion bailout. Incentives to establish the accounts cost the government almost three times as much as what was saved by reducing state-run pension obligations. That’s not a record of success.

In the United States, Social Security administrative costs are less than 1 percent of benefits paid out.

## The Bottom Line...

**Payroll taxes in combination with the Trust Fund are sufficient to pay 100 percent of promised benefits through at least 2042 or 2052 according to CBO.**

**After that, the program will still be able to pay at least 75 percent of benefits into the future, without any changes.**

which means your standard-of-living will decline in retirement. It's like forcing today's seniors to live at a 1940s standard of living.

**Will private accounts provide a higher rate of return than the current system? Hasn't the stock market consistently yielded higher returns?**

No. **Social Security is not an investment program, it's an insurance program.** Unlike investments, Social Security provides a guaranteed benefit, adjusted for inflation, for the life of the beneficiary.

Second, in order to make privatized individual accounts sound attractive, partial privatization proponents assume very high rates-of-return from an individual's investment in the stock market. But at the same time, in order to claim a crisis in Social Security, they assume future economic growth will be slow. Proponents have not been able to show how the stock market would be able to yield 7 percent returns in the future when economic growth is projected to be only around half of what it has been in the past.

While the market has had a general upward trend, there were fifteen years in the past century in which the value of the stock market fell by more than 40 percent over the preceding decade. The General Accounting Office has reported that stock returns were lower than Social Security's annual yield 35 percent of the time from 1950-1996.

Due to stock market volatility, a worker who contributed to an individual account for 41 years prior to retiring in 2001 would have received a monthly check 40 percent smaller than a similar worker who retired two years earlier in 1999. Social Security doesn't have that variability.

**It's my money, shouldn't I be able to use it how I want?**

Even under the leading partial privatization plans, you wouldn't have the freedom to use the money as you please. Most plans would strictly limit you to investing in broad-based index funds or bonds. You could not pick and choose individual stocks or particular sectors of the

economy like high-tech or health care. You would not have access to the money prior to retirement. You might be limited in the number of times you could move money among funds. At retirement, you might be required to buy a lifetime annuity—a financial instrument that would pay you a fixed monthly stipend until death—thus ensuring that you don't outlive your assets, but also ensuring that you cannot pass on your account to an heir.

**What are the administrative costs of the current system compared to private accounts?**

The existing Social Security system is extraordinarily efficient, with administrative costs totaling less than one percent of benefits paid. By contrast, depending on the details of how they're set up, administrative costs for private accounts could consume 20 percent or more of your account.

## Do Members of Congress Pay Into Social Security?

There have been rumors circulating on the Internet that Members of Congress don't participate in Social Security. That is false.

Prior to 1984, Members of Congress were covered under a separate program, the Civil Service Retirement System. However, the law was changed in 1983 to bring Members of Congress into Social Security. Since January 1984, Members of Congress have been required to pay into Social Security, and have been eligible to receive benefits under the same rules that apply to all other workers.

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## Milestones: The Future of Social Security

**2010:** Baby Boom generation begins to retire (Trust Fund projected balance: \$3 trillion)

**2018:** Social Security begins to spend Trust Fund interest earnings to meet obligations (Trust Fund proj. bal.: \$5.2 trillion)

**2028:** Social Security begins to cash in Trust Fund bonds (Trust Fund proj. bal.: \$6.6 trillion)

**2042\*:** According to Social Security trustees, Social Security exhausts Trust Fund and resorts to a pay-as-you-go system, covering at least 75 percent of promised benefits into the future (Trust Fund proj. bal.: zero)

**2052\*:** According to CBO, Social Security exhausts Trust Fund and resorts to a pay-as-you-go system, covering at least 75 percent of promised benefits into the future (Trust Fund proj. bal.: zero)

\* As you can see, projections differ greatly. But even under pessimistic projections, Social Security will never be bankrupt. Even with no changes, the program will still pay at least 75 percent of promised benefits forty to fifty years from today and into the future.

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