THE FUTURE OF SOCIAL SECURITY FOR THIS GENERATION AND THE NEXT

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

MAY 22, 1997

Serial 105–34

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

50–563 CC WASHINGTON : 1998

COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM MCCRERY, Louisiana
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska
WES WATKINS, Oklahoma
J.D. HAYWORTH, Arizona
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM MCDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
WILLIAM J. JEFFERSON, Louisiana
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
KAREN L. THURMAN, Florida

A.L. SINGLETON, *Chief of Staff*

JANICE MAYS, *Minority Chief Counsel*

SUBCOMMITTEE ON SOCIAL SECURITY

JIM BUNNING, Kentucky, *Chairman*

SAM JOHNSON, Texas
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
JON CHRISTENSEN, Nebraska
J.D. HAYWORTH, Arizona
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

BARBARA B. KENNELLY, Connecticut
RICHARD E. NEAL, Massachusetts
SANDER M. LEVIN, Michigan
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California

CONTENTS

THE FUTURE OF SOCIAL SECURITY FOR THIS GENERATION AND THE NEXT

THURSDAY, MAY 22, 1997

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

The Subcommittee met, pursuant to notice, at 10:35 a.m., in room 1100, Longworth House Office Building, Hon. Jim Bunning (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263
May 15, 1997
No. SS–5

Bunning Announces Third Hearing in Series on "The Future of Social Security for this Generation and the Next"

Congressman Jim Bunning (R–KY), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold the third in a series of hearings on "The Future of Social Security for this Generation and the Next." At this hearing, the Subcommittee will examine the findings of the recently released 1997 Annual Report of the Board of Trustees on the financial status of the Social Security Trust Funds. In addition, the Subcommittee will hear from organizations on generational aspects on the future of Social Security. The hearing will take place on Thursday, May 22, 1997, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:30 a.m.

In view of the limited time available to hear witnesses, oral testimony will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Subcommittee's first two hearings in the series have focused on the recommendations of the Advisory Council on Social Security and on the fundamental issues to consider when evaluating options for Social Security reform.

Since the last hearing, the Social Security Board of Trustees released the 1997 report on the operation and financial status of the Social Security and Medicare Trust Funds. The projections regarding the Old Age, Survivors and Disability Insurance (OASDI) Trust Funds are the same as those reported in 1996. Spending out of the Trust Fund is projected to exceed tax income in the year 2012, and by the year 2029, the Trust Funds are projected to have income sufficient to cover only 75 percent of annual expenditures. The Trustees believe that the long-range deficit of the OASDI funds should be addressed in "a timely way" and also recommend that the Advisory Council recommendations and other proposals should be "carefully evaluated by the Government and the public."

Currently, a wide range of approaches have been proposed to restore Social Security's financial solvency. These range from maintaining the program's current structure to revamping the system entirely. Organizations with different generational perspectives on Social Security reforms have begun sharing their views regarding what needs to be done.

In announcing the hearing, Chairman Bunning stated: "We're taking the issue of Social Security reform seriously. We want to listen to what people are saying and we need to know all the facts, including who is impacted by each and every proposal. Engaging the public is critical as discussions continue regarding the future of Social Security. The views of those who represent the interests of America's different generations are extremely important to this Subcommittee and must be heard."

FOCUS OF THE HEARING:

The Subcommittee will examine the findings of the 1997 Annual Report of the Board of Trustees on the financial status of the Social Security Trust Funds. The Subcommittee will then hear from organizations with different generational perspectives on Social Security reform. Specifically, Members would like to hear the views of each organization regarding: (1) the degree to which Social Security reform is necessary; (2) an assessment of the Advisory Council recommendations and other reform proposals; (3) specific recommendations for Congress to consider as it moves forward; and (4) how soon Congressional action is needed.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement and a 3.5-inch diskette in WordPerfect or ASCII format, with their address and date of hearing noted, by the close of business, Thursday, June 5, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B–316 Rayburn House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit 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 statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on a 3.5-inch diskette in WordPerfect or ASCII format.

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. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

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.

Chairman BUNNING. The Subcommittee will come to order. Today we continue our series of hearings on the future of Social Security for this generation and the next. During this third hearing we will hear from the Social Security Public Trustees. Last month the Social Security Board of Trustees released its annual report on the status of the OASDI, Old-Age Survivors, and Disability Insurance Trust Funds.

The good news is that the forecasts have not gotten worse. The Trustees predicted that the trust fund won't start running short of funds until the year 2029. The bad news is that the forecasts have not gotten any better.

It should be patently clear by now that the long-term funding problems facing Social Security are not going to go away on their own. Congress is eventually going to have to take corrective action to put Social Security on a firm financial footing.

I was encouraged by the statement of the Public Trustees which accompanied the Trustees' Report. They noted that there is an alarming erosion of public confidence in the Social Security system and that early attention to Social Security's long-range financial problems is vital in restoring public confidence in the program.

I agree with them wholeheartedly. If Social Security loses the confidence of the American people, it loses its greatest strength.

Throughout this hearing series, my goal has been to learn as much as possible about the reactions and thoughts of all segments of the population. Also testifying today are several advocacy groups who will present their different generational perspectives on Social Security reform. These groups are out there gauging the reaction of their members to the problems and proposed solutions to the Social Security system. Sometimes it is a lot easier to talk about what shouldn't be done, as opposed to what should be done. I believe I speak for everyone on the Subcommittee when I say that we are looking to you for real solutions that will work for your members.

In the interest of time, it is our practice to dispense with opening statements, except from the Ranking Democrat Member. All Members are welcome to submit statements for the record. I yield to Congresswoman Kennelly for any statement she wishes to make.

Mrs. KENNELLY. Thank you, Mr. Chairman. There has been considerable discussion about whether the Social Security Program is facing a crisis or not. Some people conjure up doomsday scenarios and argue that the Social Security Program is unsustainable. Other people believe that we can maintain the status quo and ignore all warnings. The truth probably lies somewhere in between.

It really doesn't matter whether we label the situation a crisis or not. The fact is that we need to take action to shore up the Social Security system. Prudence requires it. Social Security warrants serious and timely attention. The longer we wait, the more difficult the problems will become. A prudent homeowner does not wait until it rains to fix the roof. If we are slow in our response, there will be great damage done to our most successful government program.

Our first two witnesses today, the Public Trustees of the Social Security system, should be able to tell us, better than anyone else, what the implications are if we fail to act. They can tell us what the consequences will be if we do not live up to our responsibilities to Social Security and the people of this Nation. I look forward to hearing their testimony. In addition, I'm anxious to hear from the other panel of witnesses. I hope they will have some suggestions to us about the future of Social Security.

Thank you, Mr. Chairman.

Chairman BUNNING. If the first panel would take their seats at the witness table, we would appreciate that. The Social Security Public Trustees will be testifying first. They are Dr. Marilyn Moon and Stephen Kellison. Welcome to you both. Dr. Moon, if you would begin, we would appreciate it.

STATEMENT OF MARILYN MOON, PH.D., PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES

Ms. MOON. Thank you. We appreciate the opportunity to be here this morning. As public trustees, Mr. Kellison and I believe that our role is really twofold: First, to make sure that the annual report is done with integrity and as much care and professionalism as possible. I am happy to report to you that we are very satisfied and, in fact, highly complementary of the professionalism of the actuaries who work for both the Social Security Administration and the Health Care Financing Administration. We have worked hard with them over the last year to ensure that great care is put forward in these estimates and we are very proud of them.

Second, we believe another role is to promote public education and to help bring to the forefront some of the long-term issues that this hearing is addressing. We are very appreciative, therefore, of being able to be here and contribute to that activity. This, we think, is very important. The Trustees' Report should serve as an early warning mechanism to highlight problems and to enable Congress to move in a timely fashion to improve and change the Medicare and Social Security Programs as necessary.

As you mentioned in your opening statement, Mr. Chairman, the news, in a sense this year, is that there is no real news. Despite a careful look at the assumptions that go into the report and some actual changes in those assumptions, the dates that people focus on, for example, 2019 as the first year that Old-Age, Survivors, and Disability Insurance Program, OASDI, outgo exceeds taxes plus interest income, and 2029, the year when the combined trust funds' assets are exhausted, are the same as they were in 1996.

That does mean we are 1 year closer, which gives one pause, but the news is that the trends look very much like people thought they would. That underscores that something needs to be done about these programs and it is not too soon to think about changes.

We do know with some considerable certainty what is coming in terms of demographic changes, for example. What is less certain are some of the economic prospects. That is also where there is considerable hope of improvement but also uncertainty if things don't go as well as expected. But in general, we think that these are good estimates of what the future is likely to hold.

We also believe that there is considerable urgency to take a look at the issue for several reasons. First, it is certainly better to do something sooner than later in a program this important—efforts that would help to reassure people that we are seeking balance in the program. Taking up this issue now also gives us more flexibility in the kinds of options that are possible. A whole range of options that could be addressed now could solve the problem—that is, put the program on a better financial footing. No one change is inevitable or required at this point in time. That is a real advantage of moving sooner rather than later.

Moreover, any reductions in benefits or increases in taxes that might be necessary are smaller the sooner that they are enacted. For example, in our testimony we indicate that if we were to act now to raise payroll taxes—not something we are advocating, but rather using to illustrate the impact—the payroll tax would have to rise 18 percent more in all future years; that is, to about 6.3 percent rather than 5.35 percent in Old-Age and Survivors Insurance, OASI. But if we were to wait until 2025 to use the same solution of increasing taxes only, you would have to raise taxes by one-third to 7.22 percent.

These figures help to underscore how important it is to take on the issue sooner rather than later. Such an approach will also provide some reassurance, I think, to younger individuals that Steve will talk about in a moment.

Let me close on one final note. Although this hearing is not about Social Security and Medicare together, when we think about a solution for these two very important programs, the demographics have the same impact on both of them. And once you decide what to do about Social Security, for example, you may take off the table elements that are important to the Medicare Program.

I know this is not in your jurisdiction and it is difficult to take on two very complicated programs at once, but it is just important to note that both programs should be kept in mind when we talk about demographic changes.

I know my colleague would like to say some additional things about some of the solutions and some of the reassurances for younger people. Thank you.

STATEMENT OF STEPHEN G. KELLISON, PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES

Mr. KELLISON. Thank you, Chairman Bunning and Members of the Subcommittee. It is a privilege to be here today to speak on behalf of the Public Trustees. As Dr. Moon has indicated, as Public Trustees, we do sense a primary responsibility to ensure that fair, accurate, and objective information about the financial condition of these programs is brought forward to the Congress and to the American public. And I totally concur and strongly agree with Dr. Moon that we are quite impressed with the integrity and the professionalism of the work that goes on within the Social Security Administration and the Health Care Financing Administration on these programs.

The long-term financial challenges facing Social Security are largely demographic in nature. They really result from the existence of the baby boom generation, now beginning to enter their fifties, followed by a low birth rate, which has existed for the past 25 years. Compounding these demographic profiles of the population is the fact that life expectancy of the population in retirement has significantly increased over the past several decades and is projected to continue to improve.

As a result of all of these demographic factors, the number of workers per beneficiary is expected to decline from its current level of 3.3 to only 1.8 at the end of the 75-year projection period.

It is true that there is substantial uncertainty about making 75-year projections with any precision and there are ranges of plausible outcomes that can occur. However, the demographic conditions underlying the current problems are pretty well established and locked in and will take several decades to unfold.

One of the key findings in the Trustees' Report is that even after the baby boom generation has totally worked its way through the system, costs do stabilize but at a significantly higher level than today. This, again, is the result of low birth rates and continued improvement in life expectancy.

Throughout most of its history, Social Security has largely operated as a pay-as-you-go system. However, under current law, Social Security is currently running large annual surpluses and a large trust fund is accumulating. This trend reverses, under best estimate assumptions, in the year 2012, when the payroll tax income first falls short of benefit outgo.

This large trust fund buildup, followed by a drawdown, has a profound effect on the Federal budget, since current annual surpluses offset deficits in the rest of the budget, but that will all reverse in only another 15 years.

The trust fund buildup has led some observers to suggest that some type of advanced funding of the system be implemented so that trust fund buildup would become more permanent and not reverse itself. This could either be done through the trust fund directly or through the creation of some type of individual private accounts.

These concepts underlie proposals contained in the report of the Advisory Council on Social Security, which would either invest some of the trust fund in equities or, alternatively, create individual private accounts. The rationale of people who make these proposals largely is in one or both of two areas. First, it would increase overall savings in the economy and thus hopefully improve future productivity; and second, it might increase public confidence in the future of the system if people saw that money was being set aside with their name on it, so to speak.

One challenge that exists for any proposal to move from a pay-as-you-go system to one that has some significant degree of advanced funding is the need to finance the transition. This is a very substantial cost that would need to be financed over many years. In essence, one or more generations is put into a position of having to provide benefits to a prior generation, as well as providing some of their own benefits.

These are intriguing concepts which deserve more analysis and discussion than they have received to date, but there are also some tough questions that would have to be answered. In my remaining time let me identify a few of these.

First, investment in equities is motivated by trying to achieve higher returns, but in the process, risk is significantly increased.

This is not only financial risk but also political risk. Is the extra return worth the risk?

Second, would overall savings in the economy increase or would people simply move from one type of savings to another? If the savings is to be done through the trust fund, it would be necessary to balance the Federal budget exclusive of Social Security, rather than inclusive of it.

And finally, another important macroeconomic question: Would any increase in national savings actually increase productivity and therefore make us a wealthier Nation that could afford a wealthier social insurance program?

Those are some very important, tough questions that need to be addressed. At somewhat less level of detail are many implementation issues involving possible government ownership of equities, what to do about people who invest poorly or are unlucky, administrative costs, enforcement and regulation, whether people will be forced to annuitize or whether they might outlive their assets. Many of these kinds of questions that have faced the private pension system would be faced here.

The point is that these proposals have a lot of advantages but they have some disadvantages. They are not magic bullets or panaceas, but they do deserve careful analysis and discussion.

In closing, I would like to underscore our statement and Dr. Moon's statement that we are very concerned about public confidence in the system. It has eroded, particularly among younger generations. We do encourage the Congress to take action sooner, rather than later, because the more incremental changes can be made, people can have more time to plan their retirement and public confidence in the system would be improved. Thank you.

[The prepared statement follows:]

Joint Statement of Marilyn Moon, Ph.D., Public Trustee, and Stephen G. Kellison, Public Trustee, Social Security and Medicare Boards of Trustees

It is our privilege to be here today to testify regarding the financial status of the Social Security Trust Funds as shown in the 1997 Annual Report of the Board of Trustees of those funds. As you know, the Public Trustees are part-time officials appointed by the President and confirmed by the Senate to represent the public interest in this important process of public accountability. In our normal activities, Mr. Kellison is an actuary and consultant and Ms. Moon is an economist and researcher, both with extensive public and private experience in Social Security and Medicare.

As Public Trustees, our primary activities are directed at assuring that the Annual Trust Fund Reports fully and fairly present the current and projected financial condition of the trust funds. To this end, we work closely with the Offices of the Actuary in the Social Security and the Health Care Financing Administrations to ensure that all relevant information is considered in the development of assumptions and methods used to project the financing of these vital programs. Mr. Chairman, we would note for the record what we are sure you and this committee know well: it is an extraordinarily complex task to make financing projections for these programs for the next 75 years. It is only through the high professionalism and decades of experience of the Social Security and Medicare actuaries that such projections are possible. But it is critical to remember always that these projections ultimately are only estimates and must necessarily reflect the uncertainties of the future.

Thus, the projections in the Trustees Reports are most useful if understood as a guide to a plausible range of future results. And, as this hearing illustrates, the reports serve as an early warning system that allows us the opportunity to make changes in a timely and responsible manner.

THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND

In the 1997 report, the Old-Age and Survivors Insurance (OASI) Trust Fund, which pays Social Security retirement and survivors benefits, shows a positive balance at the end of 1995 of $514 billion with a net increase in that year of $55.5 billion. This fund has been taking in more in tax revenues than it has been spending for a number of years and is projected to continue in that mode through 2013. As the baby boom generation begins to reach age 65 after 2010, OASI benefit costs each year will increase rapidly and, beginning in 2014, will exceed annual tax income.

However, the accumulated assets of the OASI fund, interest on those assets and tax revenues are projected to cover benefit outlays until 2031. Although the assets of the OASI fund would be exhausted at that time, tax income at rates provided under current law would provide approximately three-fourths of full benefit costs in 2031. By the end of the projection period in 2071, the portion of benefits that tax income would cover is projected to decline to about two-thirds. Over the full 75-year period, the OASI fund shows a deficit of 1.84 percent of payroll, which is approximately 15 percent of the projected long-range cost of the OASI program.

THE DISABILITY INSURANCE TRUST FUND

Turning to the Disability Insurance (DI) Trust Fund, it also showed a net increase of $15.4 billion in 1996 and ended that year with a positive balance of $52.9 billion. As this committee is well aware, disability costs are more difficult to project than are retirement and survivors benefits. Historically, the Social Security Disability Insurance program has experienced periods of growth and decline for which causes cannot be established with certainty. In the early 1990's the number of workers applying for disability benefits increased rapidly, and there was great uncertainty whether this was a temporary or a long-term phenomenon. Actual experience since 1993 shows that applications for disability insurance benefits levelled off in 1994 and have actually declined in both 1995 and 1996 despite the fact that more people are moving into the prime ages for disabilities.

Notwithstanding this recent experience, the DI program must be monitored closely in coming years as policymakers consider ways to close the deficit projected for this trust fund. The 1997 Trustees Report intermediate projections show that the DI fund income will exceed expenditures through 2002, after which the fund will decline each year until it is exhausted in 2015. Over the 75-year projection period, the DI fund shows a deficit of 0.39 percent of payroll, or about 17 percent of the projected long-range cost.

If the DI and OASI trust fund projections are combined, the exhaustion date for the combined funds is 2029, 14 years later for the DI fund and 2 years sooner than for OASI. On a combined basis, expenditures first exceed tax revenues in 2012. From 2012 through 2018 interest income will be needed to supplement current tax income to meet costs, and in 2019 through 2029, current tax income, interest income plus a portion of the trust fund assets will be needed to pay benefits. Considered together, the OASI and DI programs have a projected long-term deficit of 2.23 percent of payroll, which represents an increase in the deficit of .04 compared to the 1996 projection.

URGENCY FOR ACTION

The purpose of the trustees reports is to provide the President, the Congress and the American people each year an updated estimate of the current and future financial condition of the Social Security and Medicare trust funds. In the early 1990's, the trustees reports placed highest priority for action on legislation to prevent the exhaustion of the DI fund, which was then projected to occur in 1995. Such legislation was enacted in 1994.

While the DI fund's financial problems were the most urgent in the early 1990's, the dramatic rate of growth of both Medicare Hospital Insurance and Supplementary Medical Insurance costs indicated even then that further legislation was needed to maintain the financial solvency of those programs and begin to reduce the rate of growth of heath care costs. We believe, as we have stated previously, that the most urgent priority now is to enact legislation that extends the date of exhaustion of the HI trust fund, which, as you know, is projected to occur early in 2001. We note further that, although HI's financing problem has received most of the attention recently, SMI's rate of growth historically has exceeded that of HI and is unsustainable over the longer run. Thus, legislation must be enacted quickly to reduce the growth of SMI expenditures in the near term and allow time for development of longer term solutions to financing the health care of the aged once the leading edge of the baby boom begins to reach age 65. The recent budget agreement includes a first step to improve the financial status of Medicare. However, it is only a modest down payment on narrowing the gap between Medicare's projected costs and income. Much more will be required to deal with the financial imbalance in Medicare as the baby boom generation approaches retirement.

We have in no way intended by giving highest priority to HI and SMI financing in our statements to downplay the critical importance of beginning the difficult process of developing solutions to the projected future deficits of OASI and DI. With the progress on Medicare financing in the budget agreement, we would hope that the spotlight of legislative attention can be shifted to the long-range financing issues facing both Social Security and Medicare. In this regard, we commend you, Mr. Chairman, and this committee, for undertaking this series of hearings, and we are encouraged by the widening public discussion taking place regarding Social Security's future.

The financing deficits facing OASI are smaller and further into the future than those facing Medicare, and immediate changes in OASI are not as imperative. Action should be taken soon, however, for several reasons. First, the earlier that changes are implemented the more incremental they can be. Second, enacting changes soon would permit time for workers to adjust their retirement plans. Third, there has been an alarming erosion of public confidence in the Social Security program over the past few years, particularly among younger generations. Early attention to Social Security's financing problems is vital in restoring public confidence in the program.

Another important consideration regarding the timing of action on Social Security financing is that the sooner changes are enacted the more broadly can the burden of closing the financing deficit be distributed across different age groups. For example, if it were decided to raise payroll taxes to eliminate the OASI projected deficit, employers and employees each would have to pay about 18 percent more in all future years (i.e., about 6.3 percent rather than the 5.35 percent for 1998). If the change were not effective until 2010, the rate would have to be increased to 6.57 percent, and if delayed until 2025, the tax rate would have to be increased by over one-third to 7.22 percent. Other types of changes would have similar increases in size if their effective dates were significantly delayed. Thus, while we have time to consider and plan carefully for necessary changes in Social Security, we should act as soon as support for a reform plan can be developed.

Approaches to OASI Financing Reform

Social Security's financing deficit can be solved with OR without major structural change, but a first step may be to resolve the philosophical debate about the value of privatization. The exact form of any proposal is also crucial since it will determine the extent to which we focus in reform efforts only on the pension aspects of Social Security, on its social insurance characteristics, or on a continued mix of both. And while our political process does not always settle such debates neatly, we have every confidence a way to fix Social Security's financing problem can be enacted in a timely manner.

Recent discussions of Social Security financing reform have been held in the context of the three plans put forth by the 1996 Social Security Advisory Council. All of the plans discuss the possibility of investing the trust fund assets in equities or requiring individual workers to invest a portion of their wages on their own in individual accounts. The new approaches that have become part of the discussion regarding Social Security financing attempt to get outside the traditional box of tax increases and benefit reductions to meet rising retirement costs. They appear to be premised on the idea of increasing national savings to increase economic growth so that the cost of retirement when the baby boom generation retires and beyond will require a smaller portion of national income than it otherwise would. With a larger economic pie and higher wages, a given payroll tax rate would provide more income to the trust fund to pay benefits.

To actually achieve faster economic growth, the income the trust fund receives in excess of current needs would have to add to national savings, and this can occur only if that excess is not used to offset increases in federal budget deficits. The prospects of that appear better now than at any time in recent years, but there is still a long way to go to reach that objective since the recent deficit reduction agreement still uses the current excess of Social Security taxes—about $79 billion in FY 1998—to offset deficits in other parts of the budget. But assuming a way can be found to use the excess Social Security taxes to spur faster economic growth, the attractiveness of investing the trust fund reserves in private securities would increase. An alternative would be to allow workers to invest a portion of their payroll taxes in private savings accounts. Either alternative could channel part of the additional growth into retirement income, but both approaches raise very tough questions. These questions include, among others, whether net national savings actually would increase and be invested wisely; whether the burden of regulation and enforcement and administrative costs could be minimized; whether invested assets could be conserved and turned into retirement income; and what government's residual burden for retirement income through need-based programs would be. Most important, we must not be lulled into thinking that private investment in any form can magically solve all of the retirement income issues we face as a society in the decades ahead.

Thus, while it would be foolhardy to rush to judgement on these new approaches that have been raised for meeting the rising costs of retirement, it is vital that as a nation we move ahead through informed debate toward resolving the Social Security long-range financing deficit. We are at a point in time where many options are possible. Further, since we cannot predict the future, it will make reaching agreement on changes easier if we recognize that searching for a set of changes that meet a specific point estimate 75 years into the future is less important than moving ahead soon with those changes that seem to make the most sense with full realization that Social Security cannot be insulated from future social and economic change. The strength of the Social Security program is that it can adapt as our national circumstances change. It is the acceptance of the necessity for change by all of us as individuals that is most difficult. This can be eased only by having the information we need to feel we understand why change is necessary and in which direction it should take us.

A crucial part of the process to resolve Social Security's financing deficit must be the education of the American public so that they understand and accept both the need for change and the implications of alternative reform plans. We view this education responsibility as one in which the Public Trustees can play a role by expressing a factual, bipartisan view, and we welcome the opportunity to participate in this hearing and future efforts to bring the dimensions of Social Security's financing problem to the public.

We have attached the four-page "Message From the Public Trustees" that is included in the Summary of the 1997 Annual Reports, as well as our biographical information. We thank you for the opportunity to present our views and will be pleased to answer any questions.

THE PUBLIC TRUSTEES

Six people serve on the Social Security and Medicare Boards of Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two public members (of different political parties) appointed by the President with the advice and consent of the Senate. The Boards are responsible for reporting annually to the Congress on the financial operations of the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Funds, the Hospital (HI) Insurance Trust Fund, and the Supplementary Medical Insurance (SMI) Trust Fund, and on the projected financial outlook of these funds for future years. The OASI and DI Trust Funds provide financing for the retirement, survivors, and disability benefits under Social Security, and the HI and SMI Trust Funds finance the Medicare program. In addition to the annual report to Congress, the Boards are required to notify the Congress immediately when the amount in one of the Trust Funds is unduly small and to review the general policies followed in managing the Trust Funds. The Public Trustees positions were created by the Social Security Amendments of 1983 for the purpose of increasing public confidence in the integrity of the trust funds. Stephen Kellison and Marilyn Moon began 4-year terms as Public Trustees on July 20, 1995.

Stephen G. Kellison

Stephen G. Kellison is Vice President and Chief Actuary of the Variable Annuity Life Insurance Company of Houston, Texas. Mr. Kellison dealt extensively with a variety of public policy issues as Executive Director of the American Academy of Actuaries from 1976 to 1988. He has also served on the faculties of the University of Nebraska-Lincoln and Georgia State University. Mr. Kellison is a Fellow of the Society of Actuaries, a Member of the American Academy of Actuaries, and an Enrolled Actuary under the Employee Retirement Income Security Act of 1974. He served a Chairman of the Technical Panel of Actuaries and Economists to the 1991 Advisory Council on Social Security and as Chairman of the Committee on Social Insurance of the American Academy of Actuaries. He also has held leadership positions within the actuarial profession, serving on both the Board of Governors of the Society of

Actuaries and the Board of Directors of the American Academy of Actuaries. Mr. Kellison holds A.B. and M.S. degrees from the University of Nebraska-Lincoln and is an author, speaker and expert witness in the areas of actuarial science, insurance, and employee benefits.

Marilyn Moon

Marilyn Moon is a Senior Fellow with the Health Policy Center of the Urban Institute in Washington, D.C. She is currently serving as Program Director for the Commonwealth Fund's Program on Medicare's Future. From 1986–1989, she served as Director of the Public Policy Institute of the American Association of Retired Persons. In the fall of 1989, she served as a consultant to the U.S. Bipartisan Commission for Comprehensive Health Care (the Pepper Commission). Earlier, she worked as a Senior Research Analyst at the Congressional Budget Office, and as an Associate Professor of economics at the University of Wisconsin-Milwaukee. Ms. Moon also is a founding member of the National Academy of Social Insurance and serves on its Board of Directors. Ms. Moon has written extensively on Medicare, poverty, health, income distribution, and long-term care issues. Her recent publications include Medicare Now and in the Future, "Facing Up to Medicare's Challenges," and "Fostering a Rational Debate on Social Insurance." She received her Ph.D. in economics from the University of Wisconsin.

FROM A SUMMARY OF THE 1997 ANNUAL REPORTS OF THE SOCIAL SECURITY AND MEDICARE BOARD OF TRUSTEES, APRIL 24, 1997

A MESSAGE FROM THE PUBLIC TRUSTEES:

This is the second set of Trustees Reports in which we have participated since we began four-year terms as Public Trustees on July 20, 1995. Our goal as Public Trustees is to ensure the integrity of the process by which these Reports are prepared and the credibility of the information they contain. We are honored that the President and the Senate have entrusted us with this responsibility. Further, although we are of different political parties, we approach our work as Public Trustees on a bipartisan basis because we strongly believe that this is the only way through which financial problems facing Medicare and Social Security can be solved. It is in this vein that we offer the following observations regarding the 1997 Annual Reports.

Informed Debate Is Needed

This year may finally mark the beginning of serious consideration of the future of Medicare and Social Security. The publication of the Social Security Advisory Council's report offering three very different approaches to the long-run financing problem facing Social Security has brought increased attention to that program, although it also illustrates that we have a long way to go before reaching consensus on a solution. The debate thus far on Medicare's future has focused on the need to achieve short-run savings to extend the life of the HI Trust Fund beyond 2001. But even this discussion has directed some attention to the longer run problems facing Medicare after 2010 as a result of the aging of the baby boom generation.

We welcome these discussions and hope that the trust fund reports and this Summary contribute to the factual basis necessary for an informed debate. The numbers contained in these reports are sobering, but their magnitude should not cause us to choose inaction as the appropriate response. Indeed, Americans need to become actively engaged in the debate about changes in these programs because the choices we make (or fail to make) in the next few years will carry important consequences for all of us. The aging of the baby boom generation will place heavy demands on both Social Security and Medicare, requiring substantial changes and sacrifices by some or all Americans.

A key point to remember as the debates go forward is that while Social Security and Medicare are large and complicated programs which are usually considered separately, they are clearly interrelated. Together, these programs form the foundation that Americans depend upon in retirement, both are vying for the same limited resources, and in the long run the shape of both programs will be driven by the same demographic forces that are leading us to an aging society.

Medicare

A major focus of issues facing Medicare is the imminent exhaustion of the HI Trust Fund. Under the intermediate (best estimate) assumptions in the 1997 Annual Reports, the fund will be depleted in early 2001—only 4 years from now. Legislative changes should be made this year since most proposals for slowing the growth in spending have their greatest impact only after several years. Even so, changes enacted this year to slow Medicare's growth would achieve most of their savings in the year 2000 and beyond, dangerously close to when the HI Trust Fund will be exhausted. Further, starting in 1995, income to the HI Trust Fund has been less than expenditures, and the HI fund has been drawing on its assets to meet the shortfall. In every year that passes without change, we will have to consume more and more of the trust fund's assets to meet current needs.

But focusing so heavily on HI's immediate problem diverts our attention from SMI, which has grown more rapidly than HI over Medicare's history. These two parts of Medicare are financed very differently and as a consequence, they have separate trust funds. But in practice, HI and SMI are just two parts of one program, and over time there has been shifting of benefits between them. Also, the factors that are driving up the costs of each part of Medicare are the same—better but more expensive medical technology, more medical care per person, and an aging population. Continued SMI growth at current rates will ultimately lead to costs which exceed the capacity of the funding sources—Federal general revenues and beneficiary premiums—to provide benefits.

Thus, the need to act quickly on the financial problems facing HI should not lead us to ignore SMI. Like HI, SMI's growth is unsustainable over time. Therefore, Medicare legislation this year should include changes in SMI as well as in HI.

Another fact which should be recognized in the debate about changes in Medicare is that, as history shows, the program must adjust every few years to changes in healthcare technology, methods of delivery and utilization. If we can say one thing that we think would be helpful in the public debate on Medicare financing, it is that there are no magic bullets for solving the problem of high rates of healthcare spending. Therefore, even major legislation this year cannot fully resolve the issues of healthcare cost growth. We should expect that further legislative action will be needed even before tackling the increase in Medicare costs that will occur when the baby boon generation begins to retire.

Addressing the long-run issues will be difficult and challenging under any circumstance. However, finding longer term solutions will be facilitated if we can improve the current Medicare program, find legitimate short-run savings, and improve the balance between the traditional program and private plan offerings under Medicare. These short-run challenges will likely demand continuing vigilance and legislation over the next decade.

Do the challenges facing Medicare mean that it cannot be continued? No! But Medicare cannot stay exactly as it is and it is misleading to think that any part of the program—beneficiary premiums, provider payments, controls on utilization, covered services or revenues—can be exempt from change.

Social Security

The cash benefits programs (OASI and DI) face longer term challenges. The aging of the baby boom generation will also increase OASI expenditures, but OASI annual income, including interest, will exceed outgo for almost 25 years. Thus, the financing deficits facing OASI are smaller and further into the future than those facing either HI or SMI. Immediate changes in OASI are not necessary and the magnitude of the program changes that will eventually be needed will be less than those required for HI and SMI.

Action should be taken soon, however, for several reasons. First, the earlier that changes are implemented the more incremental they can be. Second, implementing changes soon would permit time for phasing them in and for workers to adjust their retirement plans. Third, there has been an alarming erosion of public confidence in the Social Security system over the past few years, particularly among younger generations. Early attention to Social Security's longer range financing problems is vital in restoring public confidence in the program.

The Advisory Council on Social Security has put forth three different approaches to deal with the long-run financing problem in OASI. Those and other plans deserve serious discussion now so that reform legislation can be developed in the next few years which can gain the support of the American public. Some of these proposals would introduce fundamentally new concepts into the system, such as investment of the trust fund in common stock or the creation of individual accounts. Such proposals represent a profound shift in philosophy and would have significant ramifications. These ramifications deserve careful examination and consideration by policymakers and the American public before any changes are made.

Even in OASI, however, it should be possible to begin making adjustments to pave the way for longer run solutions. For example, improvements in the CPI to provide a more accurate measure of the cost of living should be actively sought and adopted for calculating Social Security annual cost-of-living adjustments. The future of the program requires not only that we make changes as soon as possible but also that we demonstrate to younger Americans a commitment to a viable retirement system that they can be assured will serve them in the future.

The DI Trust Fund faces other challenges. After significant increases in DI costs in the early 1990's, experience from 1994 through 1996 shows that applications for DI leveled off during this period. However, the DI program has, throughout its history, experienced periods of growth and decline for which causes cannot be established with any precision. Consequently, the DI fund should be carefully monitored and its experience assessed in developing legislation to close the deficit projected in the DI fund in the decades ahead.

Conclusion

We are privileged to take part in the thorough and careful process by which the Annual Reports are prepared to provide this vital public accounting. We strongly believe that these Reports serve as an early warning of the need for changes to ensure continuation of these programs and not as evidence of their failure to protect future generations. Working cooperatively, with informed public debate, we believe solutions can be found to the financing problems facing America as our population ages, and it is in this spirit that we will pursue further efforts at public education on Social Security and Medicare issues during our terms as Public Trustees.

Chairman BUNNING. Thank you both for your testimony. I would like to start the questioning.

Given that you are Trustees for both the Social Security system and Medicare Programs, do you have an opinion about whether the problems of one should be addressed before the other, or should we take them on at the same time as part of comprehensive reform legislation? Listening to your testimony, Dr. Moon, you suggested almost that but I am not sure I understand what you were saying.

Ms. MOON. Medicare has to be addressed first in terms of the problems that arise because of higher health care costs. The changes that are being proposed this year to reduce the rate of spending on the program and bring it down substantially are a good first step in that direction.

My personal view is that we will have to continue to look at health care spending problems for some time. We are still shaking out the health care marketplace for private plans, and Medicare is going to have to change over time as those changes occur. It is not going to be easy to tame that health care cost tiger.

On the other hand, Medicare and Social Security, in the long run, face very similar problems in terms of the demographics. Most Americans believe these two programs are integrally related and important.

My concern is not that they have to be taken at the same time or at the same moment in time, but rather, there needs to be a recognition, for example, that if we decide to use additional revenue sources to help bolster one program and take all the relevant taxes off the table before we turn to the other, that will place problems on the remaining program.

The other thing I would note is that people have traditionally thought of Medicare as the small piece appended to Social Security. But by about the year 2020 or a little bit after that, the combined parts of Medicare will be larger than Social Security. So from that standpoint, I think we also have to be very cognizant of Medicare.

I am not sure that they have to be taken together. I think it is essential to keep in mind what you are doing to the other program when you are operating on one of them.

Chairman BUNNING. Well obviously, the fix that we are proposing or the agreement that has come between the White House and the Congress on Medicare, is a temporary, 10-year, possibly more, fix on the funding for the Medicare system. We are going to have to reexamine that very shortly to make sure that we build in some solvency past the year 2010.

The recent Social Security Advisory Council has provided us with three basic plans or approaches to address the system's long-range financing problems. Do either of you have a particular favorite among those three choices that they brought before us in their testimony?

Mr. KELLISON. The answer to that question is no. Our role is——

Chairman BUNNING. That is what we thought.

Mr. KELLISON. Our role as Trustees really does not involve trying to develop policy recommendations and policy solutions. That is not within the scope of our assignment and I think we would diffuse our efforts and our real primary responsibilities if we did that.

These proposals are very detailed. I think the thing we tried to extract in talking about them briefly here today at this point in time are the concepts that are in there because they are new concepts. Social Security basically has not changed in 60 years in terms of its financing structure. It is basically a 50:50 sharing on a payroll tax between employer and employee.

Chairman BUNNING. Let me interrupt because I want to ask this question while I still have the orange light. Do you believe that each or all would solve the solvency problem if either of the three were enacted by the Congress? Is is one better than the other or are they all equally mediocre?

Ms. MOON. I like to think of them as three different kinds of approaches, rather than focusing on the exact specifics of each option. My guess is that is how the Advisory Council would like to have them viewed, as well. That is, no one member might have locked into exactly all the elements of the proposal he or she voted for if they were developing their own specific option.

You could solve the problem with any of those approaches and that is the relevant way to look at them, as opposed to arguing that only one of them can solve the problem.

Another important piece of the debate over Social Security is to find out what young people who will face this new system, if we change it substantially, feel about it. Steve and I will probably not be faced with a brand new system, so it is not as critical for us as it is for younger people.

Chairman BUNNING. Thank you very much.

Mrs. Kennelly.

Mrs. KENNELLY. Yes, Dr. Moon, but part of the problem is that we in the Congress and the people as a nation do not want to face up to something until it is in crisis proportion. I know that you are not policymakers but you know more about the system probably than anybody else.

Let me delve a little deeper into the question that the Chairman asked you. We now have these three approaches from the Council and we all talk about them. Are we getting ourselves into a box? Are we just looking at these three proposals and not thinking maybe there are other answers?

I know one of the things you just said was maybe a mix of these three proposals, but are there other ideas out there? Are we dangerously locking ourselves into just a few situations?

I don't feel we can accept the status quo. I really feel the demographics don't lie. But knowing all your knowledge, is there some way we could get outside the box a little more, to get some more input into this, rather than locking ourselves into these three approaches?

Mr. KELLISON. I think there probably are a number of different ways to do it. To cite one illustration, for example, there are certain key factors that have been identified as having a pretty profound effect. We hear discussions, of course, about the importance of the Consumer Price Index, CPI, getting a better measure of what the real cost of living is.

As we have indicated, life expectancy has increased substantially, yet the retirement age has stayed the same and is scheduled to increase very slightly in the next few years but still considerably less than life expectancies have improved. That has a profound effect on the system.

Productivity gains, real wage gains in the economy have been very low in the last 25 years. We see some hopeful economic signs today but we still are far below the kinds of growth rates in the economy that we saw back in the fifties and sixties.

And the question there is a richer society can afford a richer social insurance program; a less wealthy society maybe cannot afford as much. Should the benefits be adjusted, depending on the wealth of the economy?

So there are other ways of looking at the system and finding some possible solutions to it.

Ms. MOON. Most of the building blocks for change are in those proposals. There are a few others that could certainly be added to the list.

I also think that one thing that hasn't been discussed as much that might be talked about is the fact that there are some changes that one could make sooner rather than later while you are continuing to debate broader reforms changes.

It is not necessary, for example, since there is not consensus as yet, to lock into a decision about private investment or private accounts. On the other hand, there may be some moderate changes to the Social Security Program that you might decide to make, some of which have been mentioned in all those plans. Full inclusion of State and local workers is just one example. Perhaps some change or slight speed up in the age of retirement that is now set in law could be made as well.

Some of those changes might be considered separately as ways of making a downpayment on the future and providing some reassurance to younger people that you are moving in a direction to change the program without making final decisions on big structural changes.

Mrs. KENNELLY. Dr. Moon, I thank you for that because we keep forgetting the three plans had numerous agreements among them and yet the bottom line was very, very different in the plans.

Mr. Kellison, you mentioned the CPI. In this budget proposal we have, it looks like there is every intention to reduce the CPI downward by 0.3 percent. Will that have an effect, or if that number was higher, what is the effect on the Social Security deficit down the line?

Mr. KELLISON. Well, it is fairly substantial. If you just have a lesser CPI indexing on benefits and no other effects, it can be pretty substantial. I do not have the exact numbers in front of me on what that would produce, but it is a significant issue. We, I think, have looked at some projections of that sort that we would be happy to provide the Subcommittee.

Mrs. KENNELLY. My understanding is that if you made that kind of change, it would reduce the deficit by something less than 4.4 percent. In contrast, if you increased the retirement age, you would save 5.5 percent. Is this an area we should be looking at in relation to how we make these changes?

Mr. KELLISON. Well, I think it is. In terms of the current structure of the system, setting aside the more structural types of proposals that we have been talking about, the two areas in which most attention has been paid and could be paid is the area of the CPI indexing and the area of the retirement age, and both of those do have very substantial impacts on the cost of the system.

Mrs. KENNELLY. Thank you, and I thank you for your testimony. I don't know how we do this but it sometimes seems to me when people get into a position and they know so much and they have such good judgment, somehow that knowledge has to be used by all those who don't have that same kind of understanding. I don't know; maybe we can figure out a way that you could tell us your most secret thoughts on how we could fix this problem. Thank you.

Chairman BUNNING. Your most secret thoughts in public.

Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. Kellison, welcome. As a fellow Cornhusker, I see that you got most of your education in Lincoln.

Mr. KELLISON. That is correct.

Mr. CHRISTENSEN. I am glad that you are here. I want to ask you, as I have had an opportunity to go out and visit with the schools, there is absolutely no confidence, zero confidence in our schools today—the seniors, the juniors that are out there in the work force on a part-time basis working after school—in terms of ever seeing the money that they are putting into the system now coming back to them in 40 years, 45 years.

What can be done, in your opinion, to educate the public to begin a process of educating the young people of the status of Social Security—where it is, what can be done, how it can be saved, where actually they stand as a high school senior and where they stand as a 65-year-old individual? What are your thoughts on this, as an actuary?

Mr. KELLISON. Well first of all, I certainly agree with your perception. I personally was not aware of the depth of the lack of confidence in Social Security among the younger generation until I started this assignment and started giving some talks to some groups where the average age was quite young and it was an eye opener, so I certainly share your perception that there is a serious issue there of confidence in the system.

I think it certainly would be helpful if several things were done. The Social Security Administration I would like to see try to launch more of a public education program about the system and what it is and what it isn't. I think, for example, some people perceive that in the year 2029, if we didn't do anything, the Social Security Trust Funds will be bankrupt.

I guess the trust fund would be out of money yet the payroll tax income would still provide about 75 percent of the benefits. So it is not like it is hopeless. Clearly something should be done long before that point in time but it is not like there are no resources left at all.

So there are a lot of misconceptions about various things of that sort. And as we indicate in our testimony, we would certainly encourage the Congress to deal with this sooner rather than later. I think some action on the part of Congress, even if you didn't necessarily solve the whole problem at once, in a sense, incremental action even would be helpful so that the American people would have confidence that Congress is paying attention to this program and is concerned about putting it back on financial standing.

But there is a definite public education need there, particularly in the schools and the younger generation.

Mr. CHRISTENSEN. As far as the incremental action that you mentioned, how do you feel about the possibility of using the markets in terms of a small percentage of the investment?

Mr. KELLISON. Well again, that gets into the specifics of these proposals. I think there are some positives and negatives to it. Our analysis of it is that a lot more needs to be looked at in those proposals. I think there are some attractive features to do that and I think it would improve the public confidence potentially, but I think there are a lot of questions that would need to be answered on the administrative side and how it would fit into the rest of the Federal budget, for example, that we haven't really dealt with.

So it is a promising idea in some respects but I think there is a lot more analysis that needs to be put into it.

Mr. CHRISTENSEN. If you polled the seniors and talked to them, as you have had an opportunity to be out there in the schools a little bit, and J.D. and Kenny and the rest of us here on the panel get an opportunity all the time to talk to the kids in schools; there is not one of them that doesn't think they can do better at investing their money in the market than what the Social Security system has been investing the money at, in terms of a return.

So I guess, as a younger Member in Congress here, I would like to implore your leadership in this area in terms of getting out there and speaking about the issue that I think is going to affect the future generation.

It is sad to see that when you talk to the seniors, there is no confidence in the system and they are very frustrated. They feel like they are helpless. They feel like they are sending all this money to Washington and they have no idea where it is going other than to a deep, dark, black hole and they will never see it again. And even though, as you say, 75 percent of the funding will still occur at 2029 to meet the obligations, from an actuarial standpoint it would be out of money unless we are able to do something.

There are a lot of proposals on the table. I think that Senator Kerrey has been the leading proponent in this area and I would encourage our Subcommittee to tackle this, to look at it, to see if we can't figure out some way to save the system, to do the right thing and the responsible thing, and I thank the Chairman for holding this hearing and I thank you, Mr. Kellison and Dr. Moon, for your testimony.

Chairman BUNNING. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Again, I think that these hearings are helpful in the sense that they give us all an opportunity for some instructive discussions. And while we might have disagreements about where we are headed, I think we all acknowledge that we are going to have to do something to shore up the Social Security system.

Mr. Kellison, in your testimony you talked about a transition stage and you indicated that it might be expensive in that stage of transition. I think we all acknowledge that there are going to have to be steps taken to reinforce the contract with our retirees over Social Security and future retirees. What are some of those transitional steps that you would suggest to us this morning?

Mr. KELLISON. The point I was trying to make is that under a pay-as-you-go system, basically the benefits that are being provided today are essentially coming out of the payroll taxes that are being paid today. These proposals, either through the trust fund or through private investment accounts, in essence would try to advance-fund at least part of the obligation and to do that requires, of course, more money because not only are you paying the benefits to the current retirees, but you are also trying to advance-fund some of the benefits for the existing work force.

Right now we are running some surpluses so a lot of these proposals do involve at least trying to somehow take advantage of that excess and I think Senator Kerrey's proposal that Mr. Christensen recommended is essentially built around that idea.

But basically we do have to go in that direction. If we are going to advance-fund it, it will cost more money on this transitional basis. If this works the way some people think that it should work, it will increase the overall rate of savings in the economy, which would improve productivity.

So that is really the goal, is to structure it in a way that would achieve that objective.

Mr. NEAL. What about expanding IRA accounts? Do you have any thoughts on that?

Mr. KELLISON. I think basically it is important to have a viable private pension system to support Social Security. We have a three-legged stool and now some people are talking about a four-legged stool, which involves work in retirement.

We need to have a strong private pension system through employer-sponsored plans, as well as through IRAs. I don't have any particular proposals on IRAs directly but I certainly am strongly supportive of trying to simplify the administration of private pension plans. I try to encourage more employers to have them so that more can be delivered through private pension plans, as well as to supplement what Social Security is doing.

Ms. MOON. There are two issues that your question about IRAs raises. One is that Social Security is supposed to be the base and we want people to have private savings or pensions that supplement that base. When we talk about changing the Social Security system so that that base itself involves more investments with risks attached and since private pensions are an element that may have risks attached, we need to think comprehensively about how much should be a base that represents a very secure investment and how much should be put into riskier and potentially higher return investments?

It is important to think about both Social Security and these additional savings and pensions that people have.

Second, IRAs raise an additional question about how much they have helped to contribute to national savings. Do people simply shift from one type of savings into another? Certainly some of the early analysis done on IRAs hasn't found that they have particularly helped to expand national saving. We haven't been very good as a country at finding ways to encourage Americans to save more overall, as opposed to shifting from one form of an account to another. That raises some cautions in thinking about whether we are going to be successful in moving in that direction in Social Security reforms as well.

Mr. NEAL. If you expand income levels for contributing to the IRA, does that not make some sense?

Ms. MOON. It may make some sense and it may be a good thing to do. My only caution is that we sometimes think that by providing preferences to people to hold savings in a certain way, we will increase the aggregate amount of national savings that occurs, and it doesn't always happen that way.

Mr. NEAL. Thank you, Dr. Moon. Thank you, Mr. Kellison.

Chairman BUNNING. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman.

I respect each of you and your hesitation, if that is the correct word, in endorsing or not endorsing any of the proposals, because that is certainly not your role.

So since we are talking in more general terms, why has there been an erosion in public confidence in Social Security? Hasn't Social Security been a successful program?

Ms. MOON. I believe Social Security has been a very successful program. I think of it in a couple of different contexts. One is I think there has been an erosion of confidence in government in general and that affects Social Security.

Second, there is a recognition on the part of young people about the demographic bulge and it doesn't take a lot of thought to imagine that it is going to be more difficult to afford the same level of benefits in the future as we have in the past.

Some of the poll results that I have seen that suggest that people say Social Security as we know it today will not be there when I am 65 are appropriate. I don't think Social Security exactly as we know it right now will be there in 20 years. I think that is a recognition that there needs to be some changes.

The question has been do people think it won't be there at all? I hope that they won't. I fear that sometimes in trying to beat the drum and say changes need to be made, that we may push people into panic and imply that there is no solution. You have to find the right balance here of saying that there are problems that need to be addressed, but these are not insurmountable problems.

Mr. HULSHOF. I think Mrs. Kennelly was right on point. Here in this body we focus on things when they become crisis situations, even when the crises sometimes are of our own doing. But should we be going back to our respective districts and talking about the positive things about Social Security and looking at—I think, Mr. Kellison, you mentioned the words—the demographic realities that are ahead of us. Should we be talking in more positive terms about what has happened in Social Security?

Mr. KELLISON. I would certainly support that. I think that you, as Congressmen, would be in a very strong leadership position with constituents to try to carry that message. I think the demographic trends are real. They are there. They are pretty well established and they are going to be around for many decades. I think that people can understand that when you talk in terms of 3.3 workers per beneficiary dropping to 1.8.

Going back to your first question, some of the reasons for loss of confidence, in addition to those cited by Mrs. Moon, really have to do with people who do perceive that they are not getting as good a return on their money and they could do better on their own. I think the fact that we have had, in past generations, much higher benefits in relation to what people paid into it, that was because it was an early system. It hadn't fully matured yet. In a sense, those might have even been thought of as windfall benefits by some. On a moneys worth-type of basis, some of that has gone down.

On the other hand, to be fair about it, rates of return on the stock market have been booming now for over a decade. People are used to things that may not happen over long periods of time.

We do have a lot of benefits that some people forget about in Social Security that are part of the picture, too. We have a lot of survivors benefits, which is somewhat like life insurance. We have a lot of disability benefits.

So I think when people say that they could do better on their own, that may or may not be true, but I think to have a fair comparison, we do need to recognize that there are a lot of benefits in Social Security, such as survivors benefits and disability benefits, that typically they wouldn't be thinking of doing on their own.

So I think it is important, if people are going to get into that analysis, to do it on a fair comparison basis.

Mr. HULSHOF. Mr. Kellison, you mentioned, along with the demographic realities, political realities and you also mentioned CPI, so here comes this question. Should we fix CPI—we, being Congress? Should politicians take on the task of adjusting CPI or do you believe it is best left to the jurisdiction of the Bureau of Labor and Statistics, BLS?

Mr. KELLISON. Well, what we would like to see, as Public Trustees, is to have CPI developed by the BLS to be as fair a measure of inflation as possible, and that is what we think is intended. And if there is to be indexing to full CPI under Social Security, that is the index that, under current law, we feel would be appropriate.

In terms of whether you might artificially consider something less than that as a financial savings measure is really another issue. I think our primary focus is to get a fair measure. That is clearly a BLS issue. The other is a political issue that we really would not be involved in.

Ms. MOON. A lot of measures that we use and rely on are not perfect measures. To a certain extent, it has been convenient to focus on the CPI because its bias is in a direction that we think if corrected would help in reducing Federal Government expenditures and hence balancing the budget.

My view is that it is better to rely upon the BLS and use as good a measure as possible. If one decides to change the CPI artificially, we should just recognize that that is an artificial change and it is not "fixing" the CPI.

Mr. HULSHOF. Thank you, Mr. Chairman.

Chairman BUNNING. I would just like to ask both of you if, in fact, we used all of the money from the Federal Insurance Contributions Act, FICA, tax to go to old age retirement benefits, how much more would that save the system? In other words, if there were a separate program for survivors and disability, how much would that be?

If I take a portion of FICA tax and invest it in something other than government bonds and I get a rate of return on that, I don't figure in how much the survivor benefit or the disability benefit is going to be. So what portion of that program is being charged off for survivors and disability?

Ms. MOON. Disability is easy to sort out because it is separate in the program, so you can estimate that.

Chairman BUNNING. I am trying to combine the two. You look at the rate of return we are getting and you look at the rate of return you get from private investment, and there is a major difference.

Ms. MOON. So we are talking about 5.35 percent right now each, for employers and employees, for OASI. The problem with survivors and dependents benefits, though, is that many people who receive them usually get a combination of survivors or dependents benefit and their own work employment benefit, so I don't know that that is a very easy figure to pull out. For example, when I retire I may get a dependents benefit from my husband but I still will have made a lot of contributions myself, and my dependent benefit is just an additional amount above my own benefit.

Chairman BUNNING. The difference.

Ms. MOON. The difference, right. So I think that one would be tough to pull out. I don't know if you know.

Mr. KELLISON. The disability insurance, DI, part is quite clear. As Dr. Moon has said, it is 0.85 out of the total of 6.2, leaving the OASI Program at 5.35 employer and employee. There are a lot of definitional problems that Dr. Moon is quite right about. For ballpark purposes, something perhaps in the 4.5-percent range probably is——

Chairman BUNNING. Our rate of return?

Mr. KELLISON. For retirement, and the rest of it being survivors, is sort of a rough rule of thumb that we use in the private sector.

Social Security integration in private pension plans, I think, uses 4.7 as the strictly retirement piece. That may be a tough high, but something around 4.5 to 4.7 are the numbers that are typically used for that. But again, there are a lot of definitional issues. To try to carve out the survivors benefit is not an easy thing to do.

Chairman BUNNING. I don't want to try to answer Mr. Christensen's real problem with confidence but when, for the last 10 years, you have seen an Standard & Poor's, S&P, rate of return over 20 percent or thereabouts, 18 points whatever it might be, and then you look at the increase in the ability of Social Security to bring in dollars, with the law stating that they have to do it in government bonds, that may be a reason of no confidence for our young people looking at the rate of return on Social Security and the fact that it might not be there when they get older or the system won't be the same.

We know it is not going to be the same in the year 2030 because we are going to have to change some of the things that are in the system to make it more financially solvent. So I don't know how we are going to get that message to our young people, particularly my children and my children's children. It is a very difficult thing to do because we don't have the answer right now.

That is what we are asking you and other people that appear before this Subcommittee, to try to get a consensus on answers so that we can then look at the options and say "Here are our suggestions for making this solvent down the road." We can always bring in every expert we can find and they are all going to have a different answer. It is going to be up to the Congress, as it was in the early eighties, to actually sit down and make the decision as to which direction we want to take the system, with the confidence and support of the American people, not with everybody picking each other apart. This is the easiest thing in the world to pick each other apart on, just like Medicare was.

[Questions were submitted by Chairman Bunning to Dr. Moon and Mr. Kellison. The questions and responses follow:]

Question 1. Recognizing that the Trustees' "intermediate" projections represent a "best guess" about the future condition of the system, if you were to lean in one direction or the other would it be toward the "high cost" or "low cost" projections?

Answer: Due to the complexity of the many factors that determine Social Security income and expenditures and because the future is inherently uncertain, the annual OASDI Trustees Report provides 75-year financing projections for Social Security under three alternative sets of economic and demographic assumptions to show a range of possibilities. These assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised if warranted. Therefore, the projections under the intermediate set of assumptions in the most recent annual Trustees Report represents the Trustees "best estimate" at any point in time of Social Security's future financing. In our view, there is no basis for "leaning" in one direction or the other; if new information indicates that future experience is likely to vary from that indicated by the most recent sets of assumptions, all three sets of assumptions will be reviewed, and one or more sets revised as seems appropriate in the next annual report.

For policymaking, we think the more critical point is that because we cannot predict experience over the next 75 years with certainty, we should not allow ourselves ever to lapse into thinking that we can design a set of financing provisions that will keep Social Security in perfect financial balance for 75 years. Rather, what we should do is make policy changes whenever the need for such change seems evident, just as we revise the assumptions whenever new information indicates revision is needed. We believe public confidence in Social Security can best be maintained over the long run by openly acknowledging that adjustments in Social Security will be needed periodically as economic and demographic experience unfolds in future years. If that experience is more favorable than the Trustees intermediate assumptions, Social Security benefits could be increased or payroll taxes reduced in the future; conversely, if experience is less favorable, benefit levels would need to be reduced or taxes increased. But what is critical for the public to understand is that U.S. economic and demographic experience in the years ahead will affect not just Social Security financing but every aspect of our society. For example, if the productivity of American workers could be increased through better education and/or improved technology in the future, not only would the standard of living of those workers and their families be increased, but Social Security financing also would be improved.

Question 2. In light of the fact that the Trustees' long-range "intermediate" projections made in 1983 now appear to have been optimistic, if one were to ask you to design a package of reforms today, would you use the "high cost" forecast in your recent report? Said another way, should Congress build a financing cushion in the next set of changes we make to Social Security in the event your most recent intermediate forecast proves to be optimistic?

Answer: As we indicated in our response to Question 1, we think the idea of designing today a set of changes in Social Security that will keep the system in perfect balance over the next 75 years is not the best approach precisely because we cannot hope to predict with certainty economic and demographic experience over so long a period. The better approach, we believe, is for all Americans to recognize that periodic adjustments will be needed over the next 75 years as economic and demographic experience unfolds. The current status of OASDI financing is actually quite close to that projected for 1997 under the intermediate assumptions in 1983. However, there have been some critical changes since 1983 regarding our assumptions for the long-term future, particularly as to the productivity of workers in the 21st Century. Productivity experience in the last 25 years has been much lower than in the previous quarter century, and as that lower experience has continued to unfold the Trustees have taken it into account in the assumptions.

Question 3. Given that entitlement spending overall has been projected by the Congressional Budget Office (CBO) and others to grow dramatically as a percent of GDP in the future (when the baby boomers are in retirement), do you think it would be wise to build tax increases into any Social Security reform plan?

Answer: We do not think scheduling an increase in Social Security tax rates should be considered without taking into account the future financing of Medicare and other critical needs of our society. Also, an advantage of periodically reexamining the financing of Social Security in future years is that, as has been the case since 1935, each new generation will have the opportunity to make revisions consistent with its own perceived needs, values, and preferences.

Thank you for your testimony. Does anybody else have any questions? Thank you.

If the second panel would step forward, our second panel features organizations representing different generational perspectives on Social Security reform. Today we will hear from Beau Boulter, who is the legislative counsel for the United Seniors Citizens Association; Gary Green, a board member of the Third Millennium; Deborah Briceland-Betts, executive director of the Older Women's League. I can't believe that is the title of that organization. I didn't think women ever got older. Jack Ryan, executive director of the National Taxpayers Union Foundation; and Tess Canja, vice president of the American Association of Retired Persons.

If you will take your seats we will begin with Congressman Boulter.

STATEMENT OF HON. BEAU BOULTER, LEGISLATIVE COUNSEL, UNITED SENIORS ASSOCIATION, INC.; AND FORMER MEMBER OF CONGRESS

Mr. BOULTER. Thank you very much, Mr. Chairman. United Seniors Association is a 501(c)(4) nonprofit organization with more than 540,000 members across our country. We are entirely member supported, with no government grants or contracts, and we really appreciate your invitation to be here this morning to talk about the report.

We certainly agree with everybody that Social Security has been enormously successful; it provides a basic level of retirement security; it raises the poorest elderly people out of poverty; and we appreciate Social Security.

In summarizing my testimony, let me just say that what we believe is that we cannot rest on the laurels of Social Security because it is fundamentally, we believe, in trouble, very seriously so, both in the long term but also even in the intermediate term, and we think Congress will soon be faced with unpleasant choices if nothing is done almost immediately, that very soon you will be faced with the choice of either raising payroll taxes or cutting benefits tremendously or borrowing money again to meet the liabilities.

So when we look at the Trustees' Report, here is the way I sort of analyze it for our organization, Mr. Chairman. The actuarial deficit is 2.23 percent of the taxable payroll. The implications of the report are that this deficit could be eliminated if you raise the tax from 12.4 to 14.63 percent. That would be an 18-percent increase and that assumes that there is over $600 billion worth of assets in the Social Security Trust Fund.

Instead, however, the government has IOUs written to itself in the trust fund that can be redeemed, but they can be redeemed only if we borrow money or if you raise taxes.

So when you look at it that way, and I think the Trustees actually recognize this, that at the end of the 75-year period, talking about the long-term problem, at the end of 75 years you actually have a deficit which is not equal to 2.23 percent of the taxable payroll but the deficit is more like 6 percent of the taxable payroll.

In other words, in the year 2070, revenue from OASDI payroll taxes will be insufficient to pay benefits by an amount equivalent to almost 6 percent of the taxable payroll, meaning that the payroll tax would have to be increased not by 18 percent but by 47 percent to pay all of the Social Security benefits that current law has promised.

Of course, I think that is the basic problem, at least one of the basic problems, that current law promises way too much to people way down the road. The benefits are simply too rich.

At the United Seniors Association, what we would hope for in talking about reform, is to make sure that we do guarantee, that we keep the social contract with seniors who are retired or who are about to retire, perhaps looking at seniors my age and older, 55 and older, people in that age category, to make sure that they understand that they are going to get everything that current law promises them.

But when we look at younger people, and this is the second principle that we have, not that we have worked out all the details, but when we look at the younger people, we think we have to admit that current law promises way too much, and they understand that. We have all talked about the confidence problem. The tax rate would be too high. The return is way too low.

At United Seniors Association, we oppose raising the payroll tax. I guess that is the one thing we don't like about the three plans. We do think they probably would all solve the solvency problem, but some approaches we like better. We don't like particularly any approach that raises the payroll tax. What we would rather see is to take the surplus, which apparently is going to be something like $80 billion this fiscal year, if I understand it, to start taking the surplus now and diverting that into the private sector. That is about 1.2 percent of the taxable payroll, or maybe more. Maybe take a little bit more and divert it into the private sector and keep doing that year after year.

That would get us started so that when it comes time to make the structural changes and to cut the benefits for workers down the road, they will have built up savings that more than compensate for the reduction in the benefits.

So we think we have to do something like that or that Congress does. Otherwise, I think what we will see in the coming year is more and more intergenerational conflict that could really be a serious problem for our country, and that could be one of the most important societal problems for our country that we have ever faced, and we want to do everything that we can to avoid that.

[The prepared statement follows:]

Statement of Hon. Beau Boulter, Legislative Counsel, United Seniors Association, Inc.; and Former Member of Congress

Good morning Chairman Bunning and Members of the Subcommittee. I am Beau Boulter, Legislative Counsel for United Seniors Association, a 501(c)(4) non-profit citizens organization with more than 465,000 members across America. We are entirely member supported by non-tax-deductible contributions and receive no government grants or contracts. A copy of my own curriculum vitae is attached. Thank you for giving United Seniors Association an opportunity this morning to express our views on the findings of the 1997 Annual Report of the Board of Trustees and on options to ensure the future of Social Security.

At the outset, let me say that Social Security has been enormously successful in achieving its twin goals of providing a basic level of retirement security for all Americans while raising the poorest of the elderly out of poverty. It is not surprising that an overwhelming number of senior citizens give the program very high marks. But Mr. Chairman, Social Security cannot rest on its laurels. Even its staunchest supporters, among whom I count myself and the organization I represent, must be unsentimental in evaluating the program's serious flaws, for those short comings are so fundamental, so serious, that they surely will destroy the system unless they are addressed soon. The current Social Security system, unless redesigned, will be unable to sustain the level of benefits promised to future generations.

In testimony before this Subcommittee March 6, former Social Security Commissioner Robert Ball argued that the program "does not require heroic measures." He contended, "The situation with Social Security is like that of homeowners living in a sound house that they very much like and that needs only to have its mortgage refinanced." I most respectfully disagree. A more apt analogy, I fear, is that of a well loved, but termite-infested house that has provided comfort and shelter for many years but will collapse of its own weight unless something fundamental, yes "heroic," is done—first to shore it up and then, like an historic landmark, to reconstruct it from the bottom up and from the inside out with modern systems and amenities. Refinancing the mortgage will only push the financial burden off onto the lender when the decrepit shell of an asset collapses.

The White House is a good metaphor for the Social Security system. By 1948, the beloved President's house, while it looked fine on the outside, had become a health and safety hazard for its occupants. Congress didn't allow the White House to disintegrate out of false sentimentality. Instead, lawmakers made sure it was completely renovated. The entire interior of the building was removed. A new basement and foundation were built under the original exterior walls, and a new steel framework was erected inside them. Modern heating, plumbing and electrical systems were installed.

Today's White House is not your grandfather's White House, Mr. Chairman. Similarly, we cannot afford to bequeath an unrestored Social Security system to our grandchildren. I say that out of concern for our younger generations but I also say it with more than a trace of enlightened self interest because if steps are not taken soon to restore and renovate Social Security, those people depending on it now and those of us soon to become dependent on it will find ourselves lying beneath the rubble when it collapses.

Mr. Chairman, before I discuss the 1997 Trustees' Report, I want to commend Members of the Budget Committee on their Budget Resolution for recognizing the upcoming crisis in Social Security and for their finding that Congress and the President need to enact a law creating a schedule for paying off the national debt, including money borrowed from the Social Security Trust Fund. For six years now, United Seniors Association has been warning that spending surplus Social Security revenues for general government operations jeopardizes the future retirement benefits of millions of Americans starting around 2012.

FINDINGS OF THE 1997 ANNUAL REPORT OF THE BOARD OF TRUSTEES

This year's annual Trustees' Report is very clear. Social Security is actuarially unsound over both the intermediate and long terms. In 2012, less than 15 years from now, tax revenues will be insufficient to pay Social Security cash benefits. At that time, Congress will face the unpleasant choice of cutting Social Security payments to beneficiaries, raising taxes on working people, borrowing more money, or some combination of the three. There will be no other options, no side steps, no dodges. Unless we get started very soon to renovate Social Security, no matter how cleverly a proposal to "fix" the problem might be packaged to deceive the public and Members of Congress, don't be fooled, it will consist one of these three options.

Over the long term (75 years), the system faces an "unfunded liability" of approximately \$8.0 trillion. In other words, if you add up all the payroll taxes current workers are expected to pay plus all the income taxes on benefits current beneficiaries are expected to pay and subtract from that amount the total benefits the federal government will be obligated to pay them, you would get an enormous negative number, i.e., a deficit. If that negative number were expressed as a "present value," (i.e., the lump sum amount you would need invested over the 75 year period at expected interest rates to cover the shortfall) you arrive at the \$8.0 trillion shortfall, or "unfunded liability."

The Trustees evaluate the system differently. They evaluate the "actuarial deficit" by factoring in the total expected taxes and benefits of future generations of workers and beneficiaries during the 75-year period under evaluation. The present value difference between the expected taxes paid and benefits received including this group in the calculation amounts to about \$3.0 trillion. In other words, the federal government would need to have on hand, today, \$3.0 trillion in real income-earning assets to meet all of its future Social Security obligations drawing on all its available resources between now and 2070.

Instead, the federal government has on hand a ledger full of IOUs written to itself that can be redeemed at the Treasury only if taxes are raised or more money is borrowed.

According to the Trustees, the actuarial deficit of the program can be interpreted as the percentage of taxable payroll by which the system falls short of meeting its obligations, i.e., the number of percentage points by which the payroll tax would have to increase in order to pay all benefits promised in the future. The Social Security deficit expressed as a percent of taxable payroll equals 2.23 percent. The implication of the Trustees' Report is that the actuarial deficit could be eliminated if the Social Security payroll tax were raised immediately by 18 percent, from 12.4 percent to 14.63 percent.

Now, some people would use this formulation of the problem/solution to suggest that the expected deficit is really quite manageable with a little nip here, a tuck there and a slight boost in the payroll tax rate. But Mr. Chairman, don't be misled. There is more to the problem than meets the eye; much more.

First, expressing the deficit as 2.23 percentage points of taxable payroll disguises the growing extent to which the Social Security system relies for revenues on the taxation of benefits in addition to payroll taxes. Revenues from income taxes on Social Security benefits themselves are slated to grow from .23 percentage points of taxable payroll today to .94 percentage points of taxable payroll in 2075. Without these taxes on benefits, the actuarial deficit is actually 25 percent larger, amounting to 2.79 percent of taxable payroll.

Second, and more importantly, this formulation of the actuarial deficit depicts an abstraction, using "summarized," or average, rates over the entire period, which disguises the cash-flow cliff looming a mere 15 years over the horizon when Social Security starts taking in less in revenues than it pays out in benefits. It is like telling a hiker who doesn't know how to swim that he can easily ford a river because its average depth is only about 4 feet without pointing out the unpleasant fact that in the middle half of the river the bottom falls away to 10 feet.

The entire concept of expressing the actuarial deficit as a summarized percentage of taxable income relies upon the fiction that during the early part of the actuarial period, large cash-flow surpluses can be "saved" and "reinvested" in a government trust fund to earn income. Of course, as you are well aware, the surpluses to date already have been spent and all expected future surpluses are slated to be spent on everything from battleships to paper clips.

In order to eliminate the deficit by raising the payroll tax rate 2.23 percentage points, the rate hike would have to occur immediately and remain in place throughout the 75-year actuarial period. Such a policy would entail huge cash-flow surpluses running to about 2021, after which time cash flow would turn negative, and Congress once again would be faced with the same vexing alternatives: raise taxes again, cut benefits or borrow more money. Consequently, any "Two-Percent Solution" payroll tax hike would simply triple the delusion under which the system already operates in order to buy the system less than a decade more of solvency.

Expressing Social Security's future deficit as a percentage of taxable payroll is useful to the extent that is provides a bench mark to calibrate how serious the problem really is. The best way to appreciate the seriousness of the problem is to examine how far out of balance the system is at the end of 75 years, not on average during the 75 years. According to the Trustees' Report, in 2070 revenue from OASDI payroll taxes will be insufficient to pay benefits by an amount equivalent to 5.86 percent of taxable payroll. In other words, the payroll tax would have to increase 47 percent to 18.26 percent in 2070 to pay Social Security benefits promised under current law.

In the opinion of United Seniors Association, a tax increase of any magnitude, much less one sufficient to eliminate the actuarial deficit, is out of the question. Payroll taxes already are too high. They are politically unsustainable and economically nonsensical. The payroll tax rate required to pay Social Security cash benefits has risen steadily from 2 percent in the 1940s to 12.4 percent today. The economy is smaller today and intergenerational tensions are greater today as a direct consequence.

The effect of rising payroll taxes on the economy has been pronounced. Social Security payroll taxes raise the cost of labor and reduce saving and investment. According to economist Martin Feldstein, former Chairman of President Reagan's Council of Economic Advisors, the economy today is a full 1 percent smaller each year as a direct result of the burden placed on it by the presently configured Social Security system.

United Seniors Association is encouraged that the Trustees' Report calls on Congress to address the long-range Social Security deficit in a timely manner but I must say, our sense of urgency is considerably greater than theirs. United Seniors Association believes that the problems with the Social Security system are substantially larger than a cursory reading of the Trustees' Report might lead one to believe. In particular, we believe the nation must come to grips with the fact that the trust fund of IOUs, which the federal government has written to itself, does not provide a way around cutting benefits, raising taxes, or borrowing more money in 2012 to keep the system going.

The Trustees' Report concludes that the Social Security system will be able to pay benefits for about the next 34 years. We disagree. When the Social Security Administration begins to present the IOUs to the Treasury 15 years from now, there will be no available cash in the vault to redeem them. So in answer to the question, "how soon must Congress act?" We say, now!

We are also encouraged that the Trustees "recommend that the proposals in the recent Advisory Council Report and others being advanced by public officials and private organizations should be carefully evaluated." Let me turn to those proposals now.

Recommendations of the Advisory Council on Social Security

The Advisory Council on Social Security, appointed by the Clinton administration, recently offered three alternative proposals to address the long-run insolvency of Social Security. In the opinion of United Seniors Association, the three plans encompass most of the range of options available to us. However, we were disappointed that all three of the plans rely on a substantial tax increase, even though in two of the three cases, the tax increase is disguised as a "mandatory contribution." One principle on which United Seniors Association believes the renovation of the American system of retirement security should rest is that current workers will not face higher combined rates of taxation and mandatory contribution.

At one end of the spectrum, the Maintenance of Benefit (MB) plan would basically retain the current unstable, pay-as-you-go structure of the program, and therefore is unacceptable in our view. This plan would attempt to patch the system by reducing Social Security benefits, raising the payroll tax rate, increasing income taxes on Social Security recipients and forcing state and local government employees hired after 1997 to join the Social Security system. The MB plan also recommends a study of having the federal government invest large sums of payroll-tax revenues directly into private equity markets. This idea is a political non-starter. For one thing, it would make the federal government the de facto owner of large swaths of corporate America. If one believes in investing in the market for retirement security, why on earth have the government do it? Let people control their own investments.

The Advisory Council's second plan, the Individual Accounts (IA) plan moves in the right direction but still contains provisions that concern our members. The plan begins with two changes that United Seniors Association supports if they are carefully designed and implemented so as not to affect current retirees, with whom we have made a morally binding contract that must not be breached: an increase in the normal retirement age and a change in the benefit formula to reduce the growth of Social Security benefits for future retirees.

Unfortunately, the IA plan has two features that render it unacceptable in our opinion. The IA plan would increase the payroll tax on current workers by 1.6 percentage points and earmark workers' contributions in mislabeled "individual accounts" that would remain under control of the federal government. Workers would not have real property rights to these accounts and they would be centrally managed by the federal government.

The fact that the IA plan would allow workers to allocate their funds among several broad mutual funds is attractive. However, it falls short of a solution that would energize and empower workers to harness the private economy, rather than the government, to guarantee their retirement security. For example, under the IA plan, the rate of return on workers' total payroll tax payments would continue to be substantially below market returns. It would only be a matter of time, in our opinion, before a heightened tax burden yielding benefits at below-market rates of return would produce irresistible political pressure to "buy off" over-taxed workers with the promise of higher benefits. Soon, we would be right back in the destructive cycle from which we are attempting to break free.

Finally, the Advisory Council offered a third plan that would move America's retirement security system in the right direction but still, in our opinion, would be unacceptable because it entails raising the payroll tax by 1.52 percentage points. The Personal Security Account (PSA) plan would create truly private mandatory individual retirement accounts into which five percentage points of the worker's payroll tax would be reserved for retirement. Workers would have full property rights to the accounts, could pass them along to their heirs, and would have complete control over their management, subject only to the kinds of prudential considerations that presently apply to Individual Retirement Accounts (IRAs). The plan also would raise the retirement age.

Redesigning America's Retirement Security System

In addition to the Advisory Council, numerous individuals and private organizations also have proposed plans to overhaul America's retirement security system. There also has been formed within Congress the bi-partisan Public Pension Reform Caucus, led by Congressmen Kolbe and Stenholm.

In order to help our members evaluate these various plans, United Seniors Association is in the process of drawing up a set of principles that can serve as criteria for redesigning America's retirement security system. Those principles should be complete within the next month, and I will be happy to provide them to Subcommittee Members at that time.

The underlying premise of the principles is that Social Security comprises a morally binding social contract with current retirees and those individuals near retirement. That contract must not be breached. The focus of the principles is to employ the fiscal strength of the federal government to provide a safety net for elderly Americans and to empower workers to harness the power and dynamism of the free market to retire as wealthy as possible after years of hard work. In short, we hope to change the watch words of the system from "government taxes and spends" to "workers save and invest." And, as Subcommittee Members already may have gathered from my comments on the three Advisory Council plans, chief among the specific principles will be maintaining the safety net and avoiding any additional tax increases or additional mandatory contribution requirements that are not offset by reductions in the payroll tax.

We need a new model for retirement security. Fortunately, it appears that there may be an emerging consensus on the general nature of such a model. A feature of that consensus is a two-part program—part "safety net" and part personal retirement savings accounts, and there are numerous plans on the table for public discussion that all have, to various degrees, a private investment component backstopped by a government safety-net feature.

CONCLUSION

The time for action is now, Mr. Chairman, not because we face an immediate crisis but rather because Social Security suffers from a slow-acting degenerative condition that has gone untreated for too long. The problem is not to rescue the system from imminent collapse tomorrow but rather to stop the deterioration from progressing beyond the point of no return. That point is fast approaching and demands that Congress give retirement security its immediate attention.

Chairman Bunning, you and the Subcommittee are to be commended for holding these hearings and focusing national attention on this vital issue. Please allow me to close with one observation. We sometimes get so wrapped up in the numbers that we fail to see the most dangerous element of a retirement system in the process of failing. This process is socially corrosive because it fosters intergenerational resentment and antipathy.

Today's retirees have worked hard all of their lives and paid substantial amounts of taxes on the promise that Social Security would help provide them with a comfortable and dignified retirement. In effect, millions of yesterday's workers allowed themselves to become dependent on government for retirement security in their old age. Even those who resisted dependency frequently found they had no option because after paying their share of taxes they were unable to save sufficiently to provide for their own retirement. They rightfully insist on specific compliance with the social contract that has left them vulnerable to the whims of the political process.

At the same time, a growing number of today's workers resent having to pay a tax rate to support current retirees that is much higher than the tax rate paid by current Social Security recipients when they were working. Yet, in spite of the growth in promised benefits, which are slated to double in inflation-adjusted terms between now and 2070—a promise the system as currently configured cannot keep—that promise, even if redeemed, is insufficient to provide a rate of return to workers comparable to what they could gain in the private market.

Thus we have an apparent paradox: In the eyes of older generations, the Social Security system promises future retirees generous benefits, which to younger generations represent unacceptably low rates of return on the taxes they have been forced to pay in the name of "retirement contributions." Increasingly, today's workers are catching on to the bind in which they have been placed, and they don't like it. Young people will resist paying the taxes necessary to sustain the current Social Security system. If Congress tries to force them to, the result I fear will be intergenerational warfare that would tear this country apart.

This knot cannot be untied. Like the Gordian Knot, it must be cut with creative thinking and decisive action. You are doing the thinking part now. Please don't wait too long to act.

Thank you, Mr. Chairman.

Chairman BUNNING. Thank you, Beau.

Mr. Green.

STATEMENT OF GARY GREEN, MEMBER, BOARD OF DIRECTORS, THIRD MILLENNIUM, NEW YORK, NEW YORK; AND PRESIDENT, FIRST QUALITY MAINTENANCE

Mr. GREEN. Thank you, Mr. Chairman, for inviting Third Millennium to participate in this dialog on Social Security, the largest program in the Federal budget.

My name is Gary Green. I am a member of the Board of Directors of Third Millennium and the president of First Quality Maintenance, an office cleaning company employing more than 100 blue collar workers in New York City.

Third Millennium is a national, nonprofit, nonpartisan group of Americans born after 1960 and we are based in New York City, as well. My colleagues and I have appeared before Congress 12 times over the past 3 years, testifying on the need to overhaul Social Security and Medicare. We greatly appreciate the opportunity to speak on behalf of our members, in all 50 States, who desperately want Congress to reform these programs.

In order to ensure that America remains prosperous well into the 21st century, it must begin to prepare now for the impending retirement of the 70 million plus baby boom generation. This requires girding Social Security and other entitlements for the long haul.

Suddenly and remarkably, Social Security is no longer the third rail of American politics. Political leaders from both parties, such as Congressman Jim Kolbe, Charlie Stenholm, and Mark Sanford, are holding huge townhall meetings with their constituents specifically to address Social Security. The bipartisan Public Pension Reform Caucus, led by Representative Kolbe and Representative Stenholm, now boasts more than 75 members. Similar efforts are starting in the other chamber, led by Senators Bob Kerrey and Judd Gregg.

Think tanks, business associations and advocacy groups such as Third Millennium all have played major roles in transforming the way Americans use Social Security. And what my generation repeatedly discovers is a government program that asks us to contribute more than one-seventh of our income with each paycheck while, at the same time, warning us that it will be bankrupt before we retire.

No Member of Congress has ever successfully explained to my generation how we and our progeny are supposed to meet the pension and medical benefits needs of the soon-to-be-retired baby boom generation. Worse still, no one has justified the fairness of requiring us to bear this remarkable burden while making billions of dollars in interest payments on trillions of existing public debt.

Mr. Chairman, the most recent Trustees' Report forecasts a dismal future for Social Security. In just 15 years, when I turn 47, the OASDI Program will pay out more in benefits than it will receive in FICA taxes. Some suggest that this will not be a problem because the trust fund is projected to contain approximately $2 trillion. But wait. Congress has been borrowing against the trust fund every year to mask the true size of the deficit. In order to replenish the trust fund starting in 2012, Congress will have to raise taxes considerably. How well will that go over with tomorrow's workers?

Let's assume for a moment that the trust fund truly merited its name and we could readily tap into it when the time came. The trust fund would still run dry in 2029, the year I turn 64 and quickly approach retirement. Wouldn't a tapped out trust fund precipitate a crisis for my generation and the ones that follow?

There are those who insist that Social Security technically doesn't go bankrupt in 2029, even if the trust fund is exhausted. Rather, they cite the Trustees' Report, which states that in 2029 Social Security will pay 75 percent of promised benefits, and that is not so bad, after all.

Mr. Chairman, if the 25-percent cut in Social Security benefits would be such a good deal for my generation, why aren't today's defenders of the status quo advocating it for themselves? In truth, such a drastic cut would be as unconscionable for tomorrow's poor seniors as it would be for today's.

Rather than whine about the problem, which some are wont to do, our organization is working on solutions. Each time we at Third Millennium testify, we tell our elected representatives to raise the retirement age to 70, means test benefits on a scale recommended by the Concord Coalition and transform the system, over time, to one that includes private retirement accounts.

As you know, all three factions of the Social Security Advisory Council recommended using the capital markets to help ensure a higher rate of return on FICA contributions than the system is now generating. The 13 members, however, couldn't agree on how to do this.

Third Millennium has not endorsed any one Advisory Council plan but there are elements of both the Schieber and Gramlich proposals that we find attractive. Specifically, we support the Schieber camp's idea to allow workers to invest a portion of their FICA taxes in personal accounts. This would add a critical component of personal responsibility for one's own retirement that is currently absent in Social Security. We also support Chairman Gramlich's concept of limiting the number of different investment choices to a manageable number, so as not to overwhelm novice investors.

In September 1994 when Third Millennium randomly surveyed 500 Americans age 18 to 34 by telephone, we found 82 percent wanted to be able to redirect a portion of what they currently pay in FICA taxes into private retirement accounts. Taking this step would not only be politically viable; it would be popular.

Mr. Chairman, in calling Third Millennium to testify today, you asked how soon we thought Congress should act on Social Security reform. Our answer: Yesterday. America's leaders are wasting precious time. The baby boom generation begins retiring in just over a decade and there is no national plan to accommodate their massive retirement and health needs. For the good of America's future, Congress and the President should act expeditiously. If you don't, future generations will rightly wonder why you waited so long. Thank you.

[The prepared statement follows:]

Statement of Gary Green, Member, Board of Directors, Third Millennium, New York, New York; and President, First Quality Maintenance

Thank you, Mr. Chairman, for inviting Third Millennium to participate in this dialogue on Social Security, the largest program in the Federal budget.

My name is Gary Green. I am a member of the Board of Directors of Third Millennium and the president of First Quality Maintenance, an office cleaning company employing more than 100 blue collar workers. Third Millennium is a national, nonprofit, non-partisan group of Americans born after 1960. We are based in New York City.

My colleagues and I have appeared before Congress 12 times over the past three years, testifying on the need to overhaul Social Security and Medicare. We greatly appreciate the opportunity to speak on behalf of our members, in all 50 states, who desperately want Congress to reform these programs.

In order to ensure that America remains prosperous well into the 21st century, it must begin to prepare now for the impending retirement of the 70 million plus baby boom generation. This requires girding Social Security and other entitlements for the long haul.

Suddenly and remarkably, Social Security is no longer the third rail of American politics. Political leaders from both parties, such as Congressman Jim Kolbe, Charlie Stenholm and Mark Sanford, are holding huge town hall meetings with their constituents specifically to address Social Security. The Bipartisan Public Pension Reform Caucus, led by Representative Kolbe and Representative Stenholm, now boasts more than 75 members. Similar efforts are starting in the other chamber, led by Senators Bob Kerrey and Judd Gregg.

Think tanks, business associations and advocacy groups such as Third Millennium all have played major roles in transforming the way Americans view Social Security. And what my generation repeatedly discovers is a government program that asks us to "contribute" more than one-seventh of our income with each paycheck while, at the same time, warning us that it will be bankrupt before we retire.

No member of Congress has ever successfully explained to my generation how we and our progeny are supposed to meet the pension and medical benefits needs of the soon-to-be-retired Baby Boom generation. Worse still, no one has justified the fairness of requiring us to bear this remarkable burden while making billions of dollars in interest payments on trillions in existing public debt.

Mr. Chairman, the most recent Trustees report forecasts a dismal future for Social Security. In just 15 years, when I turn 47, the OASDI program will pay out more in benefits than it will receive in FICA taxes. Some suggest that this will not be a problem because the Trust Fund is projected to contain approximately two trillion dollars. But wait. Congress has been borrowing against the trust fund every year to mask the true size of the deficit. In order to replenish the trust fund starting in 2012, Congress will have to raise taxes considerably. How well will that go over with tomorrow's workers?

Let's assume for a moment that the "trust fund" truly merited its name, and we could readily tap into it when the time came. The trust fund would still run dry in 2029, the year I turn 64 and quickly approach retirement. Wouldn't a tapped out trust fund precipitate a crisis for my generation and the ones that follow?

There are those who insist that Social Security technically doesn't go bankrupt in 2029, even if the trust fund is exhausted. Rather, they cite the Trustees report, which states that in 2029 Social Security will pay 75 percent of promised benefits, and that is not so bad, after all. Mr. Chairman, if a 25 percent cut in Social Security benefits would be such a good deal for my generation, why aren't today's defenders of the status quo advocating it for themselves? In truth, such a drastic cut would be as unconscionable for tomorrow's poor seniors as it would be for today's.

Rather than whine about the problem, which some want to do, our organization is working on solutions. Each time we at Third Millennium testify, we tell our elected representatives to raise the retirement age to 70, means-test benefits on a scale recommended by the Concord Coalition and transform the system, over time, to one that includes private retirement account.

As you know, all three factions of the Social Security Advisory Council recommended using the capital markets to help ensure a higher rate of return on FICA contributions than the system is now generating. The 13 members, however, couldn't agree on how to do this.

Third Millennium has not endorsed any one Advisory Council plan. But there are elements of both the Schieber and Gramlich proposals that we find attractive. Specifically, we support the Schieber camp's idea to allow workers to invest a portion of their FICA taxes in personal accounts. This would add a critical component of personal responsibility for one's own retirement that is currently absent in Social Security. We also support Chairman Gramlich's concept of limiting the number of different investment choices to a manageable number, so as not to overwhelm novice investors.

In September 1994 when Third Millennium randomly surveyed 500 Americans age 18 to 34 by telephone, we found 82 percent wanted to be able to redirect a portion of what they currently pay in FICA taxes into private retirement accounts. Taking this step would not only be politically viable, it would be popular.

Mr. Chairman, in calling Third Millennium to testify today, you asked how soon we thought Congress should act on Social Security reform. Our answer: yesterday. America's leaders are wasting precious time. The baby boom generation begins retiring in just over a decade and there is no national plan to accommodate their massive retirement and health needs. For the good of America's future, Congress and the President should act expeditiously. If you don't, future generations will rightly wonder why you waited so long. Thank you.

Chairman BUNNING. Ms. Briceland-Betts, please.

STATEMENT OF DEBORAH BRICELAND-BETTS, EXECUTIVE DIRECTOR, OLDER WOMEN'S LEAGUE

Ms. BRICELAND-BETTS. Good morning. Thank you, sir. Thank you for providing this opportunity for Older Women's League, OWL, to testify today. We would like to commend this Subcommittee for thoroughly exploring the impact of changes to Social Security system's future before moving forward with the development of any legislative proposals.

Several times today we have heard that we are here to explore the generational differences in opinion over this issue. As a representative of the only national organization that represents the special needs of women as we age, I am here to say that this is not a generational debate; it is a gender debate. There are some very specific issues that are unique for women as we age in income and I would like to spend the next few minutes highlighting those before I go forward with the kinds of changes that we would recommend.

There are factors in women's lives which work together to make our need for Social Security more intense than men's. For instance, there is continued pay inequity in this country. Thirty years after equal pay laws were passed, women are still earning only 71 percent of what men earn for the same kind of work.

Women still predominate the same kinds of jobs that our mothers and our grandmothers held. Those are low paying; they have few benefits and no pension. They are usually sales, service and clerical. And as a result, only 13 percent of women today have pensions when they retire.

And women are still the care givers in our family. The average woman spends 11.5 years outside of the work force caring for children, for sick spouses, for aging parents. Those are 11.5 years when she is not vesting in a pension and she is not paying into Social Security. As a result, women of all ages hold a special stake in the Social Security debate.

Additionally, during the last decade the nature of work has changed. The number of part time, temporary and contract workers has grown at a rate almost double the total labor force. Their numbers, most of whom are women, are expected to increase 82 percent by the year 2000, though the new requirements for welfare beneficiaries mean that this may increase very dramatically.

Increased use of contingent workers means that women will stay in low-paying work with few benefits, such as health insurance, paid vacation, sick leave or a pension. The continued concentration of women in lower paying jobs will reduce the financial security of women, resulting in a greater than ever reliance on Social Security.

We must look at what kinds of things cause women to be very dependent on Social Security, including the fact that increasingly, women live longer than men, an average of 7 years. Many of us outlive our spouses and, according to the General Accounting Office, approximately 80 percent of widows become poor only upon the death of their husbands. Their husbands intended to retire early because of poor health and then, as a result of the loss of earnings, as well as medical expenses, the resources were depleted that were available to those widows.

Women also, as we said, care for aged relatives, spending 11 years out of the work force. Those zero years out of the paid work force are then included in the computation for their benefits and they disproportionately penalize her for the years as an unpaid care giver.

Looking at exactly what kinds of income women depend on when we retire and how unique it is compared to our male counterparts, the causes for poverty among older women, particularly those living alone, 80 percent of whom are women, can better be understood by examining the sources of income available to the group.

Social Security benefits comprise 79 percent of incomes of the poor elderly. Supplemental Security Income or SSI is 14 percent and employment earnings, employer pensions and income from assets, taken together, contribute only 7 percent. As a result, OWL must oppose any kind or form of privatization. While seeking to provide safeguards for the future, it raises a whole new set of problems. Chief among them would be to destroy the guarantee of a lifetime benefit, critical for women now and, because of rising divorce rates, continued low earnings and other problems delineated in this testimony, even more critical in the future.

Privatization ignores the social insurance nature of Social Security which, as a result of a shared risk pool, assures that those who qualify will have a minimum benefit. Were Social Security privatized, whether through individual accounts or personalized savings, women would have substantially smaller accounts than men, made even smaller because they will not include the redistributive benefit.

Privatization would hurt those women who, because of lower wages throughout their work life, had been unable to invest and therefore have little knowledge of investment markets and risk making unfortunate investment choices.

OWL would suggest two things. Both have been talked about here today. First, we believe that public confidence in the system must be restored. The problem that Social Security faces is a lack of faith in the future. We must engage in a full force educational process that would ensure that people understand all of the players' stake in the debate and that they are ready to understand what the options and implications of those are.

And second, we encourage the increase in support for research. The reduction in research at SSA during the past two decades coincides with years that awareness of the inequities women face in the Social Security system has increased. OWL joins the Council and the Advisory Board in urging an immediate enhancement of its policy, research and evaluation capability.

We look forward to working with the Members of this Subcommittee during the months ahead to achieve changes in Social Security that, while maintaining the basic principles, do not unfairly place a burden on older women in this country. Thank you.

[The prepared statement follows:]

Statement of Deborah Briceland-Betts, Executive Director, Older Women's League

Thank you for providing OWL with the opportunity to testify today. We commend this Subcommittee for exploring the impact of changes to the Social Security system's future so thoroughly before moving forward with the development of any legislative proposals.

My name is Deborah Briceland-Betts. I am executive director of OWL. Founded in 1980, OWL is the first national grassroots membership organization to focus exclusively on issues of concern to women over 40 years of age. Through education, research, and advocacy, we work to advance public policy changes that will reduce the inequities women face as they age.

INTRODUCTION

Before proceeding with my testimony, I want to make it clear that OWL recognizes the large stake every American has in the Social Security system. Social Security remains by far the most important retirement program for all our citizens. And while we believe the system does not serve women nearly as well as it should, we maintain that it is a necessary and vital income insurance plan which establishes a foundation for economic protection and security for older workers and their families.

OASDI today is supposed to be a gender neutral program. But, because lifestyles were very different in 1935 when the program was instituted, retirement plans, both Social Security and private pensions, were based on male work patterns. They still best serve the traditional family: a paid worker (usually the husband), an unpaid homemaker (usually the wife), and children. Today however, most American families do not fit that profile, and even fewer will in the future. And while Social Security is a major—often, the only—lifeline for many older women, many of us, including widows and divorced women, receive neither equitable nor adequate benefits today, nor, under current provisions, will they forty or fifty years from now. Let there be no mistake: OWL supports the principles underlying the current Social Security system, and we will work to preserve them. Our goal is to assure that, in the future, the current Social Security system more adequately responds to the patterns of women's lives.

WOMEN IN EMPLOYMENT

During World War II there was a surge of women in the labor force which declined after the war. Then, in the 1970's there was another increase. In 1950, only 34% of women participated in the labor force. In 1972, 44% of women were in paid employment, and today, according to the Social Security Administration, almost 60% of American women work.

During the last decade, the nature of work has changed. The number of part-time, temporary, and contract workers—contingent workers—grew at a rate almost double that of the total labor force. Their numbers, most of whom are women, are expected to increase 82% by the year 2000, particularly with the new requirements for women receiving welfare benefits. Increased use of contingent workers means that women will stay in low-paying work with few benefits such as health insurance, paid vacation, sick leave, or pension plans.

Pension participation is least likely among low wage, part-time workers and in many industries where women workers predominate. Gender-based annuities in many pension programs, and the general lack of indexing of pension benefits further penalize women. Pension integration, whereby a pension is reduced by a portion of one's Social Security, more commonly occurs for women workers. Further, the decrease in employer-funded defined benefit plans leaves low-paid women dependent on their own much smaller contributions to such plans that exist.

The continued concentration of women in lower-paying jobs will reduce the financial security of women, resulting in a greater than ever reliance on Social Security.

WOMEN'S REALITIES

To arrive at a more adequate level of benefits, several realities of women's lives—and their consequences—must be confronted:

- Women's wages are considerably less than men's
- Women live longer than men
- Women are the primary caregivers in America

Women's Wages Continue to Lag Significantly Behind Men's

In 1939, median earnings for full-time women workers in the labor force were 58% of the median earnings of men. More than a half century later, that figure has risen only to 71%. The wage gap is greatest between women and men aged 45 to 64—women earn 62.7% of men's earnings at the time men are at the height of their earning power during the ages 45–54, women 55–64 earn 63.9% of the earnings of men in the same age range.

A major reason for this disparity is that women have been, and continue to be, segregated in low-paying occupations; six of ten working women are in sales, service, and clerical jobs. The future does not bode well for younger women in the labor force—58% of women between 20–44 are in these occupations, just as are 59% of women between 45–64.

The Department of Labor has identified six occupations dominated by women as those most likely to experience large-scale growth by the year 2000. Wages in five of these occupations—sales work, waitressing, cashier, food worker, and nursing aide—remain at or below the poverty level. OWL's research on chronic care workers—nursing home and home health aides—found that there is rapid expansion in these areas, but the turnover of workers is high because of low wages, few benefits, lack of a guaranteed income, and no upward mobility. This has implications not only for the financial future of these workers, but also for the quality of care provided to their clients.

Already, many older women, especially those over age 65, are clustered in most of these jobs, working part-time for low pay and no benefits. The projected increase in the number of these jobs suggest that women's real earnings profile will deteriorate, rather than improve.

Although job expectations of the current generation of young women have changed and more women have entered professional jobs, they remain exceptions. Most of today's young women can expect to do the same low-paying work as their mothers and to suffer the same poverty in retirement.

Women Live Longer Than Men

In 1993, men at birth had a life expectancy of 72.1 years, women 78.9. At age 65, the life expectancy for women is an additional 19.2 years, while for men it is only 15.4 years. By 2070, according to SSA projections, a 65-year-old woman can expect to live to 87, another 22 years, while a man will live to 83, only 18 years.

Because of their greater longevity, most American women will live out their lives as widows. Currently, half of all women age 65 and over are widows, and about 100,000 women become widowed annually.

Millions of widowed older women depend exclusively on Social Security for adequate income during retirement. This is particularly true of black and other minority women. However, the Social Security benefits they receive are not adequate for their needs. Black women are more likely than white women to take the reduced benefits associated with early retirement: almost 66% begin drawing Social Security before age 65, in part because of the stress of a lifetime of low wages and physical work, and because women experience job discrimination earlier than men. The incidence of poverty is dramatically higher among minority elderly who live alone—43% for blacks and other nonwhites and 35% for Hispanics—compared with a poverty rate of 16% for white elderly persons living alone.

According to the General Accounting Office, approximately 80% of widows become poor only upon the death of their husbands. Their husbands tended to retire early because of poor health. The resulting loss of earnings, as well as medical expenses, deplete the resources available to the widows. The husband's death may, as well, ultimately mean the loss of his pension income.

The increase in the divorce rate also has contributed to the growing diversity of family roles and work patterns, since many divorced women must work to support themselves or their families.

Today, the number of women between the ages of 45 and 64, who are separated, divorced, or widowed is twice that of men. Most of these women are the sole support for their families.

The causes of poverty among older persons living alone, 80% of whom are women, can be better understood by examining the sources of income available to this group. Social Security benefits comprise 79% of the incomes of the poor elderly; Supplemental Security Income (SSI) contributes about 14%; while employment earnings, employer pensions, and income from assets taken together contribute only 7%. On the other hand, moderate to high income older persons living alone depend on Social Security for only 22% of their total incomes, while income from assets contributes 52%, employer pensions 13%, and employment earnings 12%. But because they live longer, even women with assets or savings become dependent on COLA protections as their own money begins to run out.

Women Are the Primary Caregivers for Children and Older Persons

OWL estimates that 89% of all women over age 18 will be caregivers to either children, parents, or both. Up to twelve million Americans are unpaid caregivers to older persons, almost three out of four of whom are women. Their average age is 57.

Today, women who are in midlife will spend more time caring for their parents than they have for their children. This phenomenon has been labeled the "sandwich generation" because women are sandwiched between caring simultaneously for small children and aging parents. The phenomenon will not go away. In fact, the fastest growing segment of the population is the 85 and older group. The "sandwich" is often now a triple decker: many women care for elderly grandmothers, mothers, and small children simultaneously.

Caring for aged relatives forces many women in the workforce to cut their hours, take time off without pay, and rearrange their job schedules. In a national survey, 11% of caregivers to the elderly stated they quit their jobs in order to provide care. Findings from a study done by OWL, in collaboration with the Families and Work Institute, on the balancing act for employees with elder care responsibilities, reveals that almost a quarter of the respondents drastically changed their employment situation as a result of their elder care responsibilities. This included changing jobs, becoming unemployed, becoming self-employed, or taking on several part-time jobs. Women spend a median of 11 years out of the workforce, years that she is not vesting in a pension or paying into Social Security. These "zero years" out of the paid workforce are then included in the computations for her benefits, disproportionately penalizing her for her years as an unpaid caregiver.

These factors leave women at retirement age at a severe economic disadvantage and result in significant inequities and disparities in their Social Security benefits. Despite major reforms through the years, fundamental biases against women persist.

The Older Women's League believes that there are two issues that must be addressed in any reform of the Social Security system: while these hearings are primarily focused on the future solvency of the Trust Fund, consideration of the adequacy of the system in addressing women's needs must also be of paramount importance.

Traditionally, Social Security is considered to be one leg of a three-legged stool of retirement income—Social Security, pensions and savings. Unfortunately, for many older women, Social Security is the *only* leg, and for many American women, it does not work as well as it should:

• In the 1990s, we have the dilemma of dual entitlement and single benefit. A woman in a two-earner couple who is dually entitled to both a worker benefit on her earnings and a spousal benefit on her husband's earnings can receive only the greater of the two, usually the spouse benefit.

Since 1960, the percentage of women drawing a benefit based on their own work records has remained virtually constant—36%—even though the percentage of women dually entitled to benefits on both their own work records and those of their husbands has jumped from 5% in 1960 to 25% in 1993. Those years during which a working woman paid into the system through payroll taxes do not yield higher benefits but do decrease the liability to the Social Security system. Despite the increased participation of women in the workforce, they will remain just as dependent on their spouses—receiving exactly the same spouse benefit that they would have received had they never worked outside the home.

• In addition, too many women must rely on the spouse's benefit rather than their own work record either because of wage inequities or because they have left the work force to care first for children and later for ailing parents or spouses.

• So-called "zero years" are taken into account when calculating the benefits of women who have taken extended periods of time away from work to fulfill caregiving responsibilities. Inevitably, adding zero years to the calculation results in lowered benefits.

• A divorced person age 62 and over can receive Social Security upon divorce if the former spouse is drawing Social Security, but must wait two years if the former spouse is still in the workforce. This provision was enacted as part of the Social Security Amendments of 1983. (The stated purpose of the two-year requirement was to prevent couples from obtaining a divorce in order to avoid loss of spousal benefits under the earnings test). This two-year waiting period can be a time of great deprivation with no alternative options available. It can also be regarded as imposing a penalty on divorce. Moreover, the gender inequity is clear: 60 times more women than men are dependent on their divorced spouse's earnings for Social Security benefits.

• If a widow(er) becomes disabled more than seven years after the spouse's death, she/he is not eligible for disability benefits.

The reason for the seven-year limit was the view that if a previously uninsured widow or widower in good health entered the labor market after the spouse's death, the widow(er) would be able to develop his or her own worker eligibility for disability benefits and not need to rely on the deceased spouse's coverage. However, when the seven-year restriction was enacted in 1967, less than seven years of Social Security earning was enough to qualify an individual for disability benefits.

Today, this is no longer true. Even if a widow(er) entered the labor force in covered work within a few months after the spouse's death, it would take, under subsequent adjustments in the law, close to 10 years to develop eligibility for disability benefits for those who experienced qualifying impairments. Thus, a spouse who diligently went to work and became disabled during the seventh to 10th years following her deceased spouse's death could be left without benefit eligibility that would have been assured to widows and widowers who developed their disabilities just a few years after the deceased worker's death. This is an inequity that weighs most heavily upon older women who simply were not in the Social Security-covered workforce during their family rearing and caregiving years.

In addition, there is 50-year age requirement for eligibility for widow(er)s. Developing a 10-year earnings record is a considerable burden on midlife and older women who essentially have been out of the workforce until their husbands died, and then, along with their lack of experience, face age and sex discrimination when they seek to return to the workforce.

• Technically, a widow who enters in or continues in the work force past age 65 receives her own delayed retirement credits for any month after age 65 that she does not receive Social Security benefits. If her own benefits are greater than her widow's benefits, she will receive delayed retirement credits. But if her widow's benefits are the greater amount, when she retires, she will actually receive no delayed retirement credits whatsoever. The benefits paid will be identical to those she would have received if she had never entered the work force or had retired at an earlier age.

• Women who have devoted most of their adult lives to caregiving are not treated differently than long-term wage-earners when applying the earnings test. For example, a women in her early sixties who, because she devoted herself to caregiving in earlier years, has no earnings record, may try to work in order to achieve some small savings to be used for her support in later years. In these cases, if the earnings test is applied, she is danger of losing a portion of her savings.

• Social Security does not provide spouse benefits to spouses under the age of 62 who are caring for an annuitant so disabled as to be in need of aid and attendance. In contrast. if an adult disabled child who is receiving benefits is in need of attendant care, benefits are paid to a mother providing that care regardless of her age.

The Advisory Council Recommendations

Assuring the future solvency of the Social Security Trust Fund raises another, equally important, set of issues for women. The Report of the 1994–1996 Advisory Council on Social Security highlights the difficulty of ending these inequities—for women, none of the three options proposed by the Council provides a fully acceptable solution.

OWL must oppose any form of privatization. While seeking to provide safeguards for the future, it raises a whole new set of problems, chief among them that it would destroy the guarantee of a lifetime benefit, critical for women now, and, because of rising divorce rates, continued low earnings and other problems delineated in this testimony, even more critical in the future.

First, privatization ignores the social insurance nature of Social Security, which, as the result of a shared risk pool, assures that those who qualify will have a minimum benefit, gives people with higher wages a higher benefit, and assures that benefits will continue for as long as people live. Privatization would undermine the redistributive impact of the program, and benefit only those individuals with high wages. It is clear that women cannot afford to lose a known basic benefit, with its guarantee of a progressive formula for even small increases.

Were Social Security privatized, whether through the Individual Account (IA) option or the Personal Savings Account (PSA) option, women would have substantially smaller accounts than men, made even smaller because they will not include the redistributive benefit. Further, according to a GAO report recently presented to this subcommittee, women tend to be more conservative investors than men, so that, over time, their smaller investments would lead to yet smaller returns.

Privatization would hurt those women who, because of lower wages throughout their work life, have been unable to invest and therefore have little knowledge of investment markets and risk making unfortunate investment choices; those who spend some of their money before retirement, often for long term care for a spouse or education for a child; and, those who, simply, live too long.

Importantly, particularly in light of current prospects for a balanced budget, privatization would cost America trillions of dollars. A new administrative structure have to be established and costs increased; and, as funds are paid out to individuals instead of into the Trust Fund, benefits for current retirees would still have to be paid. The only way those transitional costs could be compensated would be through increased taxes, lower benefits—and/or a huge increase in the deficit, which could result in the demise of other components of our nation's social insurance program, such as Medicare.

The Maintain Benefit (MB) option contains proposals that OWL can support; we know that some adjustment in payroll taxes and the COLA may be necessary to maintain the Trust Fund's long-term solvency. However—and we are aware that this is a complex issue—we have concerns about any proposal that extends the benefit computation period without considering the special needs of women as unpaid caregivers.

Another potential problem in the MB option is the investment of Trust Fund income in private investments. This raises complex issues, including the potential risk to beneficiaries inherent in a non-government-bond based portfolio, and questions surrounding who will make decisions on investments, and what they will be. Additionally, there will be costs associated with administering such investments; and the withdrawal of funds from the Trust Fund will have a serious impact on the deficit if the Treasury must go elsewhere to borrow.

RECOMMENDATIONS

Making the System Work for Women

OWL believes that existing data shows that the solvency of the Social Security Trust Fund can be assured with minor changes to the current system. But we believe that any proposal to address the future solvency of the Trust Fund must be analyzed for its impact on women. Such assessments must take into account the proposal's impact on both today's beneficiaries and tomorrow's.

More importantly, as Congress comes to grips with the more universal problems of solvency, it is time, we believe, to eliminate the inequities women face. The laws and regulations governing eligibility and benefits system must be rewritten to make this guaranteed benefit, so vital to American women, truly gender neutral, for both current and future recipients.

Restoring Public Confidence

One problem Social Security faces currently is a lack of public confidence in its future. Despite solid reports that the Trust Fund is fully solvent until 2037, the public, particularly younger people, believes the Trust Fund will be bankrupt before long, and they will not have benefits when they reach retirement age. This view is being actively promoted by those favoring privatization, and it appears to resonate with the public.

It is OWL's view that without the backing of an informed public, no meaningful proposals for change can succeed. Historically, people do not focus on their retirement during their younger working years, and many do not understand what Social Security is, how it works, and what effect the options presented by the Advisory Commission would have on the future of their benefits. With the special impact that the baby boom will have on the solvency of the system, the involvement of younger people in decision-making process is critical.

OWL urges the implementation, before any further Congressional action on the Trust Fund's future, of a comprehensive, nationwide education campaign that will illuminate the scope of the challenge that exists in reforming the system, and describe various reforms that have been proposed, with an accurate assessment of their impact. We believe that this is an issue that transcends partisan politics, and such efforts should be non-partisan and non-political.

Improved Research is Necessary

The report of the Advisory Council, and the more recently released report by the Social Security Advisory Board, *Developing Social Security Policy: How the Social Security Administration Can Provide Greater Policy Leadership* emphasize that the Social Security Administration, since the 1970's, given insufficient attention to policy, research and program evaluation activity. The Council report, in fact, states that the research and analysis resources within the agency are "not sufficient to address adequately the problems facing the program over both the short-and long-term."

The reduction in research at SSA during the past two decades coincides with years that awareness of the inequities women face in the Social Security system have increased. OWL joins the Council and the Advisory Board in urging an immediate enhancement of its policy, research and evaluation capability. The increased availability of data on the distributional impacts of Social Security policy options and changes is vital. It is only through such an increase that the true effectiveness of existing programs for women, and the prospects for future proposals can be properly assessed before they are implemented.

OWL looks forward to working with the members of this Subcommittee during the months ahead to achieve changes in Social Security that, while maintaining the basic principles of social insurance that lie at the root of our country's compact with its citizens, will ensure that women will have, long into the future, access to pensions and Social Security benefits, without being penalized for their caregiving years, and for living longer than men.

Chairman BUNNING. Mr. Ryan, please.

STATEMENT OF JACK RYAN, SENIOR RESEARCH ASSOCIATE, NATIONAL TAXPAYERS UNION FOUNDATION

Mr. RYAN. Thank you. Mr. Chairman, on behalf of the National Taxpayers Union Foundation and all other organizations who have struggled over the years to put Social Security reform on the national agenda, thank you for holding these hearings and inviting recommendations for review.

The financial status of the Social Security Program reveals that absent any major reform, the aging of our society is likely to have catastrophic consequences on the aftertax living standard for future generations. When one considers the looming debt of $5.3 trillion and the surge in mandatory spending from 33 percent of all Federal spending in 1963 to 66 percent in 1993, it is evident that major reform is necessary sooner, rather than later.

Despite the overwhelming evidence that the cost of Social Security will expand to unsustainable levels with the retirement of the baby boom generation, the notion still persists that Social Security is sustainable with only minor reforms. In 1996, the Trustees reported that there is ample time to address projected funding shortfalls in the Social Security Program. I disagree with this notion and testify to the fact that the longer reform is put off, the larger the sacrifices will be for our children.

From the competing alternatives suggested by the Advisory Council on Social Security Reform, the personal security accounts plan is the most intriguing. Mr. Chairman, aging societies should save more, not less. This is the best way to increase the size of the economy and hence, to ensure that future retirement claims do not come at the expense of the living standards of future workers.

With this in mind, the National Taxpayers Union Foundation developed the National Thrift Plan with the goal of demonstrating the feasibility of gradually shifting Social Security to a funded system of privately owned and managed savings accounts. This will increase retirement security and reduce pressures on spending and taxes. It will also stimulate the economy by raising the savings rate, while retaining and building upon the popular features of the existing Social Security system.

The National Thrift Plan contains a requirement that every worker set aside 5 percent of his or her earnings into a personal savings account. Unlike Social Security, workers would own this money. Since the money remains in control of the worker, it can be placed in a wide variety of investments and even passed on to their heirs at death.

Initially, workers would continue to pay Social Security taxes to maintain the commitment to current retirees. Over time, however, tax-funded Social Security benefits would phase out and taxes would be cut accordingly. To minimize hardship on the working poor, the Government would help with dollar-for-dollar matching contributions.

Thus, the National Thrift Plan, once implemented, offers a 5-percent contribution instead of a projected Social Security tax rate of 20 percent or more if the system is allowed to continue unreformed. Equally important, workers would own and control personal savings accounts contributions, whereas under an unreformed Social Security system, proceeds would be left to the uncontrollable whims of politicians.

One key point to remember is that every worker at every income level would retire with substantially more income than would be the case under Social Security—two to three times greater over a lifetime. The entire transition would be achieved without adding to the Federal debt in any year, a key test that many other reform plans fail to meet.

This plan would also restore the actuarial balance of the trust funds over the 75-year period ending in 2070. In contrast, the Advisory Commission's maintain benefits plan recommendation, which continues the same Social Security system, does not restore the trust fund balances.

In my opinion, the current Social Security system is not capable of equitably meeting the future demands of beneficiaries and providing relief from pending tax hikes. The maintain benefits plan would continue this inequitable method of financing, whereas the personal security accounts plan would attempt to reduce these inequities by taking advantage of a better rate of return in the private market.

The compelling reasons why Social Security should be reformed are as follows. First, the current Social Security system will impose an extremely heavy tax burden on future generations. According to the most plausible Trustees estimates, the cost to future workers to fund social programs as a percent of taxable payroll will rise by 6 to 9 percentage points over the next 35 years, or by 50 to 80 percent. When the employer match is taken into account, the Trustees project that the current 15.3-percent payroll tax will probably require doubling or tripling to 30 or 40 percent. This undoubtedly would crush our economy.

Second, there's a growing imbalance in the return from the Social Security system. Social Security's popularity traditionally stemmed from its generous rate of return but now, for the first time, large numbers of future beneficiaries will have to pay more into the system than they will get back. Unfortunately, the Federal Government has promised today's adults $8.3 trillion in Social Security benefits beyond the value of taxes they have paid into the system. This translates into the largest intergenerational transfer of wealth in American history.

Third, Social Security's rate of return is only 2.9 percent, compared to 9.3 percent in the private market. Economists realize that this lack of investment earnings is substantially contributing to the demise of the Social Security system. In essence, the lack of investment earnings that could be experienced in the private market is fueling the need for more taxes and the reduction in future benefits.

This leads to a final concern about Social Security. There is now an emerging consensus that in order to remain competitive in the future, America needs to raise its savings rate. It is widely believed by economists that the payroll taxes, along with the pay-as-you-go benefit structure, discourages thrift.

In conclusion, when determining the need for Social Security reform, I would recommend that the Subcommittee fully consider the issues of taxation, transfers of wealth, thrift, and the contribution rate of return. Future generations cannot afford the status quo. Reforms must be implemented today to ensure an adequate retirement policy for tomorrow's beneficiaries.

In my opinion, the Social Security reform debate should focus on the principles behind the personal security accounts plan, which, if implemented, would establish a system that instills the value of thrift, limits taxation, and provides a better rate of return for future generations. Thank you, Mr. Chairman.

[The prepared statement and report follow. Appendixes and charts are being held in the Committee's files.]

Statement of Jack Ryan, Senior Research Associate, National Taxpayers Union Foundation

Mr. Chairman, on behalf of the National Taxpayers Union Foundation and all other organizations who have struggled over the years to put Social Security reform on the national agenda, thank you for holding these hearings and inviting recommendations for review.

The financial status of the Social Security program reveals that absent any major reform, the aging of our society is likely to have catastrophic consequences on the after-tax living standard for future generations. When one considers the looming debt of $5.3 trillion and the surge in mandatory spending, from 33% of all federal spending in 1963 to 66% in 1993, it is evident that major reform is necessary, sooner rather than later.

Despite the overwhelming evidence that the costs of Social Security will expand to unsustainable levels with the retirement of the baby-boom generation, the notion still persists that Social Security is sustainable with only minor reforms. In 1996, the Trustees reported that there is ample time to address projected funding shortfalls in the Social Security system. I disagree with this notion and testify to the fact that the longer reform is put off the larger the sacrifices will be for our children.

From the competing alternatives suggested by the Advisory Council on Social Security reform the Personal Security Accounts Plan is the most intriguing. According to the Council, this plan "...envisions a smaller public system in which workers would rely more on private pensions, individual retirement accounts, and other savings."

Mr. Chairman, aging societies should save more, not less. For this is the best way to increase the size of the economy and hence to ensure that future retirement claims do not come at the expense of the living standards of future workers.

With this in mind, the National Taxpayers Union Foundation developed the National Thrift Plan with the goal of demonstrating the feasibility of gradually shifting Social Security to a funded system of privately owned and managed savings accounts. This will increase retirement security and reduce pressure on spending and taxes. It will also stimulate the economy by raising the savings rate, while retaining and building upon the popular features of the existing Social Security system.

The National Thrift Plan contains a requirement that every worker set aside five percent of his or her earnings into a personal savings account. Unlike Social Security, workers would own this money. Since the money remains in control of the worker, it can be placed in a wide variety of investments and even passed on to heirs at death.

Initially, workers would continue to pay Social Security taxes to maintain the commitment to current retirees. Over time, however, tax-funded Social Security benefits would phase out, and taxes would be cut accordingly. To minimize hardship on the working poor, the government would help with dollar-for-dollar matching contributions.

Thus, the National Thrift Plan would, once implemented, offer a five percent contribution instead of a projected Social Security tax rate of 20 percent or more if the system is allowed to continue unreformed. Equally important, workers would own and control personal savings account contributions, whereas under an unreformed Social Security system, proceeds would be left to the uncontrollable whims of politicians.

We conservatively project that this plan will boost savings by 1.2 percent of GDP by the year 2001; by 2.6 percent of GDP by 2010; and by 5.9 percent of GDP by 2065. Within 25 years there will be a pool of savings growing tax-free in individually directed Personal Savings Account equivalent to 50% of GDP. We estimate by 2050 productivity will be 26 percent higher than it would be otherwise. No less important, every worker at every income level will retire with substantially more income than would be the case under the current Social Security system. And by the 2030s, when you would be sharply raising payroll taxes under Social Security today, we would be cutting them under the National Thrift Plan.

One key point to remember is that every worker at every income level would retire with substantially more income than would be the case under Social Security—two to three times greater over a lifetime. the entire transition would be achieved without adding to total federal debt obligations in any year, a key test that many other reform plans fail to meet. This plan would also restore the actuarial balance of the trust funds over the 75 year period ending in 2070. In contrast, the Advisory Commissions Maintain Benefits Plan recommendation, which continues the same Social Security system, does not restore the trust fund balance.

The subcommittee should consider the following facts and fundamental flaws associated with the current Social Security system. The World Bank concludes that the current pay-as-you-go system "... inevitably produces low costs and large positive transfers to the first covered generations and produces negative transfers for later cohorts because of system maturation, population aging, increased labor market distortions and incentives to evade." In my opinion, the current Social Security system is not capable of equitably meeting the future demands of beneficiaries and providing relief from pending tax hikes. The Maintain Benefits Plan would continue this inequitable method of financing, whereas, the Personal Security Accounts plan would attempt to reduce these inequities by taking advantage of a better rate of return in the private market.

The compelling reasons why Social Security should be reformed are as follows: First, the current Social Security system will impose an extremely heavy tax burden on future generations. According to the most plausible Trustees estimates, the cost to future workers to fund social programs as a percent of taxable payroll will rise by 6 to 9 percentage points over the next thirty-five years, or by 50 to 80 percent. When the employer match is taken into account, the Trustees project that "the current 15.3% payroll tax will probably require doubling or tripling to 30–40% by the time todays young workers retire." This undoubtedly would crush our economy. Of special note is that 16 out of the past 20 Congresses have implemented a payroll tax increase for social programs and have raised the payroll tax 261% over this time period.

Second, there is a growing imbalance in the returns from the Social Security system. Social Securitys popularity traditionally stemmed from its generous rate of return. But now, for the first time, large numbers of future beneficiaries will have to pay more into the system than they will get back. Unfortunately, the federal government has promised to todays adults $8.3 trillion in Social Security benefits beyond the value of taxes they are expected to pay into the system. This translates into the largest inter-generational transfer of wealth in American history.

Currently, Social Securitys rate of return is only 2.9 percent, compared to 9.3 percent in the private market. Simplified, this means a 50-year-old person must pay $1,000 to get $1,900 worth of benefits at age 75. In a private market, that person would only have had to pay $206 to get the same benefits. Similarly, consider the following rate of return facts from Eugene Steuerle of the Urban Institute: "Even [when] assuming a moderate 6 percent real rate of return (and there has not been a single 30-year period since 1926 in which the stock market rose less than 6 percent after inflation), a married earner born in 1955 making $60,000 in 1993 dollars would get $750,000 less from Social Security than he or she paid in. Under the current system, a $25,000-a-year worker loses more than $260,000."

Economists realize that this lack of investment earnings is substantially contributing to the demise of the Social Security system. In essence, the lack of investment earnings that could be experienced in the private market is fueling the need for more taxes and the reduction in future benefits.

This leads to a final concern about Social Security. There is now an emerging consensus that in order to remain competitive in the future, America needs to raise its savings rate. It is widely believed by economists that the payroll taxes along with the "pay-as-you-go" benefit structure, discourages thrift.

In conclusion, when determining the need for Social Security reform, I recommend that the subcommittee fully consider the issues of taxation, transfer of wealth, thrift and the contribution rate of return. Future generations can not afford the status quo. Reforms must be implemented today to ensure an adequate retirement policy for tomorrows beneficiaries. In my opinion, the Social Security reform debate should focus on the principles behind the Personal Security Accounts plan, which if implemented, would establish a system that instills the value of thrift, limits taxation and provides a better rate of return for future generations. Any reform plan must honor current Social Security obligations while providing a sound retirement policy for younger Americans.

Mr. Chairman, thank you for holding this hearing and for the opportunity to testify on the National Thrift Plan and Social Security reform.

National Thrift Plan Project Revised Final Report by Neil Howe and Richard Jackson

In the fall of 1995, the Center for Public Policy and Contemporary Issues at the University of Denver and the National Taxpayers Union Foundation initiated a major Social Security reform project. Its purpose is to develop a viable plan to transition from the current pay-as-you-go Social Security system to a fully-funded system of individually owned and privately invested Personal Thrift Accounts (PTAs). This final report explains the rationale for this reform, describes the main features of our proposed "National Thrift Plan," and summarizes the plan's quantitative effects on public-sector budgets, on the national economy, and on individual workers in different cohorts and income groups.

The final report is organized as follows: I. The Problem; II. The Solution; III. The Plan; IV. Model and Assumptions; and V. The Results.

I. The Problem

Just a few years ago, major restructuring of Social Security was practically unmentionable. Today, a rapidly growing number of voices—from federal commissions, public-interest lobbies, private research institutes, universities, and even the mainstream media—are openly weighing radical reform proposals. Meanwhile, opinion surveys show low and falling levels of public trust in Social Security as it now stands. Three-quarters of all Americans doubt that Social Security will be able to fulfill its promises to new retirees within twenty years—and about two-thirds agree that Social Security "is in need of major reform now."

Why is this happening? And why now? There are four important reasons:

• First, there is the mounting concern that the current Social Security system will impose a very heavy burden on tomorrow's workforce. According to the most plausible 1995 Trustees' estimates (the "intermediate" and "high-cost" projections), the cost of Social Security as a percent of taxable payroll will rise by 6 to 9 percentage points over the next thirty-five years—or by 50 to 80 percent.

• Second, there is growing worry that the current system—if it doesn't crush future workers—will betray tomorrow's retirees. To keep Social Security outlays from exceeding earmarked tax revenues in 2030, we would, in that year, have to enact a roughly one-quarter to one-third across-the-board benefit cut. Most Americans are not prepared for large cuts in Social Security. Under half of the private-sector labor force participates in an employer pension plan. In 1993, according to a Merrill Lynch analysis of Census data, half of all U.S. families had less than $1,000 in net financial assets; even among adults in their late fifties, the age workers are staring directly at retirement, median savings are still shy of $10,000.

• This leads to a third concern about Social Security. There is now a growing consensus that America needs to raise its savings rate. More than two-thirds of Americans agree strongly that "government should provide more incentives to save for retirement"; among adults in their forties, the share is four-fifths. Yet economists widely believe that Social Security's pay-as-you-go benefit structure (entirely aside from its impact on the federal budget) discourages thrift. Nor is this just a U.S. worry. Reformers worldwide are turning away from unfunded retirement systems precisely because of their tendency to undermine private savings rates.

• Finally, there is the widespread disappointment about Social Security's declining rate of return on contributions. Today, for the first time in the history of Social Security, large categories of newly retiring workers are due to get back less than the market value of prior contributions, even when that value is computed at the lowest plausible interest rate. Everybody is beginning to understand that in future years these "market losers" will comprise a steadily growing share of all beneficiaries.

Reforms that merely make adjustments to the current Social Security system cannot address these concerns. Yes, future hikes in payroll taxes or future cuts in promised benefits might narrow or even close Social Security's funding gap. But the public rightly perceives the prospect of large tax hikes or benefit cuts as part of the problem, not the solution. Conventional reforms, moreover, cannot alter Social Security's built-in bias against thrift—and they would actually worsen the cascading pattern of generational inequity that destines each new cohort of participants to receive lower returns than the last.

This is bad news for a program predicated on the chain-letter notion that everyone can be a winner. Many critics used to think that Social Security's windfall paybacks were a good argument for reform: Why not cut benefits and still leave everyone a winner? That argument fell on deaf ears. Ironically, the opposite argument may now turn out to be more persuasive: Why not rethink a system that cannot possibly offer the same personal retirement security and the same long-term rate of return as genuine economic savings?

It is this logic that is leading many to advocate a radical solution: transforming Social Security into a funded system of personally owned defined contribution accounts. Such a system would differ from today's in two fundamental respects. Social Security is now a pay-as-you-go program, meaning that current payroll contributions, after a brief stop at the U.S. Treasury, go directly to pay current benefits. In a funded system, payroll contributions would be invested, create net new wealth, and thus generate an economic return over time. Popular mythology to the contrary, Social Security is a tax and transfer program in which participants earn no contractual claim to future benefits. In a system of personally owned accounts, all contributions would remain the property of participants.

One obvious advantage of such a system is that it would allow higher benefit levels and rates of return. While the long-term rate of return in a pay-as-you-go Social Security system is limited to population growth plus productivity growth, the rate of return in a funded system is equal to the marginal product of capital, which (even when adjusted for risk) is typically much higher. Another obvious advantage is the higher rate of national savings—and thus ultimately higher rates of productivity and living standard growth. A funded system benefits workers not only as future retirees, but also as wage earners. Any economic income generated by savings that is not captured by the return to capital must show up (to the extent the savings are invested domestically) as higher labor earnings

There are other benefits as well. By requiring that individuals save for their own retirement, a system of personally owned accounts would institutionalize the habit of thrift, and this might create an accelerator effect that further boosts national savings. Most economists agree that the FICA is a tax—and that taxes distort labor markets. By reducing (or eliminating) this tax, this reform would increase labor supply and hence economic growth. Finally, there is the issue of retirement security. Ironically, Social Security was originally set up because people trusted the government more than financial markets. Today, most Americans under fifty feel just the opposite. They know that Congress will necessarily renege on unsustainable pay-as-you-go benefit promises—but that no politician can take away personally owned assets invested in the real economy.

The two principles underlying this reform—funding and personal ownership—are equally important. There are some who suggest that we move toward a more funded system without giving participants personal ownership of their savings. This approach, which calls for investing part or all of the current Social Security surplus outside of government, does nothing to guarantee personal retirement security: What Congress promises it can still take away. It is also questionable whether it would amount to genuine funding—that is, the creation of net new economic wealth. Since reformers don't specify how government would make up for lost FICA revenue, privately invested Social Security surpluses may simply be canceled out dollar for dollar by a larger federal deficit. More generally, there is no institutional means to prevent Congress from diverting FICA taxes to current consumption at some future date. Only personal ownership of contributions can do that.

Another school of thought advocates personal ownership, but not necessarily funding. These reformers would allow workers to invest some or all of current FICA contributions in personal retirement accounts; meanwhile, implicit Social Security benefit liabilities for past FICA contributions would be translated into individual property rights by issuing beneficiaries "recognition" bonds—that is, formal Treasury debt. While this approach protects beneficiaries from the risk that government will default on its benefit promises, it only does so by shifting the current system's cost to the general taxpayer.

It is sometimes said that a system of personally owned Social Security accounts would shift unacceptable risks to individuals—in other words, that it amounts to totally "privatized" retirement. But personal ownership is consistent with any degree of government paternalism. It need not allow people to recklessly overconsume during their working years. Contributions can be made mandatory and restrictions can be placed on the use of retirement savings. It need not strip people of the disability and survivors insurance protection that Social Security now provides. These elements of the current system can be preserved or duplicated. Nor need it put the low-income (or simply unlucky) worker at greater risk of poverty and hardship in old age. Government can subsidize the savings contributions of low-earning workers and provide a guaranteed floor of old-age income protection.

Other critics question whether funding Social Security is really worth the effort. Since all income which is consumed tomorrow must be produced tomorrow, some say that it doesn't matter if retirees exercise claims on tomorrow's production by selling a stock or cashing a government check: The working population will have to support the retired population in both cases. This argument misunderstands the purpose of funding. By raising national savings, a funded Social Security system will increase the nation's capital stock and raise the productivity of tomorrow's workforce, thus making future retirement claims more affordable regardless of how they are paid. A pay-as-you-go system will not. It has also been argued that the long-term rate of return to capital cannot exceed the long-term growth rate of the economy, and that workers can therefore do no better under a funded system than under a pay-as-you-go system. While this claim may have had some passing plausibility when both the population and productivity were growing rapidly (Paul A. Samuelson offered his classic formulation of this hypothesis in 1958), today almost all economists agree that in fact the rate of return to capital far exceeds the rate of economic growth.

There is, however, one drawback that no honest plan to fund Social Security can avoid: the large transition cost. Since moving to a funded system means that society must begin to save at a higher rate, society will necessarily have to consume at a lower rate—at least until the productivity advantages of higher savings kick in. Or, to put the transition problem in layman's terms, current workers must pay for two retirements: their own (which now must be prefunded) and that of current beneficiaries (who will continue to rely on pay-as-you-go benefits). To finance the transition, current workers will thus have to save more, current beneficiaries will have to receive less, or some combination of the two. This challenge is compounded by the massive future deficits currently projected by the OASI trustees. As it now stands, benefits must be deeply cut (or taxes steeply raised) simply to keep the current system in balance—even apart from paying the extra cost of transitioning toward a funded system.

Most reform proposals downplay or deny the need for sacrifice—and so veer off course. One common strategy is to argue that merely by investing some or all of workers' current FICA contributions in private capital markets (either through personal accounts or in one big government pool), everybody ipso facto will better off in the long run. Yes, reformers know that Treasury will have to borrow to make up for the missing revenue. But apparently they believe that Treasury (or each worker's account) can indefinitely earn greater returns (with no greater risks) on the new equity assets than would be lost on the new debt liabilities. Ironically, the premise behind this "free lunch" assumption, made by many libertarians, is that current financial markets are massively inefficient allocators of capital.

The truth is that any plan which relies on the spread between stocks and bonds is a dicey and perhaps even dangerous proposition. If the federal government starts buying stocks and selling fixed-interest debt on a large scale, the yield on bonds will rise and the yield on stocks will fall—narrowing the favorable spread the plan depends on. Moreover, the very fact that government is betting on the stock market to defray the cost of future benefit payments will raise the risk (and hence the interest cost) of government debt. This narrows the spread even more, perhaps to the vanishing point. No major country engages in this sort of arbitrage—not just because of the negative (fiscal) effect on interest rates, but because of the corrosive (political) effect on the "full faith and credit" of government itself. On the other hand, if FICA contributions are put into individual accounts, the extra interest payable to new government debt holders will largely cancel out the (risk-adjusted) return to account holders. In the long run, this revolving door is just as unlikely to leave society better off.

Another way to make the transition cost appear small is to concede that there must be some new net national savings, but to minimize what is needed by assuming that each new savings dollar will earn a huge return. Indeed, if the total real rate of return on business equity is assumed to be high enough (say 15 percent before corporate taxes, a common if outlandish assumption), and if it is further supposed that workers' portfolios will be invested entirely in equities (another common if outlandish assumption), the transition problem all but vanishes. On the one hand, workers could finance generous retirement annuities by saving a mere one percent of payroll. On the other hand, the huge increase in private savings in the form of corporate equity would generate huge additions to federal, state, and local revenues via corporate income and property taxes. Some of this revenue could then be cycled back into Social Security, thus obviating the need for most (or all) sacrifice on the part of current or soon-to-retire beneficiaries.

A few plans acknowledge the cost of transitioning to a funded system, but try to design the reform so that the sacrifice is hidden from the public. To this end, they too mostly or completely exempt current and soon-to-retire beneficiaries from programmatic sacrifice—thus shifting the transition cost entirely to younger workers. But since they don't want to advertise this sacrifice either, they are reluctant to require that workers make new payroll contributions. Instead, they resort to some combination of two strategies: issuing government debt and raising net taxes outside the Social Security system.

The problem with financing the transition by running-up the national debt is not just that it undermines the purpose of reform by neutralizing much of the private savings boost. It would wreak havoc with the nation's popular, procedural, and constitutional firewall against excessive indebtedness. If we can borrow trillions to finance the Social Security transition, why can't we borrow trillions for any purpose at all? Those plans which issue "recognition" bonds directly to beneficiaries also raise an additional concern. By translating existing implicit Social Security liabilities (which have no constitutional protection) into formal debt, they would in effect render these benefits unreformable. The economy might collapse or the nation go to war. But short of default on the national debt, Congress would still have to pay every penny of today's Social Security liabilities.

The problem with the general tax hike strategy is that it hopelessly obscures the rationale for sacrifice. If we pay for the transition by imposing (say) a new national sales tax, the public is likely to view this new tax as a substitute for existing taxes and demand an offsetting tax cut. If it does, the result will be a larger federal deficit—which, once again, would undo some (or all) of the effect of higher private savings. On the other hand, if we pay for the transition by raising savings contributions within the Social Security system itself, the rationale for the sacrifice is clear. Moreover, if we make these contributions the personal property of workers, the benefits will accrue directly to those making the sacrifice. No one is going to say: Congress is requiring me to save more, so it had better cut my income taxes. Many, if not most, Americans will welcome the opportunity to do something—save for their future—that the vast majority confess they should be doing anyway.

II. The Solution

Whatever happened to the idea that entitlement reform requires sacrifice? What happened is that reformers were so dazzled by the long-term benefits of a funded Social Security system that they succumbed to the temptation of a free lunch. Our plan—a National Thrift Plan—is different. It fully pays for the transition to a funded system—without shell games, without adding to total federal debt, and without new general purpose taxes.

To begin with, it takes the essential step of reducing benefits under the current Social Security system. Today's retirees would face reduced COLAs and full taxation of benefits. Future retirees would in addition face a gradual phase-out of new benefit awards. At the same time, it would require all workers to make a mandatory 5 percent of payroll savings contribution, which, initially, would come on top of current FICA taxes.

This is the transition cost of escaping from the chain letter on which we have thus far been depending. Plans that pretend to manage the transition with less sacrifice are engaging in false advertising. To the extent that they actually fund Social Security, the sacrifice will be just as real. More likely, future generations will be saddled with a permanent debt service charge that requires them to pay back (under the table) much of what we claim to be giving them.

The National Thrift Plan will deliver what it advertises. At the national level, it will substantially boost net savings in each and every year. At the individual level, it will greatly increase retirement incomes and retirement security. Within a few years of the plan's implementation, all cohorts of new retirees (at all income levels) will be receiving total benefits that exceed (and eventually far exceed) current-law Social Security benefits. As the new system matures, the rate of return that beneficiaries can expect on total lifetime contributions will also rise steadily relative to current law. This improvement, moreover, will be proportional for all income groups—meaning that the new system would continue to offer low-earning workers the same relative deal that the current Social Security system does.

The National Thrift Plan also provides for a transition that is inherently stable. The best that most plans can promise is that at some distant date future generations will come out better off—if everything works out as planned. Our plan recognizes that the future is by definition uncertain. It thus insists that net savings must be positive throughout the transition—and it builds in the flexibility to ensure that we remain on this sustainable economic path. Where many other plans would tie Congress's hands by converting current Social Security liabilities into formal debt, we ensure that Congress can respond to tomorrow's unknowable challenges by making additional adjustments in benefits.

What the National Thrift Plan would not do is "privatize" Social Security. Rather, it would allow us to transition to a new Social Security system—one that continues to provide universal old-age and survivors insurance, but that does so in a way that is both beneficial for own personal futures and constructive for the nation's collective future.

III. The Plan

The National Thrift Plan would gradually phase out Social Security Old-Age and Survivors Insurance (OASI) "elder benefits" and replace them with a system of mandatory Personal Thrift Accounts (PTAs). These elder benefits—that is, retired-worker benefits, benefits for spouses aged 62 or older, and benefits for widows and widowers aged 60 and over—comprise 95 percent of current OASI benefit dollars. The other 5 percent—primarily benefits to children, widowed mothers and fathers, and nonaged disabled widows and widowers—would remain in place, as would all Social Security Disability Insurance (DI) benefits.[1]

The PTA accounts are thus designed to serve a single function: providing for the retirement income of workers and their aged survivors. In addition to the PTAs and small nonaged benefit components, the new system will include a means-tested benefit that guarantees all elders an income equal to 100 percent of the poverty line. As now designed, the National Thrift Plan will cover workers currently covered by OASDI (about 95 percent of all U.S. workers), but it could be expanded to cover the

[1] Nonaged OASI benefits could perhaps be phased out as part of a thrift plan that offered convenient and efficient life insurance requirements, but in view of their relatively small cost we decided to retain them; reform of DI benefits is a complex issue in its own right and lies beyond the scope of this project.

entire labor force.[2] The plan would be implemented starting in 1998, when PTA payroll deductions would begin.

The following outline describes the major components of the National Thrift Plan:

1. Trust-Fund Reform

(A) *Abolish the OASI Trust Fund*. The plan would formally abolish the OASI trust fund, thus acknowledging what's always been true in fact: that today's Social Security system is a pay-as-you-go program, and that its surpluses are not translated into genuine economic savings. The current OASI trust fund balance, consisting of some $500 billion in Treasury IOUs that can only be redeemed by raising taxes or borrowing from the public, will thus be erased. Any perceived loss on the part of workers who have contributed toward this paper surplus will be more than compensated by the certainty that future Social Security surpluses really will benefit their economic future. Initially, any cash surplus of OASI tax revenues over outlays will be used to offset the cost to the rest of the federal budget of implementing the National Thrift Plan. As described below, once the OASI system is determined to be in permanent cash balance the surpluses will be refunded to workers' PTAs.[3]

2. Benefit Reform

(A) *Expand Taxation of Social Security Benefits*.[4] Starting in 1998, taxation of Social Security benefits will be expanded so that 85 percent of all OASDI benefits are subject to personal income taxes.[5] In effect, this reform takes the new 85 percent taxability rule that now applies to beneficiaries with incomes over high thresholds and applies it to all beneficiaries. Since the change will affect only those households with enough earnings to pay income taxes, it will affect no beneficiaries beneath or near the poverty line. At higher income levels, beneficiaries would pay some tax. Small or large, the tax on their OASDI benefits would be at the same rate that all Americans in the same tax bracket pay taxes on their incomes—and at the same rate that future retirees will be paying taxes on their PTA withdrawals. It's worth noting that because current-law does not index the income thresholds at which benefit taxation applies, a rising share of total OASDI benefits are now becoming taxable—and eventually 85 percent of all OASDI benefits will be taxable. The principle of full benefit taxation is therefore already accepted by the current Social Security system. What our reform does is to apply that principle immediately in order to gain the crucial near-term savings that any transition plan needs.

(B) *Reduce Social Security COLAs*. Current law provides that all OASDI benefits are upwardly adjusted in December of each year by the annual growth in the Consumer Price Index (CPI). The plan provides for a one-year COLA freeze to be enacted in 1998 (thus going into effect with the benefit checks received on January 3 and 4, 1999). Thereafter, the annual COLA will be pegged to the CPI minus ½ percentage point. This permanent adjustment recognizes the growing consensus among economists that the CPI may overstate inflation (½ of a percentage point is a typical estimate)—as well as the increasing likelihood that Congress, entirely apart from broader issues of Social Security reform, will enact a COLA cut. Like expanded taxation of Social Security benefits, these provisions produce critical near-term savings.

(C) *Phase-Out New OASI Elder Benefits*. Social Security benefits are computed on the basis of annual "wage credits" earned during years of covered employment.

---

[2] Expanding coverage would ease the transition cost (or increase the transition savings), since it would increase FICA tax revenue far more and much earlier than it would raise eventual benefit outlays.

[3] Our results show that the National Thrift Plan will probably not produce a permanent OASI operating surplus until the early 2030s. Until then, though benefit outlays will be greatly reduced from current projections, the reductions will simply serve to prevent future benefits from exceeding future tax revenue. Once this initial "Boomer" cost wave is past, however, the size of the surplus (and thus the refund to worker PTAs) will grow very rapidly.

[4] Means-testing was considered as an alternative to full benefit taxation. However, we concluded that a stand-alone means-test for Social Security (as opposed to a comprehensive means-test for all federal entitlements) would be both needlessly arbitrary and expensive to administer. In any case, the progressive income tax code constitutes an implicit means-test—and is, moreover, the same "means-test" that will be applied to all PTA withdrawals under the National Thrift Plan.

[5] The 15 percent exemption reflects a generous estimate of the dollar value of most beneficiaries' prior FICA contributions that have already been subject to personal taxation, and hence brings the tax treatment of Social Security in line with the tax treatment of private pension benefits. All new revenue from the taxation of OASDI benefits will be credited, pro rata, to the OASI and DI systems. The Medicare Hospital Insurance program, however, will continue to be credited with its current-law revenue from OASDI benefit taxation, and will thus be held harmless under our plan.

Starting in 1999, the National Thrift Plan would gradually reduce the credits used in computing all new OASI elder benefits. Specifically, newly earned wage credits will be reduced by a factor of 5 percent per year until they reach zero after 20 years. Thus, workers retiring in the year 2000 will receive 95 percent of their current-law wage credit for the year 1999 and 100 percent for all earlier years. The benefit formula for each successive cohort will include an additional year of reduced credits. For example, workers retiring in 2001 will receive 90 percent of their current-law wage credit for the year 2000, 95 percent of their wage credit for 1999, and 100 percent for all earlier years. This phase-out of OASI elder benefits will already be generating large savings by the time Baby Boomers start retiring en masse in the 2010s. However, it will take years longer before the phase out is entirely complete. The last partial wage credit for OASI elder benefits would be earned in 2017; the first cohort to receive no OASI elder benefits would begin retiring in the 2050s; and the last OASI elder benefit check would be mailed out sometime around the year 2100. While this reform operates through a complex change in Social Security's benefit formula, it in effect amounts to a pro rata cohort reduction in benefits where the amount of the reduction depends on the year beneficiaries were born (or turn age 62).[6] Initial retirement awards would be unaffected for workers born before 1938; as a percent of current-law awards, they would be reduced about 25 percent for workers born in 1954, about 50 percent for workers born in 1964, and about 75 percent for workers born in 1973.

(D) *Phase-Out New OASI Spousal Benefits*. Current law guarantees that the aged spouse of a retired worker receive a benefit equal to at least one-half of the retired worker's benefit. If a spouse does not qualify for a benefit of this size on the basis of his or her own earnings history, a special "spousal benefit" fills in the difference. This 50 percent benefit supplement for retired workers with nonworking spouses, designed for another era, is a capricious windfall that has long outlived its social usefulness. Moreover, it benefits a declining number of new retiring couples—and those whom it does benefit are typically the ones least likely to need the extra income. The National Thrift Plan includes a special provision for the phase-out of all new spousal benefit awards. Effective for workers reaching age 62 in the year 2000, new awards would be reduced by 10 percent; awards for each successive cohort would be reduced by an additional 10 percent until spousal benefits are entirely phased out for workers reaching age 62 in 2009 and later. Because these reduction percentages are applied directly to new benefit awards (rather than to annual wage credits), the spousal benefit is phased out more rapidly than other OASI elder benefits. Spouses of workers born before 1938 would be unaffected; spouses of workers born in or after 1947 would receive no spousal benefit.

(E) *Guarantee a Floor of Old-Age Income Protection*. The plan will provide for a means-tested floor of protection, to be phased in from 1998 to 2002, that guarantees all Americans aged 62 and over a total household income equal to 100 percent of the poverty line. This benefit will replace the current means-tested Supplemental Security Income (SSI) benefit for the elderly. (Nonaged disabled beneficiaries will remain under the SSI program.) SSI now guarantees a floor of elder income protection that averages just 70 percent of the poverty line for single beneficiaries and 90 percent for couples. Eligibility, moreover, starts at age 65. The National Thrift Plan will thus provide more generous poverty protection than current law.

3. Mandatory PTAs

(A) *Require Mandatory PTA Contributions*. Every covered worker will be required to contribute 5 percent of earnings (up to the current year Social Security taxable maximum) to a PTA established in that worker's name. Contributions will start in 1998 at 1 percent of payroll and be phased in over 5 years. All contributions will be personal; there will be no employer contribution. The government, however, will make payments to the PTAs of all disabled workers and all young and disabled widow(er) beneficiaries.[7] Workers could satisfy part (or all) of the 5 percent payroll

[6] So-called "drop out" years will not affect this benefit reduction. If a wage year excluded from the Social Security benefit calculation is a year affected by the wage-credit phase-out, the appropriate reduction factor will be applied to the earlier replacement year. The benefit reduction will also be invariant with respect to retirement age—and thus will not penalize continued employment. The reduction factor applied to wage years after age 61 will be fixed at the average reduction factor for all prior wage years.

[7] Specifically, the PTAs of nonelderly adults who qualify for OASDI benefits because they are not expected to work—that is, disabled workers, widowed mothers and fathers, and disabled widow(er)s—would receive monthly government contributions on the basis of the disabled or deceased worker's former wages. This ensures that the PTAs of these individuals continue to be

Continued

deduction requirement by reallocating current deductions under defined contribution pension plans. Above and beyond the mandatory 5 percent payroll deduction, all workers would have the option of making additional voluntary contributions up to a dollar cap set at 5 percent of maximum taxable earnings.[8] All PTA contributions and capital appreciation will be exempt from personal income taxation; PTA funds will only be taxed on withdrawal.

(B) *Provide for PTA Matches for Low-Earners*. The government will match, dollar for dollar, the mandatory PTA contributions of all single workers aged 20 to 62 who earn up to 45 percent of the average wage. Above this level, the subsidy will be reduced by half the mandatory contribution rate times each additional dollar of earnings so that it falls to zero at three times the low wage threshold. The wage thresholds for married workers will be 50 percent higher.

(C) *Establish PTA Investment Rules*. Mandatory deductions will be made automatically by employers; voluntary deductions at a higher rate will be made at the request of employees. The self-employed will be responsible for making at least the minimum contribution to their own PTAs. Workers may choose their own certified financial manager and invest funds as they wish within certain regulatory guidelines.[9] The federal government will establish an oversight board, with public and private trustees, whose functions will include establishing these guidelines and maintaining a "switchboard" to ensure that PTA deductions are made and that all contributions (even for part-time and migrant workers) are routed to the right PTA. This oversight board will also serve as the default financial manager of PTA funds: Anyone who is unable or unwilling to deal with a private manager will have his or her PTA managed by this federal agency.[10]

(D) *Establish Rules on Use of PTA Funds*. Unlike current Social Security benefits, to which workers only have a statutory right that is subject to revision or revocation by Congress, PTA funds will be common law personal property. However (just as can legally occur in certain trusts), PTA funds will be subject to use restrictions. In the event a couple divorces, PTA assets attributable to wages earned during the marriage will be evenly divided. If the PTA owner dies, the assets will be routed tax-free into the PTA of the spouse; if the owner is unmarried, the assets become part of the owner's estate. Until age 62, no worker will be allowed to withdraw PTA funds unless he or she purchases an indexed annuity (a requirement now made feasible by the Treasury's recent decision to issue indexed bonds). This annuity, together with the spouse's own PTA annuity and any future OASI benefits, must ensure that the worker and spouse possess an income for life equal to the higher of (a) a fixed-dollar low-income threshold set at 120 percent of the poverty line or (b) 30 percent of the worker's preretirement wage. (This second test is only slightly below the current Social Security replacement rate for average-earning workers retiring at age 62.) Couples would not only have to provide for joint income, but for the survivorship of the spouse.[11] Workers aged 62 and over will be allowed to withdraw PTA funds at any time, but all funds must be invested in an indexed annuity until the above conditions are met.[12] Fund balances in excess of those required to

---

funded—an important provision in view of the fact that our plan would phase-out all OASI elder benefits, including benefits to elderly widows and former disabled worker beneficiaries.

[8] A higher dollar cap (perhaps 10 percent of maximum taxable earnings) could be a logical component of an overall national thrift plan. However, since a higher cap would increase the cost of the tax expenditure—and might not produce a commensurate increase in net savings—we felt it required further study.

[9] Clearly, investment choices must be limited and regulated. Yet to the extent possible, we just as clearly want to maximize individual choice. At a minimum, there will need to be a requirement that some percentage of assets (adjusted for age) be invested in risk-free or near risk-free debt. (As explained in the next section, our model implicitly assumes such a requirement.) Other issues to be studied include the types of investments that will be allowable and, among allowable investments, the extent to which workers will be required to diversify by investing in indexes.

[10] The government would invest all default funds according to some relatively low-risk formula (there would be two or three standard options) that includes indexed Treasury bonds and stock market indexes. The level of risk in default portfolios would also automatically be adjusted to the worker's age. Although some critics raise concerns about how financially unsophisticated workers would fare under a PTA system, most economists believe that this approach would ensure those workers a rate of return comparable to (or even better than) that of workers who enjoy sophisticated financial advice.

[11] The relatively rare event of the survivorship of the dependent child of a retired worker is not an issue here, since the National Thrift Plan would retain all current-law OASI child benefits.

[12] Alternatively, workers could be allowed to make annual withdrawals from their PTAs, with the amount not to exceed the account balance divided by the average remaining years of life expectancy.

purchase the minimum annuity will be subject to no use restrictions and may be consumed, reinvested, or passed on to heirs.

4. FICA Reform

(A) *Credit OASI Cash Surpluses to Worker PTAs.* As soon as the OASI system (including the cost of the new means-tested safety net and the PTA subsidies) is determined to be in permanent cash balance, any annual surplus of tax revenues over current year outlays will be automatically credited (pro-rated to covered wages) to worker PTAs. Thus, to the extent that benefits decline as a share of taxable payroll, the PTA contribution rate will rise above 5 percent. This provision gives younger workers a direct stake in any reforms that restrain the future cost of OASI benefits.

(B) *Provide for an Eventual Phase-Out of Payroll taxes.* Once the PTA contribution rate reaches 8 percent of payroll, OASI FICA (and SECA) taxes will be progressively reduced. This reduction will continue until OASI revenues (excluding the 3 percent PTA refund) fall to the ultimate level (about 2 percent of payroll) that is needed to pay for: (1) all OASI child and nonaged survivor benefits; (2) the means-tested floor of protection for the low-income elderly; and (3) the PTA savings subsidies. Thus, when the transition is complete, the total contribution rate under the new Social Security system (about 10 percent) will be somewhat less than the current-law OASI payroll tax rate—and no more than two-thirds of the tax rate that would eventually be required to pay for OASI's ever-deteriorating current-law deal.

IV. Model and Assumptions

The National Thrift Plan Project required the development of interlinked macro and micro models that quantify the affects of the plan on the federal budget, the national balance sheet, and individual cohorts of beneficiaries. Except for unavoidable exceptions, our macro model precisely follows the official 1995 "intermediate" scenario prepared by the Social Security Administration's (SSA) Office of the Actuary for all future years through 2070. Wherever we needed to add assumptions, we have, in the interest of prudence, tried to lean in the direction of prudence.

The following outline describes our model and our principal assumptions:

Model

(1) *Macro Module.* The macro module calculates OASI benefits, the OASI balance, PTA refunds, changes in other government outlays and revenues, and changes in net national savings. It also includes a productivity feedback equation. In calculating yearly outlay changes due to our OASI reforms, we tried to ensure the highest possible degree of accuracy for retired worker benefits by using actual SSA projection matrices that specify benefits and beneficiaries by year, by age, and by age of entitlement. (At 75 percent of total benefits, these constitute far and away the largest category.) Savings in other OASI benefit categories were estimated using the results for retired worker benefits and adjusting them as necessary. Revenues from benefit taxation were calculated using data from the SSA and the Office of Tax Analysis. Our calculations of the cost of the PTA savings match used SSA data on covered earnings; our calculations of the poverty benefit's cost are based on data published by the Urban Institute.

(2) *PTA Module.* The PTA module tracks PTA assets owned by workers at every age in every year. Specifically, it takes total yearly PTA contributions from the macro model, calculates the build up of worker assets by age and by year, and then subtracts assets that leave the system due to death or retirement. The module also adjusts portfolio composition by age. In order to accurately distribute assets, we assumed that workers' earnings vary by their age. The relationship between age and earnings was estimated using Census and SSA data and then normalized so that total yearly average earnings conform to yearly average earnings in the SSA scenario.

(3) *Micro Module.* The micro module takes the results from the macro and PTA modules and uses them to calculate total contributions and total benefits for every cohort, over its entire working life and retirement, for the following three ideal worker types: average-earners (that is, workers whose wages in every year are equal to the average U.S. wage); low-earners (whose wages are equal to 45 percent of the average wage); and maximum-earners (whose wages are equal to the taxable maximum). For each of these types, the model then generates replacement rates, present values of lifetime benefits and taxes, payback ratios, net present values of lifetime

benefits, and wage-adjusted net present values of lifetime benefits.[13] All life expectancies are weighted male-female averages.

Assumptions

OASI Baseline. To calculate a baseline scenario, we needed to make some assumption about what will happen to OASI after its trust fund's (1995) projected bankruptcy in 2031. Our assumption is that, upon bankruptcy, an immediate across-the-board benefit cut will be enacted that returns the system to cash balance. Thereafter, benefits will be adjusted annually to maintain cash balance. If Congress literally takes no action, OASI's legal appropriations would run dry and SSA would have no other choice but to enact some such measure. One could of course argue that Congress will someday correct the imbalance partially or entirely through payroll tax hikes. But while this action would have the effect of improving the baseline deal for today's cohorts of workers, it would result in an even worse deal for future cohorts of workers. The reader should keep this trade-off in mind while assessing our results.

Financial Rates of Return. We assumed two basic types of financial instruments: (a) relatively risk-free public debt, whose real rate of return to investors is assumed to be identical to the projected average rate for OASI trust fund assets (2.3% after 2010); and (b) corporate equity, whose real rate of return to investors is assumed to be 6.7% in every future year. The latter figure is the average compound rate for total real returns in U.S. stock markets over 190 years, from 1802 to 1992, as computed by Jeremy J. Siegel at the Wharton School. This is slightly lower than most estimates of the rate since 1946 and substantially lower than most estimates of the rate since 1982. According to Ibbotson Associates, the total real return on large company equity from 1925 to 1995 was 7.2%. As elsewhere, we wish to resolve any uncertainty on the side of prudence.

Portfolio Composition. Our calculation of the internal return to PTAs assumes a conservative mix of equity and debt. This mix varies by age (whether because of regulation or individual preference), with the share of assets in equity trending linearly downward from two-thirds at age 30 to one-third at age 60, then dropping to 10 percent at age 61. All assumptions about portfolio composition were suggested by survey data on how households of different ages voluntarily allocate assets.

Management Fees. Annual management fees for equity are assumed to average 0.5 percent of assets. We consider this to be a generous assumption, first, because management fees for many popular no-load index funds are today less than 0.2 percent of assets, and second, because the universal availability of a low-cost default investment option will tend to keep fees down. On the other hand, PTA managers will have to acquire certification and assume special fiduciary responsibilities. This will add to cost. Management fees for debt are assumed to be negligible.

Voluntary PTA Contributions. We assume that voluntary PTA contributions will be equal to 10 percent of mandatory contributions (including both personal and government contributions). Since the vast majority of workers will be able to contribute at least 10 percent more with full tax deductibility, this assumption may be conservative.

Savings Offset. We assume that 30 percent of all new personal contributions to PTAs will be offset by reductions in non-PTA savings. This assumption seems generous for three reasons: (1) PTAs will be subject to strict rules limiting preretirement withdrawals; to the extent that households prefer the greater flexibility of 401ks and other savings vehicles, this will limit the offset. (2) Since there will be a relatively low dollar cap on contributions, the average PTA savings dollar will reflect a much lower household income and asset profile than the average U.S. savings dollar. In other words, the majority of PTA contributors now save little (or nothing), and so will not be able to offset PTA contributions at the 30 percent rate we assume. (3) The National Thrift Plan will simultaneously reduce unfunded Social Security benefit liabilities. To the extent that households view these liabilities as assets, a large share of PTA contributions will be regarded as substitutions for (not additions to) existing household wealth.

PTA Withdrawals. Our model assumes that every worker retires and translates his or her entire PTA into an inflation-adjusted annuity at age 62. All PTA accumu-

[13] The replacement rate is the first year of retirement benefits divided by the last year of earnings. All present values (PVs) are discounted at the OASI trust fund interest rate to the year of retirement. The payback ratio is the PV of benefits divided by the PV of taxes (plus PTA contributions). The net PV of lifetime benefits is the PV of benefits minus the PV of taxes. Wage adjusting the latter means using baseline taxes in all PV calculations—so that tax payments reflect only the "hourly" cost of benefits and do not reflect the productivity gains implicit in the reform scenario.

lations at age 62 or older are ignored. These are of course simplifying assumptions. On the one hand, some PTA assets will be immediately consumed upon retirement. On the other, some people will continue to work and build up PTAs well after age 62—and others will want to preserve assets and bequest some of them to heirs. Our model also assumes that withdrawals are annuitized to a unisex life expectancy at age 62. This assumption too understates savings since joint annuities (which would be mandatory under our plan) would in reality be annuitized to joint life expectancy, which is longer. Upon the death of never married or widowed workers (at any age), assets are assumed to be withdrawn from the PTA system.

Taxes. In calculating changes in personal income taxes, we assume, for workers, that the mean marginal personal income tax rate on PTA covered earnings is 16 percent for the federal government and 3 percent for state and local governments; for retirees, we assume that marginal personal income tax rates are two-thirds of the above. Half of the savings offset to PTA contributions is deemed to occur in savings vehicles where both the contributions and the internal return are already tax exempt—an assumption that reflects the large share of current savings that takes place in tax-exempt vehicles like 401ks, Keoghs, and IRAs. In calculating changes in corporate taxes, we assume (conservatively) that corporations pay total taxes equal to 45 percent of corporate earnings after taxes and after adjustment for inflation. These taxes are assumed to flow two-thirds to the federal government and one-third to state and local governments. We further assume that the corporate equity share of the savings offset will be equal to the corporate equity share of all PTA assets.

Administrative Cost. We assume that the additional cost of administering the PTA oversight board, the PTA matches and refunds, and the expanded means-tested safety net will entail a doubling of projected current-law OASI administrative costs.

Productivity. In order to account for the impact of higher savings and investment rates on GDP and wages, we developed two productivity scenarios: a main scenario and a low-response scenario. Both scenarios assume that the productivity growth rate will begin rising in the year 2000 by 0.05 percentage points per year over baseline. Under the low-response scenario, its rise stops at 0.25 percentage points over baseline in the year 2004. Under the main scenario, it stops at 0.5 percentage points over baseline in the year 2009. Even a conservative neoclassical production function suggests that in today's economy each 1 percentage point increase in investment rates will lead to a one-eighth of a percentage point increase in the productivity growth rate. By and large, our main scenario follows this 8-to-1 response rule. Combining this productivity response with our other assumptions about rates of return, it was reassuring to find that our results for net savings were consistent with a steady and plausible share (20–30%) of additional capital income to additional GDP. However, in the interest of extreme prudence, we also developed our low-response scenario in which the productivity improvement is just half as large. In all cases, our model assumes that increases in wages will be proportional to increases in GDP.

Fiscal Dividend. Because most tax revenues (but not most public outlays) increase automatically in line with real economic growth, economists generally assume that higher productivity, in and of itself, will improve public-sector balances. The National Thrift Plan is thus almost certain to have a positive fiscal impact above and beyond that due to specific reform measures. Our model makes the extremely conservative assumption that there will be no such fiscal dividend: The dollar balance of outlays and revenues not directly affected by reforms is assumed to remain unchanged in all years.

Labor Market Response. Most economists also believe that payroll taxes reduce the supply of labor, and hence shrink tax revenues. Since our mandatory contributions would not be regarded as a "tax" by most households (after all, households will continue to own each of these PTA dollars as they are earned and invested), we do not make any downward adjustment in the labor supply. Since the plan will eventually reduce the OASI payroll tax rate far beneath current projections, a more plausible case can be made for a later upward labor supply adjustment. In the interest of prudence (and to avoid problematic deviations from the official OASDI projection scenario), we chose to make no adjustment in any year.

Poverty Guarantee. The higher retirement benefits which low-income workers would earn under the National Thrift Plan would almost certainly do something to reduce poverty rates among future elderly cohorts. In projecting the cost of the plan's means-tested safety net, however, we did not account for this feedback. Benefit costs assume both a constant poverty rate and a high participation rate (75 percent of eligible beneficiaries versus about 60 percent under the current SSI system).

V. The Results

We summarize the quantitative results of the National Thrift Plan in the two appendices following this section. The first, the "Economy Appendix," shows the impact of the plan on national savings, public-sector revenues and outlays, OASI revenues and outlays, and OASI benefits. The second, the "Payback Appendix," shows how the plan will affect workers in different cohorts and income groups. Under each heading, we tabulate the results for two productivity scenarios: our "main" scenario, in which the annual productivity growth rate improves by 0.5 percentage points, and our "low-response" scenario, in which it improves by 0.25 percentage points. All results highlighted below refer to our main scenario. The findings are slightly less favorable for the low-response scenario, but the same basic conclusions hold. In any case, the most significant differences are in the distant future when the superior outcomes of the National Thrift Plan would be manifest under any plausible productivity scenario.

As can be seen, the National Thrift Plan accomplishes its objectives:

Economy

- In each and every future year, the impact on net national savings is positive. Already by the year 2000, net savings is up by 1.2 percent of GDP; by 2010, when the Baby Boom begins retiring, it is up by 2.6 percent of GDP; by 2065, it is up by 5.9 percent of GDP.
- Initially, the increase in net national savings is due entirely to new private savings in PTAs; relative to baseline, the public sector runs a small deficit. This deficit, however, is never more than 0.4 percent of GDP and disappears entirely by 2014. Thereafter, the impact of the National Thrift Plan on the public-sector balance is hugely positive. By 2020, relative to baseline, the federal budget alone is running a surplus of 0.5 percent of GDP; by 2025, the surplus doubles to 1.2 percent of GDP; by 2030, it nearly doubles again to 2.1 percent of GDP.
- Although the small near-term deficits imply that net borrowing from the public will temporarily increase, this borrowing will be dwarfed by the contemporaneous increase in private savings. Even at its dollar peak in 2006, the negative federal deficit impact (at $45 billion) will amount to just 11 percent of net PTA savings (at $416 billion). Given any plausible assumption about portfolio composition, bond purchases by PTA accounts will be more than sufficient to absorb this new debt. Or, to look at it another way, the PTA system and the rest of government combined will be buying back debt from other bond holders.
- Total Treasury debt—that is, publicly held debt plus Treasury borrowing from the OASI trust fund—decreases in each and every year relative to the current-law baseline. Trust-fund IOUs represent obligations that (absent a change in current law) future taxpayers will be required to pay, and which our baseline assumes that future taxpayers will indeed pay. From year one, the National Thrift Plan thus reduces the total formal obligations of government.
- By 2015, total OASI outlays (which now include an OASI-funded poverty floor and PTA savings subsidies) are cut beneath baseline. By the 2030s, the OASI system begins to register large cash surpluses and PTA refunds begin. By the 2040s, PTA refunds climb to 3 percent of taxable payroll and FICA taxes are cut. By 2065, the total cost of the OASI system—including the expanded poverty floor and the PTA subsidies—falls to 2.4 percent of taxable payroll, less than one-quarter today's rate. The transition to a fully funded Social Security system is thus successfully completed.

Payback

By the year 2005, newly retiring workers will be receiving greater benefits under the National Thrift Plan than under current law. Within a few decades, they will be receiving much greater benefits. This is true for workers at all income levels, no matter what the measure of benefit adequacy. It would also be true if full current law benefits were paid after Social Security's bankruptcy and not cut as our baseline assumes.

By 2015, the average-earning worker retiring at age 65 will be receiving $20,400 more in present value (PV) lifetime benefits under the National Thrift Plan than under baseline; by 2045, that worker will be receiving $156,000 more; by 2065, he or she will be receiving $278,000 more. The share of preretirement earnings that benefits replace will also be higher—in fact, nearly twice as high by the 2060s. Although current retirees are asked to sacrifice, viewed in perspective that sacrifice is tiny: just $733 for an average earning worker who retired in 1986, or less than 1 percent of lifetime benefits.

The relative improvement in benefits over baseline will be roughly the same at all income levels. By 2065, low-and average-earning workers will be receiving lifetime benefits that are 2.5 times higher than baseline, and high-earning workers benefits that are 2.9 times higher. The National Thrift Plan thus retains the relatively favorable deal Social Security now offers low-earners.

Along with benefit adequacy, payback ratios also improve. In fact, the payback ratio on contributions rises steadily for all cohorts retiring from 2005 on, with low-earning workers doing best of all. By 2065, the PV ratio of lifetime benefits to lifetime contributions for average-earning and high-earning workers will be roughly 30 percent higher than under baseline; for low-earning workers, the ratio will be roughly 45 percent higher.

It is true that net benefits (that is, the PV of lifetime benefits minus the PV of lifetime contributions) will remain negative under both systems—and indeed, that despite the better rate of return, average-earners under the National Thrift Plan will initially have a larger net loss. This is the unavoidable cost of transitioning to a funded system. Net benefits earned by PTA contributions alone are positive in all years (because our discount rate, the interest rate on Treasury debt, is lower than the return to PTAs). But this effect is long overwhelmed by the cost of paying off unfunded benefit promises to older retirees: for average-earning workers, the net benefit does not exceed the baseline until 2044 and for maximum-earning workers not until 2059. Low-earning workers are an exception. Since their PV ratios are positive both under baseline and under reform, the larger dollar contributions give low-earners an immediate net gain. Their net benefit improves with reform in every year from 2004 on.

These net benefit measures, however, do not take into account the fact that improvements in productivity will make each dollar of contributions easier to earn. We have therefore also calculated net benefits adjusting contributions for the hours of work they reflect. According to this "wage-adjusted" net benefit measure, average-earning workers will be doing better than baseline by 2037 and high-earning workers will be doing better by 2043. Moreover, for average earners, the net benefit loss relative to baseline is never greater than $11,000. By 2050, average earners will be coming out $48,000 ahead of baseline; by 2060, they will be coming out $116,000 ahead.

Workers born in 1972 (and reaching age 65 in 2037) are thus the first cohort of Americans who will emerge unambiguously better off because of the National Thrift Plan, not just in terms of the lifetime benefits they will receive or the rates of return they will earn, but according to the harshest measure of all: their absolute dollar gain. Thereafter, with the transition now fully paid for, all younger Americans are free and clear.

All of this, moreover, overlooks another vast benefit of the National Thrift Plan: the impact that higher productivity growth will have on the living standards of future American workers before their retirement. By the year today's newborns are due to retire at age 65, the average U.S. wage will, under our "main" productivity scenario, be nearly a third higher (in inflation-adjusted dollars) than it would be under baseline.

[Additional attachments are being retained in the Committee's files.]

Chairman BUNNING. Ms. Canja.

STATEMENT OF ESTHER CANJA, VICE PRESIDENT, AMERICAN ASSOCIATION OF RETIRED PERSONS

Ms. CANJA. Thank you, Mr. Chairman. I am Tess Canja, vice president of AARP. We appreciate your invitation to present our views regarding options to restore Social Security's long-term financial health.

AARP and its members have a considerable stake in the Social Security solvency debate. I want to emphasize this personal perspective this morning. AARP membership begins at the age of 50. The majority of our members receive Social Security and they are the parents and the grandparents of tomorrow's beneficiaries, some of whom already belong to AARP.

Currently, one-third of our members work, and although they probably don't want to admit it, the first wave of boomers are now eligible for AARP membership. This means that an increasing percentage of our members will still be working.

AARP recognizes that we must consider the needs of all generations as we evaluate solvency options and solvency packages. We have adopted principles that will guide us, which are attached to our testimony.

In order to develop a solvency package that can be supported by the American people, we must first understand the public's views about the program. The message from public opinion surveys is loud and clear. Americans of all ages continue to support Social Security in very large and consistent percentages, and people of all ages agree that society has an obligation to honor the commitment it made to provide Social Security when people retire.

Despite the overwhelming support for Social Security, many people question the program's ability to pay benefits in the future. Their lack of confidence reflects many things, including misinformation about the program, the widely held belief that Congress has raided the trust funds, and an overall lack of confidence in all institutions, particularly government. In addition, many Americans believe that current Social Security benefits are too low. These factors add to the most commonly mentioned belief that Social Security will be unable to deal with the retirement of the boomers.

Even though confidence in the program is fragile, people of all ages would like Social Security to be there just in case they need it. For better or worse, the public is not prepared at this time to decide how we should strengthen Social Security. The public needs more information and time to work through the options and necessary policy tradeoffs.

Polls suggest that the public rejects most solvency options in isolation and they are especially resistant to choices that involve pain and sacrifice. However, it is important to keep in mind that options with little support in isolation, when incorporated in a broader package, will gain support.

It is important to keep in mind that under current law, Social Security can continue to pay full benefits until the year 2029. Beyond that, Social Security can continue to pay about three-fourths of promised benefits.

We do not need to alter fundamentally the current system and we should not undermine the principles that have led to Social Security's success and enormous popularity. For the sake of our children and grandchildren, we should continue to provide a guaranteed Social Security benefit that is protected against inflation and we should continue to provide an array of protections for workers and their families, including disability, survivor and dependent benefits.

Mr. Chairman, AARP agrees with the Advisory Council that any solvency package should spread the responsibility for bringing Social Security into long-term balance among all who are part of the system. Ultimately, AARP and most Americans will judge Social Security changes based on the fairness of the entire package.

We look forward to working on a bipartisan basis with our elected officials to achieve a solution that maintains the program's guiding social insurance principles, achieves solvency in a fair manner, and ensures an adequate benefit for all. Thank you.

[The prepared statement and attachments follow:]

Statement of Esther Canja, Vice President, American Association of Retired Persons

AARP appreciates the opportunity to present its views regarding options to restore the long-term solvency of the Social Security system. Americans of all ages have a stake in the future financial strength of this critical family program. We hope today's hearing will facilitate a national dialogue on options for assuring Social Security's long-term financial health and help allay fears that the program is in imminent fiscal danger.

Last month the Social Security trustees reaffirmed that the program is not in, or near, crisis but does have a long-term problem. In order to help find solutions, it is important for the American people and their elected officials to engage in an inclusive national dialogue about how Social Security works and the many options to restore the program's long-term financial stability. An early discussion of the options will allow workers and beneficiaries adequate time to voice their preferences and concerns. And, if changes are enacted in the near future, they will be less painful than those made later. Early action also would provide workers with adequate notice and the opportunity to plan accordingly.

I. PUBLIC OPINION

Public opinion polls consistently demonstrate that Americans of all ages strongly support the Social Security program and believe society should honor the long-term commitment that Social Security be there for people when they retire. Nevertheless, many people, particularly younger workers, lack confidence in the program's long-term viability. This lack of confidence has many sources, some having little to do with Social Security per se: a lack of confidence in all institutions, particularly government; a widespread perception that the Social Security trust funds have been "raided"; and a pervasive belief that benefit levels are too low—a view held particularly by the "Boomers.[1] Finally, the lack of confidence reflects the widely held idea that the program will not have the resources to finance the Boomers' retirement.

Despite a lack of confidence in Social Security, most Americans (88 percent of all individuals according to DYG, Inc.) still want to know that Social Security will be there for them "just in case" they need it. In order to ensure that benefits will be there, the public will need to become more engaged in the solvency debate. A discussion of solvency options will not be fruitful, however, unless the public's understanding of Social Security improves. Millions of Americans, convinced that the trust funds have been stolen, are unaware that even after 2029 the system can honor all but about 25 percent of the benefits currently promised, i.e., if Congress does nothing to change Social Security.

The American people not only need better information about Social Security, but they also require time to work through some of the policy tradeoffs that are a necessary part of the national debate. Right now, the public opposes most solvency options in isolation and is particularly resistant to options that require much "pain." Fortunately, there is sufficient time to engage in a meaningful dialogue that can lead to greater public support for enactment of an acceptable solvency package.

II. STATUS OF SOCIAL SECURITY TRUST FUNDS

Social Security is the nation's most closely monitored federal program and the only one that projects future income and costs over 75 years. In April 1997, the trustees reported that Social Security will be able to pay full benefits on time until 2029—the same as in last year's forecast. The combined Old Age and Survivors Insurance (OASI) and the Disability Insurance (DI) trust funds (OASDI) will take in more tax revenue annually than is needed to pay benefits until 2011. From 2012 through 2018, revenue to the trust funds plus interest earnings will exceed expected benefit payments. Starting in 2019, annual outgo will exceed annual income, and the trust funds' reserves will be gradually drawn down until they are exhausted in

[1] These findings are based on over ten years of analyses of public attitudes done for the Association by DYG, Inc.

2029. Even in 2029, without any change in current law, incoming revenue will cover about 75 percent of the benefits currently promised. (See Chart 1)

The annual trustees' report serves as an early warning system of impending problems. Throughout the program's history, changes have been enacted to improve solvency; many were adopted with considerably less lead time than we have now. The major factors contributing to the projected shortfall have been apparent for some time. One of the largest is demographics. We know that the retirement of the roughly 77 million people born between 1946 and 1964, the Boomer generation, will be costly. However, our nation has adapted to the Boomers as they moved through life's other life landmarks—when they entered school, college, the work place, and the home-buying market. Reasonable accommodations were made then, and adjustments can be made to Social Security and other retirement systems to deal with the Boomers' retirement and that of the generations to follow.

III. Report of the 1994–1996 Social Security Advisory Council

A 13 member advisory council was appointed in 1994 to recommend a solution to Social Security's long-term problem. The Council, which delivered its report this January, did not reach consensus on a single approach for restoring long-term solvency. However, it did agree on key principles and features of the current system that should be retained, such as maintaining full cost-of-living adjustments (COLAs) and rejecting means-testing. It did recommend some modest changes to the program that considerably reduce the projected shortfall.

The Council also emphasized the importance of early action to restore long-term solvency. Generally, long-term solvency can be restored by increasing revenue, reducing benefits, or some combination of the two. The last reform package, the Social Security Amendments of 1983, included revenue and benefit changes and sacrifices were asked of all who participate in the program: workers, employers, and beneficiaries. AARP believes the 1983 approach of shared sacrifice and balanced changes within the program should serve as a model for the future.

A. Principles That Should Be Maintained

The Council highlighted numerous principles of the Social Security program that should be retained. In 1995, AARP adopted a set of principles which we believe should be reflected in any solvency plan (see appendix for the complete list). AARP and the Council agree on the following principles:

- Social Security should be self-financed;
- Social Security should be compulsory;
- Social Security benefits should bear a reasonable relationship to contributions, plus interest;
- "Conventional" means testing should be rejected; and
- Social Security should continue to protect low income retirees by paying benefits that keep them from relying on means tested benefits.

The above principles have been largely responsible for the enormous support Social Security enjoys among Americans of all ages. The Social Security benefit blends the concepts of "individual equity" (a reasonable relationship between contributions and benefits) and "social adequacy" (providing an income floor). To preserve the concept of equity, benefits are computed using an individual's work history and payroll tax contributions. To provide adequacy, however, the formula is weighted so lower-wage workers receive a benefit that replaces a higher percentage of their pre-retirement wages than for average or higher earners. This weighting provides lower income workers and their families with a benefit that helps protect them from destitution when a wage earner leaves the workforce and provides a measure of dignity and independence. The progressive benefit formula is critical to lower-wage workers since they generally do not accumulate sufficient financial resources, such as a private pension or savings, to help replace wages lost when they retire or become disabled.

If Social Security benefits were conditioned solely upon need, i.e., means tested, public support would drop precipitously. And, if benefits were denied to high-income workers, they would be far less willing to support and participate in the program. Since the Social Security formula represents an implicit income transfer from higher earners to lower earners, Social Security's progressive benefit structure would not be possible in its current form if high earners opted out of the system.

The Council also endorsed, and AARP supports, the following principle:

- The goal of universal coverage should be achieved.

In order to attain universal coverage, the Council recommends extending mandatory coverage to *newly* hired state and local workers. Although Social Security covers about 96 percent of the workforce, some state and local employees remain outside the program. Mandatory coverage for all *newly* hired state and local workers would better serve both the excluded employees and the financial health of the Social Security trust funds.

Universal coverage is desirable in a social insurance program to ensure public cohesiveness. It also makes sense because Social Security provides excellent protections. For many Americans, Social Security is the only source of survivor, dependent and disability benefits, and it is their only income source that is adjusted annually for inflation. Additionally, Social Security's progressive benefit formula means lower-income workers often receive higher benefits under Social Security than under public plans.

Equity considerations also suggest that universal coverage is preferable. Some state and local employees who have also worked in Social Security-covered employment or who marry a covered employee gain a Social Security benefit with fewer contributions than other beneficiaries. Although their benefits are smaller, their overall return on the payroll taxes paid is greater. AARP believes all workers should be covered; states and localities wishing to supplement Social Security coverage should be encouraged to do so, similar to private employer pension plans.

B. Important Benefit Features to Retain or Improve

The Council concurred on numerous features of the current benefit structure that should be maintained or improved. AARP believes that one of the most important is:

- Social Security should continue to provide full cost-of-living adjustments (COLAs).

The Council affirmed that full cost-of-living adjustments are one of Social Security's most important contributions to the income security of retirees. Today, Social Security remains the dominant income source for 3 of 5 beneficiaries and virtually the only source of income for 1 in 4 beneficiaries. Given this widespread reliance on Social Security, any reduction in COLAs would mean that millions of beneficiaries would face economic hardship. Annual COLAs are the only means that most older Americans have to keep up with the rising costs of goods and services. In fact, most of the reduction in the poverty rate for those age 65 and over in the early 1970s was due to the large *ad hoc* increases in Social Security that occurred prior to automatic cost-of-living adjustments. And, since then, the poverty rate for the elderly has stabilized because annual COLAs have prevented the more than one in five older Americans—mostly older single women—who hover within 125 percent of the poverty line from falling further behind economically.

COLAs are not intended, nor do they function, as a benefit increase. COLAs help ensure that beneficiaries, particularly the oldest ones, will not outlive their resources. In an ironic twist, proposals to permanently reduce COLAs mean that as beneficiaries age, the real value of their benefits would decline. In effect, beneficiaries would be paid higher real benefits at age 65 than at age 80 although their other income has likely declined and their health care costs will have risen sharply.

Some advocate reducing COLAs by legislatively changing the Consumer Price Index (CPI), which is used to adjust benefits, or by providing partial COLAs. Those who want to reduce COLAs by changing the CPI contend the index overstates inflation. It is not clear to what extent this may be true. The Bureau of Labor Statistics (BLS) determines the CPI, revises the CPI market basket every ten years, and makes technical adjustments to the index on an on-going, as-needed basis. AARP believes that the experts at BLS, not Congress, should continue to make adjustments to the current index. We are pleased that the House overwhelmingly adopted House Resolution 93, which supports leaving the determination of the CPI to the BLS.

Others suggest limiting COLAs for beneficiaries whose Social Security benefit or Primary Insurance Amount exceeds a specified threshold. Affected beneficiaries (all those above the cut-off point) would receive a flat dollar amount of no more than the COLA provided to a beneficiary at the threshold. A "capped" COLA is a form of means testing the basic benefit package. But, Social Security is a social insurance program that provides lifetime protection for workers and their families as an *earned* benefit, rather than a benefit contingent upon income. Those who advocate means testing, in any form, ignore the insidious message it sends to workers: if you do well, if you work hard, if you save, you are penalized.

A "capped" COLA also incorrectly assumes Social Security benefits are an indicator of comparative wealth. Some individuals have low benefits because they spent only a brief period working in Social Security-covered employment and the rest of their career in non-covered employment. Many of them may be eligible for other types of pensions (typically public employee pensions and/or military benefits) or may have accumulated additional financial resources for their retirement. Yet, other beneficiaries with larger Social Security benefits may have no other income sources. To more accurately assess wealth would require beneficiaries to give a full accounting of their income and assets, which if feasible, is administratively complex and inconsistent with the concept of an earned benefit. In addition, a portion of the COLA is recaptured through the tax system for beneficiaries who pay taxes on their Social Security benefits. Finally, AARP rejects a capped COLA because it could lead to further reductions in this critical part of the Social Security benefit if the initial threshold is unindexed or actually lowered.

The Advisory Council also stated that we should:

- Increase benefits for widow/ers.

Council members recognized that widow/ers benefits are critical to the income security of millions of single beneficiaries. They proposed to finance the improved widow/ers benefits by a reduction in spousal benefits. Clearly, the loss of a spouse increases the probability of poverty in old age, particularly for women. This proposal would reallocate benefits throughout the expected lifetimes of both spouses by lowering joint benefits and raising survivor benefits an equivalent amount. This change may be worthwhile, but it deserves to viewed in the larger context of the relative needs of married couples and survivors for retirement income. Any changes should be based on findings that better adjust Social Security benefits to the actual needs of its beneficiaries.

C. Increasing Social Security's Rate Of Return

The Council members agreed that the rate of return on Social Security investments should be increased, but they differed on *how to achieve an increased rate of return* and *who should benefit from any improvement.* These differences produced the three plans that divided the Council.

The Maintenance of Benefits plan (MB), or the Ball Plan, includes five modifications to the program that restore about two thirds of the shortfall. Ball proponents believe that in order to eliminate the remainder, serious consideration should be given to investing up to 40 percent of the trust funds' assets directly in common stocks indexed to the broad market. Since the investments are being made on behalf of the trust funds, any increased returns would be credited to the trust funds collectively. Individual benefits would not be directly affected by changes in the market.

The Individual Accounts (IA) plan, or Gramlich plan, creates individual accounts alongside a pared back Social Security system. Workers would invest an *additional* 1.6 percent of wages—that is, in addition to their current payroll tax contributions—in individual accounts held by the government. Investment choices would be made by individuals but options limited to a "menu" of those selected by the trustees. The return on these individual accounts is intended to augment the reduced basic Social Security benefit.

The Personal Security Accounts (PSA), or Schieber/Weaver plan, creates larger individual accounts designed to *replace* a significant portion of the Social Security benefit. Workers age 54 and under would direct 5 percentage points of the current payroll taxes into these accounts, which would be individually managed and invested in financial instruments of the individual's choice. The investment yield would be added to a basic flat Social Security benefit, which is roughly equivalent to two-thirds of the poverty line in 1996, or $410 per month. In order to finance the transition to this new system, payroll taxes would be increased by 1.52 percent and over $1.9 trillion in new borrowing would be needed.

The IA and PSA plans require individuals to make investment decisions and bear the risks associated with their investment choices. The larger the portion of Social Security's defined benefit that these accounts replace, the greater the risk to individuals, and the greater the change to our nation's current retirement income structure.

1. THREE LEGGED STOOL

Retirement income has been compared to a three legged stool, with Social Security, pensions and private savings representing the three legs. (The Advisory Council describes retirement income as a tiered structure and adds a fourth level: means tested programs). This diversity is a source of strength that provides beneficiaries with an array of protections through the balanced distribution of risk among Social Security, employer based pensions and individual savings.

Social Security serves as the base of retirement income to be supplemented by the other two legs. In practice, for many retirees, the other two legs are weak or nonexistent. Currently over 3 in 5 older Americans count on Social Security for at least 50 percent of their total income, and 16 percent have no other income. This trend is not likely to change significantly for the next generation of retirees.

Social Security is a social insurance program with compulsory and near-universal participation. It was never intended to be a personal investment plan. In a social insurance program, workers pool their resources in a government-sponsored program to "buy" protection that they might not otherwise have purchased (or afforded) on their own or received from their employer. As social insurance, the program is shaped by societal decisions about who should receive benefits and the amount of those benefits relative to a worker's contributions. Since Social Security's progressive benefit formula deliberately blends the concepts of equity and adequacy, the program should not be evaluated solely with regard to one purpose—the level of return on one's investment.

Pensions are the second leg of the income stool. Pensions are retirement benefits earned in voluntary, employer-sponsored plans. Only half of all workers today are covered by a pension plan. Highly compensated individuals are more likely to be covered by such plans and accrue higher benefits. However, private sector pension plans are undergoing a shift in design that places greater responsibility and risk on the employee. At a time when pension plans are becoming more individual-account oriented, it is even more important to maintain Social Security's social insurance design and defined benefit promise.

Savings, the third leg, are individually held assets and investments. Like pensions, higher earners are most likely to accumulate savings and in far greater amounts. Many households have no retirement savings or use those that they do accumulate for non-retirement purposes. It seems therefore probable that many future retirees will have inadequate savings to meet their income needs.

2. The Risks of Individual Accounts

Individual investment accounts are touted not only as a mechanism to improve Social Security's solvency but also as a way to improve individuals' rates of return and to increase national savings. AARP agrees with the need for increased national savings, but we believe that this outcome should be achieved in a way that does not interfere with the goal of a secure retirement income, particularly for low wage workers and their families. Moreover, as the Congressional Budget Office (CBO) concluded in 1994, individual accounts funded through existing payroll taxes are unlikely to increase national savings.

Worker controlled accounts should not be substituted for Social Security benefits because they would shift to the individual a larger portion of the nation's commitment to assure a foundation of retirement, disability, and survivor income for workers and their families. Individual accounts would gradually transform Social Security from a universal defined benefit plan to a non-guaranteed, defined contribution or individual savings plan. Social Security's design as a secure base of retirement income—to be supplemented by pensions and private savings—would become less predictable and not be guaranteed. Indeed, the distinction between Social Security and the other legs of the retirement stool would be blurred, and the differing purposes each leg serves could be jeopardized.

The shift to individual accounts poses special risks for low wage earners. First, if individuals receive back a portion or all of their current contributions, less revenue would be available to the system to finance the progressive benefit formula that helps low wage workers. Furthermore, since low earners would be investing relatively small amounts, they would be less able to adequately diversify their holdings to shield against risk and would face proportionately larger administrative costs and higher fees that would, in turn, lower the return on their investments.

Some of the touted financial advantages of individual accounts are dubious. The rates of return are often overstated by many proponents of privatization. Stated annual rates of return represent an average, and few, if any, actually receive the "average." In fact, many receive less. Also, proponents overlook the possibility of poor investments, failed financial institutions and failed businesses. Ultimately, investment success requires considerable knowledge of investment options and strategies, a properly diversified portfolio and a willingness and the resources to bear some risk.

On the other hand, people who invest conservatively—many are lower wage earners—will see more modest returns that are unlikely to outpace the current rate of return to the trust funds. Yet, encouraging workers to invest in riskier ventures only invites hardship for those whose investments do not do well—hardships that might have to be offset through other government programs. And, unless early withdrawals and borrowing from these accounts are prohibited, workers may not wait until they retire before tapping into these accounts, thus diminishing the base of their retirement income security. The current move in Congress to allow easier access to Individual Retirement Accounts (IRA) suggests that early withdrawals from individual accounts would eventually be permitted.

Moreover, there is no guarantee that historical patterns of return on assets will continue in the future. (In fact, historical patterns represent average annual returns, which do not apply to everyone.) And, many of those with dramatic paper gains today may not realize them tomorrow when large public and private retirement programs will be selling off assets in order to finance their commitments to the retirement of the Boomers. This simultaneous unloading could drive down the price of a worker's holdings. Also, the significant administrative costs of millions of individual accounts will reduce returns.

In addition, moving from the current system to a partially privatized one poses large transitional problems. If benefit levels for those now in and those near beneficiary status are protected, then workers will have to pay to finance two benefits: those of current recipients *and* their own. Current beneficiaries and those nearing retirement face added risks. The deterioration in the trust funds resulting from the draw-down to finance individual accounts is likely to generate pressure to cut benefits for current retirees and those nearing retirement. Yet, for those nearing retirement the opportunity to offset any lost income with individual investments is limited. Similarly, younger workers who become disabled or die shortly after individual accounts are inaugurated may face lower benefits for themselves and their families. They may not have accumulated enough in their individual accounts to provide benefits that are the same as they would receive under current law.

For all of these reasons, AARP believes Social Security should not be replaced with individually controlled accounts. While individual accounts have a legitimate role to play in overall retirement income security, these accounts are best left—and should be encouraged—for the two private legs of the 3-legged stool. Given the shift to individual accounts in the private pension system, the secure defined benefit promise in Social Security takes on greater importance. Indeed, if pension coverage continues to stagnate at under 50 percent of the workforce and savings rates continue at current low levels, Social Security could, in the future, be responsible for an even greater portion of retirement income security. If greater individual control over investment decision-making is the desired goal, then public policy could encourage greater savings in existing vehicles (e.g. IRAs, 401(k) plans, etc.) that already provide for individual control. We do not have to undermine Social Security to achieve that goal.

3. RATES OF RETURN

The Advisory Council's solvency proposals are also designed to improve the "money's worth return" for future generations. Money's worth is one way of assessing the program's fairness across generations. "Fairness," however, does not necessarily mean every generation or every individual within a generation will have exactly the same rate of return. Given the variability in birth cohort size, life expectancy, changes in the economy, and Social Security's evolving nature, fairness will always be a relative measure.

Money's worth analyses often underestimate the value of Social Security by excluding disability and, in some cases, survivor and dependent benefits. Yet, Social Security is the only long-term disability insurance for 3 out of 4 workers, and its life insurance features provide income protection for 98 percent of the children in this country. According to the Social Security Administration, the Social Security survivor benefit is equivalent to a $295,000 life insurance policy for the spouse and two children of a deceased worker with an average earning history, and the disability protection is equivalent to $203,000 for that worker and his/her family. Moreover, Social Security provides disability and survivor benefit coverage for workers with pre-existing conditions, whereas in the private market they are often excluded. When these critical factors are taken into account, the full lifetime value of Social Security becomes even more apparent.

Another caveat regarding money's worth analyses is that most workers' situations change over the course of a lifetime. Few workers have close to average earnings throughout their lives, and some workers may be single for only part of their lives. Moreover, many workers have periods of unemployment or reduced earnings. Social Security protects these workers by providing "dropout years." (The Social Security benefit formula assumes a forty-year work history, but calculates the worker's benefit on the thirty-five highest earning years, thus allowing five "drop-out" years.) Many of the money's worth studies do not allow for these variations.

IV. Other Options for Change

1. Raising the Normal Retirement Age

The 1983 Social Security Amendments included a phased-in increase in the age of eligibility for collecting full benefits (the Normal Retirement Age) from age 65 to age 67, beginning with those born after 1937 and becoming fully effective for people born after 1959. In order to improve Social Security's long-term solvency, some propose further changing the age for collecting full benefits. These proposals range from accelerating the twelve-year hiatus in the current timetable, as recommended by many on the Advisory Council, to raising the full retirement age to 70 years old.

Proponents of increasing the retirement age point out that increased longevity means future beneficiaries will live longer and collect Social Security for a longer period of time. If people live longer, proponents argue, they could reasonably be asked to work longer and postpone receiving benefits in order to improve Social Security's long-term solvency. While many policy experts support raising the retirement age, the public soundly rejects the idea. Many polls show that Boomers and the following generation, the Baby Busters, intend to stop working before age 62. Their anticipated retirement ages reflect the reality of the current labor market in which the retirement age has now *dropped* to about age 62. The polls also strongly suggest that most workers are unaware of the existing increase in the age of eligibility for unreduced benefits.

Current trends affecting older workers suggest that raising the retirement age could exacerbate existing problems in the labor market. Many willing older workers are unable to find employment, and some older workers have physically demanding jobs or health conditions that make continued work difficult. Despite the elimination of mandatory retirement in 1986, age discrimination remains a significant factor in today's work place. Studies show that older workers continue to have the longest spells of involuntary unemployment, and many employers remain reluctant to hire older workers. Also, many employers have policies in place to move out their older workers, such as early retirement incentives, that younger workers tend to support. In short, age bias, health problems and limited job opportunities for older workers could mean that an increase in the Normal Retirement Age will result in lower benefits, not additional work.

AARP believes that any increase in the Normal Retirement Age should be accompanied by policies promoting expanded job opportunities for older workers and incentives that encourage older workers to extend their working careers. We are pleased that the Advisory Council agreed on the need for improved work incentives for older workers. These incentives would encourage older workers to remain in the workforce and also provide overall benefits to our economy.

2. Changing Number Of Years In Benefit Calculation

The majority of Council members support increasing the indexing period for computing benefits from the current 35 years to 38 years. This change would result in an average benefit reduction of 3 percent. While this may be a preferable alternative to *any* increase in the retirement age, it particularly disadvantages women who spend more years out of the labor force caring for family members. In evaluating this and other options, it will be critical to assess the *compounding effects* of multiple options on particular groups, such as older women.

3. Raise Early Eligibility Age (EEA)

Some not only want to increase the age for collecting full benefits, but also to raise the age—currently 62—for *first* collecting benefits. AARP believes we should maintain an early eligibility age because of the conditions in the labor market discussed above, and because many individuals are unable to work past age 62 due to ill health or physically demanding jobs. Without these protections, many older Americans would face serious economic hardship while they wait to collect benefits as well as throughout retirement. If we did raise the early retirement age, disability benefits should be expanded to protect those physically unable to work longer.

4. Increase the Taxation of Benefits

The taxation of Social Security benefits was introduced in the Social Security Amendments of 1983. Single taxpayers with modified adjusted gross incomes (MAGI) over $25,000 (adding in tax exempt interest and half of their Social Security benefits to their adjusted gross income) and joint filers with MAGIs in excess of $32,000 were to be taxed on the lesser of half of their benefits or half the amount by which their MAGI exceeds these thresholds. The maximum percentage of benefits subject to federal income taxation was set at 50 percent of benefits because employees contribute half of the Social Security payroll taxes and employers contribute the other half. Since the provision was enacted to help restore Social Security's long-term solvency, the revenue has been credited to the Social Security trust funds.

The 1983 thresholds deliberately were not indexed in order to provide Social Security with increasing revenue in the future when the number of beneficiaries will rise dramatically and the ratio of workers to retirees will decline. Initially, about eight percent of beneficiaries were taxed on up to 50 percent of their Social Security; today, almost one in four beneficiaries are affected. Without any change in current law, by the turn of the century almost one in three beneficiaries will be taxed on their Social Security.

Effective taxable year 1994, single beneficiaries with MAGIs over $34,000 and couples with MAGIs above $44,000 are taxed on up to 85 percent of their benefits. The revenue from taxing the additional 35 percent, unlike the revenue from taxing 50 percent of benefits, is credited to the Medicare Hospital Insurance (HI) Trust Fund.

The rationale for taxing up to 85 percent of benefits was to more closely conform the tax treatment of Social Security benefits to the taxation principles that apply to private pensions. However, *Social Security is fundamentally different from a private pension*. Social Security is a mandatory, almost universal social insurance program established by the government to provide income protection to workers and their families if the wage earner retires, becomes disabled, or dies. Given Social Security's unique features, it is not necessary to have parallel treatment to private pensions.

Members of the Advisory Council and others support increasing the amount of Social Security that is taxed in order to help restore long-term solvency. Options range from lowering the 1993 thresholds for taxing 85 percent of benefits (e.g. to levels that apply for the 50 percent rate) to fully taxing Social Security for all beneficiaries with taxable income. AARP recognizes that the additional taxation of benefits (assuming the receipts are deposited in the OASDI trust funds) could improve Social Security's long-term health, but we remain concerned that any further increases will result in an unanticipated heavy tax burden for many already retired middle and moderate income beneficiaries. Also, fully taxing benefits could bring millions of older Americans who currently do not pay any income taxes back onto the tax rolls. Since moderate income beneficiaries rely heavily on Social Security, the increased tax burden would be significant, and many of those affected would be unable to recoup lost income. Also, since the current thresholds are not indexed, additional taxation of Social Security will already gradually occur over time.

5. Payroll Taxes

Historically, payroll taxes have been increased as part of legislation to improve long-term solvency. Although the payroll tax is considered regressive by some, they neglect the fact many low-income workers are eligible for the Earned Income Tax Credit (EITC), which offsets some of the initial payroll tax contributions. In addition, Social Security's progressive benefit formula provides low earners with a larger portion of their pre-retirement earnings than average and high earners. Despite criticisms of the payroll tax, most workers consider it fairer than the income tax because they believe few can avoid paying the tax and because they know it is used to pay Social Security benefits. (Seventy-one percent consider it a fairer tax than the income according to DYG, Inc.) Any payroll tax increase, however, should not be a first choice and should be limited in order to protect the standard of living of younger working families.

6. Benefit Changes

Some policymakers suggest modifying the "bend points" in the Social Security benefit formula, particularly for average and higher earners. Significant reductions in benefits for average and high earners could undermine support for the program, particularly among highly compensated workers, but proposals to modify the Social Security benefit formula for high earners should be distinguished from means testing benefits—which the Association opposes—since workers would continue to receive benefits under a modified formula.

Significant changes in any aspect of the benefit formula would affect today's workers once they retire, while increasing payroll taxes affects them while they are in the workforce. AARP believes today's workers should be given the opportunity to voice their views about the timing and desirability of any additional financial sacrifices they will bear.

V. Conclusion

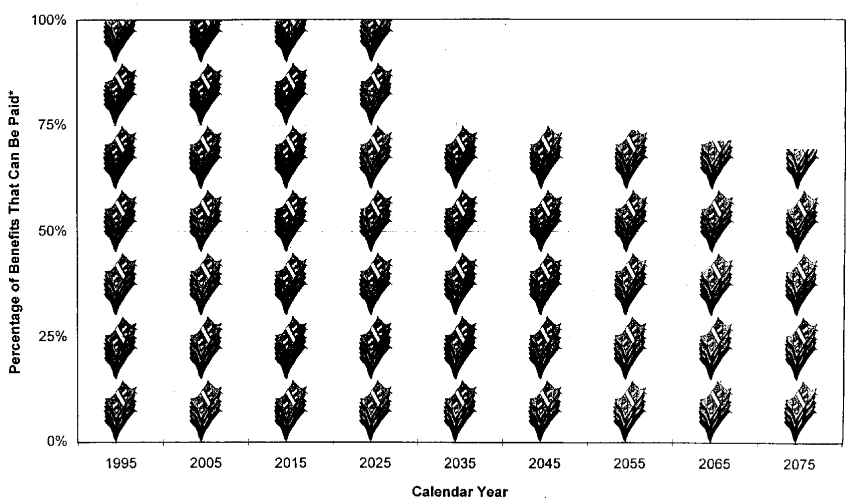
Americans of all ages need to be better informed about the Social Security system so they can participate in the debate about its impact on their future. The program has been, and should continue to be, an important part of our nation's commitment to ensuring that workers who retire, die, or become disabled, and the families and the survivors of those workers will be protected from "the hazards and vicissitudes of life." Fortunately, Social Security has over $550 billion in its trust funds, so we have time to conduct a national dialogue that will lead toward consensus.

AARP is encouraging this dialogue in our publications and in conversations with our members and other interested people of all ages. The Advisory Council proposed three solvency packages, and there are many other options that have been suggested. AARP believes these proposals and others that will emerge should be part of the public debate. It is important to recognize that while some options may have little support in isolation, modest changes that are incorporated into a broad solvency package may be acceptable to most Americans.

We agree with the Advisory Council that solvency packages should spread the responsibility for bringing the system into balance among all who are part of the system. As we continue our dialogue with our members, one-third of whom are still in the work force, and most of whom have children and grandchildren about whom they are concerned, we will be mindful of our principles and the need to preserve Social Security for future generations. Maintaining Social Security's long-term solvency and improving the overall retirement income of future generations is vital to our nation's economic well-being. The Association looks forward to working on a bipartisan basis with our nation's elected officials to achieve a solution to Social Security's long-term problems that maintains the program's guiding social insurance principles, achieves solvency in a fair manner and ensures an adequate benefit for all.

Chart 1

After 2029, About 75 Percent of Social Security Benefits Can Still Be Paid Under Current Law



* Reflects projections under the Trustees' intermediate assumptions.

Source: Office of the Actuary, Social Security Administration, June 1996

AARP

PRINCIPLES FOR SOCIAL SECURITY REFORM

Any Social Security solvency package must:

1. **maintain the earned-right nature of the benefit (beneficiaries earn the right to a benefit by working a minimum of ten years in Social Security covered employment);**

2. **maintain the link between a worker's pay and time in the labor force and that worker's benefit;**

3. **maintain a progressive benefit formula that provides a higher replacement rate for low-income earners;**

4. **provide a benefit to all who have contributed to the system and meet the qualifications for a benefit (no means-testing i.e. no conditioning of eligibility on individual income or assets);**

5. **maintain the self-financed nature of the system;**

6. **require contributions from both employers and employees;**

7. **require participation from all workers--this means newly hired state and local workers; this would not be retroactive (provide an opportunity for those workers still in non-covered employment to participate as self-employed Social Security-covered workers for the remainder of their lives in non-covered employment);**

8. **continue full and automatic adjustments of benefits for changes in the cost of living;**

9. **continue to provide disability protection;**

10. **continue to provide protection for families of workers through dependent and survivor benefits;**

11. **maintain early retirement benefits that, while reduced, are the actuarial equivalent of the amount received at full retirement age.**

AARP believes all who participate in the system (beneficiaries, employers, and employees) should share the sacrifice that will be required to achieve long-term solvency.

AARP Statement of Federal Grants & Contracts Pursuant to Rule XI, Clause 2(g)

On December 19, 1995, the President signed into law the Lobbying Reform Disclosure Act of 1995 which prohibited 501(c)(4) organizations that lobby from receiving federal funds. Although the lobbying act only applies to new grants, AARP transferred its grant programs (staff, funds, and administration) to the AARP Foundation, a 501(c)(3) nonpartisan, charitable corporation established in the District of Columbia in 1961. These transfers, effective January 1, 1996, were approved by all of the federal funding agencies.

	AARP 1995 Actual	AARP Foundation 1996 Actual	AARP Foundation 1997 Projected
Revenues			
Department of Labor: AARP Senior Community Services Employment Program (SCSEP) (1)	$50,993,000	$46,155,000	$50,600,000
Environmental Protection Agency: AARP Senior Environmental Employment (SEE) Program (2)	24,050,000	21,126,000	24,000,000
Internal Revenue Service: AARP Tax-Aide (3)	3,468,000	3,327,000	3,200,000
Housing and Urban Development: AARP Home Equity Information Center	234,000	257,000	357,000
Health & Human Services:			
AARP Early Detection and Control of Breast Cancer Project	235,000	253,000	375,000
AARP National Legal Assistance Support Project	154,000	40,000	135,000
AARP Technical Assistance Project for Statewide Legal Hotlines	100,000	40,000	125,000
AARP SSA Outreach Demonstration Program	98,000	0	
AARP National Eldercare Institute	28,000	0	0
White House Conference on Aging	6,000	0	
AARP Suicide Evaluation and Prevention Project	0	0	50,000
AARP Ombudsman Training and Technical Assistance	2,000	51,000	50,000
AARP Improving Early Access to Mental Health Services Project	0	87,000	49,000
Department of Justice	58,000	0	0
Corp for National Community Service	1,000	0	0
Total Federal Grants	$79,427,000	$71,336,000	$78,941,000

Three Largest Programs:

(1) The AARP SCSEP is a work-training program authorized under the Older Americans Act of 1965. Eligible program applicants must be at least 55 years of age, physically able to work, and have income at or below the poverty level. This program operates in 102 locations in 35 states. For the grant-year ending June 30, 1996, the program served over 13,000 individuals and had an unsubsidized placement rate of 44%.

(2) The AARP SEE Program places retired, or unemployed individuals, 55 or older, in technical assistance roles with the EPA. For the last grant year, participants were enrolled in 33 locations throughout the United States. Multi-year cooperative agreements were projected originally to result in payments of $24 million for 1997. Because this program may end before the end of 1997, a lower amount may be received in the current year.

(3) The AARP Tax-Aide Program provides free tax counseling for low and middle-income individuals, 60 and over, through a network of more than 10,000 sites and 30,000 volunteers. In 1996, this program helped over 1.5 million taxpayers.

THE AARP FOUNDATION
History and Role

The AARP Foundation was established in the District of Columbia in 1961 as a 501(c)(3) nonpartisan charitable corporation, contributions to which are tax deductible. As an affiliate of AARP, the corporation was originally named the Retirement Research and Welfare Association and was set up to engage in the study and discussion of issues affecting aging persons.

In 1983, the Retirement Research and Welfare Association changed its name to the AARP Foundation and shifted its emphasis to promoting projects and community service endeavors related to the social welfare, maintenance, and improvement of health and educational services for older persons. During the 1980s and early 1990s, the Foundation received grants for various AARP projects and also awarded small grants to a variety of community service, educational, and social welfare groups.

On December 19, 1995, the President signed into law the Lobbying Disclosure Act of 1995 which prohibited 501(c)(4) organizations that lobby from receiving federal funds. Although the lobbying act only applies to new grants, AARP transferred its grant programs (staff, funds, and administration) to the AARP Foundation. These transfers were approved by all of the federal funding agencies.

The AARP Foundation administers educational, employment, community service, and advocacy programs funded by both private and federal grants totaling about $80 million and employs about 200 staff. Major programs of the Foundation include the AARP Senior Community Service Employment program, the AARP Tax-Aide Program, and the Washington, DC based advocacy programs funded through Legal Counsel for the Elderly. The AARP Foundation's five-member Board of Directors is appointed by the AARP Board of Directors and provides oversight and guidance to the Foundation's management. Anne Harvey serves as Foundation Administrator, supervising the administrative, financial, and professional activities of the Foundation. Under a service agreement, AARP provides the Foundation with support services and specialized skills needed to carry out some of the grant-funded programs.

AARP Foundation Administrator's Office

Revised May 14, 1997

Chairman BUNNING. Thank you. If the panel would be so kind as to hold, we have a vote, so we will recess and we will come back as soon as we vote. We will stand in recess.

[Recess.]

Chairman BUNNING. The Subcommittee will come back to order. We will start questioning the second panel.

I am going to start out with a question for Beau Boulter. You say that Social Security comprises a morally binding social contract with current retirees and those individuals near retirement and this contract should not be breached. While the Advisory Council was not able to agree on everything, they did agree that any sacrifices in bringing the system into balance should be widely shared and not borne entirely by the current and future workers and their employers. The Council's suggestion was to apply appropriate income taxation to Social Security benefits.

Are you really saying that current beneficiaries should not be at all impacted by any reform proposals? Do you believe that most Americans feel the same way?

Mr. BOULTER. Well, what we are really saying, Mr. Chairman, is that current beneficiaries or those who are about to become current beneficiaries, yes, that we basically should leave them alone; Congress should basically leave them alone. This debate over Social Security reform really, in our view, should not be so much about them, what they get or what they don't get, but more about what their children and their grandchildren and what they are allowed to do during their working lives.

And we do think it is a social contract with the older Americans and that we should leave it alone as far as they are concerned.

Chairman BUNNING. Let me ask you, Beau, because this is very important. In other words, any means testing of benefits, any adjustment as far as retirees are concerned, you are saying that that shouldn't be adjusted to the current retirees or the immediate future retirees?

Mr. BOULTER. Yes. We really don't like the idea, at our organization, of means testing. In fact, we think you already have a backdoor means test through taxing the benefits.

Chairman BUNNING. The reason I ask the question, and I think it is very important that all of you understand this, is that by the time I retire, I will have put in approximately $100,000 to $120,000 into the system. I don't know if I will ever get that back.

And I'll guarantee you that if the system continues as it presently is, and the retirement age is raised to 70, the chances of my son who has my same name and is 40 years old, getting his contribution back in retirement are slim, barring some miraculous health discovery that I don't know about. He will have put more dollars into the system than he could ever recover.

What is the solution to that?

Mr. BOULTER. Well, I think the main part of the solution is to recognize that in the case of your son, that it is unfair to ask him to continue to pay more in payroll taxes with such a low rate of return, to make sure that you get what you are entitled to, knowing that he probably isn't going to get the same thing.

Chairman BUNNING. We don't have an argument there.

Mr. BOULTER. So what we do, I think, is allow him, according to our testimony and our belief, allow him to take the equivalent and a little bit more than the equivalent of the Social Security surplus, which is 1.2 percent of the payroll tax plus some, and start putting it into the private sector.

Chairman BUNNING. But there is a real transition problem here that we are looking at. You mentioned the age of 55. We have looked at age 55 to 65 and if we start at age 55, there is not a long enough transition. We are going to have to look at some age group that is much younger than that and provide a 25-year transition.

It seems to me at age 40 if we are going to keep the retirement age at 65, or at age 45 if we are going to increase the retirement age to 70, that transition period is going to have to be a 25-year transition because we can guarantee that an individual at age 45 who has 25 years to age 70, that benefit. Those are possibilities.

Mr. BOULTER. I think that is a possibility.

Chairman BUNNING. Yes, ma'am.

Ms. BRICELAND-BETTS. I think that the question goes to the social insurance nature of Social Security. When you talk about that contract and why it was originally put together, it was to ensure not that Social Security would be the sole source of income for folks, but that it would be—an unpopular phrase today—a safety net, if you will, to be there for folks who have lifetime low-income earnings, for folks who have disability, for women who take time out of the work force.

I think that that lifetime higher-wage earner that you are talking about has every opportunity, through 401(k)s and IRAs, to enhance that. It is not necessarily true that other factions of our work force, mostly women, who do very good, long-term low-wage work, have that same opportunity. And I think that that redistributive benefit that you are referring to—Social Security is not a bank account; it really is a social program—is a very important concept for us to have a further discussion about and, in our sense, to protect.

Chairman BUNNING. But when Social Security was started it obviously was not going to be the retirement for as many people. We didn't adjust the age groups and the dollar inflow to the reality of the age expectancy.

We do have a problem with that adjustment. It was never meant to be the retirement for everyone that it is now. It was never set up that way. In the early eighties when we readjusted Social Security, you know that it was supposed to be solvent for 75 years and we have never reached that point yet.

Ms. BRICELAND-BETTS. But my point it was never set up to be a dollar-for-dollar return, either. That was not the intention. It is a social insurance program.

Chairman BUNNING. No one ever said it was. The insurance part of it—I am going to have to yield to Ken because my time has expired. Go ahead.

Mr. HULSHOF. First of all, thank you, Mr. Chairman, for providing us with this excellent panel of five individuals, all of like mind. At least I think all of the testimony we have had in this series of hearings, the consensus is we should act sooner rather than later. I think I could probably get five nods of heads.

Just a quick followup. Just anecdotically, back in the district, Mr. Boulter, I have a senior who comes up to me and he says, "I worked from 1937 to 1981." He showed me his pay stubs. "Here is what I paid into the system," he says, and then he says, "Here is what I have taken out of the system," and he was angry at me because he had taken out sevenfold more than what he had put in, even taking into account compounding interest.

Mr. Green, I think the Chairman brings up a good point. What do we tell those constituents of mine who came through the Great Depression, survived it, built a business, have become successful and now we are suggesting, through means testing, that we penalize them or ask them to subsidize our generation, and I think you and I are probably fairly close in age, to subsidize our generation through means testing? What comments do you have as to what Mr. Bunning asked Mr. Boulter, Mr. Green?

Mr. GREEN. Well, as we just discussed, it originally started out not as a pension plan. Like we discussed, the 401(k)s are what should cover that.

Forty percent of the people that receive Social Security right now are above the median income level. We had the ability, earlier in the 1900s and moving forward, to allow our grandparents, our parents to have the ability to take care of their elderly impoverished.

I employ over 100 people and I have asked my employees the question. "Do you know you are putting your money into FICA system and do you know it is not going to be there? Are you angry about that?" I have personally put in about a quarter of a million dollars over the past 16 months into the system, and I am angry as well.

Not only do my employees not understand this constituent's logic, but when they do find out the facts, they are just as angry and they will need the money. Social Security should be based on need. It should be based on need because we must take care of our elderly impoverished, just as we have done throughout the entire century. For today's elderly to suddenly say, "This is mine," goes against everything that has happened in this country's history. In the Great Depression we bonded together. In World War II, we bonded together to pull through. All of a sudden, the elderly are out for themselves and not joining together to take care of tomorrow's elderly impoverished in this country? It is not right.

Mr. HULSHOF. I am going to bounce around. Ms. Canja, if I have some time I would like to ask you a question, as well.

But Mr. Ryan, you mentioned that with workers maintaining control of personal savings accounts, and we have tried to weigh the pros and cons of each of the Advisory Council's provisions, one of the things you mention in your testimony is, of course, placing this money in a wide variety of investments.

How do we ensure that individuals make wise investment choices? How do we make sure that, for instance, somebody doesn't take their money and go down to the riverboat or go to Vegas and suddenly their money is no longer available?

Mr. RYAN. It would be through an education process, similar to 401(k) plans right now, where ERISA, Employee Retirement Income Security Act, governs which funds and plans can be implemented in this type of retirement package. The same rules would have to apply, as well, to these funds. That is how you could do that. They are doing it right now in the private sector. You should be able to transition these regulations into the public sector, as well.

And if I could just point out a few statistics on the rate of return, currently, under our current system, a $25,000 a year worker loses more than $260,000 under the current system. And when you have someone coming up to you and saying, "You've given me more back than I put in," shortly, in a few more years, you will have people saying, "Hey, I put more in than I am getting back out."

Mr. HULSHOF. Right. Let me interrupt you because my time is about up.

Ms. Canja, I have to tell you that I have had some delightful conversations with the Ninth District of Missouri AARP, Representative Mack Brushwood. He was here this week. He continues to update me and it is great.

Here is—I don't know if dilemma is the right word. As I understand AARP's position, they do want cost of living adjustments, COLAS. They want their COLAs. They are not big fans of individual accounts. AARP is open to raising the normal retirement age but doesn't want to change early retirement age. It doesn't want to increase tax on benefits. It doesn't want payroll tax increases to be our first choice and does believe that reductions in benefits can undermine support of the program.

With those general thoughts of AARP's position, what are we going to do? What options do we have left?

Ms. CANJA. Oh, there are many options. I tried to point out today that really what we are going to need is a broad program with shared sacrifice, and everybody is going to have to give a little something and get something else in return.

There is such a degree within all of those things. For example, if you are talking about taxation of benefits, you can have a different threshold that would be a very moderate change; or, you can have an enormous change. If you are doing a broad package, you can have a variety of changes that—if you do it early enough—you are not going to hurt too many people.

As long as it is fair, as long as it is shared, you are pretty accurate in where we stand now on our feelings on some of these options.

Mr. HULSHOF. Mr. Brushwood has done a good job advising me.

Thank you, Mr. Chairman.

Chairman BUNNING. Mrs. Kennelly.

Mrs. KENNELLY. Yes, I would like to talk to Ms. Briceland-Betts. I have worked with the OWLs over the years on pensions. I have watched the good work that they have done. You have every reason to feel kind of frightened about this whole thing. We have, in this country, older women, divorced older women. If someone is older and in poverty, it is more likely to be a woman.

I look forward to looking at your testimony more closely because you point out some things I hadn't thought about, about what happens when the welfare mother goes into the work force and things like that.

So what I would appeal to you, and I would give the same appeal to the AARP representative, is that if, in fact, and the gentleman with you, Mrs. Canja, was at the same place that I was this morning. We had, as usual in this town, discussions. We are the only ones discussing this, by the way. They don't discuss it that much beyond these doors.

It was suggested that there is a good chance, if we are going to be able to do anything, we will have a grandfather situation where, as you know, in 1983 when we raised the age, no one born before 1960 had their retirement age raised. So there is no way you are going to do anything if you don't have a grandfather situation where those, in fact, collecting benefits now and for the near future will not be impacted.

Are you getting that information out? My first question is are you getting that out to your membership, so you can be part of the solution? What I am afraid of is that particularly groups like the OWLs, that really have seen inequities, and are so frightened about this whole thing that they won't get into the mix to see what we can do right.

And I don't mean you, of course. You are here representing the group. But I mean your members, who are very bright people around the country.

And I am afraid of the same thing with AARP. If you are so against certain things, what are your plans to fix the system?

And what I am afraid of, and the discussion I was in this morning, there are some very powerful people in this country who think they know how to fix it and I am not so sure they do know how to fix it. We, as women, still earn 70 percent of what men earn. We live longer. We are afraid sometimes to make investment choices. And we are going to have low-paying jobs in sales and services for a long time.

So all I am asking is do you have any thoughts on how, in fact, we can bring your membership into a discussion that looks for solutions to the problems of Mr. Green's, and of my three daughters? What I am afraid is that our energy, your and my energy, as one of four women on this Subcommittee, will get lost in protecting the stay-at-home moms and not have enough time for the dual earner who gets less than the stay-at-home mom. We have some huge questions here.

Have you addressed that in your groups?

Ms. BRICELAND-BETTS. Certainly. It is a very important issue. I think that, however, what we emphasize in our testimony is because of the complicated nature of this discussion, we cannot rush into a quick fix. There is not a quick fix here. And if you look at the quick fix that is being considered, it has such a disparate impact on women from now into the future. This is not the overwhelming media myth that women in the future all carry briefcases and are bumping our heads on the glass ceiling. Studies that have been done by groups like Madeline Hockstein and Daniel Yankelvoich Group, Inc., DYG, show that the children of boomers are saying you sacrificed quality for quantity. We can't live on one income in our house but we can live on one and a half. Guess who's returning back to part time, working out of the home, not vesting in a pension.

Yes, we are scared because we are the ones who stand to be seriously injured here, and we know that. And yes, we are working very hard to make sure that those, as you indicated earlier, who have the wherewithal and the knowledge for system and who understand it in its intricacies, when they get ready to make that move, to fix that system, take into consideration the very special dependence that women have.

So we say two things. We must have that education that you are talking about. We have to talk about this for a longer time, so we know what all our options are and the implications of all of these. And second, we need a lot more research before we can move. We are not saying don't move. We are saying don't move so quickly that we do damage that is going to be hard to repair.

Mrs. KENNELLY. I hear you but I also hear Ms. Canja, who says we have to do it earlier rather than later. And if you look at the elections in France that are going to take place on Sunday, what is going to happen if we wait too long is that the baby boomers are going to be that huge piece of voters, as we know older people vote more than younger people, so they are going to be that huge piece of voters. So we have to be very careful.

Look, I agree with you. The education hasn't been done. I can tell you that. There is a certain level of understanding when you have a townhall meeting and then it drops. But we have to start pretty soon, and that is one of the things Mr. Bunning and I are trying to do. The education, yes, but if we wait too long, it won't happen.

Ms. BRICELAND-BETTS. And that is why the kinds of things that we have done traditionally, when we get to this place of Social Security, this isn't the first time we have been here. This isn't we woke up and oh, my goodness, we are in a bad situation. We have done some things over the years to "buy us time" to look at the longer range.

So in terms of raising payroll tax to buy us a longer time of reviewing what we need to do, ultimately with the program it is very important because of the serious implications that any drastic change has for sections of the population.

Mrs. KENNELLY. Ms. Canja.

Ms. CANJA. We have been engaged for a long time now in Social Security education and we are into a major campaign on it right now. We do such things as have forums where we give our members, or whoever is there, a list of options. If you were Congress and you had to come to these kinds of decisions, how would you split the money? How would you make up the deficit for Social Security? How would you make it solvent? And we are engaged in that discussion, so that we are getting feedback, very valuable feedback from our members of what is acceptable, what portion of something is acceptable.

Mrs. KENNELLY. Let me just interrupt. We don't have any cameras here today or any press, so we can talk. You say what do our members need and want. I come from Hartford, Connecticut. My constituents can read annuity tables. They were in insurance. They understand this.

But what I am saying to you is if we just have this group saying "Don't change this; don't change that," where is the flexibility of trying to make Social Security work for my kids, who are Mr. Green's age?

So I am just saying let them have the view not just what I want. I have what I want. The system right now will give you what you want. If you're 50 or older, you are going to get what you have been promised. It is younger Americans that these smart people have to figure it out for.

Ms. CANJA. When we have these forums, we are not just talking about ourselves. These are people with children. They have children and grandchildren and we are saying this is a fix for the future and what can work? What can you see working for the future? We bring our own children into the discussion, so it isn't as though we are just talking to ourselves, to a generation that—let's face it—is not going to be affected as other generations are, as much affected.

So that is our emphasis right now. I think the public has to be better educated or they are not going to accept choices. They see one solution. You were talking about payroll taxes. That probably is not going to be the only thing that would happen in a package. There would be a lot of things. People don't understand that, so they are going to say, ''No, no, no, no'' to one thing, but they might say yes if they saw it was a piece of a broader package that everybody was participating in.

Mrs. KENNELLY. I have to tell you something. I read your magazine every month and I follow everything you have to say and if I don't follow it, I'm told what you have to say. I still think you have to have a little more open window, to know that something is going to happen here, because demographics don't lie.

You have this huge force of people who are very influential on this Congress and we need you to open up and help us.

Let me get Mr. Green in on this.

Mr. GREEN. I want to thank the panel for giving a glorified statement of the problem for the past 10 minutes. However, we need solutions. To sit around idle and state that we need to get more educated, it sounds great and it is great rhetoric, but the education is there, the facts are right in front of our faces.

The Gramlich plan sticks a toe in the water. It doesn't dive in. It merely sticks a toe in the water for the direction in which Social Security should go. It provides a payroll tax that people could get some significant interest on.

We hear all of the arguments about what is going to happen when the stock market crashes? Is the Government going to bail us out? That is great rhetoric and we could focus on the crash of 1987 but the bottom line is that in the 23-year period between 1967 and 1990 when the stock market was clearly flatlining a majority of the time, 5-percent returns were incurred, without dividends being invested. From 1990 to 1997, 13.7-percent returns and 17-percent returns with dividends being invested. All of these figures are indexes of the Dow.

The stock market is not a 10-year hold. When you enter the FICA system at age 21 and retire at 65, it is a 44-year hold. An index of the Dow is clearly a solid long-term investment. It is not a 2.3-percent investment like government bonds. It is not as risk-free as that. But let's use common sense. Let's not use rhetoric. The answers are in front of us. Let's educate the public based on what we have in front of us. Let's not dive in, but let's stick our toe in the water, as Third Millennium is suggesting.

Mrs. KENNELLY. Thank you.

Chairman BUNNING. Thank you. I would like to go back to Mrs. Briceland-Betts. You talked about a quick fix. One thing the Congress does not do is quick fixes, especially with this system.

Mrs. KENNELLY. She said no quick fix.

Chairman BUNNING. I know. She said she is against a quick fix. She can be assured that we will not have a quick fix for Social Security.

We are trying to search out solutions and we are trying to put them all on the table. My good friend and young colleague, Mr. Green, would like action. He thinks all things are on the table. I don't think they are. I think that we know the demographics. We know the possibilities, of what we could do, but we haven't, I don't think, thought out all the consequences of what happens when we do them.

In the early eighties, we did something. We thought the changes would last for 75 years and there was some thought that they might not. Well, the fact of the matter is they haven't and now we are to the point where we are reexamining the system and saying, "My goodness; they didn't last for 75 years."

Now we are going to have to go back and try to project a longer lifespan for the system, without damaging the system. Everybody here agrees that the system has very strong redeeming qualities. It does need some adjustments. That is why I wanted to go to Mrs. Briceland-Betts. The fact of the matter is that we are going to have to adjust those things specifically for women.

Do you have a list of suggestions that you would like to send to the Subcommittee so that we can put them in with the other suggestions that we are getting? You said in your testimony that there are other things that you would like to see done, but we would like the suggestions.

Ms. BRICELAND-BETTS. Yes, sir. We would certainly follow up with that.

I would like to take the opportunity to reply to my colleague here at the table with me that if we move too quickly, the women that we are talking about will not disappear. They depend on Social Security for 79 percent of their income in retirement. Those women are our mothers and our grandmothers. And while we are struggling, and I tell the very personal story of already supporting three generations because I have a mother and mother-in-law who both retired from retail and I have a small daughter, because of delayed childbearing. We support three generations in our household, and that is with Social Security in place.

If we move too quickly and have too much of a serious impact on those women, those women will come back home and that sandwich will become a club sandwich because we live longer and we will be carrying two generations up and one back. And then if you want to talk about the impact on the ability of these young men and women to be able to save for their retirement, we will have very, very serious and quick discussions, sir, as Congress.

This issue is very serious. We may not have the answers today but we certainly have a responsibility to raise the very special dependency of women on this income.

Chairman BUNNING. Well, I am not going to dispute that with you but that is why we are doing the hearings. We are the only ones doing the hearings. Everybody else brought their suggestions and said, "Here is the way to fix it," or "Here are suggestions on the way to fix it."

If we are going to fix it, we want to make sure that we have your suggestions on the table. So you have to bring it to the table so we can have it.

Ms. BRICELAND-BETTS. Yes, sir, we have. Our fixes that we brought to the table here, I haven't heard people address. What we have been saying is the fixes they brought to the table are not fixes. And we also brought some things to the table here today and I refuse to sit here and have it implied that we didn't come here ready to discuss this.

And what we are trying to do is to discuss all of the issues that are on the table and make sure that we understand the implications of all of them that are here.

Chairman BUNNING. You are missing my point. We had someone testify that they would like not to see too much change and we need to know all the facts and figures about how women specifically are impacted under the present system, which you have brought out very clearly. And if we are going to make sure that they are not impacted adversely in a change or a reform of the system, we need your assistance in doing that.

Ms. BRICELAND-BETTS. That is right.

Chairman BUNNING. That is what I'm making sure that we understand.

Ms. BRICELAND-BETTS. Thank you.

Chairman BUNNING. Mr. Portman, would you like to question any of the witnesses?

Mr. PORTMAN. Thank you, Mr. Chairman. I apologize that I couldn't have been here earlier. I had a bill on the floor and I would like to have been here because I wanted to hear all the witnesses. I do have a couple of questions.

First, Mr. Green, you testified today about your group's interest in having some sort of private account established and what I would like to know from you, and again I apologize that I wasn't here to hear it and you may have already answered it: Have you talked about how this Congress and how your group and others might better educate people in your generation and my generation, being a baby boomer, as to the issues and to begin to develop a consensus on this, which I frankly don't see out there yet?

Mr. GREEN. As we discussed before, our generation, what is called Generation X, is clearly turned off and has a lack of trust of the leaders in this country, for different reasons which we could probably discuss all day.

Generation X has a choice. Our choice was to do something about this distrust and get educated to make a difference, or choose the ignorance-is-bliss attitude. Our generation has chosen the latter and we are not happy about it.

Part of the goal of Third Millenium is to stand in front of legislators like yourselves and make a difference and be heard. But a big, big part of what we do is to educate our generation, because if young people don't have the education, we can't become a force.

Right now we are in a membership drive to increase upon our 2,000 members. Quite frankly, we need a cash infusion for that and that is what we are working on, raising private donations. Otherwise, it is not going to happen. I am sure that this importance of dollars is understood here in Washington, too.

What we do is, we get people together and educate them. About a month ago we had a group of 600 people in a room who really didn't understand Social Security. We had a benefit in New York

City, and the equivalent of what I am doing here today, we got up on a platform—I call it a soapbox—and explained what is going on with Social Security. I have to tell you, the people in that room were very educated; they did not have an education as to what is going on. And when these young people do have the education, they will go out and do something about it.

I would invite young people like myself on the Hill. I would have a media event day with all the young media types, MTV and such. You should go to college campuses, have townhall meetings on college campuses, just like Third Millennium does.

Mr. PORTMAN. Let me follow up with Mr. Ryan and others who may have some interest in the educational aspect. All of you have interest in it, I know.

The PEBES statement has been controversial to the extent to which it is online and there might be access, to people's private information. This is something that, thanks to Chairman Bunning, we had a hearing on right away and talked about the pros and cons. It is a difficult issue for a lot of us.

How do you all, to the extent we have time here, if you all could just go down the line, maybe Congressman Boulter first, how do you all feel about the online issue with PEBES? Do you think it is a valuable information tool? I think it is. Should it be online, and the extent to which that should be a factor in the consideration of where we go next.

Mr. BOULTER. Well, I personally have a lot of concerns about the privacy issue and we really haven't addressed it specifically, Congressman, but I do want to let you know, because we all are interested in the educational process, that Mr. Green's organization, in fact, is represented on the National Advisory board of our foundation. We have started the foundation to look into some of these issues, headed up by Dorcas Hardy, Social Security Commissioner, under Presidents Reagan and Bush, and we have participated in a number of forums.

On the privacy issue, except for a general feeling of concern, we haven't really addressed it.

Mr. PORTMAN. Mr. Green.

Mr. GREEN. We haven't addressed it.

Mr. PORTMAN. Ms. Briceland-Betts.

Ms. BRICELAND-BETTS. I think the privacy issues are very serious but I think that the education value—there should be something there that highlights Social Security, the issues in Social Security and perhaps a form that people could print out and fill in and send off, something to give them urgency to get more information. Perhaps online is too——

Mr. PORTMAN. Something that they can print out and send back and get in the mail something that is more private?

Ms. BRICELAND-BETTS. Exactly.

Mr. PORTMAN. Interesting idea.

Mr. Ryan.

Mr. RYAN. For purposes of education, what we are doing on our website currently is to have users type in what they make, date of birth, and other relevant information to calculate a benefit. So we don't have to have personal information on the Internet. That would produce benefit estimates of what they will get back from the Social Security system, and under a privatized system. Those software packages are already modeled and can be in use. We are just uploading them right now.

I think that would be an excellent solution for people to find out the benefit differences between privatization and keeping the current pay-as-you-go system.

Chairman BUNNING. Mr. Ryan, thank you. I am going to have to cut my good friend from Ohio a little short because his bill is being voted on on the floor right now and I want to make sure that he gets a chance to vote on it.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman BUNNING. Go ahead, Mrs. Kennelly.

Mrs. KENNELLY. And he has allowed me to say a few more words. I just want to say to Ms. Briceland-Betts that being on this Subcommittee and being the Ranking Member of the Social Security Subcommittee, I have done a bit of reading about Social Security and over the years, there were inequities for women.

So what I am saying to you today is that I am glad to see you there and I am glad to see me here and I am glad to see Mrs. Canja there because what I found out was there weren't any women on those particular Subcommittees when the changes took place, and there weren't any head staff on those Subcommittees.

So this is going to be a rough and tough and interesting debate, but we have to make sure we are in the room.

Chairman BUNNING. And I want to assure the panel that I have Generation X children and grandchildren very interested in Social Security. That is why I am having these hearings.

I want to, first of all, thank you all for your testimony. If you have specific recommendations, please send them in to us. If we have some questions that we would like to explore with you, we reserve the right to send the questions to you and it would be very helpful if you would answer those questions.

[Questions were submitted to the panel from Chairman Bunning. The responses follow:]

THE RESPONSES OF MR. BOULTER

Question 1. One concern that has been repeatedly expressed is the rate of return that Social Security provides, especially for younger workers. United Seniors Association supports raising the normal retirement age and changing the benefit formula to reduce the growth of Social Security benefits for future retirees. Is this fair to younger workers? What do you think employer reactions might be, should they be expected to retain older workers?

Response to Question 1:

You observe that many people voice concern about the relatively low rates of return that Social Security will provide future retirees. You then ask whether it is fair to younger workers to raise the retirement age and change the benefit formula to reduce the growth of Social Security benefits for future retirees.

If you ask the question without considering the private investment reforms United Seniors Association favors that would more than compensate for any loss in benefits caused by raising the retirement age or changing the benefit formula, there may be a strong presumption that it is not fair to younger workers.

Younger workers know they are not going to get a very good rate of return on Social Security. Therefore, if we devise a package in which we can substantially improve the rate of return, I believe younger workers would accept some change to the retirement age and future benefits promised by the program—especially in light of the fact that so many of them don't even believe they will see those promised benefits anyway. In other words, it isn't very meaningful to promise younger workers a large safety net if they can look down from the heights and see how tattered and frayed it is. They aren't going to want to have to rely on it anyway.

Your question concerning what employer reactions might be to retaining older workers is an interesting one in light of current employer behavior that is, in many cases, unfavorable to older workers. In the future, however, when employers will need workers due to several reasons, including the so-called baby bust, employer reactions should be quite favorable.

In summary, whenever we talk about the future of Social Security and what reforms might be instituted, it is important that we always keep them in context so the American public can see the whole picture.

Also, I believe a few things must happen if we are to have real Social Security reform. Younger workers must assure retirees that reform will not entail cutting current benefits. And retirees must assure younger workers that they will help them put in place reforms that will guarantee their retirement security for the future. In other words, we need an intergenerational understanding that will protect the interests of both young and old alike.

Question 2. You support individuals having full control over the management of their own personal accounts. What about the concerns raised by many that low income workers may not do as well, or that individuals may not make wise investment choices?

Response to Question 2:

Clearly, we do not have in mind allowing individuals to take all of their retirement funds and put them into high-risk investments. Not so much because we believe government should be paternalistic toward individuals—it should not—but rather because the only way to maintain the integrity of the system is to have rules that require prudent management of retirement funds—no different than we already have under ERISA for private retirement funds.

Such a system would take care of most everyone. For low income individuals and those who may not make wise investment choices even within the ERISA-like constraints, of course we must have a safety net provided by the government. However, our point is that these individuals will be the rare exception to the rule and that the system should be designed to deal with them as exceptions. A retirement security system for the 21st Century should not be premised on the few exceptions but rather on the vast majority of individuals who can and will provide for their retirement if only government provides them a conducive economic and programmatic environment in which to do so.

As I mentioned in my testimony, I think there may be an emerging consensus as to what a newly-restructured Social Security model will look like. Perhaps the best senior citizens' economic security program would be one that combines two elements: an Old Age Insurance plan (which would serve as the safety net) and a Personal Savings Account plan (which would give people the opportunity reap the rewards of long-term investment).

Under such a model, we would have the best of all possible worlds. Individuals, having saved and invested over a working lifetime, would retire with real wealth and security and have far better benefits than would otherwise been provided by Social Security. On the other hand, all individuals would have the basic social protections provided by the current system.

THE RESPONSES OF MR. GREEN

1. *Q:* You indicate that each time Third Millennium has testified, you tell your elected representatives to raise the retirement age to 70, means-test benefits on a scale recommended by the Concord Coalition and transform the system over time to one that includes private retirement accounts.

In a previous hearing in the series, we heard testimony indicating that two of the three Advisory Council proposals would increase budget deficits for as many as 30 years. Over the first 10 years, the Personal Savings Account Plan, which I assume is similar to what Third Millennium would support, would cumulatively divert $1.8 trillion into the markets by diverting 5 percentage points of the Social Security tax rates into personal accounts.

This loss to the Treasury would have to be made up somehow, through increased federal borrowing, increased taxes, or cuts in spending. Wouldn't this cause a double burden on younger workers? Has Third Millennium discussed ways to ease the cost of transition to a personal account system?

A: You bring up several very good points, Congressman—I'll take them in order. First, as to the issue of increased deficits—the public should not mistakenly believe that the choice is between large transition costs or no costs (and thus no reform). It must understand that the choice is between paying to build a better program today or paying to bail out a failed one tomorrow.

Moreover, we should understand exactly which methods of financing involve which burdens. Should we choose to finance entitlement reform through increased borrowing, there is no "double burden" on younger workers, because the bill, like so many of our other bills that together make up the national debt, will simply be handed down to later generations and the increased borrowing will offset the savings realized in Social Security dollar-for-dollar. However, this is a poor method of financing, not least because it constitutes asking our children to pay our bills. It would also increase the portion of the U.S. budget that goes toward paying interest on the national debt, which would stall America's progress toward a balanced budget. If we fund the transition through taxes, then there is indeed a double burden on the generation or generations paying those taxes, but those same workers will also realize a gain in Social Security savings.

I believe we all understand that the trust fund is borrowed in its entirety every year to offset the yearly deficit, with cash from Social Security being exchanged for special Treasury bonds. From Franklin Roosevelt's onward, every Administration has termed the trust fund a debt of the U.S. government, not an asset. Any move to change this—such as the Advisory Council proposals you mentioned—immediately results in a loss to Treasury. However, the sanctity of the Social Security system itself depends on reforming the trust fund. The question before you and your colleagues, Mr. Chairman, is whether the loss to Treasury will occur and be dealt with now, with time for deliberation and in a sound economy, or whether the loss to Treasury will occur 15 years from now, in economic conditions we cannot predict, when Social Security begins redeeming the bonds it now holds in the Trust Fund to pay benefits to the Baby Boom generation.

Please keep in mind that while Third Millennium does back some of the concepts embodied in the Personal Savings Account plan, we have endorsed no specific reform plan. We believe there is much more public education to be done. In order to minimize the impact of transition costs, though, we do lean toward diverting a smaller percentage of income than the PSA recommends, at least in the beginning. Perhaps something on the order of two percentage points should be explored and pilot-tested before we commit ourselves to diverting five. We have read and considered other ways of financing the transition, and our position is that the cost of the transition cannot accurately be determined until we see precisely what measures entitlement reform will involve. Once that is established, we will have solid numbers and we can then begin the discussion of how to ensure that the transition does not impose a painful burden on any segment of society—economic or generational.

You ask if reform now does not constitute a double burden on young adults, and I must honestly tell you it does. Indeed, it does not seem quite fair to place the burden of reform so squarely on the shoulders of the very workers who faced up to Social Security's deep problems and vowed to fix them. There will be transition costs, and Third Millennium believes that our generation is prepared to take the lead now in order to avoid disaster later. But all generations alive today should shoulder some of the burden. A reformed Social Security system has the potential to give retirees larger benefits, taken not from the wages of their children and grandchildren but from their own equity stake in America's economic growth. It also has the potential to give low-wage retirees benefits larger than they could have received under the current system, lifting them financially and improving their standard of living. It can address 21st-Century demographic projections rather than inaccurate 1930s ones regarding the length of retirement and lifespan. And finally, it can lift the burden of supporting elders from the backs of our children and grandchildren and give them the freedom to keep moving America forward in long-term prosperity. We believe these goals are worth achieving. Third Millennium is not the "gimme" group for our generation. Our philosophy is in our name—Third Millennium: Advocates for the Future.

2. *Q:* We have heard repeatedly, in testimony before the Subcommittee, that today's Social Security system provides very poor returns to most workers for the investment they make in payroll taxes. While there are certainly arguments regarding the importance of rate of return to the overall debate about Social Security, your testimony stated that Third Millennium supports raising the normal retirement age, which would ultimately reduce the rate of return for younger workers. Why does your organization support raising the retirement age?

Are your members at all concerned that it may be more difficult for employers in some industries to retain younger workers if advancement and salary increases are slowed because of the retention of senior workers?

A: Third Millennium's reason for supporting an increase in the retirement age can be summed up in one word—demographics. The normal retirement age has not changed since Social Security's inception in 1935. Since that time, according to the Bipartisan Commission on Entitlements and Tax Reform, life expectancy has increased by 17 years—most of them far healthier and more active years than in the past. Social Security was meant to support the aged in their final years. Now it supports a vibrant group for decades—and supports them with more money in benefits than they paid in taxes.

The rate of return is an important consideration for Social Security, but it is insanity to allow Social Security policy to be governed by 1930s assumptions regarding lifespan—especially when we know, and have known for decades, that those assumptions were wrong. Considering the relative wealth, health, and sheer size of the generation about to enter Social Security, stepping up the retirement age to fit current lifespan projections ile and Jon Bakija of the Urban Institute, writing in Retooling Social Security for the 21st Century, suggest that the government set a number of years during which seniors should draw Social Security and let the retirement age float with increasing lifespans, so that when the lifespan increases so does the retirement age. Again, this will lower the rate of return for younger workers, but it will also save the program from its projected insolvency. Current return rates are unrealistic. Let's face facts, Mr. Chairman—Social Security is today a great deal for exactly one generation, the one alive when it was enacted. For Baby Boomers and for everyone after them, it is a lousy deal, one that grows worse every year that passes without reform. No generation that finds UFOs more credible than Social Security believes it is going to receive the same return rates as today's seniors.

Regarding the second part of your question, I do not believe that young workers today will face employment crises due to the retention of older workers. The Baby Boom, the largest generation in American history is leaving the workforce, and following it is so-called "Generation X," a demographic only about half as large as the Baby Boom. Even with the retention of Baby-Boom workers for an additional few years—and keep in mind that any increase in the retirement age would be phased in over a number of years, not enacted immediately—I believe there will still exist a great deal of opportunity for today's young adults.

THE RESPONSES OF MS. CANJA

Question 1: In your testimony, you discussed reasons why AARP believes Social Security should not be replaced with individually controlled accounts, and that public policy could encourage greater savings outside Social Security through existing vehicles (IRAs, 401(k), etc.). You also agree with the Advisory Council finding that Social Security benefits should bear a reasonable relationship to contributions plus interest, which they clearly won't in the future, especially for younger workers. How do you suggest we go about increasing public confidence in the program?

We recognize that many young workers, despite strongly supporting Social Security, lack confidence in the system's ability to continue to pay the same level of retirement benefits in the future. The lack of confidence, while disturbing, is not surprising, and it reflects an array of factors, some attitudinal and some programmatic. Many of today's workers are skeptical about the ability of any program or institution, not just Social Security, to sustain itself over the long-term. From a programmatic perspective, the lack of confidence in Social Security reflects the widely held view that the government has mismanaged the trust funds, including the notion that the funds have been stolen. The public also believes Social Security benefits are too low and will be worth even less in the future. Finally, as you know, the public confuses Social Security and the Supplemental Security Income program, a needs-based program financed out of general revenue and run by the Social Security Administration (SSA). This confusion contributes to the widely held view that the Social Security program is mismanaged and paying out benefits to those who did not earn them.

Restoring the public's confidence in Social Security will require a significant public education effort on the part of many, particularly SSA, Members of Congress, and groups with a stake in the future of Social Security. The message must be clear: while Social Security has a long-term financing problem, it is not in or near crisis. The public must understand that Social Security is not on the verge of bankruptcy, and that even beyond 2029 (the current projected date for exhaustion of the trust funds), the system has sufficient incoming revenue to cover about 75 percent of the benefits currently promised. For too many years, and from too many sources, Americans have heard gloom and doom scenarios for Social Security that greatly exaggerate the program's financial problems. American workers need to know that Social Security's long-term financial condition can be improved with modest incremental reform. Education efforts must also place greater emphasis on the value of the social insurance aspect of the program—particularly the survivor and disability components of the system—since the value to current workers would demonstrate to younger workers that the program is protecting them now.

Question 2 (part 1): AARP believes that any increase in the normal retirement age should be accompanied by policies promoting expanded job opportunities for older workers. Do you have any specific policies to suggest?

For many older workers, expanding employment opportunities will require little more than fair and equitable treatment. Better enforcement of the Age Discrimination in Employment Act, particularly with respect to on-the-job training, is critical. Below are a number of specific policy suggestions for promoting job opportunities for older workers.

- Training: Despite improvements since the early 1980s, older workers remain underrepresented (and receive fewer hours) in employer-provided training programs. Yet, employers complain that a lack of technological competence is one of the major weaknesses of older workers. Continuous training and retraining will increasingly be required of all workers who want to remain employable. Efforts must be made to ensure that a revamped job training system does not shortchange older workers.
- Recruitment and Retention of Experienced Workers: Employers must rethink their perception of older workers as an expense and begin to view them as a reservoir of talent and experience. Many businesses have already implemented programs and policies that attract and/or retain older workers. Some options, like phased or gradual retirement,[1] are specifically geared toward older workers, but other options, such as enhanced part-time employment, job sharing, job redesign, and flexible and alternative work schedules, can help employers attract the best workers of all ages. Adjustments to employee benefit rules may be needed to accommodate and encourage these employment practices.

Question 2 (part 2): I'm sure many of your members are employers. Have you thought about whether raising the retirement age will make it more difficult for employers in some industries to retain younger workers if advancement and salary increases are slowed because of the retention of senior workers?

There is relatively little evidence either from the United States or abroad that older and younger workers compete for the same jobs. The changing nature of work and employment in the United States, e.g., the leveling of the corporate pyramid, frequent corporate restructuring to meet changing demands, the growth of the contingent workforce, the expansion of part-time work, and a decline in job tenure also suggests that the stereotypical career pattern of upward mobility in a single firm will become less and less common. Lateral mobility, along with numerous career and job changes throughout the worklife, are more likely to be the norm.

Furthermore, contrary to conventional wisdom, "established" retirement ages bear very little relationship to the opportunities for advancement and salary increases available to younger workers. This is true even in the few industries still permitted to set a mandatory retirement age (sometimes as young as 55 in some jobs, e.g., police officers and firefighters in some cities).

There are a number of reasons for this. First, despite the general elimination of mandatory retirement in the U.S., the average voluntary retirement age—the age at which people choose to retire, without any coercion from the employer—has steadily declined over the past 15 years. It is now approximately age 62. The voluntarily departure of older employees opens up jobs for younger workers to advance.

Second, employers have at their disposal a wide range of legal (and often desirable) methods of encouraging workers to leave the work force voluntarily. These exit and early retirement incentives can take many forms: supplements to a pension benefit, lump sum cash payments, retiree health benefits, etc. Indeed, the federal government frequently uses such "buy-out" plans to accomplish workforce

[1] Phased retirement programs allow older workers to reduce their work hours for a period of time in their regular job before retiring. With phased retirement, wages are generally reduced, benefits may be prorated, and a partial pension plan may be available. However, workers may be constrained from accepting phased retirement if they participate in defined benefit pension plans that base pensions on average salary in the *final* years of work. A reduced salary from reduced work could result in lower pension benefits. This issue must be addressed if phased retirement is to be promoted.

downsizings and adjustments. So long as the benefit plans are not denied to workers above a certain age, and are not used to *coerce* older workers out of their jobs, they are legitimate tools for workforce management.

Despite these existing means to manage a workforce, employers remain hesitant to hire and keep older workers. While a strong argument can be made for the retention of highly skilled, experienced, and loyal older workers, these workers are all too often forced, either subtly or not too subtly, to retire. Unless and until attitudes towards older workers can be improved, raising the retirement age remains problematic.

Thank you for the opportunity to provide the Committee with our views on Social Security solvency and the opportunity to comment on issues of importance to you. If you need additional information, please contact Evelyn Morton of the Federal Affairs Department at (202) 434–3760.

We like the way the testimony is coming in for these hearings and we really appreciate your participation. The Subcommittee stands adjourned.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]