House Committee on Ways and Means

Statement of Tim Lee, Board Member
Coalition to Preserve Retirement Security, Alexandria, Virginia

Testimony Before the Subcommittee on Social Security
of the House Committee on Ways and Means

June 23, 2011

Chairman Johnson, Ranking Member Becerra and distinguished members of the subcommittee, my name is Tim Lee and I am the Executive Director of the Texas Retired Teachers Association. I am testifying today in my capacity as a Board member of the Coalition to Preserve Retirement Security. On behalf of the Coalition, I thank you for the opportunity to appear before the subcommittee to discuss Social Security's finances. Specifically, I am here to discuss the issue of mandating Social Security coverage for public sector workers.

The Coalition to Preserve Retirement Security (CPRS) is a non-profit organization composed of members representing state and local governments, public employee unions, retiree associations, and public pension systems throughout the United States. The purpose of our organization is to assure the retirement security of millions of public employees by protecting the financial integrity of their public employee retirement systems.

Our members are found in Alaska, California, Colorado, Connecticut, Florida, Illinois, Kentucky, Louisiana, Massachusetts, Missouri, Nevada, Ohio, and Texas and represent more than 4 million public employees and retirees.

In addition, our national associations and public pension unions represent more than 15 million public workers, about one-third of whom are outside of Social Security.

The Problem

Over the years, some have recommended bringing all public workers into the Social Security program. However, mandating that all newly hired public workers must participate in the Social Security system would create significant new cost pressures for the affected state and local government jurisdictions while providing only minimal benefit to the program.

These jurisdictions, with their own long-standing defined benefit retirement plans, would have to make difficult choices. Adding an additional 6.2 percent payroll tax per worker to the benefit costs of public employers would almost certainly result in cutbacks to their existing defined benefit plans, cuts in government services, and/or increases in taxes or fees to absorb the added costs. The disruption that would likely occur for these public jurisdictions and their workers seems a high price to pay for adding an estimated two years of solvency to the Social Security program. It is estimated that mandatory Social Security coverage would cost the affected states and localities $44 billion over 5 years. This additional financial burden —which will impact all 50 states to one degree or another – could be an insurmountable budgetary hurdle particularly during these very difficult days of huge revenue shortfalls hitting virtually every state.

Background

When the Social Security system was created in 1935, state and local government employees were not allowed to participate in the system. As a consequence, state and local governments – many of which had preexisting pension programs – designed their own retirement plans in reliance on that exclusion. Beginning in the 1950s, state and local government employers could elect to have their employees covered by the Social Security program and were allowed to opt-in or -out of the system.

In 1983, there was a major revision of the Social Security and Medicare laws, triggered primarily by a concern about the long-term solvency of these two trust funds. Once again, Congress decided not to require state and local employees who were outside the system to be covered, but did end the opt-out for public employees who had chosen to be covered.

In 1986, as part of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), Congress required universal participation in the Medicare system on a "new hires" basis, but chose to leave public employee retirement plans in place, and did not change the law with respect to Social Security.

In 1990, Congress enacted a law requiring that all public employees, not covered by a state or local retirement plan meeting specified standards, must be covered by Social Security. That law, adopted as part of the Omnibus Budget Reconciliation Act of 1990 (the "1990 Act"), ensures that all public employees will be covered either under Social Security or under a public retirement plan that provides comparable benefits. Today, about one-third of all state and local government employees, over six million public employees, are outside the Social Security system because they are covered by their employer’s public retirement plan. In addition, millions of current retirees from non-Social Security public pension plans, including the 74,000 members of the Texas Retired Teachers Association, depend on those plans for a significant share of their retirement income.

In 2001, the President’s Commission to Strengthen Social Security made history by being the first commission to not recommend mandatory Social Security coverage in its proposals for Social Security reform. This is particularly remarkable, since the late New York Senator Daniel Patrick Moynihan, a vociferous proponent of forced coverage, co-chaired the Commission.

Most recently, the Bowles-Simpson Deficit Commission and the Domenici-Rivlin Task Force plan both propose to require that all newly-hired employees of state and local governments after 2020 be covered under Social Security.

The Deficit Commission concluded that excluding some public employees from Social Security and instead maintaining separate retirement systems "has become riskier for both government sponsors and for program participants and a potential future bailout risk for the federal government." Further, they argue that mandatory coverage "will ensure that all workers, regardless of employer, will retire with a secure and predictable benefit check." Our coalition strongly disagrees with both points.

Forcing newly hired state and local public workers outside of the Social Security program to participate is seen by some as an attractive way of generating additional revenues for the program in the short term. This position is flawed and should not be included in any Social Security or debt reduction package.

On June 19, 1998, then Congressman, now Speaker John Boehner wrote, "Mandatory coverage is a short-term fix for a long-term problem." For the reasons discussed below, we agreed with Mr. Boehner in 1998 and we continue to agree today.

The Myth of Covering Just New-Hires: Covering Only New-Hires is Still Harmful

Proponents of mandatory coverage contend that applying the mandate only to newly-hired workers would make it less onerous for public employers – nothing could be further from the truth. Public sector defined benefit plans rely on a constant and reliable revenue stream in order to meet actuarial goals and provide a retirement benefit for plan participants at affordable contribution levels.

Proponents of this solution fail to understand that the normal cost of the existing retirement plan will increase as a percentage of payroll as younger members are eliminated from the plan. Thus, employers and new workers will not only have to add an additional 6.2 percent for the new payroll tax, but employers may also have to increase contributions to the existing plan or cut benefits. When states and localities are under extreme fiscal stress as they are currently, this added expense will create enormous burdens with negligible, if any, positive outcomes.

Non-covered systems depend heavily on investment income to provide retirement benefits and ancillary services such as healthcare. National studies show that on average, investment income provides approximately 70% of retiree benefits. The loss of contributions from employees and employers that would be diverted to Social Security, together with the loss of income on those funds, would not only be catastrophic over time but would also result in an unfunded Federal mandate on state and local plans that by and large are securely funded. State and local pension plans would have no choice but to reduce benefits not only for new hires but possibly for current members and retirees as well.

Mandatory Social Security Coverage Will Only Extend Social Security's Solvency by Two Years, But Could Destabilize Public Pension Systems Nationwide

A study by the Government Accountability Office (GAO) concluded that adding new hires would only add two years at the most to Social Security solvency. The same report stated that moving to mandatory coverage would be very costly to the states involved. As a result, mandatory coverage provides no long-term solution to Social Security, but it creates a huge unfunded mandate on state and local governments.

According to a 2005 study by The Segal Company (which is currently being updated), mandatory Social Security coverage could cause a reduction in employee and employer contributions to existing defined benefit plans, "which are an essential part of their actuarial funding. This could destabilize the existing plans on which current workers and retirees depend." The report continued, "Lower funding would not only have an impact on retirement benefits, but could affect disability and survivor benefits as well," which are often more generous than those offered by Social Security.

State and Local Public Pension Plans Are Not In Crisis

Contrary to the premise upon which the most recent Debt Commission based its recommendation, most state and local government employee retirement systems have substantial assets to weather the recent economic crisis; those that are underfunded are taking steps to strengthen funding. As you know, pensions are funded and paid out over decades. More state and local governments enacted significant modifications to improve the long-term sustainability of their retirement plans in 2010 than in any year in recent history. According to a study produced by the National Conference of State Legislatures, in the past few years, nearly two-thirds of states have made changes to benefit levels, contribution rate structures, or both; many local governments have made similar fixes.

Perhaps most importantly, since 1985 – a period that has included three economic recessions and four years of negative median public fund investment returns – actual public pension investment returns have exceeded assumptions. For the 25-year period ended 12/31/09, the median public pension investment return was 9.25%. Moreover, for the year ended 6/30/10, this return was 12.8%.

The Costs of Mandatory Coverage Greatly Outweigh the Benefits

As noted above, mandatory coverage would only add two years of solvency to the 75-year projection for the Social Security program. But, it would cost public employees, their employers and ultimately taxpayers nationwide more than $44 billion over the first five years, according to the Segal report. Mandatory Social Security would be felt in all 50 states and over time would add new beneficiaries to the program who would draw down benefits like other Social Security recipients, increasing financial pressures on the system. It's estimated that 75% of all public safety officers (police, fire, and corrections personnel) and 40% of all public school teachers are exempt from Social Security.

The chart below illustrates how mandatory coverage would affect the home state of each member of the Ways and Means Social Security Subcommittee.

Member of Congress	Home State	Employees Affected	5-Year Cost to Employees, Employers and Taxpayers
Sam Johnson, Chairman	Texas	836,000	$5,277,097,497
Kevin Brady	Texas	836,000	$5,277,097,497
Pat Tiberi	Ohio	820,000	$4,350,432,245
Aaron Schock	Illinois	489,000	$4,237,608,792
Rick Berg	North Dakota	10,000	$65,396,921
Adrian Smith	Nebraska	17,000	$113,827,468
Kenny Marchant	Texas	836,000	$5,277,097,497
Xavier Becerra, Ranking Member	California	1,468,000	$8,205,239,780
Lloyd Doggett	Texas	836,000	$5,277,097,497
Shelley Berkley	Nevada	100,000	$831,165,283
Fortney Pete Stark	California	1,468,000	$8,205,239,780
Subcommittee Totals		3,740,000	$23,080,767,986
National Totals		6,617,000	$44,242,669,672

Source: "State-by-State Cost Analysis of Mandatory Social Security," The Segal Company, 2005

Mandatory Coverage: Tough Choices for States and Localities

If all newly hired state and local employees are forced to participate in the Social Security program, their employers – state and local government entities – and policy makers will have to make difficult decisions on how to offset these new taxes.

According to the Segal report, these taxes would likely be absorbed through "tax increases, cuts in existing benefits and/or reductions in workforce and services," none of which are particularly popular and all of which would be met with strong resistance by the affected constituencies. Many states and localities are already facing large financial challenges. Mandating Social Security coverage would only exacerbate already troubled financial landscapes for jurisdictions across the country.

Hidden Impacts

Mandatory coverage could also undermine other benefits of public pension plans. These plans, in addition to offering sound and secure retirement benefits for public workers also provide valuable benefits that reduce pressure on federal government programs. These benefits are overlooked by mandatory coverage proponents.

For instance, certain classes of public sector workers have special needs that would not be met by the Social Security program. Safety workers, like police and fire, because of working conditions and job qualifications, retire earlier than other workers, often before age 62, the earliest age at which one can collect Social Security. Consequently, if these workers no longer had their traditional defined benefit public retirement, they could be forced to retire from their public safety jobs but have little or no retirement benefits until reaching 62.

Public retirement plans also offer partial disability benefits, unlike Social Security. These disability benefits go a long way toward providing an income stream so partially disabled workers do not have to depend on public assistance programs.

Most plans provide pre-retirement survivor benefits. For children, Social Security's survivor benefits end at age 18. Many public plans provide benefits after that age has been reached if the child is a full-time student.

Early retirement, partial disability and survivor benefits are among the benefits specifically tailored to meet the needs of public workers that would be threatened by mandatory coverage.

Conclusion

Mandating Social Security coverage for all public sector workers would only create an enormous unfunded Federal mandate on state and local taxpayers and major costs and burdens for public employers without contributing significantly to the solvency of the Social Security program.

Millions of public employees in non-covered systems have placed their faith and their future in the pension plans, and have planned their retirement accordingly. It is absolutely critical to maintain the stability, confidence, security, and trust of those public employees who have served so well.