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EDUCATION AND RESEARCH FUND

Social Security Reform December 3, 1998
Submission of Dallas L. Salisbury, President, EBRI

The Employee Benefit Research Institute (EBRI) joined others in early 1995 to launch a national savings education campaign. That work led to the SAVER Act, a 1998 National Summit on Retirement Savings (see more at www.saversummit.org), and the launch of a major print and broadcast education campaign called Choose to Save™. That campaign, in print and radio form, is now being used across the nation (see more at www.choosetosave.org). EBRI and its partner organization, the American Savings Education Council, were the private sector co-organizers of the summit.

The summit led me to three clear conclusions, which were highlighted in my opening presentation and in the final summit report. First, Social Security and pensions do not provide enough income for most Americans to have a comfortable retirement. Second, any change to Social Security must be undertaken with great care if it is to do more good than harm in terms of retirement income, survivors' benefits, and disability benefits delivery. Third, the nation is not yet doing enough savings and investing education to allow a smooth transition to individual choice in Social Security for at least 60 percent of the labor force, those who are not yet saving.

As a result, EBRI has both accelerated its own educational efforts and expanded its work on the analysis of alternative methods of Social Security reform, towards our constant objective: "informed design and decision making."

We first published a major Social Security reform study in 1983, which included a chapter on individual accounts. Like every other study on the subject published since that time, the focus was on philosophy and average numbers. The numbers have been projections of how individuals would fare-"on average"-given assumptions about contribution rates and investment returns. The analysis of individual accounts published to date has been lacking in a number of ways.

First, most of the analyses ignore survivors' benefits as a value of the present system. Second, most assume that all account holders get the same rate of return, and that this rate of return is above the bond rate but below a pure equity rate. Third, they use static analysis without consideration of investment risk, and present findings as if there is not any dispersion around the mean. Fourth, they simply assume that all forms of individual accounts are possible.

EBRT began work in 1996 to overcome these weaknesses in the way Social Security reform alternatives are assessed.

First, we worked to develop a stochastic model of the Social Security program that shows a distribution of possible reform outcomes, allowing you to see the winners and the losers within a cohort, not just the average for a cohort. Further, survivors' benefits are built into the model to allow a fuller comparison of the present system relative to an individual account system (see http://www.ebri.org/SSProject/sslisting.htm).

Second, we began working with the Investment Company Institute and major 401(k) record keepers in 1996 to develop a comprehensive data base that would allow us to input into the Social Security model information on how different individuals invest by age, income, and tenure. This allows real investment allocation variation to be used to assess likely investment

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allocation, and rates of return, in an individual choice system.

Third, we began detailed administrative implementation analysis to assess what type of individual account might actually be possible given the current structure of the labor force and the current state of employer action in making SSA filings with the government. We considered the call of many advocates of individual accounts for a design that would not increase the work of small employers.

We concluded that any plan to reform Social Security by adding individual "defined contribution" accounts must address important logistical challenges and trade-offs that have been largely unrecognized in the reform debate. Such considerations will actually determine whether we can have individual accounts in Social Security, in what form, and in what time frame.

As an organization with **20** years of experience in administrative issues pertaining to employment-based savings plans, we found ourselves in a unique position to shed light on some important issues surrounding the administration of Social Security individual accounts. We've also seen Congress repeal laws such as the Medicare Catastrophic Coverage Act of 1988 and the Internal Revenue Code Section 89 "nondiscrimination" rules for health insurance plans (Tax Reform Act of 1986) because administrative issues were not worked out before reform was passed.

Our new survey of small employers' attitudes toward individual accounts (www.ebri.org) underlines the importance to small employers of not adding substantial administrative burdens or costs and not increasing payroll taxes to pay for individual accounts.

Our new *Special Report/Issue Brief* lays out the facts and trade-offs, in the hope that others will use them to examine whether and how an individual account system might be designed to achieve policy goals.(http://www.ebri.org/1198ib.pdf)

The major findings of the EBRI analysis include:

- Adding individual accounts with investment choice to Social Security could be the largest undertaking in the history of the U.S. financial market. No system to date has the capacity to administer such a system, and it would take years to design, implement, and debug a new system and new software. The Social Security Administration now has a system that could be modified, but with substantial programming and design time required.
- Direct comparisons between employment-based retirement savings plans and Social Security reform proposals are tenuous at best. Social Security covers a substantial number of workers and businesses that have traditionally not participated in employment-based plans.
- Credit-based systems such as the current Social Security program are less difficult to administer than cash-based systems, which must account for every dollar-and in an appropriate timeframe-in order to avoid lost retirement income.
- Social Security individual accounts cannot be administered like 401(k) plans-i.e., by making account contributions each pay period through payroll deduction-without adding significant employer burdens, especially on small businesses.
- If legally subject to personal property claims, individual accounts could pose administrative challenges.
- Individual account benefits would be highly sensitive to administrative cost. So much so, in fact, that a "socialized basis point" charge would be essential, as compared to a per account charge, if the lowest income individuals are to experience any meaningful account buildup.

The tools are in place to allow this Social Security reform debate to be the most substantive/fact-based in history. Those who set forth proposals will have them tested for validity and results, by EBRI and others. The ultimate result should be a better policy outcome.

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SIA: WHITE HOUSE CONFERENCE WILL ENGAGE NATION IN DEVELOPING BIPARTISAN SOCIAL SECURITY REFORMS

Solutions Should Include Personal Savings Accounts, Preserve Basic Guarantees, Offer Choices, Create No New Burdens, Hold Costs To A Minimum

Securities Industry Volunteers Expertise, Experience To Help Policymakers

Washington, D.C., December 8 – In welcoming the White House Conference on Social Security, the Securities Industry Association today outlined five principles that it believes should guide Social Security reforms and volunteered its expertise on retirement policy, investor education, and capital markets to help policymakers develop long-term solutions.

"Americans of all generations believe that the Social Security problem is real and needs to be addressed now," said Marc E. Lackritz, SIA's president. "The White House conference provides a unique window of opportunity to build on that consensus and start forging bipartisan agreement on solutions. It's imperative that our country have a viable Social Security system that will be there for tomorrow's retirees as it is for today's"

The solutions developed by policymakers, Lackritz said, should be based on principles that would: promote the preservation of the broad intents of the original Social Security system; and, encourage developing the system to give individuals greater control over their retirement assets, greater choice and flexibility in deploying them, and greater stewardship over their financial futures.

These principles as proposed by SIA are:

- **Any solution to Social Security should include some type of personal savings account.** Such accounts would increase net savings and introduce more Americans to the basics of savings and investing. This approach would continue the system's fundamental fairness by providing all American wage-earners with the same investment opportunities.

- **Basic guarantees must be preserved.** Social Security made the American wage-earner a promise: there must be a minimum guarantee equal to that now provided to America's families. That includes the right now extended through Social Security to change jobs without losing the benefits, assets, or basic rights the system delivers. Social Security reforms cannot change that promise; they must only improve the way in which Social Security delivers on it.

- **Individuals must have choices.** If working families are to invest through the Social Security system, they should be allowed to make choices that reflect their differing individual circumstances. Families of different ages, incomes, and preferences will have different approaches to investing for the future. We must recognize and allow for those differences.

- **No new burdens.** Changing the system must not become a pretext for creating new burdens for employers. There should be no new payroll taxes and no new reporting requirements or paperwork for employers.

- **The costs must be minimal.** Investing in securities to earn a higher return only makes sense if the system's costs don't balloon. The system must be structured with minimal costs. The wage-earner's assets and benefits should not be eaten up in administrative fees. This means that the discipline of competition must be built into any system for private investment of Social Security resources.

The securities industry, Lackritz said, has extensive experience in helping tens of millions of Americans plan their investment strategies through Individual Retirement Accounts, 401 (k) plans and other savings programs. "SIA is committed to using its experience and expertise to solve any problems that may arise in the administration of personal savings accounts," he said.

"We look forward to engaging in a constructive solution that is vitally important to all Americans. We pledge to help Congress and the Administration resolve issues that may arise as Social Security reforms move toward being enacted," Lackritz said.

FUNDING SOCIAL SECURITY: A STRATEGIC ALTERNATIVE
Laurence S. Seidman**

** Professor of Economics at the University of Delaware, author of the article, "Funding Social Security," *Tax Notes* October 12, 1998, p241-49 (available on request: phone, 302-831-1917; e-mail address, SeidmanL@college.be.udel.edu), and the book, *Funding Social Security: A Strategic Alternative*, Cambridge University Press, New York, 1999, l-800-22 l-45 12).

My article and book present the case for funding social security. Funding social security is not a new proposal; its basic components have been recommended by other advocates of social security reform.

There are two middle positions between our current pay-as-you-go (PAYGO) defined-benefit social security, and privatized defined-contribution social security. One is PAYGO social security with supplemental individual defined-contribution accounts. The other is *funded social security*.

Funded social security is a defined-benefit plan. Funded social security is achieved by preserving the current U.S. social security defined-benefit formula, and gradually shifting the financing from payroll taxes to a mix of portfolio investment income and payroll taxes.

Funding social security has two distinct essential elements: fund accumulation, and portfolio diversification.

Fund accumulation requires gradually adjusting tax rates, ceilings, and benefit rates to achieve substantial annual surpluses. Protection from the payroll tax increase is given to low-income workers by expanding the earned income tax credit. A large permanent capital fund would then accumulate gradually over the next century, and the fund's annual investment income would eventually enable a permanently lower payroll tax rate.

Portfolio diversification is achieved by having the social security administration contract with private investment firms (under competitive bidding) to invest this capital fund in a conservative diversified portfolio of government bonds, and corporate stocks and bonds.

With *funded social security,* all investment risk is pooled: there are no individual accounts. Private investment firms manage social security's portfolio the way they manage the portfolio of conservative risk-averse private clients. Funded social security avoids excessive reliance on either government bonds (because the yield is lower) or corporate stocks (because the risk is higher). The investment firm handles stock voting as it does for private clients.

Funding social security will eventually double the return that workers obtain on their saving-- from 2% to 4%. In a mature PAYGO system, the return equals the growth rate of real output---roughly 2%. With funded social security, the return will be roughly 4% (the average of a 6% return from corporate stocks, and a 2% return from government bonds). This doubling of the return makes a tremendous difference over a person's lifetime. For example, consider a worker age 45 saving $5,000 that year. Compounded at 2% per year it grows to $7,430 at age 65; compounded at 4% per year it grows to $10,956.

Funded social security rests on a cautious and realistic view of the stock market. It is important to emphasize two points. First, funded social security uses payroll taxes as well as portfolio investment income to finance benefits. Second, the portfolio is conservative: government bonds constitute an important share of the social security portfolio.

Like the current U.S. social security system, funded social security is a defined-benefit plan where each retiree's benefit is linked to the retiree's own wage history by a legislative formula; the benefit does not directly depend on the performance of the portfolio. If portfolio earnings fall, then a fraction of the portfolio must be sold to finance legislated benefits. However, if the portfolio performs poorly for several years, then either the legislative formula must be adjusted or payroll taxes increased. Thus, indirectly, benefits are eventually affected by portfolio performance: funded social security does not eliminate stock market risk. But it minimizes the risk for the individual retiree by pooling the risk over all retirees, utilizing a conservative diversified portfolio invested in government and corporate bonds as well as corporate stocks, spreading the risk over time by selling fund assets as a first resort while adjusting the legislated benefits formula only as a last resort, and using payroll taxes as well as portfolio investment income.

It is crucial to recognize that fund accumulation and portfolio diversification are separate components. It would be possible to have fund accumulation without portfolio diversification: social security could accumulate a large fund, but invest it solely in special non-marketable low-yield government securities (as it does currently under the U.S. Social Security system). Conversely, it would be possible to have portfolio diversification without fund accumulation: social security could maintain only a small fund, but invest that fund in a mixed portfolio. The term *funded social security* implies both components: a large capital fund invested in a diversified portfolio.

Fund accumulation is the key to raising the capital accumulation of the economy, while portfolio diversification is the key to capturing a larger share of the economy's capital income for the social security system.

Funded social security would be completely separated from the Federal budget. Congress would be expected to balance the budget without counting social security. One purpose of converting social security from PAYGO to funding is to raise the national saving rate. This purpose would be defeated if an increase in the social security surplus by $100 billion permitted Congress to increase the deficit in the rest of the budget by $100 billion.

There is no way to escape a transition cost if the objective is to raise the national saving rate through the funding of social security. Raising the saving rate entails a short run cost in order to achieve a long run gain. The cost is borne as a combination of a transitional tax increase and a temporary slowdown in benefit growth.

To protect the capital fund from a raid, each worker would be sent an annual statement that provides an estimate of his retirement benefit. The key to deterring a raid on the capital fund is to make sure that current workers realize that it is their future benefits that are being raided. If the fund is drawn down, then its investment income will be lower in future years, and so will social security benefits. If the Social Security Administration sends each worker an annual estimate of his expected retirement benefit, based on current tax rates, benefit rules, and the size of the fund and its investment income, then a raid on the fund this year would reduce each worker's expected benefit in next year's annual statement. With annual individual benefit estimates, members of Congress would be deterred from voting for a raid.

Common Objections to a Market-Based Social Security System: A Response
by Melissa Hieger and William Shipman

Executive Summary

The debate over whether Social Security needs to be reformed is largely over. The question now is what type of reform. Many experts suggest moving toward a saving and investment structure wherein some portion of the Social Security tax is invested in markets.

Opponents of privatizing Social Security, however, warn of numerous and formidable risks associated with markets. Among other issues, they raise questions of market risk, retirement benefits of low-income workers in a privatized structure, potential difficulties for unsophisticated investors in a market-based system, and the plight of survivors of deceased workers.

None of these objections survives a careful examination of the evidence. In fact, most represent a misunderstanding of financial markets and Social Security and how a privatized Social Security system would work. For example:

- Critics claim that private markets are dangerously risky and that only knowledgeable and experienced investors can successfully handle such risks. In reality, however, long-term investment in private capital markets is less risky than the current Social Security system and can be handled by even inexperienced investors.

- Because Social Security has a progressive benefit formula, some assert privatization would hurt low-wage workers. Moreover, others claim that a privatized system would appeal only to the wealthy and most savvy investors. However, because of its much higher returns, a privatized Social Security system would actually benefit low-wage workers and would appeal across all individual income and education levels.

- One of the most common criticisms of privatization is that private financial institutions would charge excessive fees, thereby reducing retirees' returns to unacceptable levels. However, actual fees and administrative costs for existing investments are generally well below 100 basis points (one percent). Assuming fees of this magnitude, yields would still be much higher than benefits currently provided by Social Security.

- Finally, critics claim that a privatized system could not provide survivors' benefits. In reality, a market-based retirement system would provide better survivors' benefits than the current system.

To read the rest of this paper, visit www.socialsecurity.org.

Melissa Hieger is a vice president and William Shipman is a principal with State Street Global Advisors. Mr. Shipman is co-author *of: Promises to Keep: Saving Social Security's Dream* and co-chairman of the Cato Project on Social Security Privatization.

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"SOCIAL SECURITY: WHY ACTION SHOULD BE TAKEN SOON"

The following statement is an excerpt from a report issued in July 1998 by the bipartisan Social Security Advisory Board, entitled "Social Security: Why Action Should Be Taken Soon."

"The Nation is engaged in an important discussion about the future of Social Security. There are many views about the kinds of changes that should be made. Whatever one's views, essential facts should be agreed upon. The purpose of this paper is to establish two realities that every citizen needs to take account of (1) the dimensions of the changes that are required if the Social Security system is to maintain solvency beyond 2032, the year the Trust Funds are projected to be exhausted, and (2) the need to make these changes sooner rather than later.

"Congress has amended the Social Security law many times since it was enacted in 1935. It has never allowed the program to reach the point where promised benefits could not be paid, and it is unthinkable that it would ever do so in the future. However, delay uses up valuable time, and gives policy makers and the American people fewer and more difficult choices. Prompt action is essential if we are to restore confidence in the future of Social Security and enable today's workers to plan for a secure retirement.

"Social Security is a social insurance program to which nearly all workers, along with their employers, are required to contribute in order to provide protection against the risk of loss of wages due to retirement, disability, or death of a worker. Retired workers make up 62 percent of all beneficiaries. But the program's income protection extends beyond retired workers. According to estimates, about 4 out of 10 young men, and 3 out of 10 young women, who are now age 20 will die or become disabled before reaching age 67. Today, 10 percent of all Social Security beneficiaries are workers who are disabled and have not reached retirement age; 11 percent are spouses and children of retired and disabled workers; and 16 percent are spouses and children of deceased workers. Whatever changes are enacted, Social Security must continue to protect these vulnerable individuals.

"Some think that Social Security should become more of a retirement savings program. They propose that a portion of a worker's earnings be placed in individual investment accounts, either on a mandatory or a voluntary basis. Others believe that the program should be maintained largely as it is now, and that solvency should be maintained without making structural changes. (See page 21 for a brief description of some of the proposals that have been made to address the long-range solvency problem.) All of the proposed changes require trade-offs. Evaluating the merits will require careful assessment of their impact on the well-being of individuals and of the society at large.

"In considering changes to Social Security, it will also be necessary to take into account the Medicare program. Over the next few years, legislative changes will have to be made to Medicare if the Hospital Insurance Trust Fund is to remain solvent beyond 2008, the year it is projected to be exhausted. Because Social Security and Medicare serve many of the same individuals, and both are financed largely from payroll taxes, they share the challenge of paying for benefits for an increasing number of older persons at the same time that growth in the workforce is slowing. It will be important for policy makers to consider the impact that changes in one program may have on their ability to assure the long-range solvency of the other.

"Finally, it is important to recognize that Social Security is only one part of our multi-pillar retirement income system. Social Security has always been intended to provide a foundation for retirement income that needs to be supplemented by individual savings and employer pensions. All parts of this system are in need of review since Americans as a whole are not making adequate provision for their retirement. Social Security reform should be meshed with a strengthening of the other parts of the retirement income system, including employer pensions, individual retirement accounts, 401(k) plans, and other saving mechanisms. Considering Social Security reform within this larger context is a vital aspect of the reform process."

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WHITE HOUSE CONFERENCE ON SOCIAL SECURITY

FAR MORE THAN AN ISSUE OF SOCIAL SECURITY

C. Eugene Steuerle

Not Just Social Security

What is often labeled as the aging problem is far more pervasive than Social Security. The issues are not just what can we afford for Social Security but what *should we* afford, and how can we obtain an adaptable and flexible government policy that deals with our most important needs over time.

New Opportunities, New Responsibilities

Much of what must be addressed in Social Security and Medicare derives from "good" things happening to us: longer lives and better health care. But we have a budget that is geared to a mid-20th century view of the world: an industrial economy, not a service and information economy; an elderly population that used to have lower, but now has equal or higher consumption levels than the young; and workers who formerly retired when they were old rather but now retire for almost the last third of their adult lives. Where "bad' things are happening to us -- e.g., children unattended by adults, failures of our educational system -- we claim that commitments to growing retirement and health benefits mean we have "more will than wallet."

Restoring Discretion to Voters and their Elected Representatives

Our laws now assert to all future generations that we know better today how to spend almost ALL of the revenues they will have IO, 50, IOO, or 200 years from today. Social Security and health entitlement programs are scheduled to continue displacing most discretionary spending over time. Revenues are growing and will probably double in real terms over the next 20 years or so, but essentially all of that growth has been precommitted. Never before in the history of our country have so many commitments and so much growth been scheduled in our laws for nearly an eternity -- and so little left to the discretion of each generation.

The Crux: Fewer Taxpayers More Beneficiaries

What forces Social Security issues to a head is the scheduled decline from a ratio of workers to beneficiaries of more than 3-to-l to less than 2-to-l. This dramatic fall in workers affects not just Social Security, not just Medicare and Medicaid nursing home care, but everything from education to defense. In effect, despite the extraordinary attention to issues of saving, the forthcoming shortfall relates to the labor market changes and the scheduled early retirement of so much of our "human capital." A vibrant labor force is the main source of our productive strength, as well as the taxes that support all government programs.

Current Levels of Benefits

Almost everyone retiring in the future is still likely to get as high or higher lifetime benefits than those retiring today. Most proclaimed "reductions" in benefits are really decreases in the rate of growth in benefits. Even after reform, benefit packages likely will be worth more than the package of about $1/4 million in Social Security and $1/4 million in Medicare for an average-income couple retiring today.

Promises Exceed Available Revenues

In a transfer system, fewer taxpayers and more beneficiaries mean that extraordinary pressures on benefits and taxes cannot be avoided. Today every three workers transfer about 20 percent of their taxable wages to each single beneficiary. They therefore support each beneficiary at about 60 percent (counting health and other elderly programs) of their average taxable wage. If we accept the scheduled drop to less than two workers, the beneficiary can be held harmless only if the tax rate rises to 30 percent of taxable wages; alternatively, the taxpayer can be held harmless only if combined elderly benefits fall from 60 percent to 40 percent of the average wage.

Added Workers Deter Benefit Cuts and Tax Increases

Outside of reducing benefit rates or raising tax rates, the most direct approach is to stem the drop in workers to beneficiaries, for example, by providing retirement benefits only for 15, 16, or 17 years of life expectancy. Fewer retirees in late middle age deters annual benefit rates from falling in old age and tax rates from rising for the young The double gain comes because later retirement simultaneously reduces the number of beneficiaries and increases the number of taxpayers -- not just for Social Security, but for Medicare and other government programs as well.

Increase in Future output

Still another approach to reform is to try to increase future resources by saving more. Given low national saving, these efforts have considerable merit. However, government's ability to control saving has always been weak: individuals can offset any government action over in another fund or through other saving and borrowing. Therefore, while there is merit in trying to increase saving and for government to fund its future promises, the anti-poverty core of the system cannot be made dependent upon the unknown success of efforts to encourage or mandate saving.

Better Protection for the Poor Possible

It is possible both to provide greater protection to low-income individuals and to rely more on individual saving accounts. The trick basically is to bump up the minimum level of guarantees in Social Security, while counting more on saving to supply growing benefits to middle- and higher-income individuals.

(As part of the plan of the National Commission on Retirement Security, I introduced a new minimum benefit that would increase basic annual Social Security benefits for a significant percentage of low-income individuals and practically eliminate elderly poverty even before adding in any saving in individual accounts.)

Watch Out for Magic Money

Many proposals now on the table from all sides count on "magic money." That is, they rely upon the government borrowing at a low interest rate, and investing the trust funds or individual accounts in higher-yielding stocks and bonds, and then making money out of the arbitrage. They also add contingent liabilities of trillions of dollars.

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AFL-CIO President John J. Sweeney Statement on Social Security

America's working families have a huge stake in the future of Social Security, and the 72 national unions of the AFL-CIO and our 13 million members will be fully engaged in the drive to strengthen this, our nation's most important and comprehensive family protection system.

Strengthening the system demands reasoned, responsible changes — not phony schemes railroaded by extremists to "save" the system by scrapping it. While the program's finances must be shored up to meet its commitments to today's workers, radical changes should be propelled neither by a false sense of "crisis" nor by questionable long-term economic projections. Rather, changes to strengthen Social Security must be guided by a clear and full understanding of the program's role in the lives of ordinary people and of the real impact of proposed changes on Americans, both direct and indirect.

In no case should the program's core guaranteed benefits upon which a majority of older Americans depend be traded in for risky and expensive private accounts. Furthermore, most Americans cannot work to age 70 or older, cannot afford cuts in guaranteed benefits, and will not tolerate changes that make the system less fair.

1. **Social Security is the foundation of retirement income for America's workers and their families and the principal insurance against family impoverishment due to death or disability.** Its role must not be compromised nor its financial condition weakened. Two thirds of older Americans rely on Social Security for half or more of their income -- and 30% of them get 90 percent or more of their income from Social Security. The system's guaranteed benefits are especially crucial to women and workers of color. Without Social Security, more than half of people 65 and older would live in poverty, compared with 11 percent today. And the system provides benefits to six million workers with disabilities and dependents, and seven million survivors of workers who have died.

2. **Social Security must be strengthened so it can meet its commitments to today's workers, just as it has to workers — without missing a check — for the last sixty years. But there is no "crisis."** "Sky-is-falling" rhetoric is being used by extremists to undermine support for the current system and replace it with costly private investment accounts. A privatized Social Security system would mean billions of dollars in fees for banks, insurance companies and investment firms — an estimated $240 billion in the first 12 years of privatization alone.

3. **Working families would be heavy losers under privatization.** Privatization proposals call for some combination of:

- -- raising the retirement age to 70 or older — which would be especially hard on workers in physically demanding jobs and workers of color, who have lower life expectancies;
- -- cutting Social Security's guaranteed benefits (one major proposal cuts them 48 percent; another reduces the maximum guaranteed benefit to $4 10 per month);
- -- reducing or eliminating cost-of-living adjustments, hitting workers with the longest life expectancies hardest.

In addition, privatization would entail dramatically higher costs (out of workers' benefits) to finance a likely unworkable system of 140 million private accounts. It would also leave benefits dependent on workers' luck or skill as investors and the ups and downs of the stock market and adversely impact workers' private pensions.

Addressing the long-run financial challenges of Social Security does indeed demand responsible changes to the system, and the AFL-CIO is committed to enacting reforms to address the system's shortfall. The AFL-CIO Executive Council has agreed upon seven fundamental principles that reforms must meet, if they are to work for working families.

- -- Steps must be taken soon to strengthen Social Security so that all Americans can be assured that the program will be there for them.
- -- Social Security should continue to provide retired and disabled workers, as well as dependents and survivors, with a guaranteed monthly benefit, protected against inflation, for life.
- -- Benefits should not be subject to the whims of the market, and private accounts should never ben substituted for the core defined benefits the system currently provides.
- -- The age at which workers are eligible for early or full benefits should not be raised.
- -- Social Security should continue to replace a larger share of past earnings for low-income workers and to provide bigger benefits to workers who earned higher wages during their careers. Replacement rates should not be cut.
- Social Security should continue to provide family insurance protection, with benefits that cover dependent and surviving children and spouses in addition to disabled and retired workers.
- -- Government budget surpluses should be used to save Social Security first, not to pay for tax cuts.

If Social Security did not exist, we would have to create it. No other system provides every working American with a core guaranteed retirement benefit protected against inflation for as long as he or she lives. No insurance policy on the market today matches the protections Social Security provides to families through its disability, dependent and survivor benefits. And no private pension system compares with the efficiency of Social Security's low administrative cost of less than one percent per dollar paid out in benefits.

The deliberation over how to strengthen the foundation of retirement income for working families is undoubtedly one of the most important national debates for the new century. We should not compromise our expectations of the system or the security of America's families.

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Questions for President Clinton
From Richard Thau and Heather Lamm
Executive Director and Chairperson, respectively, of Third Millennium
December 8, 1998

Rather than making a statement, we have several questions for President Clinton:

1) Today's workers pay the highest FICA taxes in American history, as much as $8,482 per year. At the same time, the Social Security trustees project that the program will be able to pay only 75% of promised benefits by the time our generation retires in the 2030's. Do you believe this represents an inherent unfairness built into the Social Security system, and if so, how do you plan to remedy it?

2) Some people suggest raising the FICA tax by 2.2 percentage points as a way to save Social Security. For a self-employed worker earning $30,000, such an increase would mean an additional $660 in payroll taxes over and above his/her current $3,720 annual contribution. Do you support or oppose any tax increase in FICA (including an increase in the cap on taxable wages)?

3) A male turning 65 this year has a 50-50 chance of living to 80 years of age. The female turning 65 this year has a 50-50 chance of living to 84. Many people in our generation (born in the 1960s and 70s) could reasonably expect to live into their 90s. With increasing lifespans, do you believe:
   a) that people should work longer, and the eligibility age for Social Security should be raised to 70 for people under 50, or even indexed to average lifespan?
   b) that people who can expect to spend 1/3 of their lives as senior citizens should be required to pre-fund some of their retirement needs? And if so, do you think the most effective way to create a nation of savers is to convert a small portion of Social Security into a defined contribution plan?

4) If you agree with your 1994-96 Social Security Advisory Council that a portion of Social Security contributions should be invested in the capital markets, do you believe that the Federal government should do the stock picking collectively for everyone, or that individuals should have a personal account and a choice of where to invest their funds?

5) If Social Security did not exist, and you had to create it from scratch as President Roosevelt and Congress did in 1935, would such a program include a personal account component?

6) Which constituency is more important in this discussion: those who pay the FICA taxes or those who receive the Social Security benefits?

7) Do you believe that rate of return, measured across generations, is a fair way to gauge the fairness of Social Security? If so, are you concerned that today's young adults and future generations are expected to get a lower rate of return than older generations?

UNITED STATES OF AMERICA
RAILROAD RETIREMENT BOARD
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DEC 3 1998

As Chair of the Railroad Retirement Board, I appreciate the opportunity to participate in the White House Conference on Social Security.

The $8 billion a year retirement, survivor, and disability benefit programs administered by the Board under the federal Railroad Retirement Act, and their financing, are closely coordinated with the old-age, survivor and disability insurance programs provided by the Social Security Act. Railroad retirement beneficiaries are also covered under Medicare on the same basis as social security beneficiaries.

Under the two-tier railroad retirement system, which includes both social security equivalent and staff retirement benefits, tier I railroad retirement payments are based on social security as well as railroad retirement credits, computed under social security formulas, and issued to dual beneficiaries in combined benefit payments adjusted to omit duplications. At the same time, while railroad work is covered under the Railroad Retirement Tax Act rather than the Federal Insurance Contributions Act, rail employees and employers pay tier I railroad retirement payroll taxes at the same rate as social security taxes, and a financial interchange between the two systems equitably apportions benefit payments and taxes between the railroad retirement and social security trust funds.

Legislative changes to the Social Security Act consequently become applicable to the Railroad Retirement Act, and significant changes in the social security system are of great importance to the retirement system serving the nation's rail workers and their families.

Therefore, while I have not as yet come to conclusions regarding the future direction of social security, I look forward, as the Board's public member, to being part of the discussion on this topic, which is of such vital concern to the future financial security of railroad retirement beneficiaries as well as to all Americans.

Sincerely,

Cherryl T. Thomas

Cherryl T. Thomas
Chair

STRENGTHENING SOCIAL SECURITY FOR YOUNG WORKERS

FOR MANY YOUNG ADULTS, economic prospects have deteriorated sharply in recent years. According to the U.S. Department of Education, from 1972- 1995, annual incomes for young adults age 25-34 plunged twenty-one percent for college graduates and thirty-five percent for high school graduates. The Clinton economic expansion is helping, but it cannot continue forever. A long-term commitment to full employment at living wages is still needed.

The problem results from poor standards in many of the new jobs created in our economy: part time, small business, service sector and temporary jobs. These are the jobs of the future.

As the Social Security debate moves forward, policymakers should recognize the broader economic context of America's new workplace and seek solutions that will leave younger generations with a solid safeguard for an uncertain future.

SOCIAL SECURITY MATTERS to young adults for many reasons. While annual incomes for young adults have plummeted since 1972, pension coverage for workers age 25 or less dropped one-third; for workers age 25-29, coverage dropped fifteen percent, according to the Department of Labor. The jobs of the future hold little promise of improvement.

Only 3.1 percent of temporary employees — half of whom are age 20 - 34 -- have a 40 1 (k), and not one has a pension, through their employment. Similarly, only eighteen percent of workers in small businesses (fewer than twenty-five employees) have any retirement plan. According to the Department of Labor, small businesses created seventy-five percent of all new jobs in 1995.

As Commissioner Kenneth Apfel has remarked, one-third of all Social Security beneficiaries are not retired. They are survivors, disabled workers, and their families. Many of these young families depend upon Social Security to pay rent and medical bills or finance an education.

Far from being millionaire intemet entrepreneurs, most young adults will be working in service sector jobs of short duration, with few of the safeguards that once existed for workers in the manufacturing economy. These young workers need Social Security to be there for them, and they need Social Security's future resolved in a manner that strengthens the basic survivors, disability, and retirement guarantees.

PRIVATIZING SOCIAL SECURITY IS WORSE for Generation X workers than any other age group. Privatization is touted as a remedy for illnesses said to afflict younger generations — the so-called ravage of overly abundant grandparents, a government that cannot be trusted to keep its promises, or a 21st Century American economic Ice Age. Privatizing Social Security will solve none of these problems.

Unfortunately, many young people have come to believe that Social Security will not be there for

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them (the depth of this belief, however, is not clear; it may be quite shallow). While privatization advocates claim that an individual account will restore some of their faith in Government, this claim is false both in fact and motivation. More likely, it will foster an attitude that our interests are best served by abandoning collective commitment.

More importantly, young people have never been told what privatization would do to the Social Security Trust Fund. Most young people do not want an "alternative" to Social Security; they just want Social Security to be there for them. If a privatized account will accomplish that goal, they might favor the proposal. If a privatized account threatens Social Security, they will oppose the proposal. Non-biased opinion research reaches this conclusion.

In order to divert a portion of payroll taxes into privatized accounts, privatizers must reduce Social Security guaranteed benefits for future generations by 20 **-** 40 percent and increase the retirement age. Worse, the benefit cuts seriously jeopardize millions of survivors and people with disabilities. Every privatization proposal either cuts survivors and disability benefits dramatically (15-30 percent) or has no plan at all for raising the large amounts of revenue needed to keep benefits intact. These young adults' benefits will go first to the chopping block.

STRENGTHENING, NOT UNDERMINING Social Security is the best course. Taking Social Security off budget, investing the surplus like a pension, applying FICA more fairly to wealthier workers, using general revenues, and indexing FICA to increases in life expectancy ($2 annually) are all good options. The distinction between a good proposal and a bad proposal is the degree to which it will assure the safeguard of Social Security's guaranteed benefits.

There is agreement that the Federal budget surplus can be used to strengthen Social Security, and that significant benefit cuts or tax increases should be off the table. Individual accounts are a viable option, if they are a voluntary supplement requiring no cuts in Social Security benefits.

Common ground can exist if policymakers heed public opinion. In polls by Americans Discuss Social Security, the public, when presented with the trade-offs involved with various options (such as private accounts), choose *security* over risk every time, even if it means higher FICA contributions. In the 2030 Center poll, 86 percent of all Americans say that "Congress should not reduce benefits or raise the retirement age in order to fund individual accounts."

THE 2030 CENTER is a public policy organization for young adults, founded in 1997 to provide a voice for young people's economic concerns in order to reverse the deterioration of their economic circumstances.

The 2030 Center is at the forefront of developing progressive strategies to strengthen Social Security. We speak to audiences of all ages, write articles and op-eds, advise Congressional staff, conduct survey research and policy development, train young leaders, and provide a younger generations' perspective for major events and the media.

In the summer of 1998 we released a national poll on Social Security reform, conducted by Peter Hart Research, which found deep support among young adults for Social Security. This month, we released our policy manual, *Strengthening Social Security for Young Workers.*

PRINCIPLES FOR SOCIAL SECURITY REFORM

Social Security is in serious financial trouble. By 2013, just 15 years from now, the program will begin running a cash deficit. By 2032, even if all the money owed to Social Security is repaid, the trust fund will be exhausted.

In addition to staving off insolvency, another critical reason for reforming Social Security is to give working Americans the opportunity to build real wealth for true retirement security.

Raising taxes is not the solution to Social Security's looming fiscal crisis. The Social Security payroll tax has exploded from 2 percent in 1937 to 12.4 percent today-a sixfold increase. Nor is the solution to cut benefits to current retirees. Today's seniors paid into Social Security their whole lives with the expectation that they would receive a certain minimum level of support. To change the rules on them now would be unfair.

The time has come to redesign Social Security and to begin the transition to a funded pension system based on personal retirement accounts backed up by a federal safety net. Following are the principles that United Seniors Association believes should serve as the basis for successful reform of Social Security:

- The federal government must guarantee all benefits promised to current beneficiaries and those nearing retirement.
- Workers should be allowed to establish their own personal retirement accounts and to privately invest a portion of their Social Security payroll taxes.
- Retirees and workers should be given ownership of trust fund assets.
- Saving the existing Social Security program or paying for the transition to an improved retirement system must be accomplished without raising taxes.
- The federal government should not, under any circumstances, be allowed to privately invest workers' retirement funds, nor should the government be permitted to regulate how workers privately invest their own funds beyond that required to ensure safety and soundness.

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The U.S. Junior Chamber of Commerce
CALL TO ACTION

CALL FOR DEVELOPMENT OF RESPONSIBLE SOLUTION TO THE FUTURE ECONOMIC SOLVENCY OF THE SOCIAL SECURITY SYSTEM

Adopted March 16, 1996
Revised June 25,199 7
Expires March 16, 1999

WHEREAS, real wages for middle and low income Americans have been declining since the mid-1980s, causing diminishing economic opportunities; and

WHEREAS, middle and low income Americans fear that they face declining economic opportunities; and

WHEREAS, up to 75 percent of all Americans have little or no opportunity to become savers or capital owners or to share in equal economic opportunity; and

WHEREAS, the demographics of America are changing - we are aging as a society; and

WHEREAS, as the Baby Boomers retire, the number of retirees will almost double by the year 2030, rising from over 40 million to over 80 million retirees; and

WHEREAS, the nonpartisan 1994-95 Entitlements Commission, co-chaired by Senator Robert Kerrey (D-Nebraska) and Senator John Danforth (R-Missouri), found that by the year 2030 more than all existing federal revenues, 19 percent of the Gross Domestic Product (GDP), would be consumed by the Social Security and Medicare programs causing federal taxes to double to 38 percent of GDP to pay interest on the national debt and to maintain regular budgetary needs, i.e. education, environment, defense, and job training, all before paying state and local taxes of 10 to 15 percent; and

WHEREAS, in 1945, there were 20 workers supporting one retiree, in 2030, there will be less than two workers asked to support one Social Security and Medicare recipient, and these workers will be asked to accept a 60 percent lifetime tax rate; and

WHEREAS, most Americans are concerned about their economic future, distrust large government bureaucracies, and are eager to regain a sense of being in charge, of having control in their lives; and

WHEREAS, most Americans feel that the current generation will pass a lower standard of living and less economic opportunity to their children and grandchildren, and

WHEREAS, many young Americans feel they are more likely to see a UFO than their Social Security benefits; and

WHEREAS, Social Security was established to provide for our nation's elderly, and, to that end, is one of the most effective social institutions ever created in America; and

WHEREAS, we need to meet our Social Security promises to existing retirees and future retirees;

NOW, THEREFORE, BE IT RESOLVED that The United States Junior Chamber of Commerce Executive Board of Directors:

- Recognizes that Social Security is in need of immediate revision;
- Recognizes that the future of Social Security is a concern for young people and future generations in the United States;
- Recognizes the need for capitalization of the social security system, thereof private funding;
- Recognizes that poor people and the indigent are especially hurt by the current system in place;
- Gives authority to the USJCC staff to pursue a Social Security project in local Junior Chamber communities.

Social Security has been the nation's single most successful social program, helping millions of men and women to escape poverty in old age and reducing the financial burdens that their children and grandchildren would otherwise have to bear. But now some members of Congress say that Social Security is living on borrowed time and requires a major overhaul — rather than just a tune-up with the types of minor adjustments that have been made throughout its history. Are they right? Is it time to change Social Security by creating a nationwide system of individual accounts?

The Basics

Women are far less likely than men to have retirement income from a private pension or a savings account, so the Social Security program is crucial for women. In fact, nearly 40 percent of older women living alone depend on Social Security for almost all of their income.

Today, the present system works like a defined benefit plan — when you retire you receive a certain benefit for the rest of your life. You also receive an increase in your benefit to protect the value from declining because of inflation.

The folks who want to totally revamp the system want to change it to a defined contribution plan — when you retire you'll have a certain amount of money in your personal account — and when you reach retirement age, you can cash it out or buy an annuity that will pay you a benefit for the rest of your life — but without inflation protection.

Proceed with Caution

For all the doomsday talk, the fact is that Social Security is not going broke. The most recent report from the Trustees shows that without any change to the present law, full benefits can be paid until 2032. After that, even if no changes were made, the amount of money being paid in would still cover three-fourths of expenses. So we are not looking at bankruptcy of the system we're looking at an eventual shortfall. Changes should be made but there is no immediate crisis. The house is not burning down, it just needs repairs.
Women have a particularly important stake in making sure that any changes to Social Security are carefully considered. Here are some reasons why:

- Women earn less. What happens if you didn't earn much money during your working years? The current system favors lower earners over higher earners, because of the formula used to calculate benefits. Typically women have a record of lower earnings because they leave and re-enter the workforce to care for their families and because women earn only 74 cents for every dollar that men earn. This type of protection is lost in an individualized account system.
- Women live longer. What happens if you outlive your income? The current system pays a benefit for as long as you live. Under an individual account system the size of your benefit

depends on your investments. Because women live longer and longevity is increasing, we should be careful of changes that could make matter worse. Today, more than twenty percent of older single women live in poverty.

- Can you count on the stock market? Having a private account means that you bear all the risk of investing. But even if the stock market continues to climb, a system of private accounts will only do well on average. Because women typically earn less, many will have smaller-than-average accounts.

  And because people with less money are typically conservative investors, women are likely to earn below-average returns. Moreover, you could lose your shirt if because of the timing of your retirement you have to cash out your account or convert it to an annuity when the stock-market is not performing well. Moral: Beware of rosy scenarios based on averages.

- What if you get divorced? Under the present system, a woman who was married for 10 years or more is entitled to half of her former husband's benefit while he is alive. When he dies, she is entitled to the same widow's benefit she would have received if she had stayed married. At this stage, none of the proposals include provisions relating to divorce.

- What about life insurance? The current system provides protection for the spouse and children of a worker who dies or becomes disabled. An individual account system would give less protection by only providing what's in the account at the time of death.

While the present system can clearly be improved — for example, by increasing benefits for widows, who are four times more likely than wives to end up in poverty — but it's hard to justify a major overhaul that would reduce guaranteed benefits unless there's no other choice. And that's not the case. According to the acclaimed financial writer Jane Bryant Quinn, an individual account system would be a losing deal for most people.

Making the wiser choice

Minor changes

Here are a few of the easy fixes being suggested: investing some of Social Security's revenues in the stock market, instead of exclusively in low-yield Treasury bonds as required under present law. This could increase investment returns, just as with private accounts — but without the risks to individuals. Also if the Consumer Price Index was calculated so that adjustments for inflation were on target, much of the shortfall would be eliminated.

As with any proposal that attracts the attention of Congress, we need to look at who's pushing the idea of individual accounts and why. Social Security takes in $1.25 billion every day. Clearly the fees for managing even a fraction of that sum are staggering. But whether it would benefit the majority of working Americans is less clear.

Unfortunately, the current focus on Social Security is distracting attention from what should be a more immediate concern: improving private pension coverage. Less than half of the workforce have pensions — that's the real retirement problem that Congress and the media should be looking at.

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Statement of Hmong National Development, Inc.
on Social Security Reform

by

Lee Pao Xiong
President

We congratulate the effort of this Administration on its effort of reaching out to under-represented groups, such as the Hmong community, by allowing us to share our views on the Social Security Reform. We further applaud this Administration for given us the opportunity to work with the technical language when Congress and the President restored SSI to the legal immigrants.

We were very concerned when we heard that new immigrants and refugees, who were taxpayers of this country, would be denied Social Security benefits because they were not United States citizens. Since many of the Hmong came here as immigrants and refugees, many of our elders do not have the language mean to pass the citizenship test, we were extremely worried. We came from a country where most of our people were trained either as warriors by the CIA or farmers by trade. This policy of exclusion was a grave concern for our people. However, we were relieved to know that President Bill Clinton was committed to restoring all benefits to legal immigrants and refugees, which he eventually did. We hope that you would maintain this policy of acceptance and compassion for our people.

Since the Hmong people are new to this country, we have yet to learn about the many benefits and services available to us as taxpayers through the various federal agencies, including the Social Security Services Administration. We do know for sure that our social security and other federal taxes are being taken out of our paychecks every month.

As a national organization, the Hmong National Development would like to continue working with this Administration to make sure that the Hmong community can fully utilize the benefits and services that are available to them as taxpayers.

We wish for a success at this conference. If there's anything that we can assist in this effort of reaching out to under-represented groups, please feel free to call on us. Thank you.