

**WHY SOCIAL SECURITY INDIVIDUAL ACCOUNTS (SSIA) CANNOT BE MODELLED
AFTER THE FEDERAL THRIFT SAVINGS PLAN (TSP) OR OTHER LARGE 401(K)-TYPE PLANS'**

1. The TSP is an employer-based plan. Like other large 401(k)-type plans, the TSP is sponsored and implemented by employers with the personnel, payroll, and systems staffs needed to support highly complex electronic record keeping, investment, educational, and communications operations. The Thrift Investment Board is a wholesaler of financial services. It is the employing agencies that handle the retail operations and the essential face-to-face counselling services. Such functions could not be performed by the 6.5 million employers now paying Social Security taxes. Most private employers have less than ten employees and little support staff. Over eighty percent of private employers are now reporting to the Social Security Administration on paper, a highly inefficient and error-prone operation.

2. The TYP is voluntary. Proposed SSIA's would be mandatory on the employee or the employer. Thus, SSIA's would be beset with very costly compliance problems not faced by TSP, 401(k)s, or the present Social Security system. While many employers do not comply with the present requirement to pay Social Security taxes, their employees do not lose Social Security benefits so long as their employment is verified. But failure to make timely contributions to SSIA's would reduce SSIA balances and investment income.

3. The TSP is for a relatively high income, educated and stable work force, Social Security workers' are relatively low income, uneducated, and include many temporary and part-time employees. Forty-six percent of Social Security workers earn less than \$15,000 a year. Seventy-five percent of households with incomes from \$10,000 to \$25,000 have no direct or indirect stock investments. Essential investment and other counselling services, perhaps provided by the private sector, for this population would be very costly.

A SSIA deposit of two percent of an average wage of, say, \$20,000 would produce contributions to the account of just \$400 in the first year. The average annual cost of servicing a 401(k) account is estimated to be at least \$100, based on the three government and private studies discussed in the November 1998 report of the Employee Benefit Research Institute. (Current private sector servicing costs actually run up to \$300 a year per employee for 401(k) plans with less than ten employees.) SSIA servicing costs would be much higher, as noted above. So the expense ratio in the first year would be much higher than 25 percent, or 2500 basis points (compared to the current TSP expense ratio of just 6 basis points), which would obviously be much higher than the estimated rate of return on investments. As account balances

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increased, the expense ratio would decline. Yet it is likely that there would be no net earnings, since total expenses would exceed **total investment income**, over a **forty year working** life of an average SSIA holder. Thus the present Social Security trust fund, which is invested in Treasury securities (with net **earnings** after inflation of about three percent over the past three **decades**), would clearly be a superior investment to SSIAs.

The **only** feasible way for the Social Security system to benefit from the higher returns offered by the stock market is to invest a portion of the Social Security trust fund in stocks, **which** is what virtually all **large** public and private pension and retirement funds in this country have already done.

Why **then** do SSIA proponents **claim** that their plan would be cost-effective? They argue that if the **TSP** can service 2.3 million individual accounts for \$23 a head then surely SSIAs for 148 million Social Security workers could be serviced for less, because of economies of scale. What they fail to understand is that economies of scale **can** only be realized by increasing the number **of** workers in each workplace. We are a nation of small business, and it is not **likely** that our 6.5 million employers are about to merge into conglomerates large enough to make SSIAs cost-effective. **SSIAs** are doomed to **failure** because of intractable "smallness" problems -- small businesses and small average incomes subject to Social Security taxes.

We have no experience with a system of mandatory individual savings accounts dependent on performance by low income employees and small employers. There is no empirical basis for claiming that SSIAs would be administratively or **economically feasible**.

If Congress were **to** enact the pending SSIA legislation, it is likely **that** the program would be recalled within six months.



A New Social Security: Combining Social Insurance with Individual Accounts

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I propose a compromise reform plan that would maintain social insurance features of Social Security and add to it the potential for augmenting retirement income from individually-owned saving/investment accounts. The plan thus embodies individual and collective responsibility, reflecting all the principles espoused by President Clinton, the Senate Republican Leadership Task Force on Social Security, and a Bipartisan Social Security Coalition in the Senate.

This plan, called “New Social Security,” would divide the current Social Security program in two: a defined-benefit social insurance component, like the one we have now, and a **defined-contribution individual account**, which would be new. The social insurance benefit would preserve the traditional old-age, survivors and disability (OASDI) protections, to be funded on a pay-as-you-go (PAYGO) basis using 10.8 percentage points of the current FICA for the next two dozen years. Funded by 1.6 percentage points of the current FICA, the individual account would be created without additional taxes or contributions. Such financing is feasible because we do not need these funds to pay benefits during the next couple of decades or so. The current FICA of 12.4% would remain.

This plan would remove the unfunded liabilities under the current Social Security program, keep the progressive benefit formula that protects low-income and disabled persons, cut FICA in order to create individual accounts, repeal the earnings test, and set moderate PAYGO rates over the next 75 years (10.8% for 1999-2022; 12.4% for 2023-2032; 13.2% for 2033-2042; 13.5% for 2043-2052; and 13.9% for 2053-2074).

To complement the PAYGO rates in shoring up the long-range financing, this plan also incorporates several provisions common to other plans, such as gradually increasing the retirement age, moderately raising the wage cap, covering state and local new hires, extending the benefit computation years, and taxing Social Security benefits like other pensions.

A unique feature of this plan is that the individual accounts would be mandatory now but voluntary in the future. In 2023--when the FICA needs to return to 12.4 percent--individual accounts will no longer be required. At that point, it is likely that workers who have had favorable experiences with individual accounts would continue to contribute to them. Other people would follow suit. If experiences have been unfavorable for most people, then why should the mandate continue? If the experiences turn out to be mixed, as seems likely, it would be sensible to allow individuals to choose whether or not to continue their accounts.

I propose that individual accounts be established on a time-limited basis (e.g., during the next two decades or so), as an experiment or a demonstration project, akin to the medical savings account in the Kassebaum-Kennedy bill (Health Insurance Portability and Accountability Act of 1996). The experiment would yield much data on individual accounts, such as the investment behavior and preferences of people by key demographic and economic variables (e.g., age, sex, and wage/salary), among other things. Such empirical “laboratory” data would serve as a useful guide in setting future policy.

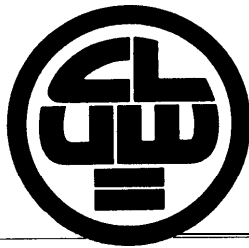
The proposed experiment raises a legitimate question about the safety of retirement income, a major concern about privatization in general. What if a person with an individual account loses everything he or she put into it during the demonstration period? Because Social Security benefit is a guarantee and receipt from individual accounts is added to that guarantee, people still will be assured of their Social Security benefits.

Other concerns about individual accounts exist. Many fear that unwise and unlucky investment decisions, or lack of investment knowledge, would make individual accounts an uncertain source of income. Others object to the administrative costs that may greatly diminish the returns of small accounts. Avoiding such problems, these accounts could be held and managed by a central authority with a limited number of investment options for account holders, patterned after the federal Thrift Savings Plan. Such a model would have the added advantage of avoiding fraudulent sales practices encountered by some individuals investing on their own.

Another distinguishing feature of this plan is the use of **PAYGO**, which some disapprove on the ground that future tax rates would be exorbitant. However, **PAYGO** will not entail high tax rates if the growth in benefits is moderated as under this plan. Moreover, using **PAYGO**, this plan will not involve sizable trust fund investments, so concerns about political interference in investment decisions and corporate governance become moot. Moot also are the controversies about the use of budget surplus and about whether the trust fund is real or illusory.

A word about the timing for establishing individual accounts is in order. I suggest we wait until the unified budget is also in surplus before we implement the carve-out for creating individual accounts. Unified budget surplus is estimated to occur in a few years. I therefore urge the Congress to pass legislation now for implementing the New Social Security plan when the unified budget surplus materializes--to create individual accounts using part of the FICA on an experimental basis and to finance the traditional Social Security on a responsible pay-as-you-go basis.

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Women's retirement security depends on Social Security. More than 20 million women were over age 65 in 1998, as compared to 14 million men. By the year 2030, it is estimated that more than 38 million women will be over age 65. However, it is not only these statistics that prove Social Security is a necessity for older women; it is women's work-life experiences that translate into a need for more, not less, retirement security. This is based on four key facts about their lives: women live longer than men, they spend less time in the paid workforce, they are paid less when they work and they are more likely to be widowed than men.

The effect these facts have on women's economic status translate into a greater need by women for secure retirement benefits. Because women earn less than men in 99% of all occupations and are also more likely to work at temporary or contingent jobs, women's average monthly Social Security benefits are lower than men's. In 1995, the average monthly benefit for female retired workers was \$621.30 compared to \$810 for male retired workers. Even if pay equity went into effect in 1998, these benefits would not reflect such equalization for more than 30 years.

By the year 2010, it is estimated that 8 million women age 65 and over will live alone. These unmarried women age 65 and older rely on Social Security for three quarters of their income. Older women with low incomes also have a greater chance of becoming ill; the increasing costs of health care mean that these women will spend greater amounts of their fixed incomes on health care costs.

Concern about Social Security's ability to meet all of its promised benefits after 2032 drives the current debate. To date, much of the discussion about Social Security's future has focused on whether part or all of the present system should be eliminated in favor of privatized individual investment accounts. A central feature of individual account proposals, though often left out of the discussion, is the necessity of cutting Social Security's guaranteed benefit levels in order to pay for the individual accounts while at the same time covering the anticipated financing shortfall. Necessary cutbacks would likely include some combination of hikes in retirement ages to age 70, cuts in the automatic cost-of-living adjustment, sharp reductions in guaranteed benefit levels and



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increases in the number of work years need to earn full retirement benefits. Most privatization proposals contemplate some mix of guaranteed, though greatly reduced, monthly benefit, supplemented by accrued contributions and investment earnings in an individual account.

Changes must be made to soon to ensure that the system can pay full benefits far into the future. However, the key issue for women is whether those changes will weaken or strengthen the social insurance protections that provide them with a foundation of retirement security. The wrong changes, such as those surrounding privatization, will have a devastating impact on women's economic security and their ability to lead independent, comfortable lives in retirement.

Although Social Security's projected financing shortfall must be addressed, at the same time it is essential to preserve the elements that have made the existing system so important for women, and so successful at raising millions of Americans out of poverty. This is especially true for older women, who are much more likely than older men to be living below or near the poverty line. These considerations include:

- ▶ Social Security must provide guaranteed benefits that women can count on to provide them a secure foundation of retirement income.
- ▶ Social Security must protect against low lifetime earnings that result from work in low-wage jobs or intermittent attachment to the workforce (by replacing a higher percentage of benefits for low lifetime earners).
- ▶ Social Security must protect against the risk of outliving retirement income, which increases with greater life expectancy, and against the erosion of the purchasing power of income that results from inflation over time.
- ▶ Social Security must provide family-based benefits that protect spouses and widows.

Social Security must provide adequate income to allow women to cope with the increased health care and related costs of aging that presently widen the economic gap for older women.



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**Statement of J. Sparb Collins, President
National Association of State Retirement Administrators**

The members of the National Association of State Retirement Administrators (NASRA) are the administrators of the State retirement systems for the 50 States, the District of Columbia, and the territories of American Samoa, Guam, Puerto Rico and the Virgin Islands. On behalf of these retirement plans and the millions of public employees, retirees and beneficiaries they cover, I would like to thank the Administration for the opportunity to participate in the ongoing discussions surrounding one of the most valuable national retirement programs, Social Security.

With the aging of the baby boom population and the growing strain on federal entitlement programs, officials at all levels of government must work together to address all areas of our national retirement policy. In addition to fostering employer-provided pensions and personal savings, national policy must also address the financial solvency of the Social Security system. However, it will be a delicate balance to ensure that fixing one leg of the proverbial retirement security stool does not break one or both of the other two. The members of NASRA are very interested in providing support, expertise and accurate information for such discussions and are hopeful that you will continue to call upon us as you tackle this arduous task.

The Social Security system is a vital program, and its financial well being must be preserved. Numerous proposals intended to extend the life of Social Security have been forwarded with far ranging and reaching proposed revisions. One provision that has appeared in various proposals is to mandate Social Security coverage for all newly hired state and local government employees. **While NASRA supports the affiliation of public pension plans with Social Security on a voluntary basis, we strongly oppose mandatory coverage of public employees under the system.**

It is important to remember that at the time the Social Security system was established in the 1930s, public employees were barred from participating in the system based on the constitutional interpretation that the federal government had no legal authority to impose taxes on states and localities. State and local plans at that time designed their own retirement plans in reliance on that exclusion, and benefits were structured and funded on that basis. It was not until the 1950s that state and local government pension plans were given the voluntary option to elect Social Security coverage. While many public employers elected to complement their own pension programs through coverage under Social Security, other units of state and local government decided not to participate in Social Security but rather provide their own independent programs of retirement benefits which they believed (and continue to believe) best suited the needs of their workforce and their citizens.

These systems must provide comparable benefits to the retirement, disability, and survivors' benefits provided by Social Security. In most cases, these systems provide substantially higher benefits. In addition, many provide flexibility to specific classifications of employees who are ill-suited to participate in a program which does not allow for normal retirement until age 62 or later and also provide supplemental benefits in the health care area. Mandatory coverage of newly hired state and local government employees will seriously disrupt the financial standing of these systems, requiring reductions in benefits, increased costs, or both. Public employer contributions to these plans already average between 13 and 14 percent of payroll, and employee contributions to these plans average between 8 and 9 percent

of pay. The added Social Security payroll tax of 6.2% on each, on top of what they already contribute to the pension fund, would simply be untenable for many employers and employees.

In addition, the coverage of newly hired state and local government employees does nothing to solve the long-term solvency of the Social Security system. Current projections by the U.S. General Accounting Office (GAO) estimate that such coverage would, in the short-term, provide additional cash flow to pay current beneficiaries. However, such coverage also imposes additional liabilities on the system and ultimately results in increasing the expenditures that must be paid out of the Social Security program. These state and local systems effectively manage retirement funds on behalf of public employees and are models for effective management of retirement savings programs that should be studied for best practices, not raided as a short-term and short-sighted fix for Social Security.

Additionally, those who espouse the unfairness of public sector employees “double dipping” by qualifying for Social Security benefits from either a second career or as a spouse, are simply uninformed. Current law already addresses this issue through the “windfall elimination” and “government pension offset” provisions that reduce Social Security benefits for those receiving a pension from non-covered government employment. The true issue of unfairness surrounds the federal government attempting to “change rules in the middle of the game” as they relate to these retirement systems, participants and taxpayers.

State and local employees, in partnership with their employers, contributed to and successfully managed these plans for the range of retirement benefits offered, with a commitment to long-term retirement savings and security. They should not now be punished for their planning and initiative. NASRA supports efforts to work with the national government as partners in our federal system, however, federal intervention into or preemption of the legitimate role of State authorities would be a drastic departure from the principles of federalism. There are serious constitutional and administrative problems with mandatory coverage, including the encroachment on State sovereignty, and the usurpation of State governments’ and their political subdivisions’ authority to perform their responsibilities and meet the needs of their workforce and their citizens.

For those public employers that have elected to have their employees covered by Social Security, a key area of concern is the seemingly never ending confidence crisis being faced. As we encourage our participants to plan for their financial futures through personal savings, employer sponsored pension plans, and Social Security, we frequently hear from those participants (particularly the younger ones) that Social Security is nothing other than a 1930’s ponzi scheme that for them will be a financial burden rather than a financial blessing. To a certain extent, this is understandable in light of the frequency with which the rules seem to change and the continual bombardment of negative press. Rule changes in such areas as eligibility age, benefit levels, COLA’s and contribution amounts make it virtually impossible for even the strongest advocates of financial planning to develop viable long term arrangements. With regard to negative press, there are those who believe that the dire predictions of failure simply set the stage for the demise of the Social Security system to be a self fulfilling prophesy. It is critical that action be taken which allow the public at large to once again have confidence that Social Security will be there for them and that it will constitute a key component of their financial security in old age.

Again, we appreciate your commitment to our national retirement savings policy and thank you for the occasion to relay our views. If we can be of further assistance, please feel free to contact me at (701) 328-3900 or NASRA's Director of Federal Relations, Jeannine Markoe Raymond, at (202) 624-1417.

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Viewpoint on Social Security Reform

The Committee for a Responsible Federal Budget, together with American Express Financial Advisors, has conducted six *Building a Better Future: An Exercise in Hard Choices* meetings around the country. Almost thirty organizations, representing diverse constituencies and political perspectives, are participating in this project. In July 1998, we published an interim report summarizing the results of the first five meetings. We will host four more meetings early in 1999, then publish a final report.

Building a Better Future: An Exercise in Hard Choices provides opportunities for diverse audiences to talk about the future of Federal programs and policies. It is, in effect, like a deliberative poll. It focuses on longer-term economic and budget issues, including Social Security, health care financing, and revenue options. Interim results indicate that Americans are willing and able to tackle difficult issues and make hard choices in order to assure a better future for all. *Exercise* participants appreciate the opportunity to learn more about these topics and discuss them with others. Elected officials appreciate learning what their constituents think about these issues.

Exercise results. Participants overwhelmingly agree that government should save short-term surpluses and then balance the budget. Rather than raise taxes to pay for baby boomer benefits, they prefer to reform programs. Participants' decisions indicate it may be easier to reach consensus around Social Security reform than on Medicare reform. Substantial majorities would include some form of mandatory individual accounts in addition to, or as partial replacement for, Social Security. On Medicare, participants split between two very different approaches: incremental change to the current program, and switching to a voucher-type system to help older Americans purchase coverage.

The Committee also has underway a project we call *The Graying of America*. In the first phase, we collected and published a wealth of information about how changing demographics affect public policy. The second phase report, to be published next year, will discuss alternative approaches resolving the challenges posed by changing demographics.

As the debate around these issues begins in earnest, we want to emphasize four concerns.

◆ *Focus on the right problem to find the right solution.* Economic growth is crucial. Growth becomes much more challenging as the population ages. The cost of current public commitments to older Americans will grow more rapidly than the economy. That could place a greater tax burden on younger generations. Policy debates should concentrate on redesigning policies and programs to meet the needs of not only an older, but a much more diverse population in the 21st century. Talking about "saving" Federal programs misses the point. The key is to promote greater

national saving and investment, which will lead to higher growth. A stronger, faster growing economy is the one sure to make an aging society more affordable. A bigger economic pie will be easier to divide than a smaller one. That is true whether the public or private sector allocates resources.

◆ ***The problem is the problem*** Current law benefit commitments to the elderly are not sustainable at current tax rates. That leaves only four options, singly or in tandem: taxes must go up; benefits must be reduced; other government programs face deep cuts; or the budget will face a dangerous spiral of deficits and growing debt. It will take a greater share of national economic output to support a larger retiree population. Policy choices will determine how much of that cost is born by government and how much by individuals and families. Changing the composition of investments in the Social Security Trust Fund will not make promised benefits more affordable. Mandating deposits to private accounts would shift responsibility from the government to individuals, but the public must recognize and accept downside risks and the continuing need for income support for the poor elderly, the disabled, and survivors. Otherwise, support for the new system will not last.

◆ ***Programs for the elderly do not exist in a vacuum.*** Social Security cannot achieve financial stability at the expense of other parts of the budget or the economy. Older Americans are important; but government also must serve competing priorities, including: Medicare; health care assistance and income maintenance for other groups; agriculture; defense, the conduct of foreign affairs, law enforcement, and investments in physical and human capital. To meet future commitments to the elderly and fund other priorities as well, the Federal government could grow to 25%-30% of GDP. (Many other democracies have done that.) But that would crowd State and local government budgets; and voters are not likely to accept a 20%-25% total tax increase. Deficit financing such government expansion is not an option. That would do serious damage to the nation's economy. Thus, we must consider Social Security reform in a broader economic and budgetary context. Current law earmarks a very substantial portion of future resources to meet today's priorities. Policy change can exacerbate or ease that problem. Freeing future generations from that burden should be a major policy objective.

◆ ***Avoid delay.*** If haste makes waste, delay could prove to be disastrous. Trust fund solvency is an inadequate and misleading measure of the urgency for reform. Within a decade, the oldest baby boomers will begin drawing Social Security retirement checks. Within fifteen years, annual cash flow to the Social Security system will turn negative. Medicare already spends more than its dedicated income-and some options for Social Security reform would aggravate that problem. There is precious little time to change expectations, behaviors, or both. If government will provide less generous benefits to some or all retirees in the future, individuals need to save more now. They will need time to make plans and alter consumption and savings patterns. In addition, small programmatic change now can make huge differences fifteen or twenty years into the future. The longer we delay, the greater the need for adjustment and the less appealing the options.

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After a year of dialogue, the time has come for bipartisan action to ensure that Social Security is fiscally sustainable and generationally responsible. The current system is neither. Overall, the challenge is to reform the program in a way that retains its beneficial effects for retired and disabled persons without overburdening workers or the economy.

Defining the problem

The first step in this effort is to define the problems that need fixing. The Concord Coalition has identified these key problems to be addressed in any comprehensive reform proposal:

- Changing demographics make the current pay-as-you-go benefit structure unsustainable. Absent change, the system will either overburden future workers with steep tax hikes or betray future retirees with deep benefit cuts.
- Workers are on track to receive increasingly low returns on their contributions.
 - a Despite a growing consensus that America needs to raise its private savings rate, Social Security's pay-as-you-go benefit structure discourages savings.
 - a Low and declining public confidence threatens support for the program.

No single reform is capable of addressing each problem. Reform legislation will require a mix of options. And, because the political process is one of debate and compromise, no one is likely to get his or her ideal result. Failure to achieve perfection, however, is not an excuse for inaction.

Establishing criteria

The second step in the process of reform is to establish a set of criteria for evaluating the final result. These criteria should be correlated to the problems that need fixing. Having a vision of the desired result will help avoid the danger of adverse unintended consequences. The Concord Coalition suggests the following criteria:

- a Social Security reform should, at a minimum, maintain the program's vital safety net protecting older Americans and the disabled against poverty and loss of income.
- Social Security reform should improve the projected "money's worth" of payroll contributions for young workers and those who have not yet entered the work force.
- Social Security reform should not add significantly to the publicly held debt, but instead, should increase net national savings.



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- The costs of reform should be borne fairly by age and income groups.
- Reform of the system should provide adequate protection against both political and investment risk.
- Because the Social Security trust funds only provide spending authority with no real resources beyond the government's power to tax future workers, reform proposals should be measured by their impact on the program's projected *operating balance* in addition to the trust funds' 75-year actuarial balance.
- Reform proposals should be grounded in prudent demographic, economic, and administrative assumptions. Any plan, including one that simply maintains the status quo, can be made to work on paper if the assumptions are drawn to fit the desired result.

Assessing the options

Social Security does not face an immediate crisis. But reform is on the political agenda in 1999 because the program is unsustainable over the long term, and early action will produce less abrupt and disruptive solutions. That leads to some crucial but often overlooked conclusions:

- The choice among options is not between "guaranteed" future benefits under the current system and "risky" or "burdensome" reform. The only guarantee about the benefit promises of the current system is that they are substantially unfunded.
- Reforms involving individual accounts should not be compared with a hypothetically solvent status quo. The proper comparison is between a reformed system *with* individual accounts and a reformed system *without* individual accounts.
- The current debate is not about the retirement security of those who have left the work force, or those who will leave in the near future. The debate is about the retirement security of those who have many working years ahead, and those who are still in grade school. For them, doing nothing is the worst option.
- There is no free lunch. Each reform option involves trade-offs and each comes with a fiscal and political price, regardless of whether it aims to shore up the pay-as-you-go system or involves a transition to a prefunded or partially prefunded system.

Saving the surplus

The currently projected Social Security surplus could be productively used to reduce federal government debt held by the public. However, there is a great probability that the surplus will be used, as it has been in the past, to finance other government spending or for tax cuts, unless steps are taken to invest it for Social Security beyond the reach of government control.

- If individually owned accounts are part of a comprehensive reform bill, the Social Security surplus could be used as an initial source of funding for these accounts. This would truly save the surplus for Social Security.



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DETROIT-AREA SENIOR POWER DAY PLATFORM ON SOCIAL SECURITY

On June 26, 1998, a regional Senior Power Day was held on Belle Isle in Detroit. At that time, a platform was affirmed and submitted to the state legislators who attended. The following statement on Social Security was part of those proceedings.

ISSUE STATEMENT

There has been a good deal of mis-information spread around in the growing debate over Social Security and very little in the way of hard numbers. According to some experts, while Social Security is solvent today, it faces a long-term funding crisis. If no action is taken, the program is expected to begin paying out more than it collects in the year 2013. By the year 2032, payroll contributions will only be enough to cover 75 cents on the dollar of current benefits.

RECOMMENDATIONS FOR ACTION

Organizations representing senior citizens, including AARP, should take the lead in meeting with representatives of youth service groups to reach an agreement and to help assure the long-term solvency of Social Security program which has benefitted people of all ages: retirees, and the survivors of death and disability. We reject the concept of "generational conflict." Together, seniors and youth need to combat the campaign of the traditional opponents of Social Security (the insurance companies and Wall Street brokerages) saying, "there won't be any Social Security for young people when they retire", thus leaving privatization as the only alternative for them.

Social Security has never been a simple insurance program. These funds also support children and orphans, disabled and low income persons. We are not trying to make Social Security take the place of pensions, or savings, or investments. It is a safety net for all citizens. For that reason we continue to support the present system of taxation of Social Security benefits on a sliding scale beginning at \$15,000 for individuals and \$32,000 for couples. We would like to be reassured that these funds end up back in the Social Security Trust Fund to help assure its survival and not as an unaccounted deposit for general tax expenditures by government.

The Detroit Area Agency on Aging is an Equal Opportunity Employer
Auxiliary Aids and Services Available Upon Request to Individuals with Disabilities
The Michigan Relay Center Number is 1-800-649-3777 (voice and TDD)

Therefore, we:

- Encourage extended debate.
- Oppose radical changes of privatization or drastic benefit cuts.
- Call upon Michigan legislators to host a forum to promote discussion between the public and Michigan federal legislators on the future of Social Security.

We at the Detroit Area Agency on Aging remain supportive of these statements.

Paul Bridgewater
Executive Director
November 30, 1998

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MASSACHUSETTS INSTITUTE OF TECHNOLOGY

DEPARTMENT OF ECONOMICS

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The Trust Fund Should Invest in Stocks and Corporate Bonds

Peter Diamond, Institute Professor

Individuals are advised to hold a diversified portfolio when saving for retirement. Corporations are advised to hold a diversified portfolio as backing for their pension liabilities. Yet the Social Security Trust Fund is 100 percent invested in Treasury bonds. By taking on some risk, the Trust Funds can anticipate receiving a higher rate of return over the long haul, and Social Security is indeed here for the long haul. With its ability to spread risk across successive cohorts of workers and retirees, Social Security is better able to take on risky investment than individuals themselves, on average. So there is no economic basis for excluding stocks from the Trust Fund portfolio.

Some people fear that the Trust Fund would invest so poorly that the return would be worse than just holding Treasury bonds. And some fear that the Trust Fund would use the voting rights of shares in a way that would be harmful for the economy. These fears can not be considered in a vague setting. Rather, we need to specify, in detail, how the investment decisions and the share voting decisions would be made. Only then can we form a judgment as to how well they would be done.

The critical step is to create an institution with independence from the day-to-day political process and with restrictions on how it can act. We have experience with creating such institutions and our experience is excellent. The Fed handles monetary policy, an equally important and controversial activity, with great independence. And the retirement savings plan for federal employees, the Thrift Savings Plan (TSP), handles both investment decisions and share voting without political interference. The key ingredients are (1) a decision-making Board that has financial and appointment independence and (2) a restriction to using broad, widely-used index funds, with the private fund managers, not the Board exercising voting rights.

The Board would have financial independence by getting its revenue from charges against the earnings on the funds it manages. The appointments would be for long, overlapping terms, subject to the scrutiny of Congress at the time of nomination, but protected from removal because of policy disputes. The Fed has just these protections, and they work.

For restrictions, the Board can only invest in broad, widely-used index funds, run by private fund managers, and selected by competitive bidding; multiple funds would be used to spread the voting power. The shareholder voting rights would be exercised by the private managers who also handle the funds of private investors, necessarily treating them all the same. The fund managers and the investment board would have strict fiduciary duties. The law could empower the Board to inform Congress and the public about any legislation that might adversely affect the Trust Fund.

So, we know how to create an institution that will work. In addition, the voting public will want to protect Social Security investment from any interference that might threaten future benefits. Politicians would not interfere with this important and independent function, because the public would not tolerate such interference.

This structure can work. Even so, being conservative about a new institution is warranted. One way to be conservative is to limit the size of stock investments. The law could mandate that the Trust Fund not hold more than a certain percentage of any single corporation, 10 percent, for example. As we learn that the political fears are not borne out, we can raise the limit. If stock investment sounds a bit unrealistic, consider that it has worked well for the members of the TSP - they have held the S&P 500 and have had very low administrative costs - considerably lower than the typical 401 (k) plan. And there has been no political interference. So, we can use this model for Social Security with confidence.

This approach to tapping into stocks has three large advantages over individual accounts - lower administrative costs, less risk for workers, and no need for a vast new regulatory mechanism to educate new investors and protect them from fraud and misleading selling tactics. (1) The administrative cost of managing Trust Fund investments would be negligible, while 150 million individual accounts would have substantial costs - the impact of even seemingly small fees can be large. For example, an annual maintenance charge of 1 percent, which is less than the 1.5 percent average currently for equity mutual funds, would eat up 20 percent of the system's benefits. Over the course of a 40-year working career, the average dollar deposited is charged 1 percent 20 times. (2) By spreading the risk over successive age cohorts, workers nearing retirement do not bear a big risk from a sudden stock market decline. And (3) the majority of the public has little experience or understanding of the principles of investment. Beyond learning to avoid fraud and misrepresentation, it is not easy to appreciate the advantages of diversification, understand the details of a risk-return tradeoff, distinguish between real and nominal returns - all of these require education, and education is expensive. Merely sending a pamphlet to every worker will not accomplish much.

Trust fund investment in stocks will make Social Security better for workers, while individual accounts are expensive, risky and introduce new problems for both workers and retirees.

This statement represents my views and not those of the Massachusetts Institute of Technology.

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Statement By Suleika Cabrera Drinane, Executive director, Institute For The Puerto Rican/Hispanic Elderly, Inc., For The Conference Publication, White House Conference On Social Security, To Take Place On December 8, 1998, In Washington, D.C.

Hello! I am Suleika Cabrera Drinane, Executive Director of the Institute for the Puerto Rican/Hispanic Elderly, Inc., the largest and major Hispanic non-profit organization serving Hispanic and other ethnic/racial minority seniors and their families in New York City and environs. The Institute provides direct assistance services to over 15,000 individual seniors a year, and informational/referral services to another 125,000. For low-income seniors, Social Security payments represents **50** percent or more of their income. Their Social Security benefits are low, since the larger number of those seniors worked in lower-occupational, lower-wage jobs and only receive small monthly payments. Due to a lifetime of no access to quality healthcare (or any healthcare in many cases), Hispanic and other ethnic/racial minority seniors have relatively poorer health than other seniors, and an alarmingly high number are at serious risk by age 60. Seniors are outraged. It is hard for them to understand how our government seems to have turned its back on the poor and low-income communities, and no longer accepts responsibility for the health and welfare of the people. The same communities that have defended this country in foreign wars and provided the physical labor in its industrial age development.

The Social Security Program was and is among the greatest social accomplishments of our democracy. Social Security is not just a retirement program, but rather a national insurance program which for a very low premium protects American citizens from economic misfortunes at every stage of life. Today, 3.8 million children, and 5.2 million widows and widowers currently collect Social Security survivors benefits. Another 4.5 million disabled workers collect Social Security disability benefits. Today, Social Security provides retirement income to workers in commerce and industry, eligible at age 62 for reduced benefits and at age 65 for full benefits. It provides a continuing income for a family in which a worker has died, become disabled or has retired. Some nine out of ten people age 65 and over receive monthly **re-**retirement benefits - four out of five workers under age 65 can receive monthly disability benefits if they are unable to work - and nine out of ten families would receive monthly survivors benefits if a worker dies. Social Security is provided by government at a cost far below the abilities of private companies **to compete, There are many who say that they can find cheaper** ways to "save" Social Security from failure, by privatizing it or by letting Wall Street

get its hands on the sizable Social Security revenues through individual taxpayer accounts or Social Security Trust Fund investments.

We heard how those same people were going to save Medicare and reduce costs, and now we are faced with Medicare Managed Care providers crying poverty and losses, and closing out their Medicare Managed Care programs for both new applicants and current members in 20 states. In some cases, even discontinuing coverage on a month's notice. They pillaged the system and now throw it out. The same fate could await Social Security if left in the hands of Wall Street or other self interested parties.

There has been talk of raising the eligibility age, means **testing** benefits, changing indices and COLAS, and increasing payroll contributions. Under current laws, the eligibility age will rise to 67 years in the next couple of years. Hispanics and other ethnic/racial seniors often at risk at age 60, would most likely never see a penny of their contributions over the years when eligibility ages are raised to 67 years, much less even higher. Other seniors would also suffer from the "gaps" between their retirement and the receipt of benefits. With the out-of-pocket cost of health care now at 20 percent of income, and rents reaching 40 percent of income, low and low-middle income seniors would have a hard time if they or the government were to gamble with Social Security funds by playing the stock market and if FICA payroll contributions were raised too high. Social Security is a contract between beneficiary and the government, whose eligibility should not be based on means testing.

Those same interest groups are trying to divide and conquer, by propagandizing that the elderly are taking money away from the younger taxpayers, and that younger taxpayers can make out better through privatization. The Baby Boomers may have thought that 30 years ago, but now they are fighting to preserve Social Security. You know why? Because they will need it. Selfish interests would destroy the security in Social Security for our children and grandchildren.

Depending on what is in it for them, their political **affiliations**, their own claim to wisdom and honest opinions, all kinds of experts have come forward pleading gloom and doom or claiming that there is no significant problem that cannot be resolved with small adjustments. It is a wonder that all of the parties have access to the same information and come up with so many different opinions. I say, don't fix it till it's broken. There is no immediate problem, and the rising costs of providing Social Security Benefits can be overcome through adjusted FICA payroll contributions for both taxpayers and employers. Certainly some of the government surplus can be used to make some adjustments. We do not need experts to help fix a machine that has been working well for a long time without them. Please leave Social Security alone. Thank you.

**Statement of Ken Duncan
State Treasurer of Louisiana**

Currently, almost one quarter million state and local employees in Louisiana contribute to public retirement systems and **do not** pay the old age portion of Social Security employment taxes. These retirement systems provide employees with constitutionally guaranteed lifetime retirement benefits based on a variety of service and age combinations. Retirement eligibility can be as early as with 10-20 years of service. The retirement systems also provide in-service disability and survivor benefits. Disability benefits are available when the person can no longer perform their **current** job.

These benefits are superior to those provided by Social Security. Excluding Public Safety personnel, the current normal cost of these public retirement systems is 14-16% of the covered payroll. The cost of the old age portion of Social Security is 12.4% of the covered payroll. The public employers/employees in Louisiana **cannot** afford to pay an additional 12.4% without increasing taxes or reducing expenditures from some other budgeted area. Thus any "new hires" would have to be covered by a new tier or plan, while maintaining the old plans for the "old hires." The benefits in addition to Social Security, which could be funded by 1.6-3.6% of the payroll, are **VERY LIMITED**. The current level of benefits are superior to that which would be provided by Social Security and augmented by the remaining 1.6-3.6% of payroll.

The soundness of Social Security for the future is a very important issue for the nation. However, a participation mandate for governmental workers does not provide long term fiscal benefits to Social Security or equal/greater benefits to governmental employees. It would result in a permanent and serious reduction in the compensation package for firefighters, police officers, teachers and other governmental employees in Louisiana and nationwide. A mandate just does not make sense.

ARGUMENTS IN OPPOSITION OF MANDATING SOCIAL SECURITY COVERAGE FOR STATE AND LOCAL GOVERNMENTS AND THEIR NEW HIRES

1. **Requiring public employees to be covered by Social Security would increase payroll taxes** The additional 12.40% cost for new hires (6.20% employer plus 6.20% for the new hire) would create a financial burden for Louisiana public employees and employers.
2. **Social Security needs a long-term solution, not a quick fix.** Coverage of newly hired public employees would increase revenues to the Social Security fund for several years. HOWEVER, Social Security does not have a short-term problem. Social Security has a long-term funding problem because excess short term revenues are not being saved and invested to pay the accruing liabilities attributable to those revenues. If the cost of **providing** benefits exceeds the funding necessary to provide these benefits adding more people to the system will make matters worse, not better.
3. **The Federal Government confirmed eight years ago that coverage outside Social Security was appropriate.** The 1990 federal law requiring all state and local employees be covered under a plan comparable to Social Security confirmed that coverage under the Retirement Systems should be the only option for these workers.
4. **Public pension plans are much more soundly funded than Social Security and provide better benefits for the dollars contributed.** Public Pension plans are able to invest in securities providing a higher return than the bonds held by Social Security.
5. **State and local employees do not believe they need Social Security coverage.** These employee groups have been outside Social Security since the 1930's in some cases.
6. **Pension portability for public employees has improved.** Most public pension plans have provisions for

purchase of out-of-state service or the transfer of in-state service.

7. **Public employees are not receiving any unfair benefits from Social Security.** Public employees in non-Social Security states do not receive a free ride. Some of them do receive Social Security benefits from other employment that was covered by Social Security, but then incur a reduction in their Social Security benefit.
8. **There would be a loss of the element of control by the state retirement systems to the federal government.** The federal government controls the benefits and costs of the Social Security program. For example, benefits can and have changed, which have adversely impacted those eligible to receive as well as those receiving Social Security benefits.
9. **Retirement benefits are an important element of the compensation package for Fire and Police Officers.** The physically demanding nature of their duties dictates that public safety officers not work beyond a certain age. The normal retirement criteria for Fire and Police Officers is any age with twenty-five years of service. To require public safety officers to work until age sixty-five would be a detriment to the safety of the public and the officers. The inherently dangerous nature of their work requires a comprehensive death and disability plan for public safety officers. Social Security does not provide the level of benefits needed by public safety officers.
10. **Unconstitutionality.** A mandate from the federal government that covers all State and local workers under Social Security probably violates the Tenth Amendment to the U.S. Constitution.

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Social Security Reform

The current Social Security program has served our nation well for over sixty years. The lives of countless elderly citizens have been greatly improved by this dependable source of income. However, as we approach the new millennium, several changes to the demographic, economic, social, and political landscape of our nation demand that a new assessment be made as to the retirement income policy that should take us well into the next century. Longevity has increased substantially since the current program was designed in 1935. Those reaching retirement age today can expect to live another 15 to 20 years on average compared to the life expectancy of the 65 year old in 1935. Today there are about 3 workers for every pensioner while there were 42 for every pensioner during the days of the first retirees of the 1940's. The aftermath of the Great Depression saw a need for older workers to leave the **workforce** to create needed jobs for the young and unemployed. Today we see a record of several years of low unemployment with the forecast of a labor shortage in the coming decades. The trust fund concept as a way of protecting future pension promises, though not well understood by the general public, gained acceptance during many years of government budgets that were largely balanced. Growing **confidence** and trust in the government as a whole, and especially the Social Security Administration, continued into the 60's. These views have now changed and the public, especially younger members, prefer some say in how their retirement future should be safeguarded and the **confidence** in the government continues to ebb with citizens in all age groups. The personal savings rate in this country continues to lag behind the rates in other competing economies. Considering all of these factors, it is time to consider fundamental changes to the social security retirement program. Changes in the program should follow certain basic principles. Designs should aim to meet the challenges posed by the following factors: 1. The demographic reality and forecasts bode problems for the current program design. 2. The savings rate in the United States needs to increase. 3. The **confidence** of workers in the system is falling and must be restored. 4. The vast majority of Americans support or accept a degree of transfer from high earning to low earning workers.

The twelve principles elicited below should guide the efforts to design the retirement income system for the coming century:

1. Current beneficiaries and workers within at least ten years of retirement should be fully protected under the current system.
2. The combination of a flat pay-as-you-go defined benefit tier and a fully funded tier of **defined** contributions can **satisfy** the desire for some individual choice and utilize the benefits of individual savings and progressive redistribution. This combination also maintains the protection of **defined** benefits with the opportunity for greater returns on retirement savings.
3. The program must be designed so that the amount of the defined benefit will ensure against poverty, but also so that individual savings are encouraged and will become the primary source of retirement income.
4. While the program should move individuals from dependency on government to a system of individual savings accounts, recognize that this will take a long time and that lower level and part time workers' contributions may have to be subsidized. Also, the use of government guaranteed minimum benefit should be used as necessary during transition.

5. Recognize that there will be a cost for transition and try to spread that **cost** across **generations** to the extent feasible. There should also be recognition that the **costs** to **try** to **fix** the current program are substantial.

6. **Establishing** individual accounts will require substantial time and the investment **and** regulatory mechanisms to protect workers' savings need to be designed and implemented **carefully**. The government may have to initially subsidize the establishment of this system

7. Administrative costs for this new program are likely to be substantially higher than for the **current** program. At least in the initial years, these administrative costs may limit the choice of investment selections for workers. There should also be recognition that the current **administrative** mechanism leaves much to be desired.

8. Some of the details for full implementation require further study, (e.g. requirement for **annuitizing** the **defined** contribution income at retirement) but this should not delay the decision for the basic design of the program for the next century.

9. Whatever the final design of the program there should be broad bi-partisan support before implementation. Such a major decision should have broad acceptance by both parties and the public to forestall immediate attempts to substantially modify the program.

10. The public still does not have a good understanding of the current program. Any new program should be carefully explained to the public along with the reasons for moving away **from** the current program

11. While the defined contribution tier of this reformed program should leave the age of retirement somewhat to individual choice, incentives for increasing productive work and reducing early retirement must be identified and implemented. This will require new long term training and education efforts.

12. While the disability program of Social Security may require its own set of reforms, this reform effort should be restricted to the retirement portion of the program and not affect the disability or survivors aspects of the current program.

Since there is broad agreement that at least a portion of the current budget surplus should be allocated to "save Social Security", Congress and the Administration should agree **immediately** to allocate the current surplus and any further surplus to individual retirement accounts until the final redesign of Social Security has been agreed to and an implementation **plan has been set**. In order to stimulate final agreement the entire amount of Social Security surplus revenue collected between now and implementation of a new program should be designated toward this commitment. This should be implemented by allocating a Social Security Bond of \$500 to each worker between the ages of 25 and 55 who earns four social security credits for 1998. This entitlement can be established by the Social Security Administration **as it processes the earnings** records for 1998 and a certificate of entitlement issued. The total **amount** of these funds should be invested in a special account by the Treasury Department **until the appropriate investment and oversight mechanisms for the reformed social security program are implemented**. This allocation will establish the principle of individual accounts and any earnings will be allocated **equally** to participants. By making these allocations at a flat rate, the **principle of redistribution is established** and each worker has claim to these funds only upon retirement.

Louis D. Enoff

December 1, 1998

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SOCIAL SECURITY REFORM MUST PROTECT PRIVATE PLANS

To redress the projected imbalance in the Social Security program, Social Security benefits must be reduced and/or revenue to the Social Security program increased. There are no "easy solutions," and it is important that all players understand -- and prepare for -- the tradeoffs and ramifications of the tradeoffs that will be made.

Today, retirement plans voluntarily sponsored by employers for their employees provide the largest source of retirement income other than Social Security for the middle three income quintiles of the elderly population. They are expected to be an even greater source of retirement income in the future.

Employers, employees, and policy makers need to understand and assess the impact of Social Security reform on retirement plans in order to design a reform program that will support and encourage the creation and maintenance of employer-sponsored plans in the future.

The ERISA Industry Committee (ERIC), an association representing the employee benefit interests of the nation's largest employers, recently released a report that examines the impact of various Social Security reforms on the financing, design, and administration of employer-sponsored plans. ERIC's report draws the following five conclusions about the reform process:

Early action on reform will be critical to its success. The potential impact of many reform proposals on the financing, design, and administration of employer-sponsored plans is significant, but can be mitigated in part if employers are provided a long time to adjust their plans. For example, employers and employees were provided 17 years notice of changes to the Social Security retirement age enacted in 1983. Precipitous changes will not provide employers the time needed to design, finance, and administer plans that will be effective in delivering retirement income in a new environment, or employees the time they will need to accumulate benefits in those plans.

Many proposals impose financial costs that have not been fully examined. In today's competitive business climate, employers will not be able to absorb increases in compensation costs due to changes in Social Security. Potential employer cost increases due to Social Security reform may be offset by reductions in other expenses, which can include reductions in benefits and/or contributions under employer-sponsored retirement plans. Payroll tax increases in any form, transition costs imposed to facilitate changes in Social Security, and reducing the ability of employer plans to take Social Security into account in determining benefits under the plan each can result in substantial increases in compensation costs.

(over)

Both reductions in the Social Security defined benefit and the creation of Social Security individual savings accounts can reshape the plans employers offer to employees in the future. Employer-sponsored plans assume the existence of a Social Security benefit similar to that provided by current law. If the size of the benefit is substantially reduced or is replaced with a defined contribution account, employer plans will have to change. Social Security reform may also have dramatic effects on the disability and dependents' benefits provided under employer plans.

Imposition of a means test would undermine the attractiveness of employer plans. Making receipt of a Social Security benefit contingent on a means test will act as an incentive for some employees not to save money for their own retirement, can encourage employers not to offer retirement plans, and will frustrate the ability of employers who do offer plans to design plans that provide uniform benefits to employees at varying wage levels in their workforce.

Administrative issues may prove the most critical and the most intractable in crafting successful reform. Employers might find it impractical to design plans that are appropriate for older workers who remain under the current Social Security system, young workers under a different system, and middle-age workers under one or more transition systems. Regarding the establishment of Social Security individual savings accounts, it is critical to recognize that no universal system currently exists -- either in government or in the private sector -- to maintain such accounts, and that employers are not an appropriate choice to manage many aspects of them.

Avoiding problems such as these will determine whether Social Security reform will earn the confidence of the American public. It can be done if we craft reform with the facts in mind.

Building a Secure Foundation

The national debate must expand to include the impact of Social Security reform on other key components of retirement security -- most critically on employer-sponsored retirement plans. It must lead to the enactment of reforms that build a more secure foundation for Social Security while preserving and enhancing savings opportunities provided through employer-sponsored retirement plans.

Employer-sponsored retirement plans are adaptable. They can thrive under Social Security reform if that reform thoughtfully takes their needs into account. Millions of workers and their families count on employer-sponsored plans to provide a major portion of their retirement income. Social Security reform must be shaped in a way that permits employer-sponsored plans not only to adapt, but to flourish, so that they can increase national savings and continue to provide a critical part of the Nation's retirement security.

For a copy of ERIC's report, "The Vital Connection: An Analysis of the Impact of Social Security Reform on Employer-Sponsored Retirement Plans," go to ERIC's website, ERIC OnLine (www.eric.org), or call the ERIC office.



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STATEMENT ON SOCIAL SECURITY

DECEMBER 1998

Social Security is an excellent program that has proved its worth over the years. It is the largest anti-poverty program in the United States and ensures that none of the millions of elderly Americans, disabled workers and their dependents, adults with severe disabilities who are dependents or survivors of their parents, and spouses and children of deceased workers become destitute. The Evangelical Lutheran Church in America is a strong proponent of Social Security in that it **further**s a more just and compassionate society and is carried out with a strong sense of elemental fairness. This church's vision of a sufficient, sustainable livelihood for all is furthered by such programs as Social Security which cares for the "widow and orphan," the disabled person, and the older American alike.

It is our judgement that Social Security needs adjustment, but that it is not in imminent crisis. There is time for a thorough debate. Any policy changes made to preserve the fiscal integrity of the Social Security system must protect the core values and benefits of the current system, provide sufficient revenues for the program well into the future, and protect vulnerable populations, particularly the working poor, women, and minorities.

There have been several proposals to make individual investment accounts a part of the Social Security system. We believe that private accounts should not be substituted for Social Security's current defined benefits. Diversion of tax revenues to pay for private investment accounts appears to make the projected long-term financing problems more severe, forcing deep benefit cuts and raises in the retirement age. An increase in retirement age for those who work in physically challenging jobs or who as a group have a lower life expectancy is not an acceptable alternative. As individual private accounts are considered, the complexities of administration should also be considered.

In general, 1) there should be no reduction of benefits and no increased restrictions on eligibility; 2) individual saving and private pension programs should be encouraged through changes in policy, but not at the expense of Social Security; 3) improvements should help all generations and not pit generations against one another; 4) risk-free disability insurance protection for workers and their dependents, survivors insurance for spouses and children of workers, and benefits for adults living with severe disabilities should be continued.

For further information contact Kay Bengston (202) 626-7942.