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SOLVENCY OF THE SOCIAL SECURITY TRUST FUNDS

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

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SOLVENCY OF THE SOCIAL SECURITY TRUST FUNDS

TUESDAY, JUNE 27, 1995

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Alan K. Simpson (chairman of the subcommittee) presiding.

Also present: Senator Baucus.

OPENING STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING, CHAIRMAN OF THE SUBCOMMITTEE

Senator SIMPSON. I am pleased to convene this hearing of the Subcommittee on Social Security and Family Policy. Today we will focus on suggestions for making the Social Security trust fund solvent, which I think is a rather worthy goal. It is a silly idea but, nevertheless, one we should pursue, I would conjecture.

In a prior hearing, we heard testimony from three trustees of the Social Security and Medicare trust funds. We heard from the Commissioner of Social Security, Shirley Chater, and the two public trustees, David Walker and Stanford Ross.

The news was stark and sobering. It should have sent shock waves through anyone who truly cares about future generations of Americans. I think all present and future retirees should be aware of the information in the trustees' report. It shows so clearly that a day of reckoning is coming.

But I do want to assure that I am not like the chap with the beard and flowing white robe, or the sandwich board—that was before your time, many of you—with a sign saying, "The end is near." He usually looked quite scraggly, with sandals on too. That is not me.

But, according to these trustees, none of the trust funds meet the long-range tests of financial solvency. In other words, none will be solvent; none of them will be solvent in 75 years.

Under the best estimate of what the future holds, which assumes moderate inflation and economic growth, the trustees report to us that the Social Security retirement trust fund will be exhausted in the year 2031.

The disability trust fund will run out in 2016. And the Medicare trust fund will be depleted—that is their term, broke is a better word—in the year 2002.

What is worse is that the expenses draining from the Social Security trust fund will begin exceeding the revenues coming into the trust funds in the year 2013.

This is the debate of the day in which we should, or must, all be focusing upon. These figures are not based on hysteria, hype, horror stories or fiction. They are cold, hard, painful facts. No one can refute them.

If we care at all about our children and grandchildren, we must take appropriate action now to prevent the trustees' forecast from coming true.

So this is what we shall address today. I have asked our witnesses to suggest proposals for making the Social Security trust fund solvent.

And I would earnestly hope that everyone will take away at least two messages from the hearing. One, the call to reform the Social Security program is bipartisan. And, two, there are a multitude of ways to immediately shore up the Social Security program.

I understand that my friend and colleague, Senator Packwood, the Chairman of the Finance Committee, will hold hearings in the coming weeks on the solvency of Medicare, that trust fund, which will go broke in 7 years. I look forward to those hearings with great enthusiasm.

Some of us may seriously disagree on whether specific action should be taken. But I think we must all come together in acknowledging that a most serious problem exists, and that corrective measures are now warranted. We must act before the crisis is fully upon us.

We have a number of fine witnesses to hear from today, including my good friend, Senator Bob Kerrey.

We have two roll call votes, beginning at 10:15. We will have the testimony of Senator Kerrey, and then go to vote. We will then return and do panels II and III.

But a word about Bob Kerrey. He is strong, independent, thoughtful, candid, provocative, partisan, and able to shift gears very well into bipartisanship—a nice trait. He is a man of ability and adroitness, and a chap who really does not take any guff from anybody, a man who I respect and admire. I have enjoyed working with him as a member of the Bipartisan Entitlements Commission.

So, with that, Senator Kerrey. We appreciate having your thoughts.

STATEMENT OF HON. BOB KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Thank you, Mr. Chairman. Where are all your colleagues?

Senator SIMPSON. They never come. [Laughter.]

I do not go and seek their attendance, nor would they come if I did. So I do not mind it at all. It is something I have been doing for 30 years, messing around with things that are filled with emotion, fear, guilt or racism. And nobody usually shows up for those.

Senator KERREY. Well, I appreciate your taking this one on, Mr. Chairman. I have come at your request, to offer what I assume are some familiar views of changes that I think are needed now in the Social Security program for a number of reasons.

One, we have a commitment on the table, and we need to honor that commitment to all beneficiaries, current and future. But, in addition, Mr. Chairman, I believe that there is another very important reason. And that is we need to help our citizens as they plan for their own retirement.

First, and perhaps most importantly, I would like to submit for the argument a definition of Social Security. Social Security is an intergenerational commitment, made by the generations who are working, to allow their wages and salaries to be taxed at a fixed percentage, and the proceeds transferred to those generations who are retired, and no longer working.

This definition is important, Mr. Chairman, because too many Americans define Social Security much differently. Too many Americans believe it is a savings program, where individuals set aside their income to be held, and then returned with interest after retirement.

Social Security is not a savings program. If it was, Mr. Chairman, if it was a 12.4 percent for-savings program, America would be the world's leading creditor, and our economy would be kicking the rear ends of almost all of our developed competitors,

More important, if it were a 12.4 percent savings program, Americans would be far more financially secure, and, very significantly, a lot more wealthy than they are today.

Now I believe we need to change our Social Security laws, and the laws relating to other Federal entitlements, for the purpose of accomplishing three worthy goals.

The first goal is the obvious one. That is to make certain that the promise we make to currently eligible beneficiaries can be kept to beneficiaries who are alive today, but will not be eligible for many years.

Second, we need to reverse the trend of American wages, salaries and benefits, that have been declining as a percentage of total U.S. output. There was a very alarming statistic put out last week by the Bureau of Labor Statistics that indicates that productivity increased over 2 percent last year, and wages, salaries and benefits declined by 3 percent. Well, part of the reason for that is that we continue to see entitlements squeezing out our capacity to make other kinds of investments.

You mentioned bipartisanship. The public sees a lot of differences between Republicans and Democrats, but there is a lot of similarity, in that there are some items where we absolutely agree, whether it is transportation, infrastructure, training or education, we know that it lifts our future ability to produce, and our standards of living as a consequence. We are reducing this capacity every single day we allow entitlements to continue to grow as a percent of our budget.

And, third, for purposes of discussion today, we need to reverse the trend towards increasing concentration of American wealth. I say to my Democratic colleagues, who are not here this morning, we often argue for redistribution of wealth.

The problem with the redistribution formula is that you have not created anything. All you have done is put it from one pocket to another. It would be far better for us to devise a way for us to increase the amount of wealth that each American household has. And I believe, by reforming Social Security, we can do that.

Changing the current course, Mr. Chairman, is not going to be easy because old habits, as you know, die hard. I am here this morning to propose that one of the most difficult habits that we are going to have to change is the habit of looking into the future, and saying the future is 5 years, which is what CBO does, or 7 years, which is the current budget resolution.

Most visionary of all today, the President is looking out there at the long period of time of 10 years, which hardly describes it adequately, when you consider the size of the baby boom generation, since 10 years does not reach the first year, 2008, when they start to retire. A 10-year view hardly gets us out to the future that we need to see.

Mr. Chairman, I would like to submit for the record a story about a young man by the name of C.A. Sorenson, who gave a speech in 1910. It was a Statewide oratory contest in Nebraska, and C.A. Sorenson was the father of Ted Sorenson. Both of these men made quite a mark on our country. C.A. was a Republican Attorney General, a friend of George Norris, elected in 1928 and in 1930, who swept out in the Democratic landslide of 1932.

But, before he left, he made a tremendous contribution to the electrification of our State. And, of course, Ted Sorenson made a strong contribution to the political career and to the efforts of President Kennedy.

That contribution began as a result of C.A. Sorenson giving a speech in the Statewide oratory contest, where he said, "We need to break with the past."

And, Mr. Chairman, being a man of the West, you will understand the metaphor he used, which was the birth of a blind, wobbly-legged calf. After it was born, it wandered off into the woods, and a couple of dogs chased after it, and they broke down a bush. The next day, along came a traveling party. They saw the path broken down a little bit, so they followed this serpentine path, and it became, in the vernacular, a well-beaten path.

When it came time to build the highway, the engineers decided that they were going to pave this serpentine path, which was originally created by this blind, wobbly-legged calf. Mr. Sorenson is suggesting that sometimes it is risky for us to merely presume that, because we have always done it that way, that is the way we have to continue doing it.

If you doubt that he was courageous in giving the speech, Mr. Chairman, you can look at the award he received. He got third place by the judges, and he was also dismissed from the Baptist college he was attending at the time. Through an act of generosity, he ended up at the University of Nebraska and the University of Nebraska Law School. So it can be fairly said that, as a result of his courage, both he and his son, Ted Sorenson, were able to make a substantial contribution to the country.

Mr. Chairman, I would like to submit the full statement because I would like to get into the details of what I think needs to be done. Mr. Chairman, the hard facts are that, as I see it, that balancing the budget, as important as it is, in some ways may not be as important as changing the trendline of our entitlement programs.

Indeed, my strongest criticism, both of the President's budget, 10 years, and the current budget resolution, for which I voted, 7 years, is that it does not take the long-term view. But, when you get into the long-term view, you can see that with our current proposals, we are continuing to move in a direction where, in a relatively short period of time—a blink of this Nation's eye—100 percent of our budget will be entitlements and net interest.

The whole country will witness Washington, D.C. being converted into an ATM machine. That is all we will be able to do is transferring money. We are headed in that direction.

If you consider the problem of declining wages to be an urgent problem that needs to be solved, I see a strong connection. A number of times in the Entitlements Commission debate, I heard it said that Democrats, who have an interest in trying to make investments in education, training, or transportation, should be alarmed by a budget that is moving in a direction that squeezes out our ability to do that.

Anyone who looks at the domestic accounts, and wants to spend money, whether it is defense or non-defense, should say that we have got to alter that trend. We cannot afford to continue going in the direction we are going.

The facts, Mr. Chairman, are irrefutable. People can ignore them if they want, but they are irrefutable. We may have difficulty forecasting 30 years into the future, but we know that the largest generation in the history of this country will begin to retire in 2008.

I suspect you referenced or read the article that was in the Washington Post this morning, talking about the retirement problem. It should be a call to arms by this Congress, to say we cannot wait. At age 50, you may be able to start jogging, quite smoking, and drink in moderation, or whatever else you need to do to live a little longer, but you do not get those 50 years back.

And if you wait until age 50 to start saving for retirement, your contribution has to be so large that you are unlikely—or perhaps even unable—to be able to make it.

Mr. Chairman, the problem that we face with retirement programs and Social Security is twofold. One, as you know, we have a commitment on the table today that we are not going to be able to keep. We are either going to cut benefits for the baby boomers, or we are going to have to raise taxes to cover what we promised to pay them. Those are the only two choices.

And if you look at the size of the tax increase that is required, particularly if you wait that long, I think most people have reached the conclusion that you are going to be looking at some substantial cut in benefits for the people that perhaps are greatest at risk at the moment, as few people will want to pay the required exorbitant taxes.

But there is a second reason, Mr. Chairman, that I think Social Security needs to be saved. And that is, I believe we need to take a look at the concentration of wealth, and take a look at what we can do to solve that problem. In my judgment, the best way is not to devise some redistribution scheme, but to devise some method whereby individuals acquire their fair share of the wealth.

Again, in the article this morning, if you look at the wages that these individuals have, imagine what would happen if 12 percent of their wages were going into a savings program, accumulating over the course of their working lives. They would not be talking about retirement problems.

You and I have a proposal that we have introduced, which calls for the Social Security program not only to be fixed, so that all generations know that the commitment that we have on the table can be met, but we begin to move Social Security in the direction of taking on the characteristics of a private savings program.

Hopefully—and I believe assuredly, in fact—solving this concentration of wealth, would give Americans the opportunity to acquire wealth.

It has been estimated that our proposal, with just 2 percent of the employee share going into a personal investment plan, would generate $1 trillion of savings, spread out over 137 million Americans in a 9-year period of time.

It is that kind of fact, Mr. Chairman, that I think we need to talk to our colleagues about, as we try to recruit Republicans who want to increase savings and Democrats who want to solve the problem of a concentration of wealth situation in our country.

Mr. Chairman, I have had many conversations with citizens in Nebraska and elsewhere in our country. I have found there to be a great deal of enthusiasm. I think we are breaking through and getting people to understand that we are not killing Social Security. We are trying to stabilize it, improve it and change it, so that it works better, and satisfies the needs of the American people

I have had some very interesting proposals that would alter our proposal, and make it even more powerful. I have had people suggest allowing lower-income workers to dedicate a larger percent of their wage than 2 percent. For example, you could take a person making $10,000 in 1995 money over the course of their working life, if you allowed them to take the full 12 percent, they could become millionaires just with that contribution. It would be unlikely that they will accumulate that kind of wealth if we continue the status quo.

It has been suggested that our private pension laws need to be changed simultaneously. We have taken action in the 1980's, both for purposes of generating money and for purposes of solving discrimination problems, that have made it more difficult.

A pension program that does not vest for 5, 6, 7 years, a pension program that is not portable, is every bit as much of a problem as a health program that is not portable.

If we are able to reform our Social Security system so that we fix the long-term program and create an individual savings program, I think it is appropriate to consider that we need to reform our pension system as well.

Along the same line, I have had an interesting idea from time to time. My staff always tries to get me not to say it out loud in public, because they think it is wacky. But, if we are able, if it occurs this year that we provide a $500 per child tax credit to the American people, why not convert that $500 per child tax credit into a credit that goes into a personal investment, established at birth, for every child in America?

Accumulating savings, Mr. Chairman, on behalf of children would, in my judgment, be a far better gift for their future, and far more constructive for our economy that merely saying that we are going to put $500 out there for consumption.

Anyway, I appreciate very much having you as a partner in this venture. I just received a note from former Senator Barry Goldwater, after shipping him the legislation, saying that I should hang onto your coattails as long as you should allow.

I think this is an opportunity for you and I to work together. But I believe the hardest, and the most important, thing for us to do is to say to our colleagues who want to delay, you delay not just at your own risk, but you delay at the risk of the American people who are wondering about what they are going to do when they retire. You do not get that time back.

This is not a situation where exercise and good behavior is going to be able to restore a mistake that we make if we delay taking action as quickly as possible.

[The prepared statement of Senator Kerrey appears in the appendix.]

Senator SIMPSON. Well, Senator Kerrey, I heard your story of the wobbly-legged calf. I thought of myself in this situation—you can see the sterling support I get from both sides of the aisle—as a wobbly-legged calf, headed for slaughter in the woods by the grizzly bears of the AARP, the National Committee for the Preservation of Social Security and Medicare, the Gray Panthers and the Pink Panthers and all the rest.

The heavyweights of the nonprofit lobbying juggernauts just wait there, I guess, not caring about their children and grandchildren, which is a curious thing, and one of the basic reasons that I have become involved.

But watching you, not only as a symbol of courage in your military background, but in this one too, it is a tremendous treat for me to work with you. I enjoy it thoroughly. You are creative and innovative. My staff too—you can see their hands reach out like stop him, stop him. And then they calm and drop back.

But I think it is important that people know how well our staffs work together. You have a splendid staff; I do too. They respect each other, they are working together. It is not just fictitious how many of our colleagues come up to us privately and say, you are doing something, you are finally doing something.

They cannot show—they do not dare show—because in their town meetings they will load them up, people with signs, and they will be strolling around the street. And deceptively frail people will jump up on their cars.[Laughter.]

So, it is not worth it to them. But it is worth it to me, and it is worth it to you, with children. And our job, I think, is to tell the story. I really believe that by the time next election year comes, whoever is in this game will be paying attention to the young people in America in a way they never have before.

And I just would ask you one question. Where do you think the young people are going to come down? Are they going to understand? Are they going to be participants? Are they going to learn what is going to happen to them?

Because anything you and I do does not affect anybody over 51, except as to a COLA. And the most devastated are the people between 18 and 45 or 50.

Do you have a thought on that?

Senator KERREY. Well, I do, Mr. Chairman.

First of all, this is the week we are celebrating another 50th anniversary, this time the 50th anniversary of the signing of the United Nations document and the creation of that organization.

We have celebrated the 50th anniversary of D Day and the 50th anniversary of the ending of various aspects of that war.

First of all, I believe that the people who won that war, and the people who won the cold war as well, the generation who are currently beneficiaries, have demonstrated that they are willing to participate in fixing this system. They do care about their children and their grandchildren. They are about their country's future, and they are willing to participate in reforming the system.

I think that the hardest thing we are going to have to deal with is this argument that very often is made—well, let us just wait 10 years. That is a long-term problem, let us wait 10 years to do it.

Let me use some mathematics. Mathematics are brutal because very often it is impossible to change them. You wish you could, but you cannot. And this issue of time, when it comes to generating wealth and savings for retirement, is a very important issue.

Let me illustrate it with this example. You want to retire at age 65, you want to quit working at age 65. Let us say that you make the decision as to how much money you want at age 50, as opposed to age 20. You have to put aside $1,500 a year to have as much as 15 years later as you would have had if you put aside $75 a year starting at age 20. There is no way to change that. It is impossible for Congress to act to change the law of mathematics. Compounding interest rates will not permit you to change it.

If you start at age zero, and your rate of return is 10 percent real—right now, with Social Security, it is 1 percent—and you say you cannot get 10 percent real, the S&P 500's give you 10 percent real over 70 years. You can get a 10 percent real rate of return.

At 10 percent, you get 10 turns in a 70-year period of time. If you start at age 20 instead of age zero, you miss three turns. And, if you start at age 50 instead of age 20, you are down to only 15 years left. You have got two turns that you can make. That is all you have got left.

So you are obliged at that point to hope that somebody will allow you to have some of their income and wealth to take care of your retirement. You are obliged to; there is no other choice.

So time is not on our side when it comes to setting aside enough money to accumulate the wealth that we need, either individually or collectively. Even the collective pool that we use for Social Security needs to be changed so that it can earn a higher rate of return than the non-negotiable Treasury instruments.

So my answer to you is, I believe all generations, if we present the facts honestly, will see that we cannot delay, that we should not wait until 1996 or 1997, or as some are saying 15 or 20 years, to fix the problem. The longer you wait, the more you will regret having done so.

Senator SIMPSON. And the longer you wait, the only two solutions remain exactly the same—cut benefits or raise the payroll tax. Is that not where we are?

Senator KERREY. It is true. And I am trying to argue—and I think correctly so—I sometimes argue incorrectly, so I use the phrase, "I think". I am prepared to have somebody counter it. But if you identify a problem of declining real wages, and a problem of concentration of wealth, it is through our retirement programs and entitlement programs that you solve both of those problems.

Because, unless you believe that you can redistribute wealth—and I do not believe that you effectively can—you have to generate it. And what Social Security can become, if we reform it correctly, is not only a retirement program that provides people with income, but it becomes a savings program to generate wealth that is distributed across every single working American household.

Senator SIMPSON. Well, I thank you so much. And I look forward to working with you.

We have cosponsored seven bills in a bipartisan way, together with the single large bill. We will have hearings at the subcommittee level on that legislation, and are doing so. And we will also have hearings at the full Committee level. That is a pledge that will be kept.

And we will vote on these issues. I do not know where the vote is; I do not even care. It does not mean a whit to me. But we are going to have this debate. And I hope young people will wake up. I am 63, and I will be smuggling it out of here in a sack. [Laughter.]

So do not worry about me. In fact, do not worry about anybody over 60. They have all got it made. They have put peanuts into the Social Security system, and they are getting out $900 a month or $1,100 a month, or $1,400 a month.

And I always love to tell it, they hate it, but I love it. I put in it from the beginning, and I want it all out—you have heard that one. That is a dandy. It is usually a shriek, a guttural cry from the back of the room accompanies that. I say to them, yeah, yeah. If you put in it from the beginning, you do want to get it all out, but let us review what you put in, and you never put in over $30 a month for 8 years. Then you never put in over $174 a month for the next 18 years. Then you never put in over $300 a month, or $400 a month.

And, in the most productive years of my life, practicing law in Cody, Wyoming, I never put in over $860 bucks a year, and neither did anybody in this room with gray hair, not one. It is the phoniest argument of all time.

And I do not intend to let it go on. And so you are going to get it all back. If you got out in the 1960's, you got it all back in 2 years. If you got out in the 1970's, you got it all back in 3 years. Now you can get it all back in the first 6 years of retirement. And these are the people who come and whoop it up. It is a great game.

Did you have anything further to add?

Senator KERREY. No, before my staff grounds me again.

Senator SIMPSON. We have a vote, just a few minutes left on the vote.

Senator KERREY. Somebody came and asked me a question. Maybe you can answer it. it was, what is it about people west of the 98th meridian that produces people like you and Simpson?

Senator SIMPSON. And you. Are you trying to get out of this now?

Senator KERREY. No. I said me and you.
Senator SIMPSON. We are bound together in a looped wristlock as we go over the cliff together.
Senator KERREY. Thank you, Mr. Chairman.
Senator SIMPSON. Thank you very much. I deeply appreciate you coming.
I am going to go and vote. We will come back and start with the panel of Stanford Ross, former Commissioner of Social Security, and former Public Trustee of the Social Security and Medicare Trust Funds, a partner of Arnold and Porter of Washington, D.C., David M. Walker, former Public Trustee of the Social Security and Medicare Trust Funds, partner and managing director of compensation and benefits, Arthur Andersen, L.L.P., Atlanta, Georgia, and Mark Weinberger, partner at Oldaker, Ryan and Leonard, Washington, D.C.
I regret that we must do it this way. We will be back in about 10 minutes.
Thank you.
[Whereupon, the subcommittee recessed at 10:32 a.m., to reconvene at 11:00 a.m.]
Senator SIMPSON. Well, my apologies. And thank you so much. I have introduced this panel prior to my leaving. If you will please proceed, with the necessary limitation of 5-minutes each.
Thank you very much.

STATEMENT OF MARK WEINBERGER, PARTNER, OLDAKER, RYAN AND LEONARD, WASHINGTON, DC

Mr. WEINBERGER. Mr. Chairman, thank you for asking me to testify this morning. I commend you for holding these hearings and having the foresight to address the solvency of the Social Security system.
I have been asked to set the stage for the hearing by briefly describing the financial health of the program. I will base my testimony on my experience as the chief of staff of the Bipartisan Commission on Entitlement Tax Reform, in which you were an active member.
The Commission was comprised of 12 Senators and 10 Congressmen and women, and then 10 Presidential appointees from the private sector.
My testimony does not represent the views of the Commission, any Commission member, or the Commission chairman. As a former staffer, I need to say this. And, if you really do not like what I have to say, they do not represent my own views either.
Mr. Chairman, conspicuously absent from the historic debate on balancing the Federal budget is any mention of the single largest Federal expenditure—Social Security.
Of the $1.53 trillion the Federal Government will spend this year, Social Security accounts for 22 percent, or $334 billion. That is more than the Federal Government will spend on every single other entitlement program combined, absent Medicare.
By the year 2005, spending on the program will increase to $566 billion. And this is before the program's costs begin to snowball when the baby boomers start to retire in 2010.

Why has there been a deafening silence on the need for Social Security reform in the current debate? It is not because politicians or the American people think it is a perfect system. In fact, to the contrary, each successive public poll confirms that Americans under 30 do not believe the program will be here for them.

And focus group participants, when asked about the program, to identify Social Security with a single word, choose words like "reform", "bankrupt", and "inadequate".

Conventional wisdom is that the American voters will punish political leaders that attempt to reform the system. Policymakers have consistently promised to protect beneficiaries and the integrity of the program, and for good reason. The program is one of the most successful Federal social programs. It provides cash and health insurance for the elderly and disabled, removes millions from poverty, and gives many of the elderly the means to live their years in dignity. It is for that reason Social Security reform is so important.

Policy leaders may be afraid of being perceived as going back on their word to the American people. However, the only way for policymakers to keep their promise to the American people is to act to reform the system. What the American people should fear is not any action by this Committee, Congress or the administration. What they should legitimately fear is inaction.

What I would like to do is show you this chart, with which you are certainly familiar, which the Commission came up with in its report to the President in August. And I think there are two things you walk away from this chart with. One is, of course, that the current trends are unsustainable.

For those who have copies of the testimony, it is the first chart attached to the testimony. The red line, the S-like line, is the commitment to future obligations for benefits to retirees that the Federal Government has to make. And the green line is the amount of revenue coming in from payroll taxes and taxation of Social Security benefits which the Federal Government is collecting.

You can see, obviously, that the green line is above the red line currently, in 1995, and we have a surplus, an annual surplus. And that is another reason many people talk about not needing to act currently to deal with the Social Security problem. The surplus is about $65 billion this year, and it is going to increase up to about $100 billion by the turn of the century.

However, even with this surplus, which was created back in 1983, when it was recognized that we were going to have to make changes to the system in order to provide for the baby boom retirement, and prevent confiscatory taxes on future generations, this chart shows that the trustees, public and otherwise, concluded that by 2030 the entire system will be bankrupt, and there will not be any money left if nothing is done in the interim.

What I would like to focus on is not 2030. Twenty thirty is light years away and, for politicians, it is many elections away. For individuals, it is possibly a generation away. What this chart shows is really important, besides the fact that the current trends are unsustainable, is that 2013 is the year that the rubber hits the road.

Twenty thirteen is the year that the red line, for the first time, crosses and goes above the green line. What that means is that there will not be enough money for the trustees coming in in taxes to pay out to the current beneficiaries. When they do not have enough money to pay out to the current beneficiaries, of course, what they have to do is go back and reach into the trust.

When they reach into the trust to find the money to pay out to those current beneficiaries, there is no cash sitting there obviously. What they find is Government IOU's. The Federal Government also does not have the money to give the trustees to pay to the current beneficiaries. So, in the year 2013, if the trustees are going to make good on their obligations to those current beneficiaries, they have to basically get the Federal Government to give them the cash in order to provide those benefits. The Federal Government has to get that cash from either of two ways—it has to raise taxes or borrow additional money by issuing new bonds to pay off the existing bonds to the trustees.

If you look at the slope of that line, the curve of the S-line, you can see what would happen to the deficit beginning in the year 2013, if we had to go ahead and borrow that money to pay off those benefits. In fact, by the year 2015, payments to Social Security would no longer be a surplus; it would be a $57 billion deficit. And then, by the year 2020, it would be $232 billion.

In conclusion, to prepare for the crossing of the lines in 2013, it is my opinion that it is imperative that policymakers develop strategies now on how to shore up the trust fund so that those who need to rely on the Social Security benefits will continue to be able to do so.

In my written testimony, I lay out some principles that I believe should be incorporated in the debate. One is gradualism, allowing people to adjust to change ahead of time. Another is that reform should be broad enough to incorporate changes in the other two legs of the retirement stool—private savings and employer-provided vehicles.

The savings problem in the U.S. today, that is going to be exacerbated by the graying of America, transcends Social Security. It is a fundamental problem that has significant ramifications to the standard of living of the elderly, as well as future generations of Americans.

I ask that my entire statement be incorporated in the record. I would be happy to answer any questions at the appropriate time.

Thank you again, Mr. Chairman, for inviting me to testify.

Senator SIMPSON. Thank you, Mr. Weinberger. You were an excellent staff person with the Commission.

[The prepared statement of Mr. Weinberger appears in the appendix.]

Senator SIMPSON. Mr. Walker or Mr. Ross? Mr. Walker, please.

STATEMENT OF DAVID M. WALKER, PARTNER AND MANAGING DIRECTOR OF COMPENSATION AND BENEFITS, ARTHUR ANDERSEN, L.L.P, ATLANTA, GA

Mr. WALKER. Thank you, Mr. Chairman. Thank you for the opportunity to appear before you again to address the important issue of how we can assure the financial integrity of this Nation's Social

Security system, in particular the OASI program, Old Age Survivors Insurance Program.

My remarks today are based upon my personal views, as an informed and concerned private citizen, who also happens to be a baby boomer, a former trustee of Social Security and Medicare, a former Assistant Secretary of Labor for Private Pension and Health Programs, and a former head of the Pension Benefit Guaranty Corporation.

Mr. Chairman, I have prepared a full statement. I would like for it to be inserted into the record, and I will move to summarize it now.

Senator SIMPSON. Without objection, it is so ordered.

[The prepared statement of Mr. Walker appears in the appendix.]

Mr. WALKER. Thank you, Mr. Chairman.

As noted in the 1995 trustees' summary of the Social Security and Medicare annual reports, based on the trustees' intermediate or so-called best estimate assumptions, the OASI trust fund is projected to be able to pay benefits on a timely basis for another 36 years. However, the projected 36-year period in the 1995 annual report is 6 years less than the intermediate estimate in the 1994 annual report.

In addition, based upon the 1995 intermediate assumptions, the OASI trust fund is expected to turn a negative cash flow beginning in the year 2013, just 2 years after the first baby boomer reaches age 65.

As a result, while the OASI program is arguably in the best relative financial condition of the four Social Security and Medicare programs, its longer-term financial condition is not good, and it is deteriorating.

As we look forward to the 21st century, and begin to address our related entitlement challenges, we need to establish a clear set of social insurance and other program priorities.

In this regard, and in my opinion, the OASI program represents the most important of the four Social Security and Medicare programs. It represents the foundation of this Nation's retirement security policy, a foundation that needs to be supplemented by private pension programs and personal savings arrangements.

In addition to being our most important social contract, I believe the OASI program also represents the social insurance program with the greatest public support and political risk.

Given the above factors, I believe it is important that we begin to take steps to assure the long-range financial integrity of the OASI program now. The need for timely action is reinforced by the fact that delay will only serve to increase the amount of needed change and the degree of difficulty in achieving it.

While timely action is desirable, from a realistic perspective, enacting any significant reforms will have to be preceded by a massive public education campaign to educate the American public on the nature and extent of our Nation's entitlements challenge, and the alternative approaches to addressing it.

With regard to OASI program reform, I believe that the financial integrity of this program can and should be maintained through a combination of program reforms and revenue enhancements.

I believe that our objective should be to assure the long-range financial integrity of the OASI program and related benefit security for current and future generations of Americans.

In my view, Congress needs to consider a number of possible OASI-related actions, including the following:

First, reviewing the accuracy, reasonableness and appropriateness of the current OASI benefit indexing methodology.

Second, eliminating any early retirement subsidy under the OASI program.

Third, raising the early retirement age—currently 62—and increasing further the normal retirement age—currently scheduled to gradually increase from 65 to 67, both on a phased-in basis.

Fourth, reviewing the existing replacement ratios, including possibly creating a new benefit bend-point, thereby further increasing the regressivity of the OASI benefit structure.

Fifth, reviewing the current spousal benefit structure.

Sixth, broadening the definition of taxable wage base to include the current value of certain fringe benefits, such as the value of employer-paid health insurance.

Seventh, increasing the OASI wage base cap and/or payroll tax rate.

Eighth, considering the conversion to a two-tier OASI program with a base defined benefit and a supplementary and mandatory defined contribution individual account element.

Finally, reviewing the current OASI trust fund investment policy, including consideration of allowing individuals to direct how their individual account is invested among several passive investment vehicles, similar to the structure of the current Federal Thrift Savings Plan, if a two-tier system is adopted.

While I believe that the above reforms should be seriously considered, I would strongly oppose two specific reforms that have periodically been discussed.

First, fully means-testing Social Security so that individuals who pay in over a number of years, no matter what they earn in retirement, should not be enacted.

Second, elimination of the payroll base wage cap should not be enacted. I believe both these actions would be counterproductive over the longer term.

In addition to the OASI program, I think it is important that we realize we cannot look at OASI in isolation. We need to recognize that the DI program is in the need of fundamental reassessment and reform, especially given recent projected disability trends.

Most importantly, the Medicare program is clearly unsustainable in its present form, and needs dramatic and fundamental reform.

In closing, as an informed and concerned private citizen, a baby boomer, and a father of two, I am extremely concerned that this Nation faces a looming—not an immediate, but a looming—retirement crisis and intergenerational crisis.

We must deal with the fundamental financial imbalance in the Social Security and Medicare programs, and our related private pension, personal savings and overall health care challenges in a timely, comprehensive and nonpartisan manner.

Doing so is critical to the long-term competitive posture and economic security of this Nation, the economic security of our children and grandchildren, and the security of American workers.

In summary, Mr. Chairman, we must have the courage to be candid with the American people about the nature and extent of our challenge. We must have the vision to see the way to deal with it in a fair, responsible and rational manner. And we must have the commitment to follow through with needed actions. I would be happy to help in any way I can in this regard.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions that you or other Subcommittee Members may have at the appropriate time.

Senator SIMPSON. Thank you very much, Mr. Walker.

Mr. Ross?

STATEMENT OF STANFORD G. ROSS, SENIOR PARTNER, ARNOLD & PORTER, WASHINGTON, DC

Mr. ROSS. I thank you, Mr. Chairman, for inviting me here today.

I also have prepared a substantial statement of my personal views on the issues, and I would ask that you enter that into the record. I will use my few minutes to summarize what I think are some major points that would add to the discussion here this morning.

Senator SIMPSON. Without objection, it is so ordered.

[The prepared statement of Mr. Ross appears in the appendix.]

Mr. ROSS. First of all, it is clear, as our recent trust fund reports have made clear, and indeed as they have made clear for several years, that the long-term deficits in the OASI and DI programs need to be addressed.

I think it is important to point out that these two programs must be analyzed separately. OASI is relatively predictable. The factors out there that create the problems are well known, and the ways to analyze it are well established.

The DI program is much more subject to variation in the growth of beneficiaries and costs, and presents a different problem. Therefore, I am going to focus first on the OASI program, and then the DI program.

The focus for reform of the OASI program should be to make those changes which will adapt the program to meet the needs of this society over the next period, and restore long-term financial balance.

I do not think the changes should be driven just by numbers and financial calculations. I think the program needs to be looked at in terms of today's realities, and what we know about the changes that have happened in our society over the 60 years since the program was first enacted, and the changes we know we can anticipate in the coming period.

In other words, I think you can put together a program of structural changes that will not only restore long-term financial balance, but improve the fairness and equity of the program, and make it serve the needs of the younger generations much better.

I agree with you that no changes should affect existing beneficiaries. They are on the rolls, there is a program there, and that is the program that they have. But we are talking about shaping it for younger people, whose confidence in the program must be restored.

Retirement age changes need to be considered, particularly raising the early retirement age from 62 to 65. Also, indexing should be reviewed, and any over-indexing removed from the system.

The benefit formulas may need to be changed. But, in all events, the program should continue to provide a basic level of support. That was the original concept; it is a social insurance concept that I believe is still valid today.

Ultimately, changes in the retirement age, indexing and the benefit formulas all need to be considered together, since they ultimately translate into a particular percentage change affecting individual beneficiaries.

I do believe though that the way you make those changes, and the structure of the changes, should be done to improve the program, not simply as a way of restoring long-term financial balance. That result should be a product of making substantive changes.

The family policy aspects of the OASI program should be reconsidered and spousal benefits reformed. For example, I think it is hard to justify automatically giving the spouse of a higher earner 50 percent, whereas the spouse of a lower earner gets the same 50 percent, but it is much less.

Spousal benefits were enacted in 1939 when the paradigm was of a male worker, a female homemaker and two children in a nuclear family. Today, most women are in the work force, even those with small children, and there are many changes in family patterns. This program has not been brought up to date to take account of these changes in our society.

I also think some of the current proposals to invest the Social Security trust funds in the private markets need to be looked at very carefully. I think that increasing the risk of loss of assets with the program is not a good idea, and I am dubious about those proposals, particularly because I think a lot of them are driven strictly by trying to achieve higher rates of return, to achieve long-term financial balance, and they may be short-sighted.

Finally, I note your proposal in the Kerrey-Simpson bills for a personal investment account. I think they are creative, and should receive full exploration. There are practical problems with introducing that kind of a concept at this time, but I believe that you are onto something that really should be thought through until we finally figure it out.

I will close by saying that I very much admire the courage you have shown here, the leadership you are providing. And I am delighted to be able to help you in any way I can to see your way through what is a difficult set of issues.

Thank you for inviting me, Mr. Chairman.

Senator SIMPSON. Thank you very much.

I hope the American people hear what you are saying, and know who you are, Mr. Ross and Mr. Walker, that you were public trustees of these programs. You had a mission, you were Presidentially placed, and you were both reviewing the status of the Social Security and Medicare programs in your printed remarks.

I urge people to get a copy of this "Summary of the 1995 Annual Reports". This is what I am dealing from. I am not dealing from some right-wing publication, or some left-wing publication. I am dealing from this.

And you have said in one sentence, "We urge that concerted action be taken promptly to address the critical public policy issues raised by the financing projections for these programs."

There is nothing clearer in perfect English, and that is where I am coming from. I am listening only to the people who are the people who represent my Government. That is what we should pay attention to, because not often do you get that kind of candidness out of the Government.

They are telling us that it is going belly-up, and that we ought to move soon. And if we do not, the older people who complain and howl about this issue will not be touched a bit. And the people who will get struck senseless in the process are people who are young.

So, Mr. Weinberger, you were chief of staff of the Commission on Entitlements and Tax Reform, of which I was a member, as was Senator Kerrey, as were 10 Senators, 14 Congresspersons, 10 citizens, Democrat, Republican, left, right.

And 30 of the 32 of us laid out the scenario of what would happen to America. It was indeed a bipartisan commission, and did majority of the bipartisan members support the Commission's interim report that stated that entitlements were a crushing problem?

Would you just briefly tell us about the findings in the report, and the outcome of the Commission?

Mr. WEINBERGER. Sure. The Commission reported to the President in August of last year. It is an interim report which, as you know, we called our Alcoholics Anonymous strategy. This is, if we can get the Commission and Members of Congress to stand up and say, "We are the Federal Government. We have a spending problem we cannot control.", the American people would stand up and applaud. Then we would work our way towards a cure and come up with specific recommendations.

For a variety of reasons, we never got to that cure because there was a lot going on in this town by December, and we never had final recommendations on how to fix the problem.

But unequivocally, 30 out of the 32 members voted for the interim report—one member was not there; one member opposed—which stated the problems that the country faces on a fiscal and social basis throughout the next 10, 20 or 30 years.

And, in doing so, you are correct in stating that entitlements are going to create a crushing Federal obligation. But, in particular, looking at the individual programs, this chart was agreed to by the Commission. It demonstrates that there is a tremendous imbalance in the financing of Social Security which could only be addressed by increasing revenues or reducing benefits.

And the fact, as pointed out by the Commission and in this chart, is that 2030 is the year of insolvency. But the Commission urged in its language that 2013 was the year we really needed to focus on.

And, if you are going to make changes by 2013, the Commission again and again urged some sort of gradualism so that you did not immediately in that year have to either reduce benefits or raise rates, or do something. We ought to be addressing these issues now, as opposed to later.

Senator SIMPSON. And that was indeed a bipartisan approach. And I think that Senator Kerrey and Senator Danforth did yeoman work. And I think the disappointing thing to all of us on the Commission was that the President did not use any single word of it in presenting the budget to the people of the United States of America. Furthermore, he left this out of the budget. It is not a partisan shot; it is just reality.

In his first budget, the President put in a tremendous section about generational accounting, intergenerational accounting. It was splendid, and it laid it all out in several pages, just as you have done, and just as I have done.

And in the latest budget, it was just cut, scissored right out of the budget. There was no comment at all—extraordinary—because that is the guts of where we are, an intergenerational issue. It is sad to see that.

It is sad to see that in the study of what we are to do in the future, we just left off Medicare. That study just left off the word Medicare. We are not to look at that. Maybe it was a typo, but I do not think so because it is too hot.

And if anybody who is involved in conventional wisdom does not think that people who are in this are not going to be punished, just look to my right and my left. That is what happens; that is where we are. And for both parties to pander to the American public as they did, and have, as we discussed the balanced budget amendment, do not worry, we will not touch Social Security. And the great huzzahs and the ringing alleluias filled the air. And we leave off a program of $330 billion bucks, just leave it spinning off in space as if it is not part of the problem of the United States.

And you, Mr. Weinberger, have described it, and I hope all the American public hears it. There is no trust fund. There is no kitty. If we ever found a kitty with the reserves that are now building in Social Security—and they are going to get big—they are what now, over $280 billion? What are the reserves today in Social Security? This is why everybody still stays asleep under a rock.

Mr. ROSS. About $436 billion.

Senator SIMPSON. Four hundred thirty-six billion are the reserves in Social Security. If the American people cannot track this, then do not worry about me, I will smuggle it out of here.

But, you want to remember what is happening. Those reserves could build to maybe $2 trillion before that date of 2013. They could get to $1.8 trillion, or $2 trillion maybe. And every single penny of it is invested in Treasury securities, or something backed by the full faith and credit of the United States of America. Is that not correct?

Mr. WEINBERGER. That is correct.

Mr. WALKER. That is by law.

Senator SIMPSON. And, therefore, what we have here is an investment of the reserves in those securities which are backed by the full faith and credit of the United States. And, therefore, we have just a shifting mass of IOU's among these programs. Is that not correct?

Mr. WALKER. It is an IOU, although there are trillions of dollars of IOU's held by others, which are related to Government securities.

Senator SIMPSON. But is that correct, all of you, that it is owed?

Mr. WALKER. Yes.

Mr. ROSS. Correct.

Senator SIMPSON. And then when this day comes, and 30 of 32 people know it will come, and the revenues do not satisfy the outgo, at that point the Social Security trustees will go to the Federal Government and say, there is no more cash flow, and now we want to redeem the IOU's. Is that correct?

Mr. WALKER. Correct, that portion each year.

Mr. WEINBERGER. Yes.

Mr. ROSS. It is not that there is no more cash flow, there is an inadequate cash flow to cover benefits.

Senator SIMPSON. Inadequate.

Mr. ROSS. So you start to divest the bonds over the period from 2013 to roughly 2036.

Mr. WALKER. It is the gap between the green——

Mr. ROSS. It is the gap between them.

Senator SIMPSON. That is right. In other words, there is not enough to cover.

Mr. ROSS. Not enough to cover.

Senator SIMPSON. Not enough to cover. A person could hear that who pays their taxes and does things right. There is not enough to cover it.

So we go to the Federal Government and say, the green checks will not go out unless we get money. So give us the money. And then the Government cashes in the bonds. Is that not correct?

Mr. WEINBERGER. It could issue new bonds. It could raise taxes, because it has to come up with the money.

Senator SIMPSON. But they would have to come up with the bucks?

Mr. ROSS. Or reduce benefits. Right.

Senator SIMPSON. Or reduce benefits. Or——

Mr. ROSS. Or increase taxes.

Senator SIMPSON. Yes, or raise the payroll tax. Not many options, are there? Are there any options?

Mr. ROSS. Not too many. If you wait until the date of exhaustion, your options are very limited. That is why I think you are doing the right thing by telling people to start now because the changes that you can make now can be gradual, with lots of notice and lots of fairness in them. Whereas, if you wait until judgment day, there is not a lot you can do.

Senator SIMPSON. Mr. Walker?

Mr. WALKER. If you do wait, what happens is that a lot of the demographic trends and savings principles work against us because we have fewer and fewer people working to support more and more retirees. That is going to continue for a number of years.

Delay will mean that you either have to make drastic benefit cuts, or more significant tax increases. And we already have fewer and fewer people working to support more and more elderly, on a relative basis.

And, in addition, if they are going to get less out of Social Security and Medicare, they need to start taking steps today to save, invest and plan to be able to make up that difference.

Senator SIMPSON. I think the American people also need to know that you, Mr. Ross, were appointed as a partisan public trustee; Mr. Walker was appointed as a partisan public trustee, one a Republican and one a Democrat. And you joined together in this bipartisan statement, calling for prompt reform, immediate reform of the Social Security program. Is that not correct?

Mr. ROSS. That is correct, Senator.

Senator SIMPSON. And you served for 5 years, Mr. Ross?

Mr. ROSS. Five years.

Senator SIMPSON. Mr. Walker?

Mr. WALKER. The same, 5 years.

Senator SIMPSON. A 5-year term.

Mr. ROSS. We did everything together for 5 years.

Senator SIMPSON. I am sorry?

Mr. ROSS. We have done everything together for 5 years. I think this is the first time we have had separate statements because we have now taken off the hats of public trustees.

Mr. WALKER. But I think it is important, Senator, as we both said, that we believe the only way we can successfully meet this challenge is dealing with it on a bipartisan basis. And we are trying to lead by example.

Senator SIMPSON. Well, that is the only way we can do it in Congress. And that is why I have joined with Senator Bob Kerrey, a Democrat from Nebraska, and Alan Simpson, a Republican from Wyoming. And I do not know what will occur, but I know we are going to get it all out. It is going to be aired. It will not be under the rug. It may be a devastating thing to deal with. It may shrivel the strong, and impale the weak, but it is time for the American public, and especially young people to hear.

If these young people cannot figure this out, people to whom we gave the precious right to vote when they were 18 years old, and maybe 15 or 20 percent of them use it, I will not feel a shred of sorrow for them. They had better gather together. Hopefully, they can get together into groups where you can pay $8 bucks dues and just raise hell with the system. [Laughter.]

Now that would be something they would want to consider, I would think. Because I think of my own sons and daughter, 32, 36 and 38, who are still smiling while they pay more in Social Security than they do in income tax. And I wonder when they will quit smiling.

Do you foresee that, at a time, there will be a tremendous generational bitterness, or any other word you might attach to it, with regard to this?

Mr. ROSS. I actually believe, Senator, that the program is adaptable. If you look around the OECD nations, we are not the only country with this problem. I think changes can be made, and have to be made. And I trust in the good judgment of the American people and the Congress to make the kinds of changes that you and Senator Kerrey are suggesting, and that Mr. Walker and I have suggested today.

I do not think we are going to hit the wall with this program. I think we are going to do the right thing. That is my judgment, that we are not going to have intergenerational warfare.

Senator SIMPSON. But would you not agree that it will not get done unless the people between 18 and 45 or 50 begin to pay closer attention and educate themselves as to what happens?

Mr. ROSS. Absolutely. I think it is absolutely vital that the program be adapted so that the kind of benefit structure, and the kind of program we have, is one that really appeals to them, so that their confidence in Social Security will rise above their confidence in UFO's.

Senator SIMPSON. That was an interesting poll.

Mr. Walker?

Mr. WALKER. Mr. Chairman, I think that the intergenerational pressure is increasing. I think that Social Security can and should be saved, and made secure, so that the baby boomers and baby busters will believe in it.

However, as you touched on earlier, I do not think we can look at Social Security in isolation. We have to look at our other entitlement programs.

And I feel differently about Medicare. Medicare is in need of dramatic and fundamental reform. We have way overpromised in connection with Medicare. Yet, if you ask their public, their perception is that Social Security is more threatened than Medicare. And we need to conduct this public education campaign quickly. We need to begin making changes, and we need to make sure that we enact those comprehensive and fundamental changes before the end of this decade.

Mr. WEINBERGER. Mr. Chairman?

Senator SIMPSON. Yes, Mr. Weinberger?

Mr. WEINBERGER. I think that the generational issue is one of significant importance, as well as the competing for other Federal funds.

Also, as you recall, in the Commission we found out that, back when President Kennedy was in office; for every dollar the Federal Government spent, only 30 cents was actually going out on automatic pilot. And 70 cents was for discretionary spending.

By 2003, we will have completely reversed that. Of every dollar the Federal Government spends, 70 cents will be spent before they have any discretion. The majority of that, of course, is all for entitlements and interest on the debt. And 75 percent of entitlements is for Social Security, Medicare, Medicaid and civil/military retired benefits.

So what you see is the squeezing out of the ability to fund any other portion of Government. And that is why it is kind of interesting in today's debate about the Federal Government's budget deficit, and getting it to balance. Big programs, including Social Security, have been taken off the table.

Senator SIMPSON. That is the tragedy, because in minutes we are going to talk about the budget resolution, which will be presented to us by Senator Pete Domenici and Congressman John Kasich.

And that is not what I want. I have my own personal views about tax cuts. I think that they are not appropriate when we are looking at a $5 trillion debt, and out into space with deficits. But, nevertheless, I want to vote for the package because it is better than nothing. And people have worked conscientiously.

I am going to ask you—and you do not have to answer—it looks to me that the Congress and the President have both now admitted to the American people that we are not "cutting" Medicare and "cutting" programs. We are slowing the growth of those programs. Is that correct?

Mr. WALKER. That is correct.

Mr. WEINBERGER. That is correct.

Mr. ROSS. I would also emphasize that you are doing a real benefit to the country by raising the Social Security issue as the Medicare reforms take place because clearly they are in the joint budget resolution.

And the linkage between Medicare and Social Security is very strong. Some of the proposals that I hear include raising the Part B premium. For most people, that premium automatically comes out of the Social Security pension.

And, as you make those changes, it is important to know how you are affecting net Social Security benefits. Medicare and Social Security pensions, for most individuals in this country who are retired, are a package. So you really need to be operating on both at once, or at least keeping both in mind as you operate on one, so you do not do something which turns out to be counterproductive.

Thinking you can just fixate on Medicare reform, without worrying about Social Security, is not sound. So what you are doing with your hearings is very important to getting sound Medicare reform too.

Senator SIMPSON. It occurs to me that when we get down to real money, this will not be a budget resolution. We will be casting some votes on physicians and hospitals, and real people. At that point in time, I think that many will not be able to cast the tough vote.

At that point, they might look around for the proposals that Bob Kerrey and I are presenting, such as CPI minus 1, or the hook of the 2 percent personal investment account, or a COLA which goes to the lowest 30 percent of the people in America, and everybody else gets only that dollar amount. And that might be able to be part of the debate that could help ease the pain of the tough votes.

I do not know. But at least it will be out there, and they can look at it.

I want to thank you very much. Your testimony is riveting. I hope people understand it—I think they do understand it. Whether we can do anything politically with it is a different matter. Right now it is all political, and it is all power. That is all on one side.

Thank you very much.

Now we have our final panel of the day. Anne Canfield, vice president, McClure, Gerard and Neuenfchwander, Inc., Washington, D.C., Heather Lamm, member of the board directors of the Third Millennium, Washington, D.C., Dr. Eugene Steurle, senior fellow of the Urban Institute, Washington, D.C., and Allan Tull, board member, American Association of Retired Persons, in Washington, D.C.

I welcome you to the panel. And we will go in this order, unless someone has a time consideration that I could accommodate. How are you all on time? Are you all right?

So, we will go with Ms. Canfield, for a 5-minute presentation, please.

STATEMENT OF ANNE CANFIELD, VICE PRESIDENT, McCLURE, GERARD AND NEUENFCHWANDER, INC., WASHINGTON, DC

Ms. CANFIELD. Mr. Chairman, and Members of the Subcommittee, I am Anne Canfield, as you have stated, vice president, McClure, Gerard and Neuenfchwander.

My testimony today is being submitted on my behalf, as well as on behalf of Stewart Sweet, principal in the firm of Capital Analysts Network.

The future of the Social Security system, and its ability to provide a secure retirement to America's workers, has been a matter of continuing professional and academic interest to us since 1981, when we were both Senate aides to Members of this Committee.

We believed then and now that providing true retirement security remains the single most important domestic policy issue facing this country.

Mounting OASDI surpluses mask a devastating long-range problem that will only worsen if action is not taken now to modernize the Social Security system.

This fact is recognized by those in charge of the system. The 1995 annual report of the board of trustees of the Federal Old Age and Survivors Insurance and Disability Trust Funds, signed by Secretary Rubin, Secretary Reich, and Secretary Shalala, as funds trustees, states that the unfunded liability of the OASDI trust fund is negative 2.17 percent of taxable payroll.

By comparison, during the Social Security crisis in 1983, the unfunded liability of the OASDI trust funds was negative 1.82 percent of taxable payroll. This means that just 12 years later, we now have a crisis that is over 19 percent worse than before the historic Greenspan Commission met to save Social Security. This problem will only get worse, the longer we wait to solve it.

In an August 4, 1994 publication, the Bipartisan Commission on Entitlement and Tax Reform stated that, "Today, the poverty rate of senior households is about 13 percent but, without Social Security, it could increase to as much as 50 percent."

The report further states that, "Social Security provides 90 percent or more of the total income for almost half of the senior households below the poverty line. Half of all American workers do not have employer-provided retirement programs, and must rely on Social Security and their savings."

With three of the President's Cabinet Members formally acknowledging the eventual bankruptcy of the OASDI trust funds, and the Bipartisan Commission on Entitlement and Tax reform recognizing seniors' level of dependence on a viable Social Security retirement system, the gravity of the situation is clear. Unless vigorous action is taken, vulnerable retirees of the future face a financial catastrophe.

The three basic approaches to restoring actuarial balance to the trust funds, within the context of the current system, are as follows: Congress can cut benefits, raise taxes or increase the rate of return on the OASDI surplus by allowing professional private money management of these monies.

If benefit cuts were chosen as the only method of restoring actuarial balance to the trust funds, every American now retiring, or retiring before 2069, would have to swallow, on average, a 14 percent cut in benefits. Each year policymakers delay taking action means even larger cuts in benefits.

The second alternative available is to increase payroll taxes, on average, by 16 percent. In our view, relying on tax increases to solve this fiscal imbalance is irresponsible.

The third option is to increase the rate of return on surplus trust fund monies. This involves taking a limited risk, banking on the American economic system being basically sound. It is hard to understand why policymakers would consider only raising taxes or cutting benefits, when the option of extending professional money management to America's nest egg is a viable alternative.

We propose a combination of options 1 and 3. Our two-part proposal restores solvency to the trust fund, and allows current workers expanded retirement savings opportunities.

Combined, our proposal assures a secure retirement system for current and future retirees, while maintaining the progressivity of the existing system.

The first part of our plan is to slow the growth in future benefit increases for more affluent workers in this country. Under the existing benefit structure, inflation-adjusted OASDI benefits will more than double over the next 75 years. Such growth in real benefits is unsound, particularly given that the OASDI trust funds have never been this far out of balance.

Instead, we would suggest allowing inflation-adjusted benefits to increase, on average, 1½ times. And then we would propose that you restructure the initial benefit package so that it is more progressive.

While my written statement details the mechanics of how this portion of our proposal would be implemented, in summary, this part of our proposal lowers somewhat, but does not stop, real OASDI benefit increases to all future retirees. And, importantly, those most in need will be held harmless, thereby maintaining the progressivity of the system.

The second part of our proposal is to expand retirement savings options. Currently, Social Security is a defined benefit plan. Each retiree is given a set, clearly calculated monthly benefit, determined by a formula established by Congress. This has advantages and disadvantages. Workers get certainty, but at a price. The vast majority of all workers in private pension plans, as well as Social Security, would be financially better off in combined contribution market plans, if the capital markets provide their historic rates of return.

We propose allowing American workers to transfer a portion of their OASDI taxes into defined contribution plans, if they wish. Workers will have the option of taking up to 1 percent of their wages and salary, about equal to $25 billion, resulting from the slowing in projected increases, and mandatorily depositing those funds in private savings accounts.

Upon retirement, workers who took the option would have their OASDI retirement benefits reduced on a present value basis by more than the amount that they initially withdrew.

In their retirement years, those workers who voluntarily participated in the program would have a reduced Social Security benefit, but would also have the principal plus the interest earned on their private savings accounts. Most importantly, today's workers would have the assurance that their retirement savings would really be there for them when they retire.

Again, the mechanics of this proposal are in my written statement, and you can refer to them if you need the details.

The one aspect of your proposal, Senator, that we would caution against—while we think it is visionary—is that in your proposal you allow the Social Security trust fund's actuaries and managers to manage up to 25 percent of the money invested in the private capital markets. In an era where we are trying to reduce the Government's involvement, we would suggest that not be done.

With that, I will close this morning, and await your questions. Thank you.

Senator SIMPSON. Thank you very much.

[The prepared statement of Ms. Canfield appears in the appendix.]

And now, Heather Lamm please?

STATEMENT OF HEATHER LAMM, MEMBER, BOARD OF DIRECTORS, THIRD MILLENNIUM, WASHINGTON, DC

Ms. LAMM. Thank you, Mr. Chairman, for inviting Third Millennium to participate on this distinguished panel.

I applaud you for your courage, and I assure you Third Millennium is doing its best to activate our generation.

The issue before us today, mr. Chairman, is not about what size piece of the American entitlement pie one generation gets, compared to the next. It is not about generational warfare yet—although I fear that in the future.

The issue before us is about looking toward the future, and realizing the severity of the problems awaiting us. It is about dealing with those facts and those problems now, before they deal with us.

Mr. Chairman, this Nation can no longer afford to wonder whether or not Social Security is in trouble. The facts speak for themselves. From Alan Greenspan to the Congressional Budget Office, to the public trustees of Social Security, who we just heard from, the experts agree that Social Security is on a collision course with bankruptcy.

Thus, the question before us is when and how we act to change the course of Social Security. Every year we wait, the problem compounds.

Unfortunately, in the current budget debate, both this Congress and the administration have punted on Social Security, with the notable exceptions of you and Senator Kerrey.

We applaud Congress and the President for embarking on a serious path toward a balanced budget. But by omitting Social Security from the budget debate, Congress and the President do a tremendous disservice to this nation.

Is it fair to ask all of us to sacrifice in all areas of our lives to achieve a balanced budget by 2002, only to turn around and find a $600 billion bankrupt Social Security system knocking at our door early in the next century?

Imagine for a moment that we are in the year 2013. For years, Congress and the President have been ensnared by special interests and partisan bickering and, as a result, have denied the need for Social Security reform. Social Security is now running a deficit, and every year plunges the United States further into debt. The nation is faced with a horrendous decision. We must raise payroll taxes on young workers by 25 percent immediately to balanced the program, or we must slash all benefit checks dramatically, leaving many needy seniors unprepared and without vital benefits.

The nation is, of course, outraged. Why must a country as great and wealthy as America have to choose between burdening its workers with unbearable tax rates and denying poor senior citizens adequate benefits?

Mr. Chairman, we will not have to make that drastic decision if we have the courage to face the situation today, rather than tomorrow.

Let us set some priorities immediately. Let us acknowledge that our Government has a responsibility to oversee a national retirement plan, but that our Government also has the responsibility to strengthen the economy for future generations, and to provide them with reasonable retirement expectations.

Let us acknowledge that Social Security, when enacted, provided a crucial boost to the economy but, if left unreformed, it will soon become a tremendous drain on our economy.

Let us acknowledge the moral imperative of supporting poor senior citizens to keep them out of poverty. But let us also come to the table and discuss real reforms that will ensure Social Security will always be there for those who need it.

The reforms proposed by you, Mr. Chairman, and your colleague, Senator Bob Kerrey, are reasonable, incremental, necessary and, in my eyes, deserve the full support of all other future-looking Senators.

A national survey we commissioned last year found that 82 percent of young people want to be given the freedom to invest part of their Social Security payments into private retirement accounts that they would own, control, and even pass along to their children and grandchildren.

Allowing workers to contribute a part of their payroll tax to individual retirement accounts, as you propose, would lead to a tremendous boost in savings and capital formation.

Furthermore, we believe that your proposals dealing with the Consumer Price Index, the cost-of-living adjustment and the retirement age are logical adjustments that reflect America's changing economy and demographics.

Another reasonable alternative we support is to ask upper middle-class and wealthy seniors to relinquish part of their benefits under an affluence test. It makes no sense that we vilify teenage mothers who are barely subsisting on AFDC while, at the same time, bestowing billions on wealthy retirees who have received two, three or four times what they paid into Social Security.

Imagine how less Draconian the Senate's likely cuts in education, infrastructure, environmental protection and research funding would be if you were to put Social Security on the table.

Needlessly maintaining Social Security as a sacred cow means that other worthwhile investments in the future are slaughtered.

Mr. Chairman, I believe this Congress' ultimate challenge is far-sightedness. Would a private business, knowing that financial disaster is pending, wait until tomorrow to deal with the situation? Would an individual family, realizing it is running into financial troubles, wait until tomorrow to change course? Why then should the Federal Government be held to any lower standard?

Every generation of Americans has its own assets and liabilities. And I truly do not believe that most people in my generation are whining about the future we are inheriting. But we can no longer sit idly by as politicians compromise our economic future and, more importantly, the future of our children to pacify powerful special interest groups.

Young people have an obligation, both as citizens and as the parents of the next generation, to offer solutions, to have a voice, and to demand action.

We are willing to sacrifice because we know the consequences to our generation and to future generations if we do not. But we are not willing to accept inaction on the part of today's leaders. To avoid action now is a moral and economic assault on future generations.

Mr. Chairman, no generation in American history has been left with the tail end of so many dysfunctional systems as the generation currently graduating from college and entering the workplace. My peers, and those after us, will pay large amounts of our paychecks into programs that the experts agree will be bankrupt by the time we retire.

We are on the verge of inheriting a $5 trillion national debt, a crumbling national retirement system, decreased national savings, and an increasing number of retirees who expect to be generously supported.

As a generation, we wonder how we can face this tremendous fiscal burden, and still lead this Nation into greatness.

With boldness and clarity of purpose, let us seek answers together for the good of Americans today and tomorrow.

Thank you.

Senator SIMPSON. Thank you very much.

[The prepared statement of Ms. Lamm appears in the appendix.]

And now, please, Dr. Steuerle?

STATEMENT OF C. EUGENE STEUERLE, Ph.D., SENIOR FELLOW, THE URBAN INSTITUTE, WASHINGTON, DC

Dr. STEUERLE. Thank you, Mr. Chairman. It is an honor to appear before you today. And let me add my own congratulations to you and Senator Kerrey for your courageous efforts in leading us to deal with this difficult issue.

As has been made quite clear by the previous panel, the promises of benefits within OASDI are far in excess of the payroll taxes and other income sources available to the trust funds.

The problems posed by Social Security, however, extend beyond mere adequacy of the trust funds themselves. In the early 1950's, expenditures on retirement, disability and health occupied less than 10 percent of Federal expenditures. Today they comprise almost 50 percent, and the percentage is continually rising.

The current unsustainable growth in retirement and health expenditures, in my view, is helping to support a disinvestment in our Nation's and our children's future. I believe we are on a path that almost no one would choose, even as a compromise.

You have asked that the bulk of my testimony concentrate on suggestions for making the trust funds more solvent. Let me begin with several important process issues.

First, Social Security reform must bring long-run revenues and expenditures into line, and not depend upon perpetual, long-term deficit financing within Social Security itself. We cannot consider our problems solved if we merely reach a 75-year balance of receipts and expenditures which, as you know, is a traditional Social Security goal.

Social Security cannot run perpetual deficits that will be financed by the general taxpayer, who must come up with the funds to pay the interest and the principal on the monies attributed to the trust funds.

Second, as emphasized by Stanford Ross, reform of programs for the elderly really ought to be considered as an integral whole. There are very important interactions among Social Security, Supplemental Security Income and Medicare, among others.

Just as one example, some worthwhile trade-offs would become apparent, such as increasing cash benefits for the very poorest of the elderly in exchange for more tightly controlled Medicare expenditures that are in the budget package being considered today.

Third, as you have noted, Mr. Chairman, reform must begin—and should begin—as soon as possible. The longer we continue to delay dealing with Social Security's problems, the more likely legislation will be centered on cash flow fixes, such as increases in tax rates, rather than on long-term reforms.

Raising the retirement age, reducing the rate of growth of unfunded benefits for each new cohort of retirees, or gradually building up private funds in saving, occur only gradually over time.

One reason for gradual implementation of these types of reforms is to avoid large differences in benefits between cohorts who retire 1 year and those who retire the next year. The so-called "notch baby" problem could look like a Sunday picnic by comparison.

Finally, Mr. Chairman, I would like to argue, as a process issue, that reforms should center on the lifetime value of benefits. For an average-income couple retiring today on Social Security and Medicare, the lifetime value of benefits is coming close to a half million dollars under current official projections.

These figures demonstrate that the public system might be considered more than adequate if we were not supporting so many years in retirement and such an expensive health care system.

Let me move on to structural reforms of Social Security that I would favor. First, as in the Simpson-Kerrey bill, I would increase and index the retirement age for both old age and survivors insurance and Medicare. Data on income and wealth distributions reveal that the near elderly and young elderly are among those most capable of bearing a reduction in the rate of growth of benefits.

I believe we ought to place greater restriction on early retirement options for many of the same reasons.

I would include all contributions to Social Security in the calculation of benefits. The current system inconsistently provides a greater return to some of the rich members of society than to many moderate-income spouses and many elderly individuals who work an extra year in the system.

I believe we could cheaply remove all elderly from poverty as part of Social Security reform.

And I would expand the tax base to include non-cash compensation. The Social Security Administration today projects that the tax base will continue to erode, and that this is a significant—although not dominant—reason for long-term deficits.

I believe we could gradually adjust spousal and worker benefits so that spouses are treated more equally. Many working spouses and low-income non-working spouses are granted smaller benefits than non-working spouses of higher income retirees.

I would eliminate the earnings test, with its perverse signal that we do not want the elderly to work.

I would gradually adjust indexing of benefits so that higher-income individuals' benefits do not grow so fast.

And as you propose, Mr. Chairman, I would strongly consider moving part way towards a double decker system, where there was some funding of retirement benefits and some money that is saved.

There are a few options that I do not favor. I would not remove the cost-of-living adjustments, primarily because the benefits for the young elderly, who are the most capable of work, would often end up to be three or four times larger than the benefits for the old elderly who truly are in need.

I would not apply an annual means test for cash benefits because I believe if you mandate that people participate in the retirement system, then they have to get something back for their dollars.

I would not subject all earnings without limit to Social Security taxation because I believe that, at higher levels, this type of tax discriminates against self-employed individuals and their capital income.

And I certainly would not put Social Security on a pay-as-you-go basis, where the tax rate is always raised to fill some gap, and we fail to deal more substantially with putting benefits themselves on a sustainable path.

In summary, Mr. Chairman, by thinking about fundamental principles, I believe it is possible to sort through a variety of options for reform.

Social Security reform is needed, not only to bring trust funds into balance, but to restore to each generation of voters and representatives the right and the ability to decide how to devote future Government revenues to the most important needs of their time.

Senator SIMPSON. Thank you very much indeed, doctor.

[The prepared statement of Dr. Steuerle appears in the appendix.]

And now, Mr. Allan Tull, please?

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STATEMENT OF ALLAN TULL, BOARD MEMBER, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, DC

Mr. TULL. Thank you, Mr. Chairman.

As you mentioned, I am Allan Tull, a member of the board of directors of AARP. We appreciate your invitation to testify about Social Security's long-term solvency.

The Association hopes that today's hearing will help people realize that Social Security is currently not in crisis, and that long-term balance can be restored with modest changes.

The 1995 annual report of the Social Security trustees shows that, without any change in the current law, full benefits can be paid until the year 2030, one year later than last year's forecast.

Thus, Congress and the President have time to enact thoughtful changes to improve Social Security's long-term financial health. The sooner—and I must stress, the sooner—we act, the less painful the remedy, and the longer Americans will have to adjust.

The 1983 solvency package included both revenue and benefit changes, and sacrifices were shared by workers, employers and beneficiaries. This approach is fair, and should serve as a model for the future.

AARP has not endorsed a particular solvency package, nor are we currently proposing one of our own. We first need to get feedback from our members and their families, and the American people.

The latest addition of Modern Maturity, which I have with me, has several articles about Social Security's solvency, including Senator Kerrey's description of the proposal that you and he cosponsored.

We would, however, like to comment on several options that have already been raised.

First, I would like to express concern with proposals to reduce COLA's. COLA's are the only way most beneficiaries' have to keep up with increased prices. Without these adjustments, millions of beneficiaries would slip into poverty.

A COLA cut also results in significant long-term losses because the base on which future benefits are calculated is smaller. In effect, COLA reductions mean that, as beneficiaries age, the real value of their benefits declines.

AARP also urges Congress to reject means-testing any part of the Social Security benefit, including COLA's. Social Security is an earned benefit, based on past contributions, not need. It already includes a progressive benefit structure, and taxes the benefits of better off beneficiaries.

The availability of benefits to all who have contributed has been largely responsible for Social Security's unparalleled popular support.

Furthermore, means-testing would penalize savers. Those who acted responsibly by saving for retirement would find their reward to be reduced benefits. This is absolutely the wrong message to send if we want to promote savings.

Raising the retirement age is another widely discussed solvency option. However, if the labor market does not generate jobs for older workers, or poor health prevents continued work, many will retire on permanently reduced Social Security benefits.

Any increase in the retirement age should be accompanied by protections for older workers who cannot stay in the labor force, and by expanding job opportunities for older workers.

Given strong public opposition to an increase in the retirement age, proponents must first convince the American public.

Payroll tax increases and/or changes in the benefit formula have also been proposed. They too should be considered as part of the solvency package, provided that they do not dramatically alter workers' rates of return.

Some propose individual Social Security accounts that workers manage themselves. This change will hurt low-income earners, who are currently helped by Social Security's progressive benefit formula. Moreover, Social Security's lifetime inflation protection, and the dependent, survivor and disability benefits are too costly in the private market.

Vehicles like 401(k) plans and IRA's already permit individuals to save and control their investments. Yet these plans have not reached their full potential. If greater savings and investment control are the goal, then the policymakers should look to improved pensions and savings, rather than undercutting Social Security.

AARP believes all generations have a stake in preserving and strengthening Social Security's future. The emerging solvency debate will help Congress develop a package that asks for reasonable sacrifice among workers, beneficiaries and employers. The package should ensure adequate time to adjust to the changes.

AARP stands ready to work towards this goal.

Thank you, sir.

Senator SIMPSON. Thank you very much, Mr. Tull.

[The prepared statement of Mr. Tull appears in the appendix.]

Senator SIMPSON. A few questions. I would like to go to Ms. Lamm.

Many of these proposals suggested by you and your colleagues would negatively affect the Social Security benefits that your generation and you will be entitled to.

Specifically, you state that you support the bills introduced by Senator Kerrey and myself, which would not affect anyone who is currently receiving benefits. I know that is tough to get that through some of these groups, but it would not affect anyone who is currently receiving benefits, or due to receive benefits in the very near future. That gets lost in the clutter.

But it seems almost selfless, and quite generous, that a group such as yours would support dramatic cuts in your own benefits. Why is that?

Ms. LAMM. Well, Mr. Chairman, we have time to plan. And that is why we are encouraging reforms now, so that we can begin to plan, to save. We can begin to prepare ourselves for 40 years down the road when we will be retiring.

I think the promise that is made to current retirees should not be affected under your proposals, but we should have the option. Since the experts have told us that the system is not going to be there for us anyhow, in some ways we are not really sacrificing at all.

If the system is not going to be there for us, we need to have other options. Under your proposals, we feel that we are given those options; we are given the chance to contribute 2 percent of our payroll tax into our own accounts. We are given the chance to see some return on our Social Security benefits.

And I think the most important factor is that we have time to plan, we can plan, we can save. Apparently more people under 30 are saving in IRA's than even the baby boomers. So we are beginning to save, but we need to have that incentive to do so.

Senator SIMPSON. From my work on the Commission, and listening to the testimony, I have determined that many young Americans, young people, pay more in payroll taxes than in income taxes. And let me be very clear—I personally find that situation intolerable.

Some of your colleagues have suggested that, as we take a look at reforming the Social Security program, we should consider raising the payroll taxes. How do you respond to that suggestion?

Ms. LAMM. I think that it is not a wise decision at all. The amount that we would have to raise payroll taxes to balance these programs is just incredible. We cannot bear that burden. Nobody can bear that burden.

We are not talking about just a slight increase. Even a very slight increase is harmful, considering what we already pay. It is not the way to go.

Senator SIMPSON. Well, who would pay the payroll taxes—the young, the worker, or the old, the retired?

Ms. LAMM. Clearly, it would be my generation, and those after me, who would be paying the increased payroll taxes.

Senator SIMPSON. Would it not be a little difficult to envision how a retired person would be paying much in payroll tax?

Ms. LAMM. It does not make sense to me, Senator.

Senator SIMPSON. It does not really seem possible, does it?

Ms. LAMM. It does not.

Senator SIMPSON. I do not think it is.

Did you have a comment, Mr. Tull? We will come to that because that is an issue I want to try to develop here, on payroll taxes.

Let me come to Mr. Tull.

Ms. Lamm represents a group of young Americans, a huge pool of young Americans, many of whom are children and grandchildren of your membership, AARP.

How do you feel your membership would respond to a suggestion to increase payroll taxes to pay for their retirement benefits, knowing that their own children and grandchildren will be paying dearly for it, and paying most all of it?

Mr. TULL. I think our response would be that, in order to get Social Security solvent, back on the trolley track, we need to look not just as the payroll tax as a solution, but we need to look at a whole series of alternatives, or a combination of moves that can be put together as a package that would solve this problem.

Your particular proposal includes a variety of considerations, and I think that is the direction in which we have to go. I would not want to say that we favor or oppose a payroll tax as a one-phase fix of the problem.

Senator SIMPSON. I have here your testimony from that magazine of Modern Maturity, July-August, 1995. It talks about Social Security. It says where you stand. This is your official publication.

Mr. TULL. Yes.

Senator SIMPSON. AARP focuses on Social Security. You have submitted here five options, supported by the AARP which, if instituted by the year 2000, would shore up the Social Security trust fund. I want to include that option list in the record because three of the five options on this list include a tax increase—a payroll tax increase—together with assuring that all new-hired State and local workers come into Social Security, which they are not about to do, because they know that it is going to go broke, so it will be very difficult to lure them into it.

[The information appears in the appendix.]

Senator SIMPSON. But three of the five options here include a tax increase, and some are substantial. On what did you base these options? Did you take a survey of your membership?

Mr. TULL. No. Those are just that. They are options that we wish our membership to comment upon and feed back to us in terms of how they and their children and grandchildren would view these as possible alternatives.

As I say, we have not in any shape or form formulated our plan or our recommendation as to how to solve this solvency question.

Senator SIMPSON. In communicating with your members, did you inform the membership that increases would fall directly on only their children and grandchildren, and not themselves. And if you did, what did they say?

Mr. TULL. This magazine has just gone out to the membership. What is said in this article is basically what we have said to the membership at this point. However, we have had other articles in our Bulletin, and other communication sources that have discussed the question in the past. But what we have said to our members is what you see in that issue of Modern Maturity.

Senator SIMPSON. Let me ask it another way, if you could respond. Who does your membership believe is going to pay the payroll taxes that you wish to submit as a solution to the insolvency of Social Security?

Mr. TULL. Well, I do not say that we have that. As I said earlier, the only option to solve the Social Security problem would obviously involve future generations in coming up with a shared responsibility, fiscal and otherwise, for getting Social Security back on track.

Senator SIMPSON. Well, let me ask it another way. I have practiced law long enough. What are your members going to pay in payroll tax increases if they are retired?

Mr. TULL. Well, they would not be paying anything if they were retired.

Senator SIMPSON. That is right. And you represent the American Association of Retired Persons.

Mr. TULL. Yes, which includes a high percentage of working members, as well as retired.

Senator SIMPSON. Well, that is odd to have a group like that, to have a name like retired persons and represent people who are not retired. I do not understand that, but we can get to that later.

I am just asking who do they believe will pay the payroll taxes? The payroll taxes will not be paid by the retired people, whether they are retired in name only or just retired. Who will pay?

Mr. TULL. I would also point out that those people in the higher-income brackets are paying income tax on their Social Security benefits, which are going into the fund.

Senator SIMPSON. That is true. And that money is going to the health insurance fund. I certainly hope you believe, as I do, that we should not remove that because, if we remove it, it will only decrease the size of the health insurance fund.

Mr. TULL. That is correct.

Senator SIMPSON. I am not in favor of that either. That is certainly a remarkable accord.

Nevertheless, so that people understand it, payroll taxes are paid by people who work. They are not paid by people who are retired. So three of the five options from this organization as to how to correct the insolvency of Social Security simply call for increased payroll taxes. One option is raising taxes every 10 years to 6.5 percent, and to 7.4 percent in the year 2060. One is phasing an increase in wages subject to payroll tax from $76,000 to $114,000. And, finally, a phase-in, increasing payroll taxes to 7 percent.

So those are things we want to discuss with various organizations as we proceed.

Dr. Steuerle, in your testimony you provided a great number of suggestions to balance the Social Security program, and I thank you for that.

When do you think the serious debate over reform of Social Security programs, such as those you offer, occur?

Dr. STEUERLE. Well, Senator, as you propose, I believe the debate ought to be intensely engaged now. Indeed, I think reform ought to be enacted as quickly as possible.

For instance, if we are going to start adjusting the retirement age, I would do it almost immediately. If we are going to increase retirement age by a month or two months per year, or whatever it ends up to be, the sooner we start, the slower the pace can be, the less likely we are to create "notch baby" and similar problems.

There is also another reason for this, having to do with generational equity. That is that most current retirees really have not paid in full for their retirement, so I think they can help bear some of the burden of getting the system in order, just as future retirees.

I would like to make one comment, which I think is related to the previous discussion. When I talk to audiences about this issue—and I am often dealing with a middle-aged audience of baby boomers—I tell them that most of the changes we are talking about mainly affect them and their children, whether it is tax increases or benefit adjustments.

Take, for instance, the Medicare adjustments that you might be considering in this budget package. The cumulative impact of those changes are going to be far less upon the current retirees than they are upon future retirees. So future retirees—that is, baby boomers and their children—have to choose. We know the system is imbalanced, and we have to choose between whether we work longer, whether we get lower annual benefits, or whether we put higher taxes on our children. Those are the only options we have.

And it is for those generations that the debate should really be engaged, even more so than for the current retirees, who probably would be affected much less.

Senator SIMPSON. Well, I keep saying that Senator Kerrey and myself, in our work, our efforts will not affect anybody who is retired now. Anybody over 65 is certainly not even on our screen. They will not be affected in any way by what we are doing. Even if it became Draconian, no one over 60 will really be touched, but with a powder puff in this one.

But people 55 might be touched with a COLA, which is going to go full force to the lowest 30 percent in society. They get the full COLA, CPI, that is it. And then everybody else in America gets only that dollar amount.

If we cannot even get that done, does not anybody understand what happens to the discretionary budget of the United States, if you cannot even slow a COLA, which sucks up between $7 billion and $20 billion a year in Social Security. And it goes out to people regardless of their net worth or their income.

And if we could just gather up $7 billion of it, or $10 billion of it, we could fund everything we are going to try to do here—programs for Parkinson's disease at $11 million, $12 million or $15 million, programs for this and that, for health. And I do not even vote on 62 percent of the national budget.

If nobody can understand that yet, we have all failed the test. I do not vote on 62 percent of the national budget; it just goes out the door. And it goes to people regardless of their net worth or their income.

And if we do not slow the growth of these programs, in 10 years we will not vote on 72 percent of the national budget. And does anybody that has half a bean on their shoulders know what will happen then? It will mean that you will continue to go out and cut the discretionary programs, the things you really care about.

Maybe if the NEA is something you care about, guess who gets hit in this process, when you cannot slow the growth of the entitlements. Maybe it is health research or the Public Health Service, or farm programs, or a railroad, or Amtrak. Those things will not be served, and cannot be paid for when the money is being sucked up in this tornado.

Now I hope that dribbles down through the national consciousness, but I will not count on it.

Maybe H.L. Mencken, over there in Baltimore, was right when he called Americans the subspecies of Boobus Americanus who cared more about perils to their hide, with regard to security than they cared about their country. He writings were dazzling. Enough.

Dr. STEUERLE. Senator?

Senator SIMPSON. Yes.

Dr. STEUERLE. Just one example. In the current budget debate, health research, as a percent of our national income, is already scheduled to go down, even as health consumption expense go up dramatically. So, in the long run, with this type of automatic pilot budget, we are probably hurting the long-term health care of our people, as opposed to putting more into health research and less into current health consumption.

Senator SIMPSON. Let me just ask a few more questions, and then we will conclude. You have been very patient. But we will do more of these. There will be more hearings. It does not matter to me who shows up—I will be right here. I have eaten a good breakfast, and I am as fresh as a daisy, ready to press on.

Now, Ms. Lamm, on the last panel, every one of those three witnesses called for prompt action, immediate action to reform the Social Security system. You and your colleagues also were asking for swift action.

Yet I remember last year, when we tried to reach a consensus about the entitlements and the crisis, we could only get a handful of commissioners—five or so—to step forward and be part of the solution. And what an experience it was. It seems to me that grass roots support and education will be the only possible way to begin reforming the Social Security program.

And I think that is why your organization is so very crucial, because you hold the promise. Do you have any brief comments on that? Am I missing something?

Ms. LAMM. No. I think that is absolutely where it has to happen. We have got to decipher, to get through the partisan rhetoric out there. We have got to get through all of the misinformation that the American public gets tossed at them on a day-to-day basis concerning things like the trust fund.

They say, it is my money I put into it. I want to get back what I put in. We have got to open the debate on all of those arguments and help the American people understand that this is not about a trust fund that says Joe Smith put his money in it. It is not about that at all. It is about the future of the economy of this country. And we have got to deal with it now.

So I would encourage all sorts of public education efforts. We are trying to do our best on this end, but it is not easy.

Senator SIMPSON. How are you doing with your membership?

Ms. LAMM. Young people are a tough group to reach, unfortunately. I think that when we do reach people, they are very convinced. They love the message. But the cynicism about Government among young people is dangerously high. They do not think Social Security will be there for them, but they are not convinced that the Government can fix it. So that is another message we have to get through—that if we act now, we can fix these things.

So it is tough reaching people our age.

Senator SIMPSON. Since they will know that it is going to go broke faster if we do nothing, when do you think they will decide that they might band together and say why should we pay into a system which, as you describe in your testimony, is dysfunctional?

Ms. LAMM. I think it is not too far out there. As my generation enters their late 20's, and begins to have families and try to buy a house, and realize how difficult that is, and try to begin saving for retirement.

As they continually see this enormous amount of money going out of their paychecks in the form of FICA, which many of them do not yet know what means, but they will soon, when they are trying to save for their retirement and they start to realize the truth about the Social Security problem, I think we will see some action.

It could take two forms. It could take a peaceful, let us act now type of approach, or I fear it could take a much angrier approach that would then be pointed at senior citizens.

Senator SIMPSON. What does your generation think FICA is, a rock group? [Laughter.]

Ms. LAMM. I am afraid some of them do.

Senator SIMPSON. Or a dog? Fido—oh, excuse me, that is FICA.

Ms. LAMM. I am not sure they know what it stands for, but they do not think that it is going towards their retirement. As I said, more people in my generation are already saving for their retirement, which is an astounding fact. But they are already saving for their retirement. So I think the message is getting out up there, that Social Security will not be there, and we need to do something about it.

Senator SIMPSON. Ms. Canfield, in your testimony you mentioned that the Kerrey-Simpson proposal had a serious flaw—maybe others—but at least it is a start.

The flaw you noted was the provision to invest up to 25 percent of the Social Security trust fund surplus in capital markets. My own State of Wyoming dealt with that on the ballot, and it was not too highly successful.

You stated that the Government should not be in the business of picking stock winners over losers. But could you support placing the surplus into a stock fund, representing the entire stock market? In that way, the Government would not be picking the winners and losers, while, of course, benefiting the capital markets and the equity markets.

Ms. CANFIELD. First of all, Senator, I think both of us are very supportive of your efforts, and that the proposal overall is wonderful. And it is visionary, as I stated.

However, having the Government choose one form of investment over another, even one stock fund versus another, we do not think it should be that centralized. We think that it should be more dispersed, and that it should be done much more on an individual basis, through individual choice, because you are basically going to have the ability of the Government to make markets.

Senator SIMPSON. Well, your testimony also said that we could balance the Social Security trust fund by modestly cutting Social Security benefits by 14 percent, and implementing some version of a PIP, personal investment plan, such as Bob Kerrey and I are proposing. Is that correct? Would this benefit cut be phased in?

Ms. CANFIELD. Oh, no, no. I am saying that, if you do nothing, your are faced with either a 16-percent across-the-board tax hike or a 14-percent across-the-board benefit cut, on average.

What we were suggesting though is a combination of things in order to get the balance. One is that, under the current system, in inflation-adjusted terms, real benefits are scheduled to double over the next 75 years. Instead of allowing them to double, we said why not increase them 1½ times?

The second piece of that was to allow a part of the money to be put into privately-managed accounts, so that it could earn a little bit higher rate, or a market rate of return. And the combination of those things, if a person took that option—it would all be voluntary—their combined benefit would be higher than what they are currently projected to get under the current system, even though I doubt that they will get anything right now.

Senator SIMPSON. You have been in this a long time. You have no desire, and do you hear anything we are suggesting, that is going to "cut" the benefits of current retirees or those who are just about to retire? Nobody has even talked about that. You would not dare even breathe it. And I have never said it. So it is nothing you have in mind in your proposal, is it?

Ms. CANFIELD. Not at all. Actually, I think any of these proposals saves Social Security and secures retirement for this generation, as well as the next.

By doing nothing, I think you are really throwing the system up in the air and allowing it to go into default.

I think the overall unfunded liability for the system right now in OASDI is about $5 trillion. In HI, it is about $10 trillion. So it clearly needs to be addressed.

Senator SIMPSON. And I think the unfunded liability in the retirement programs of the United States is $600 billion. Am I not correct about that? Unfunded liability in Federal retirement is something like $600 billion. You do not hear much talk about that either. It is all out there, plus leaving $335 billion off budget, while we play around with the numbers. This is really fascinating stuff.

But back to Dr. Steuerle for one question about COLA's. In your testimony, you said that you could not support significant paring down of the COLA's. It seems to me that it would be fairer to limit COLA's because they were not part of the original contract. I get this stuff about, well, it was a contract, and you cannot break the contract.

Well, the original contract did not have a thing to do with COLA's. COLA's fell upon us from Wilbur Mills, a Democrat, and President Richard Nixon, a Republican, who decided that this was a very powerful political instrument because each year they would raise the benefits during election years.

Each year, on every even-numbered year, they would raise the benefits. Is that not a terrible thing for politicians to do? And they did it. And it was eating the system up. And they said, wait a minute, we will do a COLA. So it was never a part of the original contract.

Nobody is talking about cutting benefits. I never have. The Concord Coalition has a scale they would look at with regard to that. But we are trying to keep the program from bankruptcy. So then how do you address this issue of COLA's?

Dr. STEUERLE. Senator, in my view, I like to distinguish between the additional cost of COLA's puts on the system, versus the technical issue of how it might be designed.

What I would agree with is, by some analyses, when the COLA's were put into the system, they were not paid for. And so, by some calculations, they added to the cost of the system. They could have been paid for as a structural matter if we had been willing to lower the initial benefits enough to pay for them.

For instance, suppose I buy a private insurance plan where I allow the retirement benefit to go up 3 percent a year—let us say that is automatic. The insurance company does not care if I have that provision, but it is going to charge me enough to pay for it. It might give me a lower initial benefit.

My concern is reflected in the figure at the back of my testimony. First, I showed under current law for a group of average-wage workers—that is, people in a similar situation in the wage distribution throughout their lives—what their benefits looked like in a given year. I took the year 2030, under current law, and showed how benefits actually went down a little bit gradually. That is because each generation tends to be a little richer than the previous one. So, under the current formula, the old elderly get lower Social Security benefits than do the young elderly.

Then I show a line, if you dropped COLA's altogether, what would happen to that distribution of benefits. You could end up with the old elderly receiving one-third to one-quarter of the benefits of the young elderly, on average. Older people at the same point in the income distribution during their lives would receive only one-third or a quarter of what the young elderly receive.

And the young elderly are those who are more capable of working, which is one reason that you are willing, and I am willing, to increase the retirement age. These are the people that have the highest wealth and the most support from their families.

So my goal is to move that top line down across the board for all age groups, to achieve essentially the same thing you are attempting in terms of cost saving. That is, I am after the same actuarial cost saving, in an insurance sense. But what I am trying to avoid is having the old elderly end up with much lower benefits, relative to the young elderly.

So it is a technical design issue, not an issue of whether one is trying to save on costs.

Senator SIMPSON. Well, that is helpful. We will look at that, and we will look at the suggestions from the AARP and all groups, with regard to COLA's and how we get to saving this system.

We all know one thing—at least the trustees know it and the Entitlements Commission knows it—and that is that chart is real. And, in the year 2013, this thing is headed for the bow-wows.

And why do we want to wait until then, when we will do only one of two things at that time? We will raise the payroll taxes or cut the benefits. There is no other alternative that has been suggested to the Entitlements Commission or to this panel, not one, no other suggestion. Take your pick—cut the benefits or raise the payroll tax.

Ms. CANFIELD. One thing I might add, Senator.

Senator SIMPSON. Yes.

Ms. CANFIELD. It is important that you do something now, because right now you have a little cushion here with the surplus cash flow. That could be invested at a higher rate of return, and actually help you out a little bit on solving the long-term problem.

Senator SIMPSON. Well, I also have a fear that the Advisory Committee on Social Security will come in with a great pile of pablum because of the heat that they are getting right now, and will say everything is well, and fly in the face of this report and every rational approach to it, and say that we do not have to do anything right now.

But let me just say that this is a very important program.

But let me insert in the record—oddly enough it came just this morning—the article in the Washington Post, "Baby Boomers Retirement Could Be a Bust. Living standards may drop as Social Security rolls bulge."

I want that in the record because it really means that people cannot count on Social Security as their retirement. And, if they do, it is totally shameful that they believe that will be there for them in some small amount.

[The article appears in the appendix.]

Senator SIMPSON. I would just say to you that I intend to continue to build a record in this area. And it is my feeling that we should start now to do something.

The former trustees, one Democrat and one Republican, are telling us that. Bob Kerrey and I are going to work toward a bipartisan solution, and continue our efforts. We are rather unthreatened people.

He was running for reelection to the U.S. Senate, and was talking about these things in the heat of an election year. So you will not frighten either one of us. It will not work. We are going to try to restore solvency, and do things for at least the children of America, who hopefully will join us in this effort.

I think it was either Henry James or William James who said, "To do a thing, be at it." And we will not get anything done unless we get at it. And on my watch, we will open this can of worms, and maybe even fish with the contents.

And we must begin. There will be more hearings. I will remind you that the next hearing will be on the discussion of privatization of Social Security.

Let the record also show that the cameras present today were from the Senate Recording Studio, CNN, AARP and CBN.

I thank you very much for your participation and your patience during the roll call vote.

This will conclude the hearing.

[The prepared statement of Senator Baucus appears in the appendix.]

[Whereupon, at 12:36 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Max Baucus

Thank you Mr. Chairman. Senator Kerrey. My remarks will be brief and I will get right to the point. Close to 150,000 Montanans are Social Security recipients.

These Montanans have paid all their lives into the Social Security system, believing and trusting that the money would ultimately come back to them; that this contract would be above the Washington political and budget game.

Robert Olandt, from Rollins in the Flathead, expresses it perfectly:

> "Sir, you and I and countless others are or have been paying Social Security premiums with the expectation that this program will, in fact, not be diminished . . . that quality of life may be preserved as we enter later maturity. Just getting old is bad enough. There has to be some dignity as well."

Or George and Marcella Feeley, writing last month from Billings:

> "We are an elderly couple living on Social Security and a small state pension, the total of which does not exceed $20,000 a year. On this we are barely able to maintain a decent lifestyle, and have no complaints about the way that we are compensated . . . Any erosion in Social Security and/or Medicare would be disastrous for us, and it is difficult to imagine what it would do to the millions of older folks who are in much worse financial and health condition than we are."

That should be the bottom line of Congress. The security of people like the Feeleys, all over Montana and all over America.

People who depend on Medicare services and Social Security checks to keep themselves out of poverty.

They have earned those Social Security checks.

And it would be scandalous if Congress were to let them down.

The Social Security Trust Fund is not facing insolvency. It has an estimated life span of thirty-five years. We are in good shape, thanks in part to the Bipartisan Commission Congress created in the 80's as well as the leadership of Senator Moynihan. So let us keep the promise.

Thank you.

Prepared Statement of Anne Canfield

Mr. Chairman and Members of the Subcommittee, I am Anne Canfield, Vice President, McClure, Gerard & Neuenschwander, Inc. My testimony today is being submitted on my behalf as on behalf of Stuart J. Sweet, Principal, Capitol Analysts Network.

The future of the Social Security system and its ability to provide a secure retirement to America's workers has been a matter of continuing professional and academic interest to us since 1981 when we were both Senate aides to Members of this Committee. We believed then and now that providing true retirement security remains the single most important domestic policy issue facing this country.

The proposal we are making today—

- Restores solvency to the OASDI trust funds;
- Provides today's workers with a more secure overall retirement program by allowing workers to choose a retirement plan that best meets their individual needs;
- Enhances total benefits to retirees;

- Implements the largest marginal tax rate cut in history by converting Social Security from a payroll tax to a deferred compensation program;
- Prevents an intergenerational clash from occurring; and
- Dramatically increases the opportunity for all income and social classes to own stocks and bonds in America.

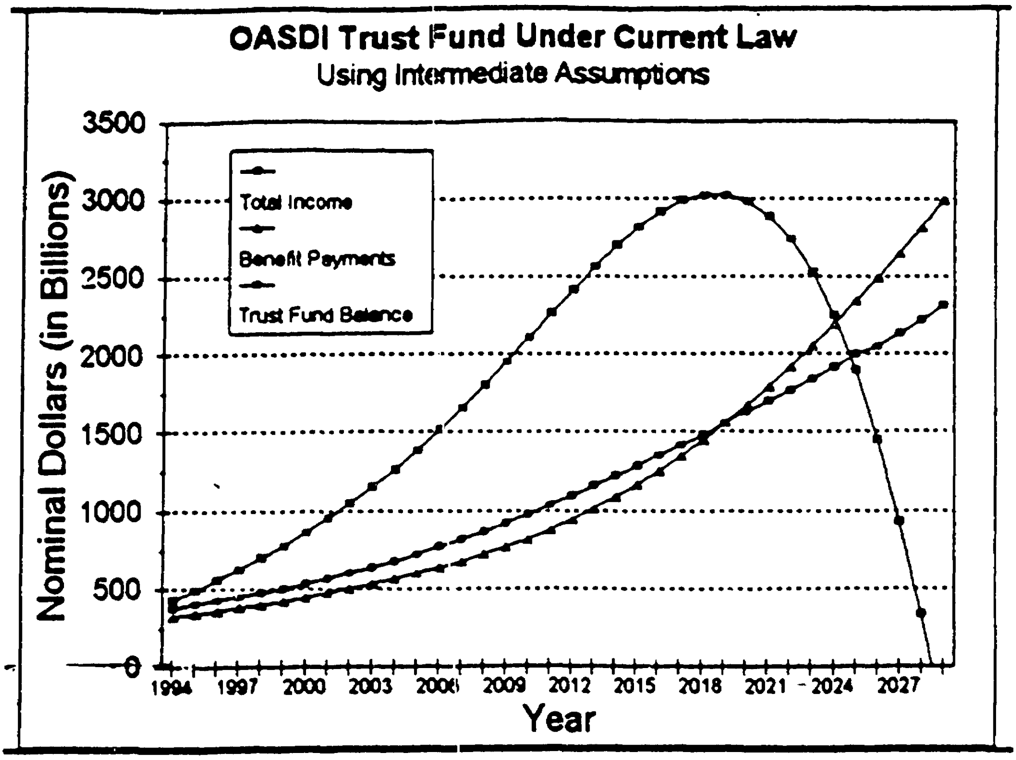
THE PROBLEM

Mounting OASDI Trust Fund surpluses mask a devastating long-range problem that will only worsen if action is not taken now to modernize the Social Security system. This fact is recognized by those in charge of the System. The 1995 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds, signed by Secretary Rubin, Secretary Reich, and Secretary Shalala as Funds Trustees, state that the unfunded liability of the OASDI Trust Fund is −2.17 percent of taxable payroll. By comparison, during the Social Security crisis in 1983, the unfunded liability of the OASDI Trust Funds was −1.82 percent of taxable payroll. This means that just twelve years later, we now have a crisis that is over 19 percent worse than before the historic Greenspan Commission met to "save Social Security." This problem will only get worse the longer we wait to solve the crisis.

In an August 4, 1994 publication, the Bipartisan Commission on Entitlement and Tax reform stated that "today, the poverty rate of senior households is about 13 percent, but without Social Security, it could increase to as much as 50 percent." The report further states that "Social Security provides 90 percent or more of the total income for almost half of the senior households below the poverty line. Half of all American workers do not have employer-provided retirement programs and must rely on Social Security and their savings."

With three of the President's Cabinet Members formally acknowledging the eventual bankruptcy of the OASDI Trust Funds and the Bipartisan Commission on Entitlement and Tax Reform recognizing seniors' level of dependence on a viable Social Security retirement system, the gravity of the situation is clear. Unless vigorous action is taken, vulnerable retirees of the future face a financial catastrophe.

The following chart demonstrates the severity of the future crisis if no action is taken to rectify the situation.



FINDING A SOLUTION

There are three basic approaches to restoring actuarial balance to the OASDI Trust Funds within the context of the current system. Congress can cut benefits, raise taxes, or increase the rate of return on the OASDI surplus by allowing professional private investment in these monies.

Option I: Cut Benefits

If benefit cuts were chosen as the only method of restoring actuarial balance to the OASDI Trust Funds, every American now retiring or retired before 2069 would have to swallow, on average, a 14 percent cut in benefits. Each year policymakers delay taking action means even larger cuts in benefits.

Option II: Raise Taxes

The second alternative available to policymakers to restore actuarial balance is to increase payroll taxes on average by 16 percent. Relying on tax increases to solve the fiscal imbalance in the OASDI Trust Funds is unacceptable.

Option III: Privately Invest OASDI Surpluses

The third option available is to increase the rate of return on surplus trust fund monies. This involves taking a limited risk, banking on the American economic system being basically sound. It is hard to understand why policymakers would only consider raising taxes and/or cutting benefits when the option of extending professional money management to America's nest egg is a viable alternative.

THE SOLUTION

We propose a combination of Options I and III. Our two-part proposal restores solvency to the OASDI Trust Funds and allows current workers expanded retirement savings opportunities. Combined, our proposal ensures a secure retirement for current and future retirees while maintaining the progressivity of the existing system.

Part I: Slowing the growth in future benefit increases for the More Affluent.

Currently, the Social Security Administration (SSA) calculates initial benefits history as follows. First, it collects the entire earnings history of an applicant who has filed for benefits. SSA then indexes the earnings of the applicant so that each year of his/her earnings history is measured in 1995 dollars. A specified number of the lowest years of earnings are dropped, and the remaining observations are averaged to generate an "Average Indexed Monthly Earnings" (AIME) amount for the applicant.

Under current law, 90 percent of the first $426, 32 percent of the next $2,141, and 15 percent of any AIME amount over $2,567 are paid to the applicant as a basic retirement benefit. The dollar amounts defining each benefit bracket are increased annually by the percentage change in "average covered wages" that took place in the preceding year. Transitions across the 90 percent, 32 percent and 15 percent benefit brackets are known as "bend points."

Since the "bend points" are indexed to the annual increase in average covered wages, real OASDI benefits rise over time because, historically, wages increase faster than inflation. In fact, if real wages increase by only one-percent a year due to productivity increases, inflation-adjusted OASDI benefits will more than double over the next 75 years! Such growth in real benefits is unsound, particularly given that the OASDI Trust Funds have never been this far out of balance. We, therefore, propose indexing the 32 percent and 15 percent "bend points" to the consumer price index, while leaving the 90 percent "bend point" indexed to the wage index. In addition, we would suggest establishing a fourth, 5 percent "bend point" that will be phased in at the upper end of AIME wages.

This portion of our proposal lowers somewhat, but does not stop, real OASDI benefit increases to all future retirees. And importantly, those most in need will be held harmless. This portion of our proposal increases the progressivity of the system.

Part II: Expanding private retirement savings options.

Currently, Social Security is a defined benefit plan. Each retiree is given a set, clearly calculated monthly payment determined by a formula established by Congress. This has advantages and disadvantages. Workers get certainty, but at a price. The vast majority of all workers in private pension plans, as well as Social Security, would be financially better off in a defined contribution plan if the capital markets provide their historic rates of return on the monies invested.

We propose allowing American workers to transfer a portion of their OASDI taxes into defined contribution plans if they wish. Workers will have the option of taking up to one-percent of their wages and salary—an amount equal to $25 billion—resulting from the slowing in projected benefit increases, and mandatorily depositing those funds in private savings accounts. Upon entering retirement, workers who took the option would have their OASDI retirement benefits reduced on a present value basis by more than the amount they initially withdrew.

In their retirement years, those workers who voluntarily participated in this program would have a reduced Social Security retirement benefit, but would also have the principal plus the interest earned from their private savings accounts. Most importantly, however, today's workers would have the assurance that their retirement savings would really be there for them when they retire.

We believe millions of workers will take the option—even though their promised Social Security retirement benefits are discounted—because current workers, particularly younger generations, believe that paying for the Social Security program is simply a tax, rather than a deferred compensation program. Few younger workers ever expect to collect an OASDI benefit. To them, any funds placed in a private account with their names on it looks and feels like a tax cut.

Everyone taking a voluntary benefit cut will feel better off, otherwise no one will accept. Paradoxically, those electing not to take the cut will be better off too since each time someone partially "opts out," the actuarial status of the OASDI Trust Fund improves. In some ways, this process is similar to a corporate bankruptcy reorganization. Skeptical unsecured creditors settle while those who believe in the reorganization stick it out.

If our proposal were adopted, employees would make an annual selection to either remain in the core OASDI program or take advantage of the option to redirect a portion of their OASDI taxes to portable savings plans managed by private sector investment managers in exchange for a discounted OASDI benefit upon retirement.

For those workers electing a partial "opt out," their employers will send a fixed percentage of their OASDI payroll tax receipts to professionally managed savings plans selected by their employees. Workers will be able to choose from a menu of investment vehicles that vary in aggressiveness provided to them by their employers. Thereafter, whenever employers send their OASDI taxes to the Social Security Administration, another fixed percentage will be sent to private, but professionally managed savings plans. Every quarter, plan managements will mail to each worker, statements listing the value of their accounts.

Upon changing employment, workers will transfer their investments to the preferred list of savings plans on the menus provided to them by their new employers. Their investments in their previous accounts will be transferred to their new investment accounts.

It is important to point out that the after-tax paychecks of workers remain the same. In the early years of this transition program, instead of paying 6.2 percent to the OASDI Trust Funds, workers will pay 5.2 percent to OASDI and one-percent to their private savings plans, if they elect to do so.

These percentages would vary in the future, depending on the amount necessary to pay all OASDI benefits in full. As the bend point changes we propose take hold, employees could lower their OASDI payment percentage further if they choose while raising their defined contribution payment percentage by a like amount. Alternatively, workers can choose to rely exclusively on Social Security benefits, as they do now. In this case, their entire OASDI payroll tax contributions will be sent to Social Security.

Under this portion of our proposal, these portable privately held pension plans will be professionally managed, just the way trillions are now managed for millions of Americans through the existing private pension system. Further, these plans will be subject to ERISA rules and Department of Labor and SEC oversight to ensure that such monies are prudently managed.

Thus, workers who select to "opt out" of part of the Social Security system will receive two types of benefits: a Tier I and a Tier II benefit. The Tier I benefit will be an irreducible guaranteed minimum adjusted payment received from the Social Security Administration. To ensure stable retirement incomes, at the time of retirement, the private accounts of workers will be converted to annuities creating a "Tier II" benefit. Gradually, over time, the Tier II benefit will grow in significance relative to the Tier I benefit.

Unlike the Tier I benefit, the Tier II benefit will be a private property right enforceable in a court of law because it will be received from regulated private companies, not the federal government. This is an important benefit. Right now, OASDI taxpayers do not have a contractual right to receive their benefits. A Supreme Court decision rendered in 1960 established that the OASDI tax is a tax on labor contracts and is levied independently of any statutory provisions mandating OASDI benefits.

Thus, in the *Flemming* vs. *Nestor* decision (363 U.S. 603, 1960), the Supreme Court declared that Congress could legally eliminate all benefits overnight, and even choose to raise the FICA payroll tax at the same time. Hence, workers do not have valid property rights guaranteeing them "iron clad" retirement incomes from Social Security. Our proposal gives Tier II contributors such property rights, enforceable in courts of law.

Our proposal restores fairness to the Social Security retirement system. The 1983 Amendments fundamentally changed the structure of the OASDI system from a "pay-as-you-go" system to one which unsuccessfully attempted to vest itself by establishing a massive sinking fund. In effect, the Amendments mandated that today's workers not only pay for today's retirees' benefits, but that they also begin saving to accumulate funds to pay for their own retirement benefits. Worse yet, however, in addition to paying for two generations' retirement benefits, they are also mandated to subsidize general government spending by accepting a low, non-market rate of return on their retirement savings. In fact, they are being asked to not only pay twice, but possibly three times for a retirement benefit that may well not be there for them to collect when they enter their retirement years.

Current OASDI policy undermines the progressivity of the Social Security system. This is particularly unfair to lower income earners whose retirement incomes, in large part, take the form of Social Security retirement benefits. Current policy forces them to accept a low, and in some cases, negative rate of return on their principal retirement assets—promises of future Social Security benefits from a system that is actuarially unsound. Meanwhile, higher income individuals enjoy the benefit of professional money management and far higher rates of return in building their private retirement incomes—they are not as dependent on OASDI benefits.

There is an added benefit to our proposal. Our plan has the salutary effect of raising the after-tax reward for working since it raises the expectations of young workers that they too can achieve retirement security through a combination of Tier I and Tier II benefits. If one assumes there is no chance of getting any benefits, then the payroll tax must be viewed as a direct tax on working and a reason not to go to work. In contrast, if one assumes there is a 100 percent chance of collecting a valuable deferred annuity, it is another reason to go to work.

By raising worker's retirement expectations of getting paid by the Social Security Administration, policymakers will implement the largest marginal tax rate cut in history. For the many members of "Generation X" who believe by lopsided margins they will never see a dime in benefits, transforming their attitudes would carry a special wallop. The 12.4 percent of their salaries going to OASDI would be perceived as a 14 percent pay increase!

SIMPSON/KERREY PROPOSAL

We believe the Simpson/Kerrey plan is visionary. Both Senator Kerrey and you should be commended for recommending an innovative plan to partially privatize the OASDI trust funds, while at the same time, restore actuarial balance to the system. The proposal, however, has one serious flaw. The provision incorporated in the Simpson/Kerrey legislation allowing the Social Security Administration to invest up to 25 percent of the surplus OASDI trust fund monies in the capital markets should be deleted from the bill. It would be ironic if, in an era during which we are trying to reduce the presence of the federal government, legislation were enacted leading to more political control over the private economy.

The government should not be allowed to privately invest the OASDI trust fund monies because 1) the investment would likely be dictated by political, rather than economic considerations; and 2) it is unlikely that government-compensated money managers would be able to successfully invest these funds. Typically, governments do not have good track records in picking winners and losers in the marketplace.

This is not the first time Congress has been faced with the issue of what to do with a large Social Security surplus. In 1939, faced with an accumulating reserve fund of $47 billion, Senator Vandenberg (R-Michigan) of the Senate Finance Committee stated that this accumulation of funds was "the most fantastic and the most indefensible objective imaginable. It is scarcely conceivable that rational men should propose such an unmanageable accumulation of funds in one plan in a democracy." Senator Vandenberg's advice is timeless.

THE TIME TO REFORM IS NOW!

More than ten years ago, we put forth a similar plan to privately manage the OASDI Trust Fund surplus at a time when the surplus was just beginning to grow. Since then the surplus monies have effectively been spent because those funds have been used to offset the deficit in the general account. As a result, today's workers have lost more than ten years worth of principal and interest that could have been earned at a market rate of return during a major bull market.

Our proposal would transform Social Security into a modernized, actuarially sound national pension system that provides true retirement security. Such an evolution will remove the economic distortions caused by the Social Security payroll tax and, by creating a large real Social Security surplus that is privately held and managed, eliminate the necessity for future Social Security OASDI tax increases.

Interestingly, Congress debated this issue once before. In 1935, during debate to create a Social Security system, Senator Clark (D-Missouri) offered an amendment allowing employers who had their own compulsory annuity program for their employees the right, along with their employees, to opt out of the program.

The Clark amendment was defeated in the Senate Finance Committee on a tie vote, but was later passed by the "New Deal" Senate, with a Democratic majority of more than 2:1, by a vote of 51-36. We think the Senate was right on June 19, 1935, and a "motion to reconsider" would be in order!

Later, the Clark amendment held up final agreement on the Social Security legislation in the House-Senate Conference Committee for three months. Unfortunately, the Senate receded to the House on the Clark amendment, with the proviso that a special, joint legislative committee be formed to study the underlying issue and report to Congress the following year. The Clark amendment was never reconsidered, but we hope that Congress will do so now—even if it is 60 years later!

Prepared Statement of Hon. Bob Kerrey

Mr. Chairman and members of the Committee, I have come today at your request to offer my views of changes that are needed now in Social Security, if we want to honor our commitment to all beneficiaries today and tomorrow and if we want to play a constructive role in helping Americans plan for their retirement.

First, a program definition: Social Security is an inter-generational commitment made by the generations who are working to allow their wages and salaries to be taxed at a fixed percentage and the proceeds transferred to those generations who are retired and no longer working.

This definition is important because too many Americans define Social Security differently. Too many Americans believe it is a savings program where individuals set aside their income that is held and then returned with interest after retirement. Social Security is not a savings program. If it was, Mr. Chairman, if it was a 12.4 percent forced savings program, America would be the world's leading creditor and our economy would be kicking the rear ends of all of our developed competitors. More important, if it were a 12.4 percent savings program, Americans would be more financially secure and a lot more wealthy than they are today.

Mr. Chairman, I believe we need to change our Social Security laws—and the laws relating to other Federal entitlements—for the purpose of accomplishing three worthy goals:

First, we need to make certain the promise we make to currently eligible beneficiaries can be kept to beneficiaries who are alive today but who won't be eligible for many years.

Second, we need to reverse the trend of American wages, salaries and benefits declining as a percentage of total U.S. output. Workers who receive paychecks will see their purchasing power erode unless and until we stabilize the erosion of Federal discretionary spending. The reason is that the increasing proportion of the Federal budget that must be devoted to entitlements is crowding the investments in education, infrastructure and other needs that could help lift our standards of living.

Third, we need to reverse the trend towards increasing concentration of American wealth, not by redistributing wealth, but by changing our retirement laws (including Social Security) so that all working Americans can look forward to accumulating wealth.

Changing the current course we are on will not be easy. Old habits die hard. However, make no mistake: Changing course will make life easier for 137 million working Americans who feel life's treadmill moving faster under their feet.

Changing the current course will be difficult because we must break with tradition. Let me tell a story to make this point.

On February 17, 1912, a gutsy nineteen-year-old boy gave a speech in the Nebraska Statewide Oratory contest. He was a freshman at the Grand Island Baptist College. His name was C.A. Sorensen. He had been born and raised in a sod house near St. Paul in north central Nebraska. The topic of his speech—"The Hand of the Past"—is as controversial today as it was then.

After a selection by the band and a prayer by Reverend R.R. Coon, Mr. Sorensen was the first to speak. He began his address with this paragraph:

"There is a popular belief that rises like a mountain chain across progress. It is the belief that things are sacred because they are old, or conversely, that things are dangerous because they are new. Of this belief is begotten an undue reverence for the past and the achievements of the dead. Thus we, the living, are in intellectual bondage to the spirits of the dead. We offer up our prayers before the shrine of time-honored falsehoods. The voice of the past, right or wrong, is to us the voice of God. In our logic, the conclusion 'It must be right' follows the premise, 'It has long been believed.' In dress and at table, in education and in marriage, and at last in dying and being buried we follow seriously the customs and traditions our well meaning, but not infallible, ancestors have handed down to us."

We, who sometimes wonder if ever a man threw caution to the wind before telling what was on his mind, should wonder no longer upon discovering these words. That C.A. Sorensen took risk in giving this speech can be discovered in the next day's headline: "Occasions a Protest: Pastors of Several Churches Deprecate Oration of College Student." His courage can also be discovered by examining his prizes: Third place in the contest awarded by the judges, and dismissal from the Baptist College awarded by the school's officials.

An act of kindness from a stranger, the newspaper publisher in Lincoln, brought the young man to the University of Nebraska and the Unitarian Church. As a consequence, he went to law school. He was elected as a Republican to the office of Attorney General in 1928 and again in 1930. He was swept from office in a Democratic landslide in 1932, but not before he and his good friend Senator George Norris had built the foundation for the electrification of his mostly rural, undeveloped State. This contribution—and that of his son, Ted Sorensen, who was an important part of the political career and success of President John F. Kennedy—was possible because C.A. Sorensen had the courage to break with the habits of the past.

His speech was based upon a poem, "Calf Ways," which knew some popularity at the time. The poem describes how a baby calf wandered away from the pasture of his birth into the woods. This blind and wobbly legged calf broke a small, serpentine path as he went along his way. Dogs chased after the calf breaking a slightly larger opening. And, the next day a traveling party came into the clearing, and chose the winding route of the calf. Their choice produced a well beaten and eventually well known route. When it came time to build a highway, the engineers went along with custom . . . and the instincts of a blind, wobbly legged calf.

The closing lines of the poem tell the story:

"For men are prone to go it blind along the calf-ways of the mind And work away from sun to sun to do as other men have done."

Mr. Chairman and members of this Committee this poem describes the potential folly of doing things the same just because they have always been done that way. It points to the danger of our yielding to call of the habit.

One such habit is the decision to treat the future as if its horizon is no further away than five, seven, or at most 10 years. Our Budget Enforcement Act requires us to look ahead five years. The Republican Budget Resolution covers seven years. Even the President's time span is limited to 10 years.

This shortening of the future by elected political leaders is most unfortunate. It is unfortunate for fiscal reasons because we do not plan for the expenditures required to fund the health and retirement need's of America's largest generation, the baby boomers. When they start to retire in 2008, the cost of our entitlement programs goes up sharply.

It is also unfortunate because we humans often have difficulty acquiring a strong conviction that our actions can determine the quality of our future. So long as we believe the forces beyond our control are guiding our destiny, we are discouraged from acting differently.

The future described by the Republican budget and the outline of the alternative budget presented by President Clinton this week contain many elements in common. Both balance the budget. Both call for tax cuts. Both reduce the rate of growth of Medicare.

Without doubt or uncertainty, balancing our Federal budget will increase National savings and should promote economic growth. This is a worthy goal and Americans should support the tough choices required to get there.

However, Americans should support Congressional efforts to do more than balance the budget. This is not our only fiscal challenge. It may not even be our most important. In addition, Americans should support action needed to keep us from becoming an entitlement society. Unfortunately, both the President's proposal and that of the Republican leadership continue our drift in this direction. Vehement denials by either cannot hide the facts.

The facts are that in 1995 entitlements and net interest consume 66 percent of the Federal budget. At the end of seven years the Republican budget would allow entitlements and net interest will to consume 72.6 percent of the Federal budget; under President Clinton they become 71.4 percent. And, the angle of this upward incline steepens when America's largest generation—the baby boomers—begin to retire 13 years from now.

The facts are that under the Republican budget or the Clinton budget, entitlements and net interest will consume 100 percent of the budget in 2013. That is the year a sophomore in high school today will be old enough to be eligible under our Constitution to serve in the U.S. Senate.

Thus, the facts—as opposed to the political rhetoric—inform us that both the Republican and the President's budgets do not ask Americans to change their laws so as to alter a course which will in about one generation's time allow us to witness the dawning of a new age: America as the complete entitlement society.

Neither of the budgets under consideration, nor the various proposals to reform welfare for the poor being debated will make much of a difference. While they may solve other problems, America's Federal Government will become a giant money transfer machine in a blink of this nation's eye unless we decide to do things differently.

I believe we *should* do things differently. I believe America should not become an entitlement society. I believe America should move away from an attitude of entitlement and *towards* an attitude of endowment.

Why? Because it allows us to restore America as a land where families are certain they have the opportunity of moving up the economic ladder into the middle class and beyond. Further, it allows us to restore America as a land where the opportunity to accumulate wealth is available to all.

If 100 percent of our Federal budget is entitlements, we will not be able to pool our collective resources and build roads, bridges, rail systems, and other infrastructure needed to maintain our competitive edge. We will not be able to make certain that all Americans have the opportunity of increasing their knowledge and skills. We will not have the capacity to develop technology, do research, build and operate parks, keep our streets safe, defend our nation, or contribute to a more peaceful world.

If 100 percent of our Federal budget is entitlements, then the future will be one of continued decline in the standard of living for those who do not have skills and the continued widening of the gap between the economic haves and economic have-nots. This should be a future that all American political leaders seek to avoid.

The condition of wages, benefits, and salaries in decline even during times when productivity is on the increase will persist unless we stop the growth of entitlements as a percentage of total Federal spending. Although there are some partisan differences, Republicans and Democrats agree that significant portions of Federal spending adds to America's future productive capacity.

There is a second trend which will persist unless we alter our course: The trend towards increased concentration of wealth. Those who are concerned about this should look carefully at Social Security as a way to help Americans of all incomes acquire more wealth.

Mr. Chairman, there are two ways to acquire wealth. I can either generate it on my own through a life time of saving and investment, or I can hope the government will redistribute someone's wealth to me. To put it straight: Redistribution is fools gold. Moving money from one pocket to another is at best a disincentive to create new wealth; at worse it encourages wasteful, self-indulgent attitudes.

Every time I present this point of view I hear the rejoinder: "You don't understand, Senator. I can't save money. By the time I pay all my bills and my taxes I don't have any money left over."

Well, I say, what about the 12.4 percent payroll tax the law instructs us to take out of your wages for Social Security? What if we changed the law so that just 2 percent of that tax went into a private investment plan operated by the Social Security Administration, but which you would own, steer into higher yielding investments, and could pass to your heirs? And, what if I showed you that with just 2 percent your retirement security would be larger and more flexible than the current system?

And, Mr. Chairman, that—as you know—is the thrust of the proposal that you and I have made. It restores the long-term solvency of Social Security AND provides a glimmer of hope for tens of millions of American families who today have little chance of accumulating wealth. With just 2 percent of wages, 137 million workers would accumulate a trillion dollars in new savings over the next nine years.

This IS powerful stuff, Mr. Chairman. But we have to be willing to do things differently, to take a different approach than the one we are on now.

And, Mr. Chairman, we could make our proposal an even more powerful wealth generator if:

We allowed lower income workers to dedicate a larger percentage of their wages to their Personal Investment Plans;

We changed our private pension laws so that defined contribution plans vested easier and were more portable;

If there must be a tax cut, we should alter the $500 per-child tax credit so that the money goes into a personal investment plan for the child rather than being consumed.

These are the kinds of suggestions I have heard from Americans who have looked at our plan and agree with its goal of an America where wealth is less concentrated and all families have more personal financial security that is independent of their government.

Mr. Chairman, a common argument used by Republicans and Democrats against our proposal is that we can afford to wait. This is a long term problem; time is on our side, they say, so, let's put this one off for 10 to 15 years.

To that I say, "Baloney!" The mathematics of compounding interest rates compels those who want all Americans to accumulate more wealth to create a system where savings contributions will be made over as long a period a time as possible. Better to put away a small amount of money from birth than wait until you are 50 as most of us tend to do. Wait until you are 50 and you will discover the terror of not being able to save enough to provide the security you will need when retirement occurs.

Time is not on our or the American people's side. Our delay is their disaster.

Senator Simpson, I thank you for your leadership on this issue. You are as good a partner as I could have. For our country and our future I pray we are successful in changing our Social Security laws.

Attachment.

THE KERREY-SIMPSON PROPOSAL

The Kerrey-Simpson proposal consists of eight bills aimed at curbing the growth of entitlement spending and reforming our federal retirement programs to promote savings and preserve the purpose and goals of these programs for future generations.

(1) Congressional and Federal Retirement Reform Act of 1995
(2) Military Retirement Reform Act of 1995
(3) CPI Review and Adjustment Act of 1995
(4) COLA Limitation Act of 1995
(5) Long-Term Budgeting Act of 1995
(6) Social Security Eligibility Age Adjustment Act of 1995
(7) Personal Investment Plan Act of 1995
(8) Strengthening Social Security Act of 1995

The first seven bills address specific economic, fairness, and budget savings process issues that contribute to the growth of entitlement programs as a share of federal outlays. They include reforms to the Congressional, federal, and military retirement systems, reforms to the overall budget process and inflation-related calculations affecting entitlement spending. Taken as a group, these seven components would restore long-term balance to the Social Security system.

The final bill is a comprehensive Social Security reform package that restores long-term actuarial balance to the Social Security system by updating it to reflect today's changing demographic, lifestyle, and savings patterns. It includes several components of the first seven bills, as well as other reforms to further strengthen and update the system.

THE NEED FOR REFORM

Spending on entitlement programs and interest on the national debt will consume over 64% of Federal outlays this year, more than double the percentage of 30 years ago. The Congressional Budget Office projects that mandatory spending will continue to consume an ever-increasing share of federal outlays. In fact, by 2012, unless appropriate policy changes are made in the interim, projected outlays for entitlements and interest on the national debt will consume all tax revenues collected by the Federal government. The major drivers of this growth are federal health and retirement programs due in large measure to demographic pressures as baby boomers retire.

The Kerrey-Simpson proposal responds to the wake-up call sounded last year by the Bipartisan Commission on Entitlement and Tax Reform and further reinforced last month by the Social Security Trustees' Report by beginning to reform federal retirement programs, including Social Security. Although the OASDI Trust Fund (Old Age Survivors Disability Insurance) is expected to be able to pay benefits for the next 34 years, the strain caused by the aging of the "baby boom" generation will be felt long before then.

By 2013, Social Security benefit payments will exceed the tax revenues dedicated to the program. After this occurs, the cash flow shortfalls in Social Security will cause the total federal deficit to increase rapidly unless policy changes are made. The Public Trustees urge that "reforms should be undertaken sooner rather than later to ease the transition to providing financial stability in the next century." The Kerrey-Simpson proposal includes sweeping reform to bring the program back into long-range actuarial balance and preserve and strengthen it for future generations.

Further, the Personal Investment Plan Act and the personal investment plan component of the Strengthening Social Security Act introduce a true savings aspect to the Social Security program. Countries that save and invest more grow faster and have more rapid improvements in the standard of living of their citizens. In the United States, private savings have dropped from more than 8 percent of the economy in the 1960s to about 5 percent today. The revolutionary "personal investment plans" created in these two pieces of legislation would allow Americans to earn higher rates of return on their retirement contributions by shifting funds from Treasury securities to productive investments in the economy while increasing private savings and providing more retirement flexibility.

FEDERAL AND MILITARY RETIREMENT REFORMS

Any change in entitlement and retirement programs must begin in Washington. Congress must lead by example before asking anything of the American people. In this spirit, the Kerrey-Simpson proposal begins by aligning the retirement program for Members of Congress and Congressional staff with that of all federal employees and introducing overall adjustments to the federal retirement programs to bring them more in line with private sector standards.

(1) Congressional and Federal Civil Service Retirement Reform

Current Law: The Civil Service Retirement and Disability program provides retirement and disability benefits for retired Federal civilian employees and their survivors. The program consists of two systems, the Civil Service Retirement System (CSRS) and the Federal Employee Retirement System (FERS).

CSRS, a traditional defined benefit program, began in 1920. CSRS covers only those Federal employees hired before January 1, 1984. As a result of the 1983 Social Security amendments mandating Social Security coverage for new federal employees, federal employees hired after December 31, 1983, are required to enroll in FERS, a mixed defined benefit and defined contribution system. Participants therefore have a three-component retirement plan -- Social Security, the FERS basic benefit, and savings from the Thrift Savings Plan.

Workers under CSRS and FERS are required to contribute a percentage of pay toward these programs. Executive and judicial branch personnel currently contribute 0.8 percent of pay for the FERS program. They accrue pension benefits (a percentage of their average salary during their three highest-paid years of service) at a rate of 1 percent per year and accrue benefits at a rate of up to 1.1 percent of pay per year of service. Congressional employees (including Members of Congress) participating in FERS contribute 1.3 percent of pay and receive accrual rates of 1.7 percent per year for the first 20 years of service and 1 percent for more than 20 years of service.

Federal employees participating in the CSRS program contribute up to 8% of pay and accrue benefits at a rate of up to 2.5% of pay per year of service.

Proposed Changes:

(1) Equalize contribution and accrual rates for all federal employees. This provision would lower the FERS contribution and accrual rates for Members of Congress and their staff to equal those rates applicable to Executive and Judicial branch employees.

(2) Reduce accrual rates under FERS and CSRS by 0.1 %.

(3) Change benefit calculation from "High 3" to "High 5". This provision would adjust the benefit formula for both CSRS and FERS by changing the salary base from the employee's highest three consecutive years of pay to his or her highest five years. The amount of the benefit will generally decline if pre-retirement pay is determined over a longer period.

These changes would be effective beginning on January 1, 1997.

(2) Military Retirement Reform Act of 1995

Current Law: Currently, military retirement benefits accrue at a rate of 2% per year for the first 20 years of service. Thus, for 20 years of service, the retirement benefit is 40% of active duty pay. For each additional year of service up to 30 years, the benefit increases to 3.5% of active duty pay, reaching a maximum of 75% after 30 years of service.

In addition, military retirees receive a post-retirement cost of living adjustment of the CPI minus 1% until age 62. This 1% reduction is made up in the form of a lump sum payment at age 62. Finally, military retirees receive a lump sum payment at age 62 of 10% of retirement pay to adjust the retirement pay to the level it would have been with a 2.5% accrual rate for the first 20 years of service.

Proposed Changes: The Kerrey-Simpson Military Retirement Reform Act would hold the accrual rate at 2% after 20 years of service and eliminate the lump sum payment at age 62. This proposal would only affect those retirees who joined the military after July 31, 1986 and thus are not eligible for retirement until 2006.

OVERALL REFORMS

In order to share the cost of controlling entitlement spending and add clarity to the federal budget process, the Kerrey-Simpson proposal includes these overall entitlement reform measures:

(3) Consumer Price Index Review and Adjustment Act

Current Law: Social Security, civil and military retirement, veterans' compensation, and several aspects of the Federal income tax system (rate brackets, the standard deduction, and personal exemptions) are adjusted annually based on annual increases in the Consumer Price Index (CPI). Although the CPI is not a cost of living index, it is used as a measure of the rise in the cost of living for these programs.

The CPI is a weighted average of goods and services -- the market basket -- purchased by a representative urban worker. The market basket includes components such as housing, food, medical services, transportation, and other goods and services.

Proposed Changes: Many economists and technicians believe the current CPI formula overstates cost-of-living increases by up to 1.5 percentage points. To address this situation, the Kerrey-Simpson proposal would set up an expert panel to study the accuracy of the current CPI measure and report recommendations within one year to the Secretary of Labor and the Congress. The panel would consist of three members appointed by the Director of the Office of Management and Budget, three members appointed by the Director of the Congressional Budget Office, and the Chairman of the Federal Reserve Board. So that we are not simply delaying action by creating another commission and later ignoring the recommendations, adjustments based on CPI would be calculated at CPI less 0.5 percentage points until the panel completes its work. The Congressional Budget Office estimates that this action will decrease the deficit by about $66.7 billion over the next five years.

(4) COLA Limitation (Excluding lower benefit recipients)

Current Law: Monthly benefits paid to Social Security and federal and military retirement beneficiaries are automatically increased annually for changes in the cost of living as measured by the Consumer Price Index.

Proposed Change: This proposal would limit the cost of living adjustment for Social Security, CSRS, FERS, and military retirement beneficiaries whose benefits are above the 30th percentile of benefits paid. **All beneficiaries would continue to receive a COLA.** Those below the 30th percentile would receive the full COLA that they would receive under current law. All other beneficiaries above the 30th percentile would receive a flat dollar amount equal to the COLA due beneficiaries at the 30th percentile.

(5) Long-Term Budgeting Act of 1995

Current Law: Currently, budget projections issued by the Congressional Budget Office and Office of Management and Budget project five years into the future.

Proposed Change: The first and most important recommendation endorsed by a majority of the Bipartisan Commission on Entitlement and Tax Reform was that the federal government make major spending and tax decisions with reference to a longer time period than the traditional five-year budget window. This short-term outlook lulls us into complacency. Life looks pretty good for the next five years. When discretionary spending was the largest share of our budget, short-term planning may have been appropriate. However, the next 30 years will bring a period of significant increases in entitlement costs and interest. In fact, we only need to look six years into the future to see the bankruptcy of the Medicare program. Therefore, the Kerrey-Simpson proposal requires CBO and OMB to include 30-year projections in budget estimates.

In addition, this proposal requires the President to include generational accounting information each year in the Administration's budget. Generational accounting measures lifetime net tax rates, which further helps us understand the long-term, generational impact of current fiscal policies.

SOCIAL SECURITY

The Old Age Survivors Disability Insurance (OASDI) Trust Fund is expected to be able to pay benefits on a timely basis for the next 34 years. However, the strain caused by the aging of the "baby boom" generation will be felt long before then. By 2013, Social Security benefit payments will exceed the tax revenues dedicated to the program. After that time, the Trust Fund will steadily decline until exhaustion in the year 2030. The Kerrey-Simpson proposal brings the program back into long-range balance and preserves and strengthens it for future generations.

(6) Social Security Eligibility Age Adjustment Act of 1995

Current Law: Under the 1983 Social Security Amendments, the normal retirement age (NRA) will gradually rise at a rate of two months per year beginning for people currently age 57. The NRA will reach age 66 for persons age 52 today and will remain at age 66 for 12 years. It will then begin to rise again by two-month increments starting with persons now age 40, until it reaches age 67 for persons under the age of 36.

Workers who retire and collect benefits before reaching the NRA take a permanent reduction in benefits. Workers retiring at age 62 today (the current early eligibility age) receive 80 percent of the full benefit. Benefits for workers retiring at age 62 are scheduled to decrease gradually to 70 percent of full benefits as the NRA increases to age 67.

Proposed Change: One of the primary forces driving the financing problems of the Social Security program is the aging of the American population. The good news that Americans are living longer, healthier lives is having a profound impact on retirement programs such as Social Security. For example, in 1935, when Social Security was established, the average American lived to 61 years of age. In 1994, the average American's life expectancy was 76. By 2025, it is expected to be 78 years of age.

The impact of increased life expectancies on the Social Security program is further amplified as the large "baby boom" generation reaches retirement. Retirement programs such as Social Security, which is based on "pay-as-you-go" financing, rely on each generation having enough children to support the preceding generation's retirement. The baby boomers didn't. For example, in 1950 there were over 16 workers contributing to the Social Security system to support each retiree. By 1990, that number had fallen to just over three workers per retiree, and by 2070 the ratio is expected to fall to approximately 1.8 workers supporting each retiree. It is these inexorable laws of arithmetic and demographics that converge to jeopardize the integrity and solvency of the Social Security program.

Responding to these changes in the work force, this legislation would accelerate the date the NRA reaches age 67 by eliminating the 12-year plateau during which the NRA will remain at 66. The NRA would continue to increase by two-month increments until it reaches age 70 for those persons currently under age 29. No one currently over the age of 51 would be affected, allowing workers sufficient time to plan for this change.

In addition, this proposal would increase the Early Eligibility Age beginning in 2000 at a rate of 2 months per year until reaching age 65 in 2017. This rise will correspond with the rise in the NRA from age 67 to 70 and would preserve the five-year spread and 70% of full benefit pay-out designated for those who choose early retirement in current law.

Finally, after the year 2030, normal retirement age and early eligibility age would continue to increase at a rate of one month per two years. This automatic increase will maintain the ratio of years in the work force and years in retirement as life expectancy continues to rise.

(7) Personal Investment Plan Act of 1995

Current Law: Social Security is financed through a payroll tax authorized by the Federal Insurance Contributions Act (FICA). Under FICA, employees and employers pay taxes at equal rates on wages up to $61,200 in 1995. The employer and employee tax rates are both 6.2 percent, for a combined rate of 12.4 percent.

Proposed Change: This is an optional program that would allow workers to choose to divert 2.0 percentage points of their OASDI payroll taxes to their own personal investment plans. An employee can choose one of two investment categories for his or her Personal Investment Plan -- or PIP -- contribution. Employees who choose this option will be able to invest their PIP contribution in a low, medium, or high-risk investment fund, modeled after the "Thrift Savings Plan" available to federal employees. The second option will be modelled after the Individual Retirement Account. Employers who choose this option will be able to invest their PIP contribution in investment vehicles currently permitted by IRA's, including stocks, bonds and mutual funds. This optional program would allow participants to earn higher rates of return on a portion of their Social Security payroll tax contributions, shift funds from Treasury securities to productive investment in the economy, introduce more flexibility for retirement decisions, and increase personal and national savings. In addition, any balance remaining in the Plan upon the employee's death would belong to the employee's estate.

The benefit formula for those who opt into the PIP would be actuarially reduced to offset the long-term cost of the payroll tax reduction. Therefore, this proposal would have no impact on the long-term solvency of the OASDI Trust Fund.

(8) Strengthening Social Security Act of 1995

This comprehensive Social Security reform package applies components of several of the Kerrey-Simpson bills to correct the long-range program deficit and introduce a true savings component to the program.

It would eliminate the long-range actuarial deficit, allowing the OASDI program to pay benefits on a timely basis for the 75-year period examined by the Social Security actuaries. In addition, it leaves the Trust Fund with a stable ratio (Trust Funds as a percentage of annual outlays), ensuring timely payment of benefits well beyond the 75-year period.

(1) Establish Individual "Personal Investment Plans". Similar to the stand-alone Personal Investment Plan Act described above, this provision would divert 2 percentage points of each taxpayer's OASDI payroll taxes to their own personal investment plan. This is a mandatory provision intended to allow participants to earn higher rates of return on a portion of their Social Security payroll tax contributions, shift funds from Treasury securities to productive investment in the economy, introduce more flexibility for retirement decisions, and increase personal and national savings.

(2) Accelerate the currently scheduled NRA increase to age 67, further increase the NRA to age 70 for persons under age 29; increase early eligibility age (EEA) from 62 to 65 and establish link to normal retirement age; index both NRA and EEA after 2030. This provision is identical to the changes included in the "Social Security Eligibility Age Adjustment Act" described above.

(3) Limit Social Security COLAs to the adjustment for the Social Security beneficiary in the 30th percentile of benefits. This provision is identical to the Social Security provisions included in the "COLA Limitation Act of 1995" described above.

(4) Limit Social Security COLAs to the CPI less 0.5 percentage points. This provision would apply the CPI calculation included in the "CPI Review and Adjustment Act of 1995" described above.

(5) Adjust formula for determining primary insurance amount.

Current Law: Two calculations are used to determine the amount of a worker's initial Social Security benefit. First, an average monthly earnings amount is calculated from the earnings record. All monthly wages from past years are indexed for the change in average wages that has occurred since the year in which the wages were earned (indexed to age 60). These amounts are then averaged together, with any wages for age 60 and after, to produce the average indexed monthly earnings (AIME).

Second, the primary insurance amount (PIA) is calculated. A progressive formula is applied to the AIME to determine the PIA. The PIA is the basic monthly benefit payable to a worker retiring at the normal retirement age (NRA). If a worker retires at a later age, the PIA amount is increased; if the worker retires at a younger age, it is reduced. For a worker becoming eligible in 1994, the PIA formula was the total of: 90 percent of the first $422 of AIME; 32 percent of the next $2,123 of the AIME; and 15 percent of AIME above $2,564. The dollar amounts at which the percentage rates in this formula change are called "bend points". The bend points used for each successive cohort are increased annually by the growth in average wages. The percentage rates in the PIA formula, known as replacement rates, do not change.

Proposed Change: This provision would modify the benefit formula over a 25-year period beginning in 2030, to provide a more progressive benefit formula. Specifically, the option would add a third bend point above the point where the current 15 percent bracket begins. It would then apply a 10 percent rate to the extent AIME exceeds the new bend point. Over 25 years, the 15 percent bracket would be replaced with the 10 percent bracket, and the 32 percent bracket would be partially replaced with the 15 percent bracket.

(6) Modification of spousal benefits.

Current Law: Spousal benefits are monthly benefits payable to a spouse or divorced spouse of a retired worker. They can equal up to 50 percent of the retired worker's full benefit (PIA). Spousal benefits are generally paid if (1) a currently married spouse is age 62 or older, (2) a currently married spouse is caring for one or more of the worker's entitled children who are disabled or have not reached age 16; or (3) a divorced spouse aged 62 or older is not married and the marriage to the worker had lasted 10 years before the divorce became final. This spousal benefit is payable only if it is larger than the reteurement benefit, which is based on the spouse's own earnings record.

Proposed Change: This provision would gradually reduce the Social Security spousal benefits for new beneficiaires from a maximum of 50 percent to a maximum of 33 percent of PIA. This provision increases equity within the system between one- and two-earner families. The reduction would start in 2000 and would be phased down at one percent per year. It does not apply survivor benefits, and therefore, does not affect widows, or benefits resulting from a spouse's own earnings.

7) Redirect revenues received from taxation of Social Security benefits from HI Trust Fund to OASI Trust Fund. OBRA-93 created a second tier of Social Security benefit inclusion for tax purposes which applies to taxpayers with "provisional" income greater than $34,000 for singles and $44,000 for married, filing joint taxpayers. Eighty-five percent of the excess of the taxpayer's provisional income is taxable. Revenue raised from this provision is currently deposited in the HI Trust Fund. This proposal would re-direct this revenue to the OASDI Trust Fund.

(8) Invest a portion of the OASDI Trust Funds in equities beginning in 1998. Under this proposal, beginning in 1998, a portion of the Trust Fund assets would be phased into a stock index fund. The phase-in period would last 15 years, at the end of which 25% of Trust Fund assets would be in an alternative investment. The rationale for this proposal is to allow the Trust Fund to earn a higher return, as well as to invest this surplus into productive assets and businesses in the economy.

PREPARED STATEMENT OF HEATHER LAMM

Thank you Mr. Chairman and Members of the Committee for inviting Third Millennium to participate on this distinguished panel. My name is Heather Lamm. I come before you as a member of a group of people born after 1960 who are concerned about the future of America. Third Millennium's mission is to redirect our country's attention from the next election cycle to the next generational cycle, and in the process inspire our generation to action. The issue before us today is not about what size piece of the American entitlement pie one generation gets compared to the next. It is not about generational warfare. The issue before us is about looking toward the future and realizing the severity of the problems awaiting us. It is about dealing with those facts and those problems now, before they deal with us.

Mr. Chairman, this nation can no longer afford to question whether or not Social Security is in trouble. The facts speak for themselves. From Alan Greenspan to the Congressional Budget Office to the Public Trustees of Social Security the experts agree that Social Security is on a collision course with bankruptcy. By 2030, the program will run out of money. But by 2013, the date we really should focus on, the trust fund is projected to begin running deficits. This crisis is not a result of "trust fund looting," or of waste, fraud, and abuse in the system. The trust fund will begin to run deficits as a result of the forces of demographics and simple arithmetic. America is experiencing a demographic shift that will double the number of Americans over age 70, from 24 million today to 48 million by 2030. Our Federal retirement programs must change to adapt to these new realities. If left unchecked, Social Security will consume almost half of our nation's revenues by 2030. Can we afford such a system?

Thus the question before us is when and how we act to change the course of Social Security. Every year we wait the problem compounds. Unfortunately, in the current budget debate, both this Congress and the Administration have punted on Social Security. We applaud you for embarking on a serious path toward a balanced budget. But by omitting Social Security from the budget debate, Congress and the President do a tremendous disservice to this nation. Is it fair to ask all of us to sacrifice in all areas of our lives to achieve a balanced budget in 2002, only to turn around and find a $600 billion bankrupt Social Security system knocking at our door early next century?

While Social Security's collapse may seem very distant, to my generation it is a reality that is literally right around the corner. Last year Third Millennium commissioned a national survey that found that nearly twice as many young adults believe in the existence of UFOs as believe Social Security will exist by the time they retire. The crisis of confidence in Federal retirement programs among young people is astounding; our lack of faith in this system has broadened into a cynicism about government in general that will not be healthy in the long run.

Imagine for a moment that we are in the year 2013. For years Congress and the President have been ensnared by special interests and partisan bickering, and as a result have denied the need for Social Security reform. Social Security is now running a deficit, and every year plunges the United States further into debt. The nation is faced with a horrendous decision. We must raise payroll taxes on young workers by 25 percent immediately to balance the program, or, we must slash all benefit checks dramatically, leaving many needy seniors unprepared and without vital benefits. The nation is of course outraged. Why must a country as great and wealthy as America have to choose between burdening its workers with unbearable tax rates, and denying poor senior citizens adequate benefits?

Mr. Chairman, we will not have to make that drastic decision if we act soon. We can ensure that Social Security continues to provide benefits to those who need them and we can maintain reasonable tax rates if we have the courage to face the situation today, rather than tomorrow.

Let's set some priorities immediately. Let us acknowledge that our government has a responsibility to oversee a national retirement plan, but that our government also has the responsibility to strengthen the economy for future generations, and provide them with reasonable retirement expectations. Let us acknowledge that Social Security, when enacted provided a crucial boost to the economy, but that if left unreformed, it will soon become a tremendous drain on our economy.

Now is a good time to recall the admonition of the 1937-38 Advisory Council on Social Security: "The protection of the aged must not be at the expense of adequate protection of dependent children, the sick, the disabled, or the unemployed; or at the cost of . . . lowering the standard of living of the working population."

Let's acknowledge the moral imperative of supporting poor seniors to keep them out of poverty. But let's also come to the table and discuss real reforms that will ensure Social Security will always be there for those who need it. The reforms proposed by you, Mr. Chairman, and your colleague Sen. Bob Kerrey, are reasonable, incremental, necessary, and, in my eyes, deserve the full support of all other future-looking Senators.

Our national survey last year found that 82 percent of young Americans want to be given the freedom to invest part of their Social Security payments in private retirement accounts that they would own, control and even pass along to their children and grandchildren. Allowing workers to contribute part of their payroll taxes to individual retirement accounts, as you propose, would lead to a tremendous boost in savings and capital formation. It would keep interest rates low and provide billions of dollars to the economy that could be used for new plant and equipment, research and development and worthwhile investment projects.

Furthermore, we believe that your proposals dealing with the Consumer Price Index, the Cost-of-Living Adjustment, and the retirement age are logical adjustments that reflect America's changing economy and demographics.

Another reasonable alternative we support is to ask upper middle class and wealthy seniors to relinquish part of their benefits under an affluence test, as proposed by the Concord Coalition, starting at annual household incomes of $40,000 and up. It makes no sense that we vilify teenage mothers for barely subsisting on AFDC, while at the same time we bestow billions on wealthy retirees who have received back two, three or four times what they paid into Social Security, including interest. It defeats the very idea of personal responsibility to mail billions worth of Social Security checks to wealthy retirees each year, especially when that money comes from the likes of union workers or minimum wage earners.

Imagine how less Draconian the Senate's likely cuts in education, infrastructure, environmental protection, and research funding would be if you were to put Social Security on the table. Needlessly maintaining Social Security as a sacred cow means that other worthwhile investments in the future are slaughtered.

Mr. Chairman, I believe this Congress' ultimate challenge is farsightedness. Would a private business, knowing that financial disaster is pending, wait until tomorrow to deal with the situation? Would an individual family, realizing it is running into financial troubles, wait until tomorrow to change course? Why, then, should the Federal government be held to any lower standard?

Every generation of Americans has its own assets and liabilities, and I truly don't believe that most people in my generation are whining about the future we are inheriting. But we can no longer sit idly by as politicians compromise our economic future and, more importantly, the future of our children, to pacify powerful special interest groups. Young people have an obligation, both as citizens and as the parents of the next generation, to offer solutions, to have a voice, and to demand action. We are willing to sacrifice because we know the consequences to our generation and to future generations if we do not. We are willing to accept reduced benefits and an increased retirement age. But we are not willing to accept inaction on the part of today's leaders. It is crucial for all Americans that we begin to confront Social Security today. To avoid action now is a moral and economic assault on future generations.

Mr. Chairman, no generation in American history has been left with the tail end of so many dysfunctional systems as the generation currently graduating from college and entering the workplace. My peers and those after us will pay large amounts of our paychecks into programs that experts agree will be bankrupt by the time we retire. We are on the verge of inheriting a $5 trillion national debt, a crumbling national retirement system, decreased national savings, and an increasing number of retirees who expect to be generously supported. As a generation, we wonder how we can face this tremendous fiscal burden and still lead this nation into greatness. With boldness and clarity of purpose, let us seek answers together for the good of Americans, today—and tomorrow. Thank you.

PREPARED STATEMENT STANFORD G. ROSS

Mr. Chairman and Members of the Subcommittee, I am pleased that you have invited me to testify at this hearing on the solvency of the Social Security Trust Funds (Old Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund). I have recently completed a five-year term as Public Trustee of the Social Security and Medicare Trust Funds and in that capacity have recently testified before both this Subcommittee and the full Committee. I welcome this further opportunity to contribute to the important effort you have commenced to secure the future of the Social Security program. The views I will be offering today reflect my individual views and should not be taken as reflecting the position of any organization that I am presently associated with or have been associated with previously.

I first take note of the bills introduced recently by Senators Kerrey and Simpson and commend them for the leadership they are demonstrating in attempting to bring needed reform to this area. While as my testimony today shows, I do not agree in all respects with their specific proposals, I do believe that the problems they are seeking to address are real and that many of the directions they are suggesting are sound. I think they understand perhaps better than anyone that with programs this complex and sensitive, it is inevitable that reasonable people will have different positions on particular issues. I believe we all have the welfare of the country, and particularly future generations, as our paramount concern, and it is important to have serious discussion of this subject.

I will first comment on the OASI trust fund and then provide some remarks on the DI trust fund. OASI and DI must be analyzed separately for a variety of reasons. OASI is relatively predictable, while DI is much more subject to variation in the growth of beneficiaries and costs than OASI (where workers must die or reach a specified age to satisfy eligibility for benefits). Also, OASI is vastly larger than DI; in 1994, DI expenditures were only 12% of the combined OASDI outgo. Finally, the legal framework and historic background of these programs is distinctly different and the problems that they present are particular to each program.

Focus for Reform—I have been asked to provide a broad overview of the situation in which the OASI program finds itself today. Necessarily this requires addressing a considerable number of issues in summary fashion. I think the place to start is to state a focus for reform of the OASI program. As our recently issued trust fund report showed, the OSAI trust fund meets the short-term (10 year) test of solvency, fails the long-term (75 year) test, and is expected to be exhausted in 2031, some 36 years from now. As our report recommends, the long-term deficit, some 2.17 percent of payroll, should be addressed and actuarial balance achieved.

The largest part of the OASI financial problem stems from the demographics of our country. At present there is about a 3 to 1 worker to beneficiary ratio which will decrease to about a 2 to 1 ratio by about 2030. But the issues that need to be addressed go beyond numbers and financial calculations. It is necessary to reform the structure of the program in ways that will meet the expectations of younger generations. Confidence must be restored that the Social Security program is in the nation's larger interests and that it will continue to be a vital part of our society.

My belief is that the Social Security program is fundamentally sound; that it has served the American public well for some 60 years; and that the challenge is now to make those changes which will adapt the program to meet the needs of the society over the next period. Thus, the focus of reform should be future oriented, solving the problems that the program is manifesting in the present based on an understanding of the past.

I would undertake reform to make the OASI program perform as well as possible over the long-term by making program changes that take account of present realities. Long-term financial balance should be restored by structural changes. The long-term deficit is around two percent of payroll, which, while a serious deficit, is not an alarming situation as is the case with the Medicare program. Most importantly, there is short-term solvency; indeed, there are sufficient finances to pay benefits for about another 36 years. While there is not time urgency in some senses, it is the case that if changes are undertaken sooner rather than later, they can be more incremental, phased-in more gradually, and generally done in a way that best preserves and maintains the program for the benefit of all generations. Thus, the sooner we act the better, and I commend you for the courage and energy you are displaying in pushing forward on this subject at this time.

With that general focus, I would now like to turn to some specific reform issues that I know are very much at the heart of any reforms that will be undertaken.

Retirement Age—The so-called normal retirement age under present law is 65, which it has been since the beginning of the program, and is scheduled under the law to become 67 in the next century after a long transition period. Many current proposals would raise this retirement age by anywhere from an additional one to three years, i.e., to 68 or 70, and shorten the transition period. Some have also proposed in effect indexing the retirement age by having it rise automatically in the future as mortality rises, in which case if there are sufficient mortality increases, as seems likely, it could rise above age 70.

I find many of the proposals for increasing the retirement age unsatisfactory because they neglect the central fact that most Americans under present law retire before the so-called normal retirement age. Social Security benefits become available at age 62 under present law and far more qualified persons elect to receive a benefit at age 62 than at age 65. Indeed, something like 70 percent of the qualified persons elect to receive Social Security benefits before age 65. While the law provides for an actuarial reduction that produces a reduced benefit so that arguably there is no cost to the system, I do not think that this provides an adequate analysis of the effects of the early retirement option. In fact, because Americans can get a benefit early, there is an undue incentive to retire early. Retired persons stop contributing to the economy and stop paying Social Security and other taxes. I think that the early retirement age should be raised to age 65. Obviously, such an increase should be phased in over a transition period as with any increase in retirement age. This change would restore the program to its original form when benefits were payable only at age 65 and not before.

I believe that one of the most serious flaws in the 1983 reform legislation was to raise the so-called normal retirement age to 67 while leaving the early retirement age at 62. The major effect of that pattern of change is simply to provide reduced benefits for people electing to retire at early ages. This will inevitably put more pressure on the means-tested Supplemental Security Income program as the reduced benefits become increasingly inadequate as people live longer. Congressman Pickle introduced in the last Congress a bill to restore long-term solvency to the OASI program by primarily making increases in the normal retirement age while allowing benefits to continue to be paid as early as age 62. He attempted to deal with the unfortunate consequences of this approach by calling for an enhanced SSI program, but I believe his bill, while well-intentioned, was highly problematic as a solution to long-term problems of the OASI program.

I would be reluctant to see the so-called normal retirement age increased further at this time. Perhaps in the interest of restoring long-term financial balance, an increase of a year, to 68, might be justified, provided that the early retirement age was raised to 65. I think that going beyond that before we see whether people can, in fact, work longer, might have unfortunate effects.

I also believe that indexing the retirement age would not be a good idea. I think the public would find it hard to understand why the legal retirement age was a moving target. Moreover, to the extent they did understand its purposes, it might undermine support for the program and further erode confidence in the government's ability to run fairly and efficiently a major social program. If further increases are justified in the retirement age beyond what the Congress making the reforms decides, future Congresses can enact them.

I do support the provisions of present law that give increased credits for work beyond the so-called normal retirement age and think these should be reviewed and perhaps increased to provide even greater incentives for people to work longer. While it is unlikely that many people will do so under present circumstances, it does seem to me a proper reflection of the social policy that ought to be embodied in the relevant laws affecting retirement decisions.

Indexing—Many of the current proposals for Social Security reform would significantly affect the indexing of Social Security benefits. Many believe that the annual benefit formulas "over-index" and some believe that indexing is not a necessary part of the program but simply an additional benefit that was added during a profligate period when the OASI program was unduly expanded. My view of this subject is that appropriate indexing is an essential element of the Social Security program. Once an initial benefit is set and a person has stopped working, indexing to keep the benefit intact in the light of cost of living increases is a necessary part of the program. Prior to automatic indexing being introduced in 1972, Congresses took ad hoc action to achieve the same results. The historical record demonstrates the necessity of keeping benefit levels current by action in one form or another.

What constitutes appropriate indexing is a difficult issue. When indexing was first introduced in 1972, the formulas were incorrect and produced a so-called "double-indexing" that was not corrected until 1977. Indexing was further reviewed and changed in 1983. Some believe that the CPI index used to adjust benefits probably is not a correct reflection of the market basket for retired persons and that a separate index should be constructed that likely would be somewhat less than the current CPI index. More technical work should be done here, and my speculation is that if the indexing were properly corrected it would have a favorable long-term financial effect on the program. I would not favor any mechanical reduction of indexing, such as making it CPI minus .5 percent, or limiting indexing for higher level beneficiaries. This would add an arbitrary element to the program which is inconsistent with sound social insurance principles.

A fundamental aspect of the program which I think it is important to review is that benefit formulas are indexed to the increases in wages and prices. I think that in years in which wage indexing exceeds prices, there is no problem. But where price increases exceed wage increases, it may be incorrect to have beneficiaries do better than current workers. Accordingly, I would review whether the indexing should be the lower of wage increases or price increases and this aspect may have beneficial long-term effects for both the fairness and financial solvency of the program.

In general, I think that an overall review of indexing is in order. It has an intrinsic relationship to retirement age issues and benefit formula issues. While an arcane subject, it is critical to reaching a sound reform package for indexing to be appropriate in the light of decisions on all major elements of the program. In the final analysis, all changes affecting benefits are reflected in a particular percentage change affecting individual beneficiaries.

Benefit Formulas—At present, the amount of earnings replaced for an average earner in the system is 42%. Because of the progressive nature of the formulas used, 56% of the earnings of a low earner are replaced and 28% of the earnings of a maximum earner are replaced. These formulas are the product of incremental changes in the program made over a long period. I think they generally reflect a sound pattern for a social insurance program. Certainly by the standards of the OECD countries, an overall average replacement rate of 42% is not high.

While it would not be inconsistent with the notion that the program should provide a "basic level of support" for the average replacement rate to be somewhat lower, I do not think it could be substantially lower without creating serious problems for the program as presently conceived. If the average replacement rate becomes too low, it would not be adequate to provide a basic level of support and "means testing" might have to be introduced to the program, which would be totally inconsistent with the social insurance concept.

The program reflects "needs" considerations in several ways. Its basic premise is that the loss of earnings from retirement creates a presumptive need for replacement income. Benefits are related to earnings and the program is a self-supporting, contributory system. Since persons entering the work force cannot know for sure whether they will be a high, average or low earner, or whether they will have a spouse or dependents, social insurance concepts generally involve a measure of progressivity in the benefit formulas and some amount of redistribution within the group of covered persons. The program, by providing a basic level of protection, has not only prevented widespread poverty among aged workers and their families, but has contributed to a better life for Americans of advanced age.

The limitation on taxable earnings protects higher earners from making undue contributions and subjecting benefits to income tax provides an adequate assurance of fairness without means testing. I would be in favor of increased taxatior of benefits by, for example, dropping the income thresholds, but oppose any kind of means testing of the benefits as inconsistent with the basic premises of the program.

If it is necessary in the interests of long-term solvency to reduce the benefit formulas to lower the replacement rates, that would probably be preferable in the present climate to increasing the tax rate. However, historically, every major reform package as in 1977 and 1983, has had some increases in taxes along with benefit decreases, and it could well be that with any bill on the way to enactment this historic pattern will prevail. If it does, the tax increases as well as the benefit increases could be smaller and would reflect a concept of "shared sacrifice." Various of the reform bills introduced in recent years, such as that by Chairman Rostenkowski in the last Congress, reflected this kind of a concept.

Spousal and Dependent Benefits—A prime example of why I think the focus of Social Security reform should be adaptation to present conditions can be found in the provisions relating to spousal and dependent benefits. Under present law, unless a spouse has an individual earnings record that produces a higher benefit, the spouse is automatically entitled to a benefit equal to 50% of that of the primary earner. Benefits are also given for dependents, with family maximums to limit the amount of such benefits. This pattern of spousal and dependent benefits goes back to the 1939 Social Security Act and was based on a paradigm that there would be a male worker, a female homemaker who did not have earnings, and a nuclear family with two children on average.

In fact, in the present world most women work, even those with small children, there are many single parent families, and there are a variety of social patterns that were not contemplated in the 1930's. Increasingly, many married couples view themselves as an economic partnership, and in the case of family dissolution, there is a sharing of the assets accumulated during the marriage.

I find present OASI provisions in this area incongruous. It is impossible to justify a spouse married to a higher earner being automatically entitled to a larger benefit than a spouse married to a lower earner. At a minimum, a flat benefit that treated all spouses equally would be an improvement. However, it may be that there should be a phasing out of spousal benefits and a phasing in of an earnings sharing concept.

The family policy aspects of the OASI program that seemed appropriate in 1939 ought to be reviewed even more fundamentally to determine what is appropriate in 1995 and on into the next century. In fact, in many countries in the OECD, spousal and dependent benefits have been curtailed and social security programs have moved towards providing benefits based on earnings of the worker, with family assistance programs financed by general revenues used to deal with the needs of spouses and dependents.

The ultimate goal of the OASI program in the United States perhaps ought to be that all workers would have their own earnings record and would receive benefits based on this record. While some expansion of the SSI program to deal with spouses of low income workers who have not earned an adequate benefit would be necessary, I think in the long run the OASI program would be far sounder if it returned to its original 1935 concept of providing only earnings related benefits for workers who made contributions. Survivor benefits could be a part of workers' benefits since joint and survivor annuity concepts are increasingly standard in retirement arrangements and fulfill worker expectations for sharing retirement benefits with spouses.

Investments—Another reform proposal that has currency recently is the proposal that at least a portion of the resources in the Social Security trust funds should not be invested in U.S. Treasury securities backed by the full faith and credit of the United States Government, but should be invested in private markets to seek higher returns. It is hoped that these higher returns would provide more income to the program and thereby relieve long-term financing difficulties. Some have advocated this approach in order to lower the benefit decreases or tax increases that would be needed to attain long-term solvency.

I have great doubts about these proposals. I do not think that higher gains can be secured without higher risks and I think that Social Security trust funds should be invested in a risk averse way to maintain confidence in the program. The investment in U.S. Treasury securities assures a reasonable rate of return with minimal risk. Moreover, if these funds are invested in private markets, they will displace investments by other persons in the private markets and the society as a whole may not be benefitting, for if there are greater returns, the trust funds will be benefitting at the expense of someone else. Moreover, if, as happens, the private markets have a downturn, the Social Security beneficiaries' assets will be at risk. I would not want to be a Public Trustee issuing a report some year that showed a 10% decrease in the value of the assets held by the Social Security trust funds.

Under present law, while there is a buildup in the Social Security trust funds over a period to around 2011, there is then a divesting of those securities until the trust funds are exhausted. Just as there will be unanticipated effects on the private markets if those funds were invested in private markets during the buildup, the same would be true when they were divested.

I think it would be desirable to give renewed consideration, as was proposed by Senator Moynihan a few years ago, to returning the Social Security trust funds to a pay-as-you-go basis, but with an appropriate contingency reserve, and avoiding the myriad problems of trust fund buildups and divestitures. If this were done, the program might have less of an impact on the general deficit problem. Even if the program continues to be based on partial funding, care should be given to avoiding unnecessarily large buildups of trust fund reserves. Thus, the whole question of investments involves considerations which go far beyond the notion of trying to secure a larger rate of return in the short or medium term for the trust funds to alleviate solvency problems.

Individual Investment Account Supplements—I think the idea advanced in the Kerrey-Simpson bill of a Personal Investment Plan (PIP) is creative and should receive full exploration. If something like two percent of the Social Security taxes could be invested in an individual retirement account, the investment of which was directed by the contributor, that would be a good way to build confidence in the program and perhaps to stimulate habits of saving in the public. Perhaps over time this idea could be expanded upon and perhaps voluntary additions to the mandatory two percent would be possible.

Unfortunately, under present law, if two percent of the payroll tax were to be redirected in this fashion, benefits under the OASI program would have to be reduced greatly. On the other hand, raising the payroll tax by two percent to create this account would not be in accord with the feeling that is prevalent in the country that there should be no tax increases for any purposes. The elective allocation of two percent with a concomitant reduction of benefits is also fraught with problems.

Perhaps a way could be found to find some amount, even one percent, that could be used to start this development and perhaps the climate will change and a payroll tax increase of one or two percent for this purpose might seem justified at some point to build upon this start. Nonetheless, although the feasibility of this idea at this time requires more study, I think that Senators Kerrey and Simpson are to be commended for proposing this innovative way of approaching the need to expand the retirement income available to younger generations in a way that will be most satisfactory to them.

Linkage to Other Programs—While the challenge of adapting the Social Security program to the coming period is itself daunting, I would urge that in the process of doing so, consideration be given to the linkage between the OASI program and other closely associated programs, primarily the Medicare program and the Supplemental Security Income program. As I have testified previously before this Subcommittee and the full Committee, the situation of the Medicare program is alarming. The HI trust fund is projected to be exhausted some seven years from now, in 2002. Action is needed on an urgent basis to provide financial stability to this program in the short term and to fundamentally restructure it in the longer term.

The linkages between the Social Security program and the Medicare program are quite direct in some respects. For example, the Part B premium is generally withheld from the Social Security pension payment. To the extent the Part B premium is increased, the available Social Security pension goes down. Thus, if there is going to be an increase in Part B premiums, it should be recognized that a reduction in Social Security benefits at the same time may compound the difficulty that beneficiaries will experience in having sufficient income after payment of the Part B premium for living expenses.

In a general way, if income from payroll taxes has to support both the Social Security and Medicare programs, amounts allocated to one program are not available in the other. Thus, while the focus on Medicare reform is stronger today, even as that reform is done, the subject that you are probing today, namely, the solvency of the Social Security program, should be kept in mind and some way must be found to work on both subjects in a consistent and coordinated way.

Similarly, the Supplemental Security Income program needs to be kept in mind. As OASI changes are made such as raising the retirement age or lowering benefit formulas, more people will require Supplemental Security Income. Because this means-tested program is supported by general revenues, any increase in general revenues needed to sustain it will further contribute to the problem of general budgetary deficits. History shows that there has not been adequate attention paid to these linkages. For example, in 1983, when the last major Social Security reform package was enacted, there was little consideration given to the possible effects on the SSI program of raising the so-called normal retirement age without raising the early retirement age.

Finally, it must also be kept in mind in making changes in OASI retirement benefits what is expected to happen with other sources of retirement income so that public policies affecting private pensions, personal savings, and employment of older workers can work in concert to assure that future retirees have an adequate level of income.

Disability Insurance Program—The Congress took action in 1994 to restore short-term solvency to the disability program. Without that action, the DI trust fund would have been exhausted in 1995. Some $172 billion was reallocated from the OASI trust fund over ten years. The DI trust fund now will not be exhausted until 2016. Last year's reallocation, by restoring short-term solvency to DI, provides a valuable opportunity to review and reform the Social Security Administration (SSA) disability programs.

In fact, two related cash-benefit disability programs are administered by SSA: DI, which is part of the Social Security program; and Supplemental Security Income (SSI), a means-tested welfare program. Spending for disabled beneficiaries was at approximately $60 billion in 1994 ($38 billion in DI and $22 billion in SSI). With recipients of benefits growing to approximately 8 million (plus an additional 1.6 million dependent spouses and children of disabled workers), these programs are now the fourth largest category of entitlement spending.

As these programs have grown in size over the years, there have been significant changes in the composition of the beneficiaries. Overall, the SSI program has shifted in increasing proportions from elderly to disabled beneficiaries. Within these DI and SSI disabled beneficiaries, there have been shifts from older to younger, from men to women, and from medically classified physical impairments to sociologically and psychologically classified mental disorders. The reasons for the changing nature of the SSA programs are not well understood, and recent problems with alcoholics and drug addicts, mental impairments, childhood disability situations, and fraud and abuse, have led many to question basic assumptions underlying these programs.

Recent growth in these programs reflects not only a rise in new enrollees but a fall in benefit terminations. Even with an improving economy, disability claims are still high, and SSA has a current backlog of over one-half million applications. Ideally, an estimated 1.2 million of present DI recipients need to be reexamined.

Additionally, health care benefits derive from these SSA cash payment programs. Not only do the cash benefits provide essential income support to a vulnerable population, but medical care under the Medicare and Medicaid programs is tied to the DI and SSI awards. Disability, therefore, is not simply a problem of government cash payment programs, but is also a problem of government health care programs and—most importantly—an overarching problem of public policy generally.

As the government has shifted to emphasizing the rights of the disabled to be part of the mainstream, emphasizing "equal access" and "equal opportunity" through the ADA, it is critical that SSA disability entitlement programs not create unnecessary dependencies or perverse incentives. One of the central issues is whether the government is adequately spending money on rehabilitation and training to help the disabled enter the mainstream as opposed to primarily providing only maintenance. Money and effort spent on assistance to return to work, for example, is relatively small in comparison to that spent for pensions. I believe an employment strategy should be a major focus of the SSA programs.

Administrative problems of the Social Security disability programs are longstanding. Political compromises in 1956 and 1972 over enacting DI and SSI provided for the states to make initial disability determinations but with 100% federal financing of their costs. It is questionable whether the states have adequate incentives to be effective and efficient, even whether SSA has authority to make necessary changes in procedures to achieve a humane and cost effective administrative system.

The SSA disability determination process, with many stages of administrative and legal review, has never worked as well as might be desired from the standpoint of the beneficiaries, the administrators, or the courts. Attempts at procedural reform in the past have often met with only fleeting congressional support and considerable public controversy. The present crisis in backlogged claims, failure to conduct adequate reviews, and inability to introduce cost efficiencies and administrative improvements reflects a persistent condition of these highly complex and difficult-to-administer programs. Considerable work on a priority basis needs to be done to achieve a cost-effective administrative process.

SSA is presently undertaking a study of disabled beneficiaries which will be delivered to the Congress later this year. This study is expected to become the catalyst for hearings and reform legislation that goes back to basics and resets these SSA programs for the 21st century. Changes in our society, the work force and our economy suggest that major adjustments in the programs are needed to control long-range program costs and to adapt the program to present and future circumstances. Clearly, incentives should be changed and the disability decision process improved in the interests of beneficiaries and taxpayers. Hopefully, once this needed research is completed and the situation fully aired by the Congress and clearly presented to the public, the Congress and the Administration will work cooperatively to take action over the next few years to make these vital programs more cost effective and financially stable over the long term, thereby enhancing and preserving them for the benefit of current and future beneficiaries.

Conclusion—Your hearings this morning present a large canvas and I have painted in broad strokes to try to give you what help I can. I have not attempted to offer you a specific set of proposals, but instead to address basic considerations suggested by the need to adapt the Social Security program for the future and achieve long-term financial solvency in the Social Security trust funds. The Advisory Council on Social Security is expected to present in the near future detailed plans and has the staff and resources available to design and cost out integrated packages of proposed changes. We all look forward to studying the results of its considerable efforts.

Finally, I commend you once again for the leadership you are showing in this area and look forward to continuing to help you in any way I can. I will be happy to answer any questions you may have about my testimony or about the subject matter of the hearing. I thank you once again for the opportunity to appear before you today.

PREPARED STATEMENT OF C. EUGENE STEUERLE *

Mr. Chairman and Members of the Subcommittee:

As has been made quite clear by the trustees of the various Social Security trust funds, the promises of benefits within the Old Age, Survivors, and Disability Insur-

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* Any opinions expressed herein are solely the author's and should not be attributed to the Urban Institute, its officers, or trustees.

ance (OASDI) are far in excess of the payroll taxes and other income sources available to the trust funds. The problems posed by Social Security, however, extend far beyond mere adequacy of trust fund balances. In the early 1950s, expenditures on retirement, disability, and health occupied less than 10 percent of federal expenditures. Today they comprise almost 50 percent, and the number is continually rising. Social Security by itself is now over one-quarter of all federal expenditures other than interest on the debt. When the baby boomers come to retire early in the next century, a federal government in approximate budget balance could come to devote almost all its expenditures on retirement and health to the exclusion of almost everything else.

This nation, I believe, is committed to taking care of its most disadvantaged citizens, as well as trying to insure a basic retirement living for our elderly. Nonetheless, needs compete for limited resources. We must choose wisely which additional dollars of resources can best be used to meet which additional needs. The current unsustainable growth rate in retirement and health expenditures, in my view, is helping to support a disinvestment in our nation's and our children's future. Our current budgetary procedures choose retirement and health over educating our youth, helping children who now have the highest poverty rates in the population, preventing crime, restoring promise and order in some of our central cities, or simply allowing individuals to keep more of their tax dollars. I don't mean to imply that making other budget choices is easy. We are on a path, however, that almost no one would choose, not even as a compromise.

PROCESS REFORM ISSUES

You have asked that the bulk of my testimony concentrate on suggestions for making the trust funds more solvent. Let me begin with several important process issues.

First, Social Security reform must bring long-run revenues and expenditures into line and not depend upon perpetual, long-term, deficit financing within Social Security itself. We cannot consider our problems solved if we merely reach 75-year balance of receipts and expenditures, a traditional Social Security goal. Such a balance implies that after a few years of surplus in the current period, due largely to the relatively small birth cohort now retiring, Social Security can run perpetual deficits that will be financed by the general taxpayer, who pays interest or principal on moneys attributed to the trust funds. This is foolhardy. Long-run expenditures and sources of funds must also be brought into line.

Second, reform of programs for the elderly ought to be considered as an integral whole. There are very important interactions among Social Security, Supplemental Security Income (SSI), and Medicare, among others. For example, if Social Security and Medicare were considered together, I believe that we would be less likely to continue the trend toward increasing Medicare benefits relative to cash benefits. Some worthwhile trade-offs would become more apparent, such as increasing cash benefits for some poor elderly in exchange for more tightly controlled Medicare expenditures. As another example, transfers to the poor through SSI or Social Security should be integrated.

Third, reform ought to center on long-run structural, not short-term cash flow, problems. To achieve this goal, reform should begin as soon as possible. When the baby boomers begin retiring, the fiscal impact of paying off the many new unfunded promises made to them hits with a bang. The longer we continue to delay dealing with Social Security's problems, the more likely legislation will be centered on cash flow fixes, rather than long-term reforms. For instance, increasing tax rates or cutting back on cost-of-living adjustments can add quickly to trust fund balances. Raising the retirement age, reducing the rate of growth of unfunded benefits for each new cohort of retirees, or gradually building up private funds and saving, on the other hand, occur only gradually over time. One reason for gradual implementation of the latter reforms is to avoid large differences in benefits between new retirees from one year to the next. While the cash flow revisions add quickly to trust fund balances, they often fail to deal with the issue of how Social Security should be structurally designed for the long-term.

Fourth, reform should center on the lifetime value of benefits, which take into account how many years are spent in retirement, the treatment of spouses, and the cost of medical care. It may turn out that a system that is only adequate or barely adequate when considered on an annual basis for a worker's cash benefit only is moderately generous when measured on a lifetime basis for all benefits for the family. For an average-income couple retiring today on Social Security and Medicare, for instance, the lifetime value of benefits is now coming close to a half million dollars under current official projections (see Table 1) . The projected growth of health care costs in these projections, of course, is not sustainable. Nonetheless, based on lifetime benefits, these figures demonstrate that the public system might be considered more than adequate if we were not supporting so many years in retirement and such an expensive health care system.

STRUCTURAL REFORM OF SOCIAL SECURITY [1]

Moving beyond issues of process, the structural reforms I would tend to favor for Social Security are related generally to trying to achieve a balance among principles, such as first taking care of those elderly with the greatest needs, achieving maximum benefit to society from available resources (economic efficiency), and granting similar benefits to those who are in equal need and make similar contributions to Social Security.

Increase and Index the Retirement Age for both OASI and Medicare. The twentieth century has seen a vast expansion in the number of years of retirement supported by government. For a couple retiring at 62 today, annuity payments under Social Security on average can be expected to last for 25 years—that is, until the longer living of the couple is expected to die. More and more years of retirement support have been provided to individuals who are further and further from expected death. Data on income and wealth distributions, adjusted for family size, reveal that the near elderly and young elderly in their 60s are generally better off in most economic terms than are much of the rest of the population. And these numbers don't even take into account the potential to work for many retired near and young elderly.

One means of increasing the retirement age is to adjust gradually the Normal Retirement Age until it effectively provides a constant expected number of years of retirement support, such as fifteen. Once that target is reached, the Normal Retirement Age would be indexed to grow with life expectancy so that the years of expected support stayed constant. If later societies decide that more years of retirement support should be provided, at least those demands will compete fairly in a budget process with other demands of the population. But there is no good policy reason to pre-ordain such a result. A society that has come to expect more and more years of retirement support—at the cost of smaller and smaller shares of total resources for younger populations—will take time to adjust to such a change of emphasis. Disability programs, unemployment programs, private retirement and insurance plans, and even seniority pay scales all will be affected. This argues further for beginning the process soon so that it can take place in a way that allows individuals time to adjust.

Place Greater Restriction on Early Retirement Options. Given the tendency of the older elderly to be relatively poorer than much of the population, as well as in need of assistance for long-term care and other problems of old age, Social Security benefits ought to be restricted for those individuals who, by retiring early, increase their probability of later falling back on the public sector for more support. Thus, the early retirement age of 62 should be increased or the requirements for its use made more restrictive.

Include All Contributions to Social Security in the Calculation of Benefits. Equity and efficiency considerations argue strongly for the inclusion of all contributions to the Social Security system in the calculation of benefits to be received. The current system inconsistently provides a partial rate of return on the earnings of high-income individuals who work the minimum number of years, but provides a zero return on all the earnings of many moderate-income spouses, on the additional earnings of many elderly individuals, and on extra years of work by individuals at all income levels. Many anomalies result. For instance, 50 years of work at $35,000 per year will yield lower benefits than will 35 years at $50,000. Working spouses often get nothing at all out of their contributions. With other changes to the benefit formula, this reform need not add at all to the cost of the system.

Remove the Elderly from Poverty. Benefits in Social Security ought to be adjusted over time so that all elderly eventually receive some minimum that would remove them from poverty. Changes in the benefit formula provide one means of achieving this end, although the minimum would need to be adjusted so as not to give undue support to those receiving substantial pensions from other government retirement programs. In addition, actuarial adjustments—e.g., lower initial benefits in exchange for higher survivor's benefits—should be made in the benefits provided to couples so that a spouse is not left in poverty when widowed.

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[1] For further discussion of Social Security reform see Steuerle and Bakija, 1994, *Retooling Social Security for the 21st Century; Right & Wrong Approaches to Reform.*

Expand the Tax Base to Include Non-Cash Compensation (Social Security Tax Reform). Just as in income tax reform, Social Security tax reform ought to expand the tax base to include non-cash compensation. Someone earning $30,000 in cash wages will pay substantially greater Social Security tax than someone earning $25,000 in cash and $5,000 in nontaxable employee benefits. Current law also encourages excessive consumption of health care. The Social Security Administration today projects that the Social Security tax base will continue to erode in the future as nontaxable employee benefits rise relative to taxable cash wages—a significant, although not dominant, reason for the long-term deficit. At least this erosion should be stopped.

Gradually Adjust Spousal and Workers' Benefits So That All Spouses Are Treated More Equally. Under current law, most working spouses and low-income nonworking spouses are granted much smaller benefits than are nonworking spouses of high-income workers. Yet higher-income spouses do not have greater need, and no case can be made that the benefits to nonworking spouses are related in any way to contributions made. Any funds raised by gradually adjusting spousal benefits so that all spouses are treated more equally could be spent to help finance a conversion suggested above: providing some marginal return or benefit for the contributions of all working spouses.

Abolish the OASI Earnings Test and the "Health Earnings Test"—The Requirement that Elderly Workers Cannot Receive Medicare if Their Employer Provides Health Insurance to Its Workers. The simple fact is that the earnings test is a tattered remnant of a bygone era. Although delayed retirement credits and other offsets are now being provided in part, the earnings test remains one of the many signals that our society, as well as government, sends to our citizens when they still have a life expectancy as long as 15 or 20 years: "You should retire. You are old. We do not want you to work." Today, of course, the "health earnings test" may be an even bigger obstacle to work by those over age 65.

Consider Gradual Adjustment of Indexing so That Benefits for Higher-Income Individuals Do Not Grow So Fast. A case can be made for less than full wage indexing of the benefit formula itself, so that real benefits do not grow as much over time. Given a choice between this type of change and increasing the retirement age, the latter is in my view superior because of its ability to maintain the retirement income for the very old who have lower incomes than both the younger elderly and the nonelderly. Nonetheless, after other changes are made, the benefit formula itself must be adjusted to bring long-term expenditures and revenues into line. This represents one way to achieve that goal

Move Part-Way Toward a Double Decker system and the Funding of Retirement. Almost all of the reforms discussed so far are aimed primarily at getting Social Security back into balance and improving the equity and efficiency associated with particular groups such as working spouses. Some believe that our retirement systems should go beyond these reforms and deal in particular with another issue—an increase in retirement saving. One possibility is to stack a layer of funding on top of most or all of the current Social Security system, e.g., through mandated private pension plans. A small portion of the current Social Security tax, as I have suggested in the past and as contained in proposals by the chair of this subcommittee, Senator Alan K. Simpson (R.-WY) and Senator J. Robert Kerrey (D-Neb), could also be designated for funded accounts associated with each individual.

Although there is much merit in this type of approach, let me add several cautions. First, movement toward funding requires many workers to contribute twice—first, for their funded plan, and, second, to existing retirees for whom few or no funds have been saved. Second, the additional saving required to support a funded system adds to the amount of benefit reduction or tax increase required simply to get the existing Social Security system into order. Finally, the switching of some money into funded individual accounts within Social Security changes budget accounting so that some liabilities are recognized as they accrue (when the money is put into the accounts) rather than when pension cash payments are finally made down the road. By itself, this appropriately raises the measure of the unified deficit—which, hopefully, induces some further actions to get our fiscal house in order.

There are also a number of options that I do not favor.

Do Not Remove Cost of Living Adjustments. Eliminating or significantly paring cost-of-living adjustments (COLAs) tends to have its harshest impact on those for whom the system was built in the first place: those who are truly old and in need of income. If lower levels of benefits are sought, it would be better to cut back on benefits initially or to lower the rate of growth of benefits from one cohort of retirees to the next. Otherwise, benefits will eventually be distributed so that a typical younger entrant into the system could have benefits that are almost four times as high than a typical older elderly person already in the system for many years(see

Figure 1). Of course, there is still justification for moving to a better measure of cost-of-living changes.

Do Not Apply an Annual Means Test for Cash Benefits. The Social Security benefit formula and the income tax together operate as significant means tests—the first, on the basis of lifetime earnings, and the second, on the basis of annual income. A further annual means test for Social Security would exert too much of a penalty on private saving for retirement. It would essentially be a new "earnings test," with no offsetting credits, applied to both earnings from work and from saving. It would also offer substantial rewards to those who transfer their assets to their children, as now happens with many who receive long-term care in Medicaid. Annual means testing also ignores the logic behind mandating participation in a Social Security program: requiring everyone to contribute to their own retirement benefits when they can afford it. If society is going to require a person to buy insurance, whether for accident or retirement or anything else, shouldn't they at least end up with some coverage as a consequence?

Do Not Subject All Earnings Without Limit to Social Security Taxation. Among very high income individuals, raising the limit on taxable earnings tends to increase benefit levels far beyond where they need to be to deal with retirement needs. Raising this limit also creates great disparities between capital income earned by the self-employed and capital income earned through ownership of stocks, bonds, and savings accounts. Only the former is subject to Social Security tax, thus creating a discrimination against self-employed individuals who employ capital in their businesses.

Do Not Put Social Security on a Pay-As-You-Go Basis Where the Tax Rate is Always Raised to Fill Any Gap. If tax rates must rise—such as to deal with the swelling of needs of the elderly when the baby boomers retire—then the choice should be made explicit and the taxes devoted specifically to a particular problem. Taxes should never be designed to rise automatically to deal with failure to put benefits on a sustainable path. Among other reasons, pre-scheduled, automatic, tax rate increases for only some budget programs put other government programs at a disadvantage in competing for scarce resources in the budgetary process.

SUMMARY

By thinking about fundamental principals underlying a Social Security system, it is possible to sort through a variety of options for its reform. Social Security reform is needed not only to bring trust funds into balance, but to help restore to each generation of voters and representatives the right and ability to decide how to devote future government revenues to the most important needs of their times. In terms of detail, I recommend that serious attention be given to increasing the retirement age, restricting early retirement, deterring further erosion of the tax base, and making further benefit formula adjustments, as needed, such as slowing down the rate of growth of real benefits, especially for higher-income workers. I would also consider movement toward a more funded public system, or mandated private system, although this adds to the other expenditure cuts or tax increases that are required. At the same time, I would endeavor to fix other efficiency and equity problems within Social Security, such as including all years of contributions in determining benefits, removing the elderly from poverty, and granting fairer treatment to working spouses. I would not recommend changing cost-of-living adjustments in a way that tended to make the old elderly even poorer relative to the near and young elderly, converting Social Security into a welfare system based on annual income, including all earnings and self-employment income in the tax base without limit, or scheduling tax rates to always rise to fill any gap between promised benefits and current revenues.

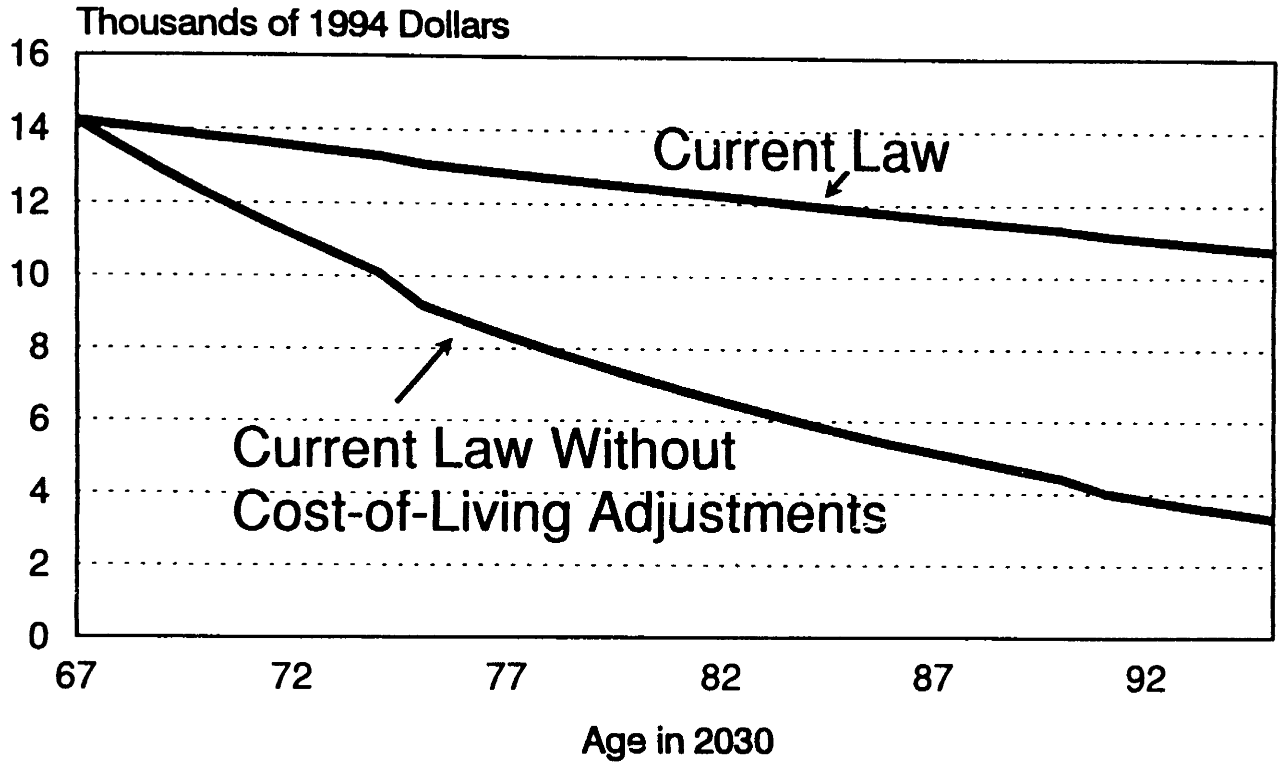
Table 1
Annual and Lifetime Social Security and Medicare Benefits
Average Wage One Earner Couple
--1993 dollars--

Year Cohort Turns 65	Annual Benefits: Social Security	Annual Benefits: Medicare		Lifetime Benefits Assuming Survival To Age 65: Social Security	Lifetime Benefits Assuming Survival To Age 65: Medicare
1995	$ 14,600	$ 9,600		$ 237,000	$ 232,000
2030	$ 20,800	$ 26,400		$ 324,000	$ 497,000

Notes: Data are discounted to present value at age 65 using a 2 percent real interest rate. Table assumes survival to age 65 and retirement at the OASI Normal Retirement Age. Projections based on intermediate assumptions of the 1993 Social Security Board of Trustees reports, adjusted by the authors for the estimated impacts of 1993 enactments.
C. Eugene Steuerle and Jon Bakija, THE URBAN INSTITUTE.

Figure 1: Annual Value of OASI Benefits For Different Cohorts at a Point in Time

Average-Wage Workers in 2030



Assumes 4% future price growth and 5% future wage growth. Source: C. Eugene Steuerle and Gordon Mermin, THE URBAN INSTITUTE. Calculations based partly on Christopher Bender's Social Security Administration Replacement Rate Model, Hamilton, Rabinovitz, & Alschuler, Inc.

PREPARED STATEMENT OF ALLAN TULL

The American Association of Retired Persons (AARP) appreciates the opportunity to present its views regarding options to restore the long-term solvency of the Social Security system. Americans of all ages have a stake in the future financial strength of this critical program.

The Association hopes today's hearing will not only facilitate debate on ways to help restore Social Security's long-term financial health, but also help allay fears that the program is somehow in imminent fiscal danger. The Social Security trustees have projected that the system can continue paying benefits for another 35 years without any change in current law. But this projection does *not* mean that we should wait until the funds are exhausted, as was the case in 1983. An early discussion of solvency options will allow workers and beneficiaries to voice their concerns and permit a full and open debate on possible courses of action. Congress can then build a consensus to enact changes in the near future that would be less painful than those made later and that would provide workers with sufficient notice and opportunity to plan accordingly.

I. SOCIAL SECURITY TODAY

A. SOCIAL SECURITY'S CRITICAL ROLE IN RETIREMENT INCOME

Although not intended as the sole retirement income source, Social Security provides 90 percent of total income for 26 percent of the elderly. For 14 percent of older beneficiaries, it is their only source of income. For 3 out of 5 older persons, Social Security provides over 50 percent of their income. Despite progress in reducing poverty among those age 65 and over, older people's incomes still lag far behind that of other adult age groups. In 1992, the median household income of persons over age 65 was only $17,160, less than half of the income of the under 65 population ($35,169). It would be ironic if the improvement in the economic situation of some older people became a justification for fundamentally restructuring Social Security—the program most responsible for the progress that has been made.

B. STATUS OF SOCIAL SECURITY TRUST FUNDS

The 1994 annual report of the Social Security trustees projects that the trust funds will be able to pay full benefits on time until 2030, which is one year later than last year's forecast. Until 2013, the Old Age and Survivors Insurance (OASI) and the Disability Insurance (DI) trust funds combined (OASDI) will take in more tax revenue annually than is needed to pay benefits. From 2013 through 2019, revenue to the trust funds plus interest earnings will exceed expected benefit payments. Starting in 2020, annual trust fund outgo is projected to exceed overall annual income, and trust fund reserves will be gradually drawn down until they are exhausted in 2030.

Social Security is perhaps this nation's most closely monitored federal program, and one of the few that projects future income and costs over 75 years. The annual trustees' report serves as an early warning system of impending problems. As early as 1989, the Social Security trustees called for a discussion of options to deal with the program's long-term problems. While the 1990 Social Security Advisory Council focused on Medicare, this year the Council has accepted the trustees' charge to review financing issues and develop recommendations for restoring Social Security's long-term balance. The Council currently is studying options and is expected to report later this year.

Although action to restore long-term solvency should move forward in the near future, Social Security is neither in crisis nor near crisis. Congress and the President have time to enact changes that will restore Social Security's long-term health. Carefully thought-out adjustments to help assure Social Security's solvency have always been part of the program's dynamic history. Moreover, the factors contributing to current long-term financing problems are not a recent discovery. The enormous cost of providing benefits for the almost 75 million members of the Baby Boom generation has been anticipated almost since its size became apparent. Indeed, the Boomers have strained our nation's resources at various stages in their lives—when they entered school, college, the work place, and so on. At each step, the nation accommodated this demographic wave, and additional adjustments can be made as the Boomers enter retirement.

II. RESTORING LONG-TERM SOLVENCY

Social Security's long-term solvency can be restored by increasing revenue, reducing benefits, or some combination of the two. The last solvency package, the Social Security Amendments of 1983, included revenue and benefit changes. Sacrifices were asked of all who participate in the program: workers, employers, and beneficiaries—an approach that should serve as a model for the future.

A. Principles Of Social Security Should Be Maintained

The Social Security system reflects a series of principles that originated with the program or evolved with its growth. AARP believes solvency proposals should not stray from the principles that have successfully shaped the program as we know it today.

Social Security's benefit structure reflects the following principles:

- Benefits are earned;
- Benefits are related to pay and time in the workforce; and
- Benefits are not based on need but are nevertheless progressive.

These principles are largely responsible for the enormous popularity that Social Security enjoys among Americans of all ages. Social Security benefits represent a blend of the concepts of "individual equity" and "social adequacy." To preserve the concept of equity, the benefit formula directly relates earnings to benefits by using an individual's work history and payroll tax contributions to calculate benefits. In order to provide adequacy, however, the formula is weighted so that lower-wage workers receive a benefit which replaces a higher percentage of their pre-retirement wages than for average and higher earners. This weighting assures lower income workers and their families a floor of protection against destitution when a wage earner leaves the workforce. This is particularly important since these workers generally do not accumulate additional financial resources to help replace lost wages, such as a private pension or savings.

While many people may not understand the complexities of Social Security's progressive benefit formula, they know that everyone who is eligible for Social Security receives a benefit based on their contributions, not their current financial circumstances. This has been one of the fundamental strengths of the program. If Social Security were conditioned upon need, AARP believes public support would drop precipitously to the levels associated with welfare programs. If benefits were denied to high-income workers, they probably would be far less willing to support and participate in the program. Since the Social Security formula represents an implicit income transfer from higher earners to lower earners, Social Security's progressive benefit structure would be unsustainable in its current form if high earners opted out of the system.

Three additional Social Security principles can be identified. They are

- The system is self-financed;
- Employees and employers contribute equally; and
- Participation is compulsory.

A new tenet was added in 1972 and implemented in 1975:

- The initial benefit amount is adjusted annually to reflect increases in the cost-of-living in order to keep the benefit whole.

Cost-of-living adjustments (COLAs) were viewed as an effective way of stabilizing trust fund outgo and maintaining the value of benefits as individuals aged. These annual adjustments were adopted as an alternative to the very generous benefit increases Congress had been awarding, usually on an every other year (election year) basis. Indeed, COLAs were adopted as a more conservative fiscal alternative to these large ad hoc increases, not as an effort to increase benefits.

III. OPTIONS FOR CHANGE

Solvency proposals continue to be developed by legislators and policy experts. Some plans blend revenue and benefit changes, while others rely exclusively on benefit reductions. Packages with modest or no revenue increases contain more dramatic benefit reductions, particularly if a single benefit change is being proposed, such as raising the retirement age.

AARP has not endorsed a particular solvency package, nor are we currently proposing our own at this time. However, we would like to comment on several suggestions that have been put forward.

A. Universal Coverage

Today, Social Security covers about 95 percent of the workforce, with some state and local employees remaining as the largest non-participating group. The Omnibus Budget Reconciliation Act (OBRA) of 1990 extended Social Security coverage, effective

July 1991, to those state and local employees not covered under another system. Mandatory coverage for all newly hired state and local workers would better serve both the excluded employees and the financial health of the Social Security trust funds.

Universal coverage is desirable in a social insurance program to ensure public cohesiveness, and it makes sense because of the excellent protection provided. For most Americans, Social Security provides their only source of survivor, dependent and disability benefits; it has indexed, annual cost-of-living adjustments; and is portable from job to job. Additionally, given Social Security's progressive benefit formula, lower-income workers often receive higher benefits under Social Security than under public plans.

Equity considerations also suggest that universal coverage is preferable. Some state and local employees who also have worked in Social Security-covered employment gain a Social Security benefit with fewer contributions than other beneficiaries. Although their benefits are also smaller, their overall return on the payroll taxes paid is greater.

The Association supports requiring participation in Social Security for newly hired state and local workers that currently are not covered by the program. Most of those currently not contributing will eventually qualify for Social Security benefits in any event. States and localities wishing to supplement Social Security can do so, just as private employers do.

B. Raising the Retirement Age

The 1983 Social Security Amendments included a phased-in increase in the age of eligibility for collecting unreduced benefits (the Normal Retirement Age) from age 65 to age 67, beginning in the year 2000 and becoming fully effective in the year 2022. In order to improve Social Security's long-term solvency, some propose further raising the age for collecting full benefits. Others not only want to increase the Normal Retirement Age but also the current age 62 eligibility for first collecting reduced benefits. Both approaches are benefit cuts for future retirees.

Increasing the retirement age has been promoted because increased longevity implies that future beneficiaries will live longer and thus collect Social Security for a longer period of time. If people live longer, proponents argue, they could reasonably be asked to work longer and postpone receiving benefits in order to improve Social Security's long-term solvency. Current labor market trends affecting older workers, however, do not support this rosy scenario. Many willing older workers are unable to find employment, and some older workers have physically demanding jobs or health conditions that make continued work difficult. Despite the elimination of mandatory retirement in 1986, age discrimination remains a significant factor in today's work place. Studies show that older workers continue to have the longest spells of involuntary unemployment, and many employers remain reluctant to hire older workers. In short, age bias, health problems, and limited job opportunities for older workers could mean that an increase in the Normal Retirement Age will result in lower benefits, not additional work.

While many policy experts support raising the retirement age, the public soundly rejects the idea. In a February 1993 poll conducted for NBC News/Wall Street Journal, and in a poll conducted last July by ICR for AARP, almost three out of four respondents of all ages (74 percent) opposed raising the age for collecting full Social Security benefits. A September 1994 survey of workers under age 35, conducted for Third Millennium, shows that only 29 percent support raising to 70 the age when individuals become eligible for full Social Security benefits, and only 9 percent strongly support the increase. Although respondents were not asked why they opposed a change, a March 1994 Employee Benefits Research Institute (EBRI) poll may help explain some of the resistance. The poll shows that Baby Boomers expect to retire at age 60, and the following generation, the Baby Bust, intends to stop working at age 61.

AARP believes that even the current increase in the Normal Retirement Age should be accompanied by policies promoting expanded job opportunities for older workers and protections for those who cannot remain in the labor force such as earnings limit liberalization. To raise the age further, adequate notice and a long lead time should be given to affected workers. Finally, the Association urges proponents of raising the age for collecting full benefits to educate the American public about the change, its rationale, and its implications.

C. Cost-Of-Living-Adjustments (COLAs)

Given the widespread reliance on Social Security, it is important to continue providing fully indexed, annual cost-of-living adjustments. Annual COLAs enable all beneficiaries to keep pace with increases in the cost of goods and services. In addition, COLA's prevent many older Americans—particularly single women—from becoming poor. If COLAs are reduced, millions more would have difficulty meeting expenses.

In fact, most of the reduction in the poverty rate for those age 65 and over in the 1970s was due to the large ad hoc increases in Social Security which occurred prior to automatic cost-of-living adjustments. Since then, the poverty rate has stabilized because annual COLAs have prevented the more than one in five older Americans who hover within 125 percent of the poverty line from falling further behind economically.

An annual inflation adjustment is especially important because increased longevity means some older Americans will outlive their other resources. Permanently reducing COLAs means that as beneficiaries age, the real value of their benefits declines. In effect, beneficiaries would be paid higher real benefits at age 65 than at age 80 although their income has likely declined and the ability to supplement income is limited. Other benefits, such as pension benefits, are generally not indexed for inflation.

Some suggest limiting COLAs for beneficiaries with a Primary Insurance Amount (PIA) at or below a specified level. Those above that level would receive the same amount as the COLA provided at the specified level. AARP believes this is a flawed approach for dealing with Social Security's long-term deficit because it attempts to introduce need as a precondition for receiving full COLAs. This is a form of means testing the basic benefit package. Social Security is a social insurance program that provides lifetime protection for workers and their families as an earned benefit rather than as a benefit contingent upon income. Those who advocate means testing ignore the insidious message it sends to workers: If you do well, if you work hard, if you save—you are penalized.

A capped COLA also assumes Social Security benefits are an indicator of comparative wealth, but this is not necessarily so. In particular, some individuals have low benefits because they spent only a brief period working in Social Security-covered employment and the rest of their career in non-covered employment. Many of those working outside Social Security may be eligible for other types of pensions (typically public employee pensions and/or military benefits), or may have accumulated additional financial resources for their retirement. Yet, other beneficiaries with larger Social Security benefits may have no other income sources. To more accurately assess wealth would require beneficiaries to give a full accounting of their income and assets, which is administratively complex and inconsistent with the concept of an earned benefit.

Limiting COLAs would result in a declining standard of living for beneficiaries above the threshold, and would be particularly harmful to those closest to the threshold, who would likely still rely on Social Security for the bulk of their retirement income. Their income loss will also be compounded over time because the base on which future COLAs will be calculated will also be smaller. AARP also rejects this approach because it could lead to further efforts to reduce COLAs. Moreover, the proposal would be complex and difficult to explain to beneficiaries.

Some have suggested reducing COLAs by changing the Consumer Price Index (CPI). While some analyses suggest the current CPI overstates inflation, it is not clear if and to what extent this is true. The Bureau of Labor Statistics (BLS) currently examines the CPI and makes "technical" adjustments on an intermittent and periodic basis.

AARP believes that trained economists at BLS, not Congress, should make any adjustments to the current index. The issue should be evaluated by BLS to determine whether changes are warranted. Such a review may also need to examine the extent to which older consumers' purchases differ from wage earners. Since older consumers spend a much larger percentage of their income on health care, which has grown much faster than overall inflation, the CPI could underestimate increases in the costs of goods and services older Americans purchase.

D. Increased Taxation of Benefits

The Social Security Amendments of 1983 first introduced taxation of benefits by specifying that single taxpayers with modified adjusted gross incomes (MAGI) over $25,000 (including tax exempt interest and up to half of their Social Security benefits) and joint filers with incomes in excess of $32,000 were to be taxed on the lesser of half of their benefits or half the amount of income above these thresholds. The maximum percentage of benefits subject to federal taxation was set at 50 percent of benefits because employees pay half of the Social Security taxes and employers pay the other half. Since the provision was enacted to help restore Social Security's long-term solvency, the revenue has been credited to the Old Age, Survivors and Disability Insurance (OASDI) trust funds.

The 1983 thresholds deliberately were not indexed in order to provide the Social Security trust funds with increasing revenue in the future when the number of beneficiaries would rise dramatically and the ratio of workers to retirees would decline. Initially, about eight percent of beneficiaries were taxed on up to 50 percent of their Social Security; today, almost one in four beneficiaries are affected. By the turn of the century, almost one in three beneficiaries will be taxed on their Social Security.

Effective taxable year 1994, single beneficiaries with MAGIs over $34,000 and couples with MAGIs above $44,000 are now taxed on up to 85 percent of their benefits. The revenue from taxing the additional 35 percent, unlike the revenue from taxing 50 percent of benefits, is credited to the Hospital Insurance (HI) Trust Fund. (This was done largely to avoid a budgetary point of order in the Senate.) The 1993 change will affect about 5.5 million persons, including about 1 million people in the 15 percent tax bracket. The impact of the added taxation falls hardest on middle income beneficiaries for whom the lost income is significant and often difficult (if not impossible) to replace.

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

To help restore solvency, some propose changing the current tax treatment of Social Security by reducing the 1993 thresholds for taxing 85 percent of benefits to those that apply for the 50 percent rate or even lower, or changing the percentage of benefits taxed to the level actually contributed by an individual. AARP is concerned that lowering the thresholds for taxing 85 percent of benefits or taxing all benefits except the employee's contributions will result in a heavy tax burden for many middle and moderate income beneficiaries. Also, it could heighten the anxiety of today's workers about the value of their Social Security benefit when they retire.

E. Payroll Taxes

Increasing payroll taxes is a common method for enhancing trust fund revenue. The payroll tax is considered regressive by some, but many low-income workers are eligible for the recently-expanded Earned Income Tax Credit (EITC) which offsets some of their initial payroll tax contributions. In addition, Social Security's progressive benefit formula provides low earners with a larger portion of their pre-retirement earnings than average and high earners. Despite criticisms of the payroll tax, most workers consider it fairer than the income tax because they believe few can avoid paying the tax and because they know it is going to pay benefits. While some suggest that a future payroll tax increase could raise this tax to a burdensome level, a reasonable increase incorporated in a broad package with other solvency changes may be appropriate. In fact, a March 1995 poll conducted for the Employee Benefits Research Institute suggests that 64 percent of all workers favor a payroll tax increase to ensure the program's long-term solvency. However, even a modest payroll tax increase should also continue to maintain a reasonable rate of return for future beneficiaries.

F. Benefit Changes

Some policymakers suggest modifying the benefit formula to reduce the rate of return for average and higher earners but still maintain the current rate of return for low earners. Such proposals are worthy of review. However, the rate of return should not be lowered to the point where it would undermine support for the program, particularly among highly compensated workers.

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

Proposals to modify the Social Security benefit formula should be distinguished from means testing benefits. Means testing in any form is bad Social Security policy—a view unanimously expressed by the four expert Social Security witnesses who testified before the Bipartisan Commission on Entitlement and Tax Reform last July. The simplistic appeal of denying or reducing benefits to those who do not depend on them violates Social Security's earned right principle, is likely to undermine public support, and penalizes those who have saved in order to live comfortably during their retirement.

G. Individual Accounts

The creation of individually controlled accounts has been proposed as a mechanism to improve the program's solvency and/or to promote national savings. AARP agrees with the need for increased national savings, but we believe this goal should be achieved in a way that does not interfere with other retirement objectives or adversely impact the income security of workers, particularly for low wage workers and their families.

Social Security, the first leg of the retirement income stool, is a social insurance program, with compulsory and near universal participation. Pensions, the second leg, are retirement benefits earned in voluntary, employer-sponsored plans. More highly compensated individuals are more likely to be covered by such plans and tend to accrue higher benefits. Savings, the third leg, are individually held assets and investments, which higher earners, again, are most likely to accumulate in far greater amounts. All of these programs are ultimately subsidized in whole or in part by taxpayers.

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

Also, Social Security's progressive benefit formula would be weakened because a portion of average and high earners' payroll taxes help finance the more progressive benefit for lower-paid workers. In addition, the Social Security trust funds will collect insufficient income to guarantee current benefit promises, and future benefits will have to be cut beyond that necessary to restore solvency. Large benefit reductions could undermine public support for a program that provides benefits most Americans of all ages regard as modest at best.

Moving from the current system to a partially privatized one poses large transitional problems. If payroll taxes are reduced, the pressure to cut benefits for current retirees and those nearing retirement could increase. Yet, these individuals would not have had the opportunity to offset the lost income. If their benefits are protected, then current workers will have to pay more in order to finance both current benefits as well as their own. Similarly, younger workers who become disabled or die before they have accumulated sufficient individual accounts may have considerably smaller benefits than under current law.

The advantages of individual accounts are also dubious. The rates of return for these accounts are often overstated. People who invest conservatively will see more modest returns, but encouraging workers to invest in riskier ventures only invites hardship for those who invest unwisely—hardships that might have to be offset through other government programs. Many workers, particularly those with little in savings, lack knowledge and experience in investing. Since lower earners are likely to receive a modest amount in rebated taxes, they could face large administrative fees for individual accounts that will reduce the return on their investments. Also, if accounts are too small to undertake adequate diversification, ultimate yields could be threatened by over-reliance on a single type of investment. Still another pitfall is that unless early withdrawals and borrowing from these accounts are prohibited, workers will not wait until they retire before tapping into these accounts. In fact, most lump sums in the private sector are currently cashed-out.

Indeed, private sector pension plans are currently undergoing a shift in design, with responsibility and risk being placed on the employee. The impact on long-term retirement security is as yet unknown, but the above pitfalls have raised many questions. At a time when pension plans are becoming more individual-account oriented, it is even more important to maintain Social Security's social insurance design. In short, individual accounts should not be a substitute for Social Security, nor should they undermine or interfere with the basic Social Security benefit or structure. Any role for individual accounts should be in addition to the floor of protection provided by Social Security.

IV. THE IMPORTANCE OF EDUCATION

In order to engage the public in the solvency debate, the July/August issue of Modern Maturity will feature several articles about Social Security (see attached). They include an overall discussion of solvency options, as well as a "point/counterpoint" featuring Representative Bill Archer and Senator Bob Kerrey. Magazine readers are encouraged to discuss Social Security and potential solvency options with their children and grandchildren, and to write to the Association to express their views. This is the beginning phase of an Association effort to assess the views of our members on this important matter.

In addition, a greater effort should be made to improve worker awareness of the need for alternative sources of retirement income. While this will not alleviate Social Security's future funding problems, it could encourage tomorrow's beneficiaries to save more on their own. As more workers begin receiving a Personal Earnings and Benefit Estimate Statement from the Social Security Administration, they could begin to appreciate the value and importance of their Social Security benefit. However, only the farsighted understand how much more will be needed in retirement and plan to take the appropriate steps.

AARP, in order to help educate the public about the importance of other retirement income sources, has developed a pre-retirement planning program that companies throughout the nation offer to their employees. If workers become more knowledgeable, they will come to appreciate the value of all three legs of the retirement income stool—Social Security, pensions and savings. And, hopefully, if saving improves, employees will have a more secure retirement, and our economy will have added capital to help it expand and invest in the future.

V. CONCLUSION

Maintaining Social Security's long-term solvency and improving the overall retirement income of future generations is vital to our nation's economic well being. Social Security solvency options should ensure adequate benefits as well as maintain the social insurance principles that are central to the program.

Given the shift to individual accounts in the private pension system, the secure defined benefit promise in Social Security takes on greater importance. Indeed, if pension coverage continues to stagnate at under 50 percent of the workforce, and savings rates continue at current low levels, Social Security could, in the future, be asked to carry an even greater burden for retirement income. The importance to both current and future generations of Social Security, as a universal pension, cannot be underestimated.

Attachment.

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Point

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Securing Social Security

By Representative Bill Archer (R-Texas)

A lot has changed in my 22 years on the House Ways and Means Committee. My views on Social Security haven't.

Social Security has never been an entitlement program; it is an "earned-right" program, and it's Congress's job to do whatever is necessary to deliver it—today, tomorrow, and in the 21st century.

That was my opinion when I first sought a seat on Ways and Means, the committee that deals with Social Security. That's what I fought for when I became ranking minority member of the Social Security Subcommittee, and when I was appointed to Ronald Reagan's National Commission on Social Security Reform. The only thing that has changed is that now, as chairman of the Ways and Means Committee, I have a real opportunity to help ensure that the system will meet its obligations.

I will continue to strongly oppose means-testing, including taxing benefits. It violates the earned-right concept; far worse, it serves as a powerful disincentive for savings at a time when the rate of personal savings in the United States continues to drop. I believe any policy that discourages personal savings has the unintended effect of encouraging people to view Social Security as a sole-source retirement system—something it was never intended or financed to be.

What's the right way to reform the system? First, we have some time. Social Security is in trouble, but it's not in crisis. It will not run a deficit until 2013 nor run out of funds until 2030. We have time to find a lasting solution; we needn't settle for a hasty fix. But we should begin a public dialogue about Social Security now.

Anything we do should meet certain requirements. It should:

- Be fair to today's generations of retirees—and to tomorrow's.
- Stabilize benefits so older workers can make retirement plans based on realistic expectations.
- Address a larger context that includes creating incentives for private savings and pensions.

Raising the retirement age for future retirees is often discussed. Less-frequently mentioned is ensuring that the Social Security disability program is properly administered. From 1984 to 1994 the United States population grew by 11 percent, but the number of individuals on disability went up 40 percent. Congress has had to redirect funds from the retirement trust fund to keep up with this growth. In the next 15 years as much as $275 billion could be redirected for this purpose.

People who work and pay into Social Security must be able to count on disability benefits to support their families if disability strikes. But benefits should only go to those who are truly disabled. The Social Security Administration must be enabled to separate those who remain legitimately disabled from those who are recovered and should have benefits stopped. This first step would go a long way toward restoring public confidence in Social Security—but larger reforms must also be developed.

For any reform to work, the public must understand what is at stake and how they will be affected. Many of today's retirees don't realize how fast they get their money back—plus interest—once they start collecting benefits. An average earner who retires this year at 65 will get back all his or her contributions plus interest in eight years. For workers who always earned the maximum the payback time is about 11 years—still a very good return given that at 65 the average man is now expected to live past age 80, the average woman to almost 85.

And those who retired just 15 years ago got back all of their contributions plus interest in only two years! For today's younger workers, however, payback times will be much longer—often longer than their projected lifespans. So any reforms must be intergenerationally fair.

I want to stress that any reform measures being contemplated will not affect those who are already retired, or those who are close to retiring. Congress knows that many retirees depend on Social Security to meet basic living expenses.

This is why we must start a nationwide dialogue now between the young and the old, between the government and the private sector, to secure the future of the Social Security system. Its problems can be solved—but not without communication and cooperation.

Only by working together will we restore the most important social program ever enacted to its full stature and stability. ■

AARP foc
on Social Securit

Counterpoint

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We can't afford to wait

By Senator Bob Kerrey (D-Nebraska)

A recent report by the Board of Trustees of the Social Security system contains good news and bad news for those concerned about the health of the largest, most successful retirement-insurance program in the world.

The bad news is that Social Security faces long-term insolvency. The good news is that we still have time to fix it with relatively modest reforms that don't harm current beneficiaries—if we start today.

Social Security's Trustees identified a long-term problem caused by the retirement of the singularly large Baby Boom generation. But the Trustees did not identify another problem—one I view as an opportunity. Contrary to popular myth, Social Security is not a savings program. It is a strong and noble commitment by the generations who are currently working to pay for the retirement of those who are not, with the expectation that the generations to come will do the same when they retire.

The details are as follows: In 1994 an estimated 139 million Americans paid a 6.2 percent payroll tax, which was matched by their employers; this generated a total of $345 billion in income for the Social Security Trust Fund. Interest from investments—which are limited by law to U.S. government securities—generated an additional $31 billion. Retirement and disability checks to beneficiaries totaled $317 billion for the year.

Thus Social Security is not a savings program. It consumes money rather than saves it. I believe the best way to preserve the intergenerational contract at the heart of Social Security is not just to fix the program's long-term insolvency, but to make it more closely resemble a savings program for the nation. In addition to being good for individual households, shifting Social Security toward a savings-oriented program can be part of an effort to return the United States to the status of creditor nation.

The insolvency problem is due to unprecedented demographic changes that are throwing a wrench into the assumptions on which Social Security was built. The system of each generation paying payroll taxes to support the previous generation's retirement works well, provided each generation has enough children grow up, enter the workforce, and pay the taxes that fund retirement benefits. My generation didn't. Today there are nearly five people in the workforce for each retiree; after the Baby Boomers retire by 2030 there will be fewer than three. Moreover, Americans are living longer, so are collecting more in lifetime benefits.

The consequences are enormous: By 2012, when my generation begins to retire, every dollar the federal government collects in taxes will go directly to spending on entitlements and interest on the national debt. A year later, in 2013, we will begin to pay for benefits out of the Social Security Trust Fund's surplus. Just under two decades later the Trust Fund, and the surplus along with it, will be exhausted.

Is the sky falling? No. Is America going bankrupt? No. Will Social Security collapse? Of course not. It's far too popular and has done far too much good to let that happen.

But if we wait until the system goes bust, we will force excruciating options on our children: Because there would be nothing available to support the Social Security benefits of a large generation of retirees but the payroll taxes of a relatively small generation of workers, our children would be forced to either slash benefits dramatically or impose a huge tax increase on themselves.

Senator Alan Simpson (R-Wyoming) and I are proposing legislation that would meet this growing challenge. Our proposal will be based on some basic beliefs:

- First, individuals must have time to plan for any changes we make in retirement policy. Our plan would therefore take effect gradually, and *would not cut core benefits for Americans now over age 50*
- Second, members of Congress must be willing to lead by giving up some of their own retirement benefits.
- Third, paying into Social Security should be an act of saving for the individual and the nation.

One of the most exciting prospects for reforming Social Security is to allow future beneficiaries to invest a portion of their payroll tax in an IRA-type account. The result would be not only to give individuals more control over their retirement future, but also to increase private savings by tens of billions of dollars a year. Such a system would dramatically improve the

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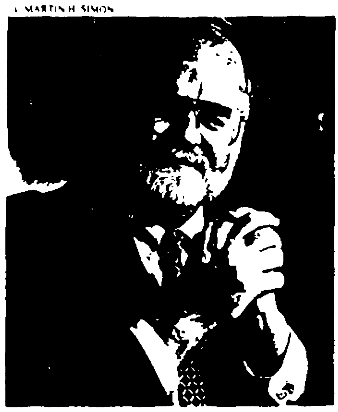
Where we stand

Options for the future

By John C. Rother
Director, AARP Legislation and Public Policy Division



Is it true that Social Security faces bankruptcy soon and won't have the money to pay benefits to those now contributing when they retire? Will Social Security survive for our children and grandchildren? What needs to change to strengthen Social Security for the future?

The Social Security system was created 60 years ago during the Great Depression to protect American workers and their families against the financial hardships that resulted from the loss of income when a wage earner faced retirement. Throughout Social Security's history, both payroll taxes and benefits have been modified to reflect the changing needs of families and individuals, a changing workforce, and the financial solvency of the program.

Social Security is often called a "compact between the generations," since the program asks workers to pay Social Security taxes to fund benefits for those who are currently retired, disabled, or the survivors of deceased workers. Those who pay in today in turn earn the right to similar insurance protection in the future.

Social Security is solvent—able to fully pay benefits, on time—for the next 35 years. The program is overwhelmingly supported by people of all ages. Yet despite its popularity, its remarkable success in improving the economic well-being of beneficiaries, and its perfect record of always paying benefits on time, Social Security is increasingly under attack. Some of its critics claim we need to overhaul the program.

In addition to these direct attacks, a more subtle but potentially more dangerous threat is posed by the fading confidence younger workers have in the program's long-term viability.

Most of the attacks on the program are off the mark. Those who say we can't afford to pay benefits to every contributor ignore the fact that Social Security is an earned benefit paid to retired and disabled workers, their families, and dependents of deceased workers. If modest adjustments are made there will be no need to turn it into a "means-tested" welfare program or to drastically change its current character.

Social Security remains our most popular federal program largely because everyone who pays into the system for 40 quarters receives a benefit regardless of other income. Some critics, notably the Concord Coalition, would cut benefits for individuals above a certain income level. But they underestimate the importance of Social Security's universal benefit promise in maintaining strong public support for the program. If higher-income Americans had no stake in the system, benefits for everyone else would be put at risk. Since most of today's workers are not saving nearly enough and fewer than half are covered by pension plans, they will not have enough other income in retirement and therefore will depend on Social Security.

Unfortunately, young workers often express skepticism about their own Social Security benefits. They forget Social Security's valuable disability and survivor protections that enable families to cope with income lost when a wage-earner becomes disabled or dies. These insurance protections would be far more expensive if purchased in the private market. Some younger people also ignore the indirect benefit they receive by not being simultaneously responsible for the financial support of their children *and* their parents.

Social Security's trust funds

Payroll-tax contributions are credited to specially designated trust funds in the federal Treasury. Any money not used to pay benefits or administer the program is invested, as has always been required, in government securities. These securities, which will earn over $30 billion in interest during 1995, are a loan from Social Security to the government, just as individuals who purchase Treasury or savings bonds loan the government their money. They are hardly "worthless IOUs," as some have claimed. As the trust funds build reserves, their ability to earn a good investment return becomes more important. Some suggest investing some of the reserves privately in order to earn a higher return, contributing substantially to long-run solvency.

According to the Trustees' 1995 report, by 2013 payroll-tax contributions alone will not cover the full cost of promised benefits, but the trust funds' securities will be able to make up the difference through 2030. Of course the government's ability to finance future benefits, whether by raising payroll taxes or by using income taxes to redeem these bonds, will depend on the economy's overall health at that time. If economic growth continues, the burden on future workers to finance the retirement of the Baby Boom generation should not be significantly higher than it is on today's workers.

Carefully thought-out adjustments to maintain Social Security's solvency have been made throughout its history. If Congress decides how to restore long-term (75-year) solvency reasonably soon, the changes made could be less painful than any adopted later, there would be more lead-time for those affected to prepare, and confidence in the program's solvency would improve.

Historically, when adjustments to Social Security have been made they have involved a combination of adding revenue and reducing benefits.

Revenue options

Following are potential sources of additional revenue and their contributions toward restoring 75-year solvency to Social Security:

- Add all newly hired employees in state and local governments that have their own pension systems and don't now participate in Social Security. Including these people in the program would achieve 11 percent of the goal.
- Raise the amount of federal income tax beneficiaries pay on their Social Security. In 1994, about $6 billion in revenue was credited to the trust funds as a result of the taxes paid by almost 25 percent of beneficiaries. This amount will increase automatically over time since new retirees generally have higher incomes and more of them will be taxed on their benefits. Some suggest we increase the number of beneficiaries who are taxed on their Social Security by lowering the threshold for taxation, or increase the amount of benefits taxed for those already paying. Taxing up to 85 percent of the benefits of all those now taxed at the 50 percent rate achieves only 1 percent of the goal. If Social Security benefits were subject to the same tax rules as private pension benefits, the additional revenue would achieve 2 percent of the goal.
- Raise payroll taxes. Employees and employers each now pay 6.2 percent of the first $61,200 of a worker's wages to the two Social Security trust funds. (Another 1.45 percent goes to Medicare Part A.) Increasing the payroll tax to 7.3 percent now for both employee and employer would restore long-term solvency. Increasing the taxable wage base by $10,000 would achieve 8 percent of the goal.

Benefit options

Following are possible benefit reductions toward restoring 75-year solvency to Social Security:

- Reduce cost-of-living adjustments. A one-time 0.5 percent decrease would bring the trust funds only 0.5 percent closer to the solvency goal, while a permanent 0.5 percent reduction would achieve about one-third of the goal. Not only would the real value of benefits diminish over time with a COLA cut, but the base on which future benefits are cal-

Five approaches to solvency

These options, developed by AARP's Public Policy Institute, illustrate the trade-offs needed to ensure Social Security's long-term financial stability. Each is sufficient on its own to meet the goal. The options assume Congressional action by 2000 and the inclusion of all newly hired state and local government workers in Social Security. They also assume that additional revenues from these changes are invested in private securities to generate higher returns for the trust fund.

1. Beginning 2010 increase payroll taxes every 10 years (now 6.2 percent each for employee and employer). In 2010 increase tax to 6.5 percent and continue increasing until it is 7.4 percent in 2060.

2. Beginning 2000 reduce initial benefits for new retirees by an average of 13 percent, but proportionately more for high earners than for average and low earners.

3. Beginning 2000: Gradually reduce initial benefits for high and average earners by an average of 16 percent. Phase in increase in wages subject to payroll tax from $76,000 (projected) to $114,000. Increase portion of benefits taxed to maximum of 85 percent for individuals with incomes above $25,000, couples with incomes above $32,000.

4. By 2027 complete gradual rise of normal retirement age to 69 for workers born after 1943. By 2000 increase number of workyears counted in benefit calculation from 35 to 40.

5. Accelerate phase-in of normal retirement-age to 67 by 2015. Beginning 2020 increase payroll taxes (employee and employer) to 7 percent. In 2000 reduce initial benefits slightly for high and average earners. Make one-time 0.5 percent COLA cut. Increase portion of benefits taxed to maximum of 85 percent for singles with incomes above $25,000, couples with incomes above $32,000.

Where we stand

culated would also be smaller. Reductions in the COLA would particularly hurt those beneficiaries who rely on Social Security for the bulk of their income and those who live longer—mainly women.

• Increase the age to collect full Social Security benefits from the current-law 67 for those born in 1960 and after. Speeding up the currently scheduled increase in the retirement age from 66 to 67 for those born from 1949 through 1959 would achieve 11 percent of the 75-year solvency goal; actually raising the age for full benefits to as high as 70 would achieve 76 percent of the goal. Raising the retirement age is popular among many policy analysts because people can still get full benefits by working longer. For those who are unemployed and cannot find work, and for older workers who are physically limited, an increase in the retirement age may not result in additional years of work; rather, it would represent a large and permanent cut in benefits unless they can make it on their own savings until a later age when their benefits would be higher.

• Modify the current Social Security benefit formula to reduce benefits for those with higher wage histories. Currently the system provides low-wage workers with higher paybacks on (replacement of) their contributions than others receive. One option to help achieve solvency would be to further reduce the benefit return of future average and high earners. Lowering their return by about 12 percent would move the trust funds 30 percent closer to solvency. Of course, if benefits for average and high earners were reduced dramatically, it would take them longer to recover their own contributions, and scaling back benefits too far could undermine support for the program.

What you can do

We've outlined just a few of the options that could restore Social Security's long-term solvency. Ultimately, Congress and the President will have to craft a package the public can accept. Although Congress appears unlikely to act on solvency proposals right away, all of us have a stake in the coming debate about how to maintain Social Security for future generations. If we want to maintain a strong Social Security program for our children and grandchildren, everyone must be prepared to share in the sacrifice.

This debate is just beginning. AARP wants to hear back from you, its members, and your families about how best to restore Social Security's long-term solvency. Five general approaches to that solvency are described on page 101; talk to your younger relatives and find out what they think about these options. Also, remind them of the importance of saving for their own future. If Americans started saving more today, our nation's economic prospects would improve and our retirement systems would be more secure.

AARP has not yet endorsed any of these proposals. For us to participate constructively in the solvency debate, our Board of Directors is eager to hear from you. Your Association knows that Social Security can and must be strengthened, but there is ample time to better understand and debate the options. We urge you to send us your views; write Social Security Options, AARP, 601 E St NW, Washington, DC 20049.

Now is the time to reopen the channels of communications among generations so that Social Security will remain sound for the future. The compact between the generations that underlies the program is one of the most important compacts in American life. Social Security has worked well for the past 60 years; now it's up to us to make sure it is there for generations to come. ■

Counterpoint

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entire culture of savings in our nation. People who for the first time have large private savings accounts are likely to see their value and begin to invest more and more in them. And increasing our private savings rate means the U.S. can once again be a creditor, rather than a debtor, nation.

The Kerrey-Simpson plan will propose restoring Social Security's solvency by gradually raising the age at which Americans are first eligible to receive full retirement benefits from 67 to 70—a move that would not affect Americans now over age 51—and limiting the growth of COLAs for some beneficiaries.

The only *un*acceptable option to me is inaction. Inaction is based on the cozy but flawed assumption that 35 years of solvency gives us 35 years to wait. This is the argument of those who say we can wait until next year, or the year after, or the year after that. But every day we wait, our options become more excruciating.

I doubt that anyone wants to see the same year that marks the 60th anniversary of Social Security, one of the greatest legislative achievements in American history, also remembered as the year we failed to save and strengthen it when doing so was relatively easy.

This is a challenge to which the members of AARP—whose commitment to long-term planning and to their country, children and grandchildren preserved and built the United States into the greatest power on Earth—are uniquely suited. I look forward to achieving it with you. ■

AARP on Social Securi...

Perspective

and the elderly poor. And it offered aid to children in single-parent, almost always female-headed households where the parent was presumed to be unable to support the family (Aid to Dependent Children, later renamed Aid to Families With Dependent Children).

But most Americans, in the 1930s and since, have considered the Social Security Act's most important provision to be the establishment of a permanent system of old-age benefits. There had been considerable debate about how to construct such a system. Many of its advocates had wanted it funded directly out of general revenues, as some European nations had done. The committee decided in the end, however, to pay for the system with a new and separate tax on employers and employees—both to ease pressure on the federal budget and to insulate the program from future political attacks.

Although passage of the Social Security Act was an epochal moment in the history of American social welfare, the system the original bill created was a limited one. It excluded large categories of people from participating. In all, the system promised to provide benefits to only about half of all workers. Even before the first recipients began getting payments in 1940, however, coverage had been revised and expanded. A 1939 law extended benefits to recipients' dependents. Later revisions added most of the previously excluded workers to the rolls, raised benefits, and finally (in 1972) indexed payments to the consumer-price index.

By then almost every older person in America was eligible for Social Security—and the result was dramatic. Once the poverty rate among the elderly had been three times that of the population as a whole. By the mid-1980s, however, the poverty rate among the elderly was slightly lower than that of the general population. Social Security was not the only reason for that change, but it was a central element in the dramatic reduction of poverty among older Americans.

One measure F.D.R.'s Committee on Economic Security had considered, and postponed, was a system of national health insurance. Proposals for national health insurance revived intermittently for the next 30 years until they became part of Lyndon Johnson's Great Society. By then the proposals for health-care reform had taken a very different look from what early national-health-insurance proponents had envisioned.

Johnson's proposal for health-care reform was, in fact, relatively conservative—at least when compared with the expansive visions of some New Dealers. He would make free hospital and medical care available to the elderly, not to everyone. He would fund the system just as Roosevelt had funded Social Security: through payroll taxes on employers and employees. And he would require no basic changes in the way hospitals and doctors worked. An open health-care market would continue.

These programs are insurance, not welfare

Medicare's subsequent history has often been turbulent. As the price of health care has spiraled and the number of elderly Americans has risen, the costs of the system have reached levels its founders never imagined. Trying to contain costs in recent years, Presidents, Congresses, and state and local governments have made numerous changes—many of which have added to recipients' out-of-pocket expenses or restricted the kinds of medical care available to them. And yet just as Social Security has survived for six decades, Medicare has survived its first three decades with its essential popular support largely intact—although the support for Medicare will soon be sorely tested as the 104th Congress begins its efforts to make radical reductions in the cost of the program.

Why have Social Security and Medicare fared so much better, at least so far, than the rest of the social-welfare system? Programs for the elderly are popular in part because most people do not consider them "welfare." They are a form of "insurance," and hence do not arouse the traditional hostility of many Americans to direct public assistance. They are popular because they are universal. Virtually all Americans are potential beneficiaries, and all have a stake in seeing that the programs survive. They are popular because they are successful. They have lifted millions of elderly people out of poverty; they have ensured that older Americans have access to the medical care they need; and they help younger Americans by lessening the burden of caring for aging parents.

But perhaps the most important reason for the continued strength and viability of Social Security and Medicare is the size and power of their principal constituency.

Older Americans are among the largest, best organized, most effective "interest groups" in the nation. In our country's highly pluralist democracy, those who mobilize most successfully are the most likely to get their way. For more than a generation older Americans have succeeded more brilliantly than almost anyone else in both making their own power felt in the political world and persuading others that their interests are, in the end, the nation's interests. ■

Alan Brinkley is professor of American history at Columbia University and the author of The End of Reform: New Deal Liberalism in Recession and War *(Knopf, 1995).*

PREPARED STATEMENT OF DAVID M. WALKER

Mr. Chairman and members of the Sub-committee, thank you for the opportunity to appear before you again to address the important issue of how to assure the financial integrity of this nation's Old Age Survivors Insurance (OASI) program. My remarks today represent my personal views as an informed and concerned private citizen who also happens to be a former Public Trustee of Social Security and Medicare, a former Assistant Secretary of Labor for Pension and Welfare Benefit Programs and a former head of the Pension Benefit Guaranty Corporation.

As noted in the Trustees Summary of the 1995 Social Security and Medicare Annual Reports, based on the Trustees' intermediate or "best estimate" assumptions, the OASI Trust Fund is projected to be able to pay benefits on a timely basis for another 36 years. However, the projected 36 year period in the 1995 Annual Report is six years less than the intermediate estimate in the 1994 Annual Report! In addition, based on the Trustees' 1995 intermediate assumptions, the OASI Trust Fund is expected to turn a negative cash flow in 2013, just two years after the first "baby boomer" reaches age 65. As a result, while the OASI program is arguably in the best relative financial condition of the four Social Security and Medicare programs, it's longer term financial condition is not good and it is deteriorating.

As we look forward to the 21st century and begin to address our related entitlement challenges we need to establish a clear set of program priorities. In this regard, in my opinion, the OASI program represents the most important of the four Social Security and Medicare programs. It represents the foundation of our nation's retirement security policy—a foundation that needs to be supplemented by private pension programs and personal savings arrangements. In addition to being our most important social contract, I believe the OASI program also represents the social insurance program with the greatest public support and political risk.

Given the above factors, I believe it is important that we begin to take steps to assure the long-range financial integrity of the OASI program. The need for timely action is reinforced by the fact that delay will only serve to increase the amount of needed change and the degree of difficulty in achieving it. While timely action is desirable, from a realistic perspective, enacting any significant reforms will have to be preceded by a massive campaign to educate the American public on the nature and extent of our entitlements challenge and the alternative approaches to addressing it. I hope that my testimony today along with my other related speeches and actions will serve to further this public education process and stimulate additional debate regarding alternative reform approaches.

With regard to reform of the OASI program, I believe that the financial integrity of this program can and should be maintained through a combination of program reforms and revenue enhancements. I believe that our objective should be to assure the long-term financial integrity of the OASI program and the related benefit security of current and future generations of Americans. In my view, the Congress needs to consider a number of OASI related actions including the following:

- Reviewing the accuracy, reasonableness and appropriateness of the current OASI benefit indexing methodology;
- Eliminating any early retirement subsidy under the OASI program;
- Raising the current early retirement age (i.e., 62) and increasing further the normal retirement age (i.e., currently scheduled to gradually increase from 65 to 67), both on a phased-in basis;
- Reviewing the existing replacement rates, including possibly creating a new benefit "bend point" thereby further increasing the regressivity of the OASI benefit structure;
- Reviewing the current spousal benefit structure;
- Broadening the definition of the taxable wage base to include the current value of certain fringe benefits (e.g., employer paid health insurance premiums);
- Increasing the current OASI wage base cap and/or payroll tax rate;
- Considering conversion to a possible "two tiered" OASI program with a base defined benefit and a supplemental and mandatory defined contribution/individual account element; and,
- Reviewing the current OASI Trust Fund investment policy, including consideration of allowing individuals to direct how their individual account is invested among several "passive" investment vehicles (similar to structure of the current Federal Thrift Savings Plan) if a "two tiered" system is adopted.

While I believe the above reforms should be seriously considered, I would strongly oppose two specific reforms which have been periodically discussed. Specifically, I would strongly oppose any attempt to "fully means test" the OASI benefit by eliminating the benefit for certain higher income individuals who have paid into the program over a number of years. In addition, I would strongly oppose eliminating the taxable wage base cap. I believe that both of these proposed reforms would be inappropriate, inequitable and counter-productive over the longer-term. Specifically, I believe that these two reforms, both individually and collectively, would serve to undermine the long-term public commitment to the OASI program. In addition, the OASI program is already partially means tested since payroll taxes generally increase for the higher paid and benefit replacement rates are regressive.

While my testimony is focused on the OASI program, I believe that it is important that we not view the OASI program in isolation. Specifically, I believe it is important to recognize that the OASI is but one of four Social Security and Medicare programs- all of which face insolvency at varying dates in the 21st century. In addition, these four programs are major contributors the escalating fiscal challenge relating to our current entitlement programs. In this regard, in my view, when considered on a combined basis, our current Medicare and Social Security programs promise significantly more than this nation can reasonably be expected to deliver in the next century. My view is based on known demographic trends, the current national debt, projected fiscal budget deficits, projected financial imbalances in the Social Security and Medicare programs, projected health care costs and various other factors. Several of these factors represent facts which can not be changed (e.g., rising dependency ratios, longer life spans). At the same time, the nature, timing and magnitude of the projected financial imbalances facing the Social Security (i.e., OASI and DI) and Medicare (i.e., HI and SMI) programs are distinctly different.

With regard to the other Social Security and Medicare programs, the DI program is in need of fundamental re-assessment and reform, especially given recent and projected disability trends. Most importantly, the Medicare programs (i.e., HI and SMI) are clearly unsustainable in their present form and are in need of dramatic and fundamental reform!

Failure to effectively address the financial imbalance in the other social insurance programs on a meaningful and timely basis, especially the Medicare programs, will likely have long-term adverse implications for the Social Security program since Congress has had a history of re-directing funds from the "relatively better financed" social programs to shore up any "troubled" programs. One relatively recent example of this was the re-direction of the additional tax revenues resulting from increasing the Social Security benefits income inclusion percentage from 50% to 85% from the OASI Trust Fund to the HI Trust Fund. Another more recent example was last year's action by the Congress to redirect of a portion of the OASI payroll tax to the DI program in order to prevent the then impending insolvency of the DI program. These actions served to strengthen the HI and DI programs, respectively, at the expense of the OASI program. In my opinion, this type of short-term and stop-gap action must stop! Each social insurance program should be designed to stand on its own two feet.

As we look forward to the 21st century and consider our very real entitlement challenge, we must assure that we as a nation make promises that we can afford and that we keep the promises that we make! We must strive to achieve reforms which are inter-generationally fair, fiscally responsible and economically rational manner. We must also address the widening gaps between what Americans think they have been promised, what they expect to receive and we can realistically deliver in connection with the Social Security and Medicare programs . These related "expectation gaps" are particularly acute among many in the so called "baby boom" and "baby bust" generations.

In addition to enacting needed Social Security and Medicare reforms and addressing the above expectation gaps, we need to take appropriate steps to stimulate the private pension system and encourage individuals to plan, save and invest for their retirement. These actions are also extremely important since any significant reform of the Social Security and Medicare programs will serve to increase the pressure for employers and individuals to do more in order to assure that Americans have a reasonable standard of living in their retirement years.

In closing, as an informed and concerned private citizen and a father of two, I am extremely concerned that this nation faces a looming retirement and inter-generational crisis. We must deal with the fundamental financial imbalance in the Social Security (i.e., OASI and DI) and Medicare (i.e., HI and SMI) programs and our related private pension, personal savings and overall health care related challenges in a timely, comprehensive and non-partisan manner. Doing so is critical to the long-term competitive posture and economic security of this nation, the economic security of our children and grandchildren and the retirement security of American workers and retirees. Given the nature, magnitude and political implications of this challenge, I believe that we should; begin now with the needed massive public education campaign, consider selected interim reforms, and enact more dramatic and fundamental reforms before the end of this decade. Achieving the more dramatic and comprehensive reforms is likely to require the creation of a "Greenspan" type commission given the significant policy and political implications of any such initiative. In any event, I stand ready to assist the Congress address this important challenge in a reasoned, responsible and non-partisan manner.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions that you and the other subcommittee members may have.

PREPARED STATEMENT OF MARK A. WEINBERGER

My name is Mark Weinberger. I am a partner in the Washington, D.C. law firm of Oldaker, Ryan and Leonard. I want to thank the Subcommittee for asking me to present my views on the fiscal problems facing the Social Security System and the difficult political and substantive problems that must be overcome to address them.

I will base my testimony on the projections agreed to by the Bipartisan Commission on Entitlement and Tax Reform, and presented to the President in September of this past year. I served as Chief of Staff of the Commission. The 1995 Social Security Trustees' Report only slightly modifies the data used in the Commission's Interim Report to the President (August 1994). My testimony today is not meant to represent the views of the Commission or any Commission member. The conclusions I draw from the Commission's findings in the Interim Report are solely my own.

Introduction

Mr. Chairman, I commend you for holding these hearings and having the foresight to address the solvency of the Social Security system, even at a time when such foresight is not necessarily rewarded. In fact, I venture to guess that not many individuals are bestowing praise and rewards on you for holding these hearings, or for introducing legislation along with Senator Kerrey (D-NE), to address the undeniable risk to the future health of the Social Security system. Having received 350,000 post cards from seniors lambasting the Commission's recommendations on Social Security, before recommendations were even considered by the Commission, I can empathize with your mail room personnel and your other staff members whose jobs have undoubtedly intensified as a result of your efforts.

Conspicuously absent from the current debate on balancing the federal budget is any mention of addressing the single biggest federal expenditure--Social Security. Of the total $1.53 trillion in federal expenditures in 1995, Social Security will account for nearly 22%, or $334 billion. That is more then the federal government will spend on all other entitlement programs, except Medicare, combined.[1] By the year 2005 (the last year for which the Congressional Budget office has projections), costs of the program in constant dollars are expected to increase to $566 billion. And, this is before the program's cost is expected to really start snowballing, when the baby boom generation starts retiring in 2010.

Why has Social Security been ignored during the current budget debate? It's not because either politicians or the American people believe that it is a "perfect" federal program that should be left alone. To the contrary, each successive public poll confirms

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[1] All means-tested programs (e.g. Medicaid, Food Stamps, SSI, Veterans' pensions, student loans, child nutrition, family support, EITC) are expected to cost $193 billion, Federal Civil and Military programs $74 billion. Unemployment Compensation $21 billion and miscellaneous other programs $42 billion. Source: CBO April 1995 Baseline Projections for Mandatory Spending.

While the program remains relatively healthy in the short-term, adequate reforms can be instituted to preserve its primary function--to provide benefits to the needy and prevent destitution and dependency of the elderly.[2]

The reason that policy makers must act, is that failure to do so will be much more painful to the program's beneficiaries than inaction. Stated another way, many politicians have vowed in past elections to protect the Social Security system, and protect the program's beneficiaries. The only way to keep that commitment is to act to reform the Social Security system--not to refrain from action.

Any policy maker who has taken the time to look through the Social Security Trustees' latest Report, has skimmed the Bipartisan Entitlement and Tax Reform Commission's reports or has attended the hearings of this Subcommittee knows this. The difficult part will be getting the American public to understand the need for action. Otherwise, the American people's fear and distrust of the federal government's action on Social Security may become a self-fulfilling prophecy. Only through public education, and honest and constructive debate, can action to address the Social Security system's problems mirror the courageous efforts currently under way to address the other problems with the federal budget's fiscal imbalance.

The remainder of my testimony discusses the current status of the Social Security Trust Fund by analyzing what the Trust's "surplus" means and detailing the demographic changes that are occurring in the United States.

The Social Security Trust Fund[3]

Overview. Social Security, enacted in 1935, provides monthly benefits to retired workers and their dependents and to survivors of insured workers. Today, the program covers approximately 43 million individuals. The program has been expanded steadily since its inception in the 1930s. The Social Security program is credited with reducing the poverty rate for senior households to 13%, from what would otherwise be approximately 50%. Social Security provides approximately 90% of the total income for almost half the senior households below the poverty line.

The OASDI Trust Fund. For some time, policy makers have been aware that the baby-boom generation will pose a particular set of challenges for the Social Security program. Traditionally, the Social Security program has been run largely on a pay-as-you-go basis. The 1983 Social Security amendments, anticipating the special burdens the

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[2] For a good discussion on the motivation of the Social Security program's founders with respect to primarily creating a needs based program, see Retooling Social Security for the 21st Century, Eugene Steurle & Jon M. Bakija (1994)

[3] For purposes of this Testimony, the "Social Security Trust Fund," refers to both the Old Age and Survivors Trust Fund (OASI) and the Disability Insurance Trust Fund (DI)--often referred to as the OASDI Trust Fund.

baby boomers' retirement would place on workers in the future, included provisions for accumulating a substantial trust fund to pre-fund a larger share of its own retirement benefits than prior generations.

Peak end-of-year asset projections continually reduced. In the first projections, after passage of the 1983 amendments, the OASDI Trust fund was projected to be solvent until at least 2063. Actuaries estimated that the Trust fund would grow from about $27.5 billion in 1983 to about $20.7 trillion in 2045 (current dollars). However, in almost every year since 1983, the estimates of accumulations in the Trust fund have been revised downward. By 1994, the peak asset year was no longer projected to be 2045, but rather 2020. And, the $20.7 trillion amount was estimated instead to top out at $3 trillion ($1.1 trillion in 1994 dollars).

Overall surplus will exist in the near-term, but quickly diminish over time. [See chart I.] Despite the continued downward estimates, the fact remains, that the Social Security Trust Fund is currently running a surplus and is expected to continue to do so over the near-term. The annual surplus is estimated to be about $65 billion this year, rising to nearly $100 billion annually around the turn of the century. Once the baby boom generation begins to retire in approximately 2010, the surplus will rapidly decline. Even with the current surplus, the Social Security Trustees' best estimate is that the Trust will be totally bankrupt by 2030.[4] In 2030, current 30-, 40- and some 50-year-olds will qualify to receive benefits.

However, is there really a need to reform the program now, when insolvency is not projected for 35 years? Absolutely. About one-half of the surplus is attributable to positive cash-flow; that is, the excess inflow of tax revenues (payroll taxes plus the taxation of Social Security benefits) over outlays to beneficiaries. The other half stems from accounting transactions where interest owed to the Trust fund on federal obligations it purchased is credited to its account. Accordingly, the Trust fund's actual cash-flow, or operating balance, is lower than its reported balance--by about half.

This distinction is important and often overlooked. By 2013, the cash outflow to beneficiaries will exceed the cash inflow from taxes, causing the Trust fund to be drawn upon. When the Trustees look into the Trust to take out the cash, all they will find are federal Treasury obligations--federal IOUs to the Trust.[5] In order to draw down the Trust fund assets and pay off the Social Security beneficiaries, the Trustees will have to call in these IOUs.

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[4] One should note that immediately after the 1983 amendments to the program, the Trustees' best estimate of the year of Trust fund exhaustion was 2063. By 1990, the Trustees moved the date forward to 2043. In 1993, the date was again moved forward to 2036 and again in 1994, to 2029. The latest Trustees' report estimates exhaustion in 2030.

[5] By law, the Trustees are allowed to invest only in government bonds.

Because there is no cash sitting in the Trust, the federal government will have to acquire the cash from somewhere to pay off the Trustees. It has two alternatives: increase taxes or borrow it by issuing more bonds to pay off the existing bonds. Of course, it could immediately cut benefit levels to the level of revenues. However, such immediate reduction in benefits will be very difficult. Another, more troublesome alternative, would be to monetize the debt (print more money), leading to a host of other problems.

Accordingly, by 2013, the Federal government faces the situation of either instituting higher taxes, restricting benefits, or increasing the debt to fund the Social Security cash flow imbalance. In any event, the surplus is gone in 2013. In fact, absent action in the interim, by 2015 Social Security obligations will increase the deficit by approximately $57 billion. By 2020, the revenue shortfall will have widened to $232 billion.[6] Thus, concentrating on the current Social Security surplus, and using it as an excuse for inaction, would be myopic policy.

Primary Reasons for the Social Security Program's Projected Growth

Demographics, Demographics, Demographics. The demographic makeup of America is changing. The share of the population over the age of 65 will continue to grow well into the next century. Today, approximately 13% of the United States population is over age 65.[7] By 2030, that percentage will increase to over 20%. As a reference point, in 1991, 18.4% of the population in Florida was over the age of 65.

As the baby boom generation begins retiring, around 2010, there will be a greater proportion of elderly in this country than any previous generation. There are approximately 24 million people over the age of 70 alive in the United States today. By the year 2030, there will be twice as many--48 million. [Chart II.] More importantly, back in the 1950s, there were approximately 8 working-age Americans for every person over 65 years of age. Today, there are fewer than 5 working-age Americans for all those over 65. By 2030, there will be just two working-age Americans for each person over 65 years of age. [Chart III.]

Compounding the fact that there is an increased number of retiring Americans, is the fact that Americans are living longer. The framers of Social Security had the right idea. When they created the program, in 1935, and chose 65 years of age as the normal retirement age, the average life expectancy of someone born that year was only 61!

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[6] A similar analysis can be done on the Health Insurance Trust Fund. While the HI Trust Fund is projected to be solvent through 2001, it is currently running an operating shortfall. By 2001, the annual shortfall will increase to $41 billion. That sum is the savings Congress will have to find to keep the deficit from growing as a result of Medicare payments. If action is not taken in the interim, by 2020, Medicare's annual operating deficit is projected to be $352 billion; by 2030, it will be $1.9 trillion.

[7] Statistical Abstract of the United States.

Today, the average life expectancy is 76. By 2030, it is expected to approach 80 years of age. [Chart IV.]

Accordingly, because there are an increasing numbers of Americans claiming benefits for a longer and longer portion of their lives, with fewer workers to support their transfer payments, it is inevitable that there will be continued strain on the Social Security program if it remains unchanged.

COLAs (Cost of Living Adjustments). Automatic increases in benefits account for about one-third of the increase in all entitlement programs. COLAs, which are pegged to the overall consumer price index, are expected to average more than 3% a year through 2000. Since Social Security is the largest entitlement program, and its annual benefits are increased annually through COLA adjustments, a significant portion of the automatic increases occurs in this program.

Moreover, Social Security "bend points" are increased annually based on changes in the average wage growth. Accordingly, benefits increase automatically to the extent wage growth in the economy at large increases. The Social Security Trustees estimate that wage growth will exceed inflation by 1% in its intermediate projections for the Social Security Trust Fund.

Accordingly, the primary causes of the growth in Social Security which is projected to occur through the next century is not necessarily something that Congress can control. They are driven by a "graying" of America and higher standards of living. However, Congress has the responsibility to recognize that the growth in these programs will place a significant strain on the economy and the social safety net programs themselves.

The current programs are clearly not sustainable in their current form at the existing funding levels. There are only three choices facing policy-makers: curtail the growth in benefits, restrict eligibility or increase funding for the program. Until then, the American people will not have confidence in these programs and the country's financial house will remain out of order--with or without a balanced federal budget in 2002.

Principles for Reform

I believe the following principles should be incorporated in any attempts to reform the Social Security system:

- Reform should be instituted immediately, so that it could be phased-in over time. Individuals should be given time to incorporate changes in the Social Security program into their long-term financial plans. In addition, like changes to Medicare, changes to Social Security will likely have an effect on the responsibility of employers. Many private sector retirement plans are integrated with Social Security benefits. Accordingly, changes in Social Security will require changes in private sector employment obligations.

Moreover, immediate and significant changes to the program will not prove easy politically. As we are seeing with the proposed changes to the Medicare program--to prevent its impending insolvency--changes to the Social Security system will likely take significant political will. It will likely be difficult to find the necessary changes in Medicare to save the $270 billion over the next 7 years called for in the Budget Resolution. However, it's interesting to note that such savings will not even be enough to bring the HI program into intermediate- or long-term balance.

- Reform should take into consideration the realities of longer life spans and the increased ability of individuals to remain a productive part of the work force for a longer portion of their lives.

- Reform should maximize economic efficiency. The Social Security system is not a good investment for most working Americans. The long-term return on a worker's investment is predicted to average approximately 2% (in real terms). For many higher income and single Americans, the return will be negative. Investments by working Americans in their retirement through the Social Security system should not result in a lower return than they can get from private investment alternatives with comparable risk.

- Reform should underscore and make explicit the purpose of the Social Security program. The system should be explicitly progressive, providing benefits for those individuals who need them to remain out of poverty. Many Americans are not aware of the "welfare portion" of Social Security and the transfer of wealth that occurs within the system.

- Social Security should be designed to supplement private savings, not replace them. Individuals should be responsible for providing adequate retirement savings for themselves and their families. Where an individual cannot so provide, the Social Security system should be available as a safety net. Accordingly, Social Security should not be reformed in a vacuum. Private sector savings incentives--employer plans and personal savings incentives--should also be reviewed.

- Reform should transform at least a portion of the Social Security program into a true savings program. To the extent current surpluses in the Trust Fund are invested in federal obligations, with the general treasury in turn spending the funds, there is no increase in net national savings as a result of Social Security contributions. A portion of an individual's Social Security taxes should be placed in an account separate from the general Social Security Trust Fund. Such amount would be available for investment in assets other than federal obligations and could be so directed by the contributor. The funds would not be available to be spent by the federal government. Further, to foster the accumulation of wealth between generations, such funds would be available to pass on to the contributor's heirs.

- Reform should ensure horizontal equity. Aspects of the current system which result in different benefit levels to generally similar-situated taxpayers who contributed identical amounts of taxes should be removed. For example, two couples with identical earnings and payroll tax contributions receive different benefits upon retirement where one couple had a single worker and the other couple achieved the earnings through two workers (each earning half the wage of the other couple's single earner). The one-earner couple would receive $21,600 (1995) in benefits annually while both spouses are alive and $14,400 when one dies, compared to $19,272 dollars and $9,636, respectively, for the two-earner couple.

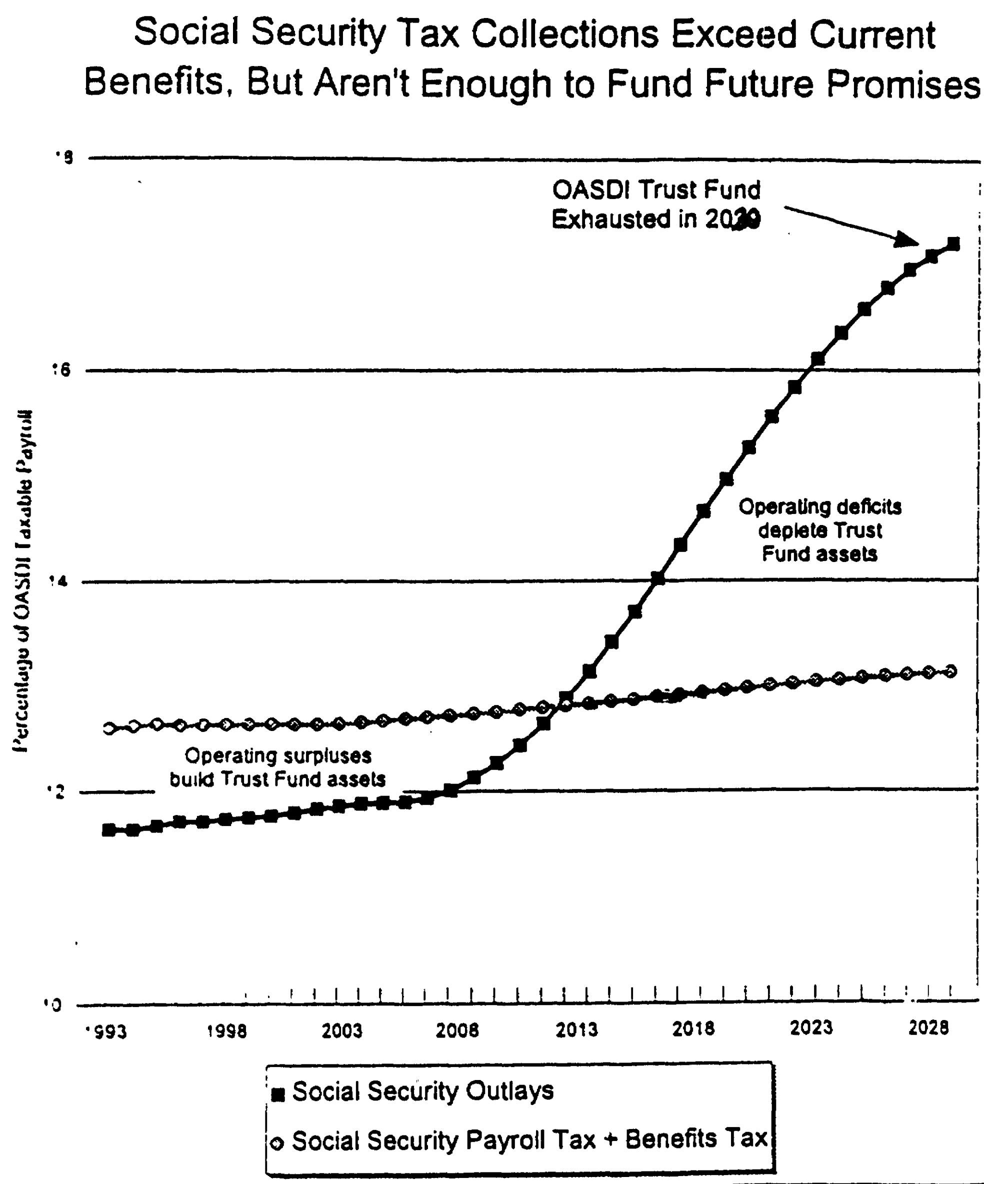
- Payroll taxes should not be increased to fund additional benefits. Too often in the past, funding imbalances have been bridged with payroll tax increases. In 1937, the first year of Social Security taxes, the tax rate was 2% on wages up to $3,000. Today, the Social Security tax rate is 12.4% on wages up to $61,200. This is on top of the Medicare HI tax, which is applied at a 2.9% rate on all wages. [Chart V.] Increased payroll taxes significantly depress wage growth and standards of living for working Americans. In addition, such taxes deprive many workers of the ability to accumulate private savings.

Conclusion

It is critical that principles for reform of Social Security be spelled out early by policy-makers so that each can be considered fully. The Social Security system touches the lives of virtually every single American. In order to implement a successful reform of the system, the American people must be informed of the problems and the need for action. But, it is equally important to develop a consensus about the principles of reform, so that the American people can have confidence that the changes are fair as well as necessary.

In doing so, confining the debate to tinkering within the current parameters of the system may be overly limiting. The federal government's role in providing retirement benefits to a significantly increasing elderly population is going to prove extremely costly as we move into the 21st century--costly to American workers and to the economy. The federal government should plan now to strengthen the other two legs of the stool--private savings and employer provided retirement vehicles--in addition to relieving some of the pressure on the federally financed leg.

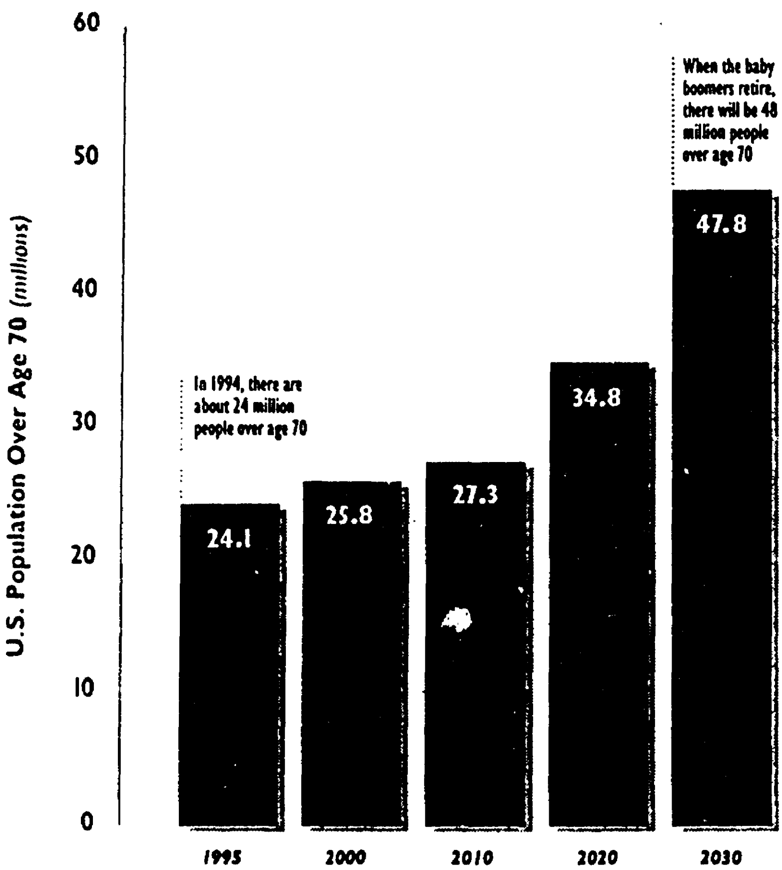
CHART I



Using the Trustees' best estimates, the Social Security program will run cash surpluses through 2012, and will start running cash deficits beginning in 2013. Those deficits will rise to more than 4% of payroll by 2030. To cover Social Security outlays, payroll taxes would have to increase from 12.4% today to more than 16.5% in 2030.

CHART II

The Number of Americans Over 70 Will Double



Source: Bipartisan Commission on Entitlement and Tax Reform.

CHART III

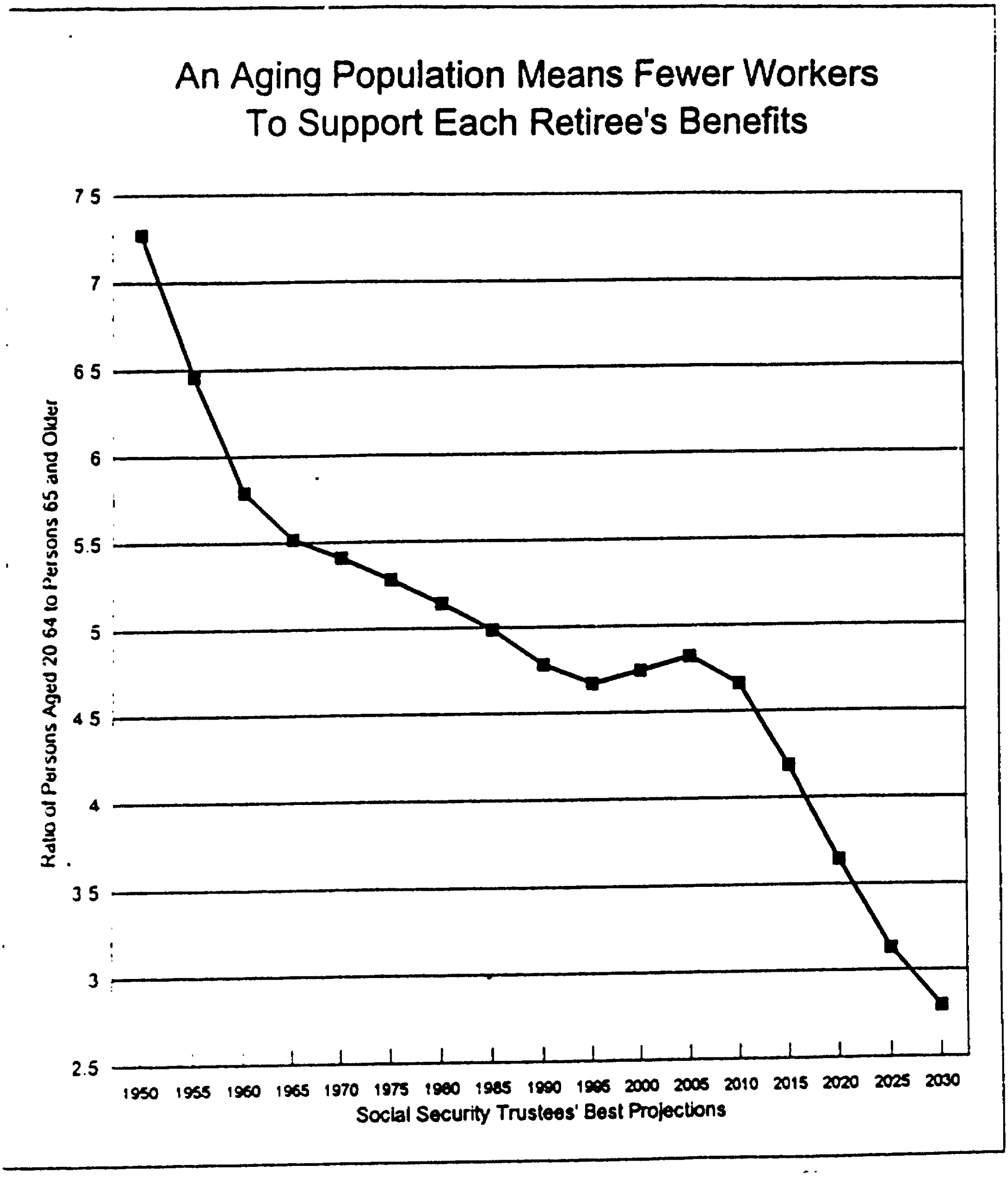

An Aging Population Means Fewer Workers
To Support Each Retiree's Benefits
Ratio of Persons Aged 20 64 to Persons 65 and Older
7 5
7
6 5
6
5.5
5
4 5
4
3 5
3
2.5
1950 1955 1960 1965 1970 1975 1980 1985 1990 1995 2000 2005 2010 2015 2020 2025 2030
Social Security Trustees' Best Projections

CHART IV

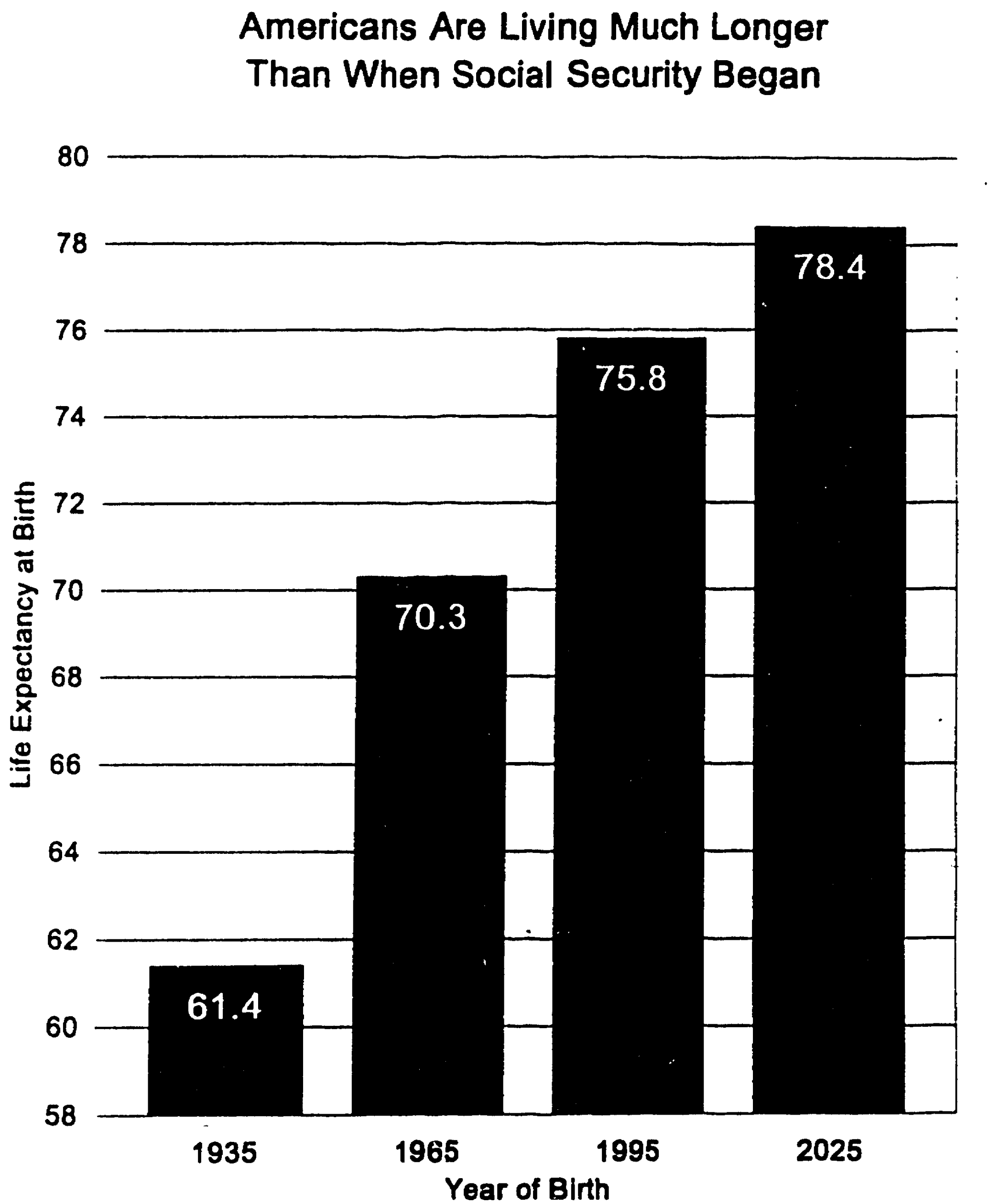
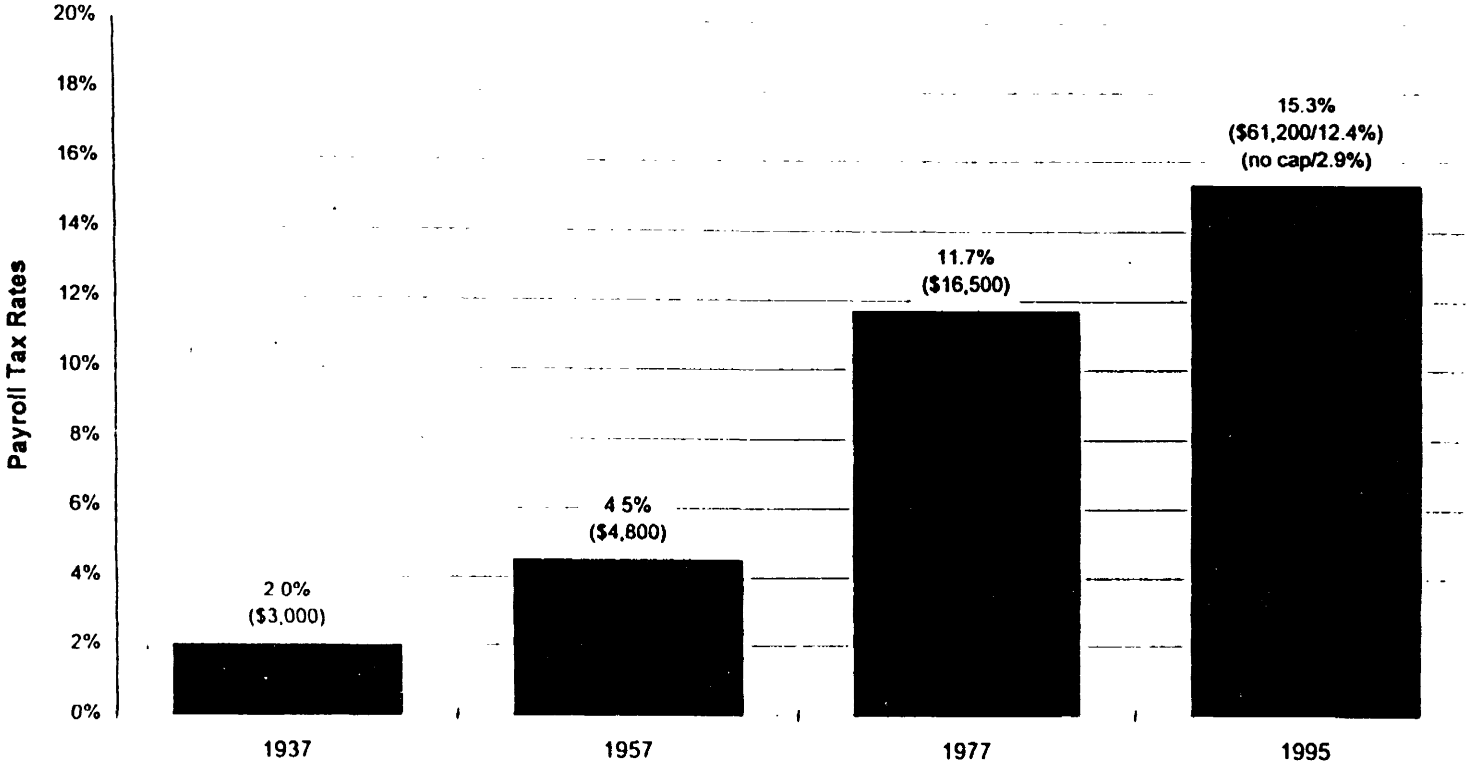

Americans Are Living Much Longer
Than When Social Security Began
80
78
76
74
72
70
68
66
64
62
60
58
Life Expectancy at Birth
61.4
70.3
75.8
78.4
1935
1965
1995
2025
Year of Birth

CHART V

Payroll Tax Rates Have Grown Dramatically, From 2% to More Than 15%, While Wage Base Has Grown from $3,000 to More than $60,000



When Social Security was first enacted, the payroll tax rate was 2% of the first $3,000 of wages Today, the payroll tax rate (Social Security and Medicare Part A) is 15 3% The Social Security portion (12.4%) is imposed on an indexed wage base ($61,200 for 1995 (est)), the Part A portion (2 9%) is imposed on all wages, with no cap

COMMUNICATIONS

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Academy committees and work groups offer expert testimony, provide technical information, comment on proposed legislation, and work closely with federal and state officials on insurance-related issues. The Academy's Department of Public Policy coordinates the work of committees and work groups with the needs of public policy makers.

OVERVIEW

This testimony presents potential solutions to the financing problems facing the Social Security program. Our purpose is to draw attention to those proposals with the greatest potential to solve the financing problems and to describe other proposals with little potential to solve the problems but that may be widely debated. We believe that the debate should focus on proposals in the first group. This testimony is intended to be an objective analysis of potential solutions. It is not intended to favor any particular position.

The Social Security program, which consists of the Old-Age, Survivors, and Disability Insurance (OASDI) programs, was designed with the following characteristics: (1) benefits are based on a balance between "individual equity" and "social adequacy," (2) financing from, or on behalf of, participants makes the program "self-supporting" and gives participants an "earned right" to benefits without a "means test," and (3) participation is mandatory. Most proposed changes would retain these characteristics, but some would not.

The financial status of the OASDI program is derived from data provided in the 1995 Trustees Report. This report, which is published every year, describes the financial viability of the program. The OASDI program is evaluated on the basis of 75-year projections. To determine whether the OASDI program is expected to have income that is reasonably close to the expected cost over the next 75-years, tests of long-range close actuarial balance are applied. The failure of any program to pass the test of long-range close actuarial balance does not necessarily mean that insolvency is imminent. Rather, the test provides a warning to policy makers that changes are necessary to preserve the financing of the program in the long run.

The American Academy of Actuaries Committee on Social Insurance believes that the warning provided by these tests of long-range actuarial balance is strong enough that Congress should act now to bring the Social Security program back into long-range balance. This would allow changes to be phased-in and give workers time to adjust their personal savings to maintain a desired standard of living in retirement. Delay will limit the options for change and require that such changes be made with less notice, causing economic dislocations and resentment, and making the benefits less predictable.

The section that follows describes potential solutions to the future financial problems of the Social Security program. A detailed summary of the financial status of the Social Security program is available in a recent report by the Committee on Social Insurance. The report also provides a summary of the financial status of Medicare as well as solutions to Medicare's financial problems. The report "Solutions to Social Security's and Medicare's Financial Problems" is available from the American Academy of Actuaries.

SOLUTIONS TO SOCIAL SECURITY'S FUTURE FINANCIAL PROBLEMS

Assuming that the existing structure of the OASDI program is maintained, then restoring financial soundness would require that either tax income be raised, or benefit outgo be reduced. Some combination of tax changes and benefit changes would likely be enacted, so that the effects would be shared by workers and beneficiaries.

Possible solutions with tax changes include the following, in order of significance:

1. **Increase the payroll tax.** Payroll tax rates (FICA and SECA) have been raised many times in the past. Currently, the tax rate for Social Security is 12.4 percent, split equally between employers and employees. In theory, changes to the tax rate could solve as much of the long-range problem as policy makers choose to solve. Furthermore, the changes could be tailored to meet Social Security's cash-flow needs, ameliorating the effects of building up and then drawing down the trust funds. Also, the income rate at the end of the 75-year projection period could be very close to the cost rate then.
2. **Increase the limit on taxable earnings.** About 85-90 percent of earnings in covered employment are below the current limit on taxable earnings of $61,200. Removing the limit for employees and employers could solve about half of the long-range financial problem, even though the additional tax income would be partly offset by increased benefit costs, assuming that all covered earnings would continue to be creditable for benefit-computation purposes. Removing the limit just on the employer tax would offset about one-fourth of the long-range financial problem without increasing benefits. The revenue that could be raised by such proposals would not track Social Security's needs very well, because income would increase immediately (when it is not needed) and the increased income in later years (when it is needed the most) would be partially offset by higher benefits. Thus, these proposals would leave in place the pattern of trust fund build-up and draw-down, although the year of fund exhaustion would be much later. Finally, it raises questions as to the appropriate role of government in providing very high retirement benefits to workers with the highest incomes.
3. **Increase taxation of benefits.** Most benefits (up to 85 percent) will be subject to income tax eventually under current law. Most of the income raised through this benefit taxation is returned to the Social Security program, although a substantial portion is transferred to Medicare. The additional revenue that could be raised through additional benefit taxation is relatively modest, although together with a reallocation of Medicare's portion to Social Security, the total could meet nearly one-fourth of Social Security's long-range deficit (while making Medicare's worse). Taxation of benefits can be viewed as a benefit cut, rather than a tax. Also, it can be regarded as an alternative to a means test that preserves the "earned right" to benefits and treats them more like private pensions are treated.
4. **Expand coverage.** This method of generating additional income has little potential to solve Social Security's projected long-range problem today. The remaining noncovered groups are small and very difficult to cover for a variety of reasons, including constitutional concerns, because most noncovered employees work for religious organizations and state and local governments. If all of the noncovered groups could be covered, the effect would be to eliminate about one-tenth of the long-range deficit.

Possible solutions with benefit changes include:

1. **Raise the retirement age.** The normal retirement age is already scheduled to increase gradually to age 67, starting after the turn of the century. The timing of these increases could be accelerated, and the ultimate age could be raised even higher. Such proposals track Social Security's financial problems well, because (1) they reduce benefit payments substantially and (2) the reductions in benefits occur just when they are needed. Raising the normal retirement age gradually to age 70 for beneficiaries reaching that age in 2037 and later would solve about half of Social Security's long-range problem. Such a proposal could save somewhat more if the *early*-retirement age (currently, age 62) were also raised. If the early-retirement age were not raised, the effects on benefit adequacy of greater actuarial-reduction factors becomes an important issue. Increasing the normal retirement age while retaining the current earliest retirement age is tantamount to reducing benefits, because benefits would be available at the same ages after the change but at a reduced amount at each age.
2. **Reduce cost-of-living increases (COLAs).** Current 100-percent CPI-based indexing could be reduced or limited to a portion of the total benefit (fully protecting low-income beneficiaries). This has the potential to save considerable money, with the exact amount depending on the details of the proposal. For ex-

ample, reducing each future COLA by 1 percentage point would eliminate about two-thirds of the long-range deficit. The timing of the savings would not track Social Security's needs well, however, because they would be roughly a constant percentage of benefits, while the need for savings is greatest at the end of the long-range period. These proposals would result in a "longevity penalty," as benefits would be able to purchase less and less as beneficiaries age.

3. Change the initial benefit formula. The percentages in the formulas that are used to compute initial benefit amounts could be reduced, either across-the-board or in a way that protects low-income beneficiaries. This type of change can produce almost any desired amount of savings, and, if the change were phased-in, it could be timed to coincide with Social Security's needs. Adequacy issues should not be ignored. Reductions in the benefit formula can go too far, making monthly benefits inadequate for a substantial proportion of the beneficiary population.

4. Switch to price-indexing of the initial benefit formula. The current wage-indexing could be replaced by price-indexing (based on the CPI). Over many periods of time, price-indexing would have saved money, but its effects are unpredictable. Over some periods, it would have cost money, and these periods tend to be when the economy is struggling and Social Security's financing worsens.

One possible solution would not directly affect taxes or benefits, but would have a bearing on Social Security's financing problem.

Change the investment procedures. Currently, the assets of the Social Security trust funds are invested in United States government bonds, as required by law. Those bonds pay market rates of interest, but many analysts believe that greater returns could be achieved, on average, in the more volatile equity markets. Investment procedures could be changed to allow such investment, with appropriate safeguards against market manipulation through, for example, the use of indexed funds. Still, the vast sums involved could have unintended effects on the equity markets. The potential additional income from changing the investment procedures would depend on the size of the fund. Under pay-as-you-go financing, the additional income would be trivial compared to the size of the long-range deficit.

A fourth group of proposals would involve changing some of Social Security's basic principles. These include:

1. Partial or complete privatization. Chile privatized its social security system in 1981 (although certain government guarantees were left in place for low-income individuals and in the event of adverse experience). The changes put into effect there are often cited as a model for changes that could be made in the United States. A less extreme variation on this idea is to divert the "extra" payroll taxes being collected today (above what is needed to meet current obligations) to IRA-type accounts. In a sense, this latter proposal is another way to modify the program's investment procedures, by placing a percentage of the accumulating assets in the private sector. Of course, an important difference is that the private-sector accounts would be owned by the individuals contributing to them, and the funds would not be available to meet the needs of future beneficiaries who had not contributed. Thus, such changes would shift the program's balance toward individual equity and away from social adequacy.

2. General revenue financing. Many social insurance programs in other countries receive some financing from the general treasury, and that principle could be adapted to the United States Social Security program. General revenue financing can be in the form of direct government subsidies. Alternatively, nonpayroll-based taxes, such as value-added taxes (VATs), can be earmarked for the program. Although such proposals could solve Social Security's financing problems completely, they would compromise the basic principle of a "self-supporting" program financed by participants who "earn" their right to benefits.

3. Means test. Rather than reducing benefits a little for most or all beneficiaries, comparable savings could be achieved by greatly reducing or even eliminating benefits to much smaller groups of otherwise eligible people who have income or assets above specified thresholds. These proposals would also compromise the concept of an "earned right" to benefits and shift the program's balance toward social adequacy and away from individual equity.

EFFECTIVENESS OF PROPOSALS

With respect to proposals that would increase the program's income, the two with the greatest potential effect are:

- increasing the payroll-tax rate and

- increasing the limit on taxable earnings.

With respect to proposals that would reduce the program's outgo, the three with the greatest potential effect are:

- raising the retirement age,
- reducing the cost-of-living increases,
- and changing the initial benefit formula.

CONCLUSION

Social Security's long-range deficit could be eliminated by the enactment of one or more of the proposals described above. Putting a solution into place now, rather than later, would restore the public's confidence in the program and provide time for individuals planning their retirement to accommodate the changes.

The American Academy of Actuaries Committee on Social Insurance believes that the warning provided by the tests of long-range actuarial balance is strong enough that Congress should act now to bring the Social Security program back into long-range balance. This would allow changes to be phased-in and give workers time to adjust their personal savings to maintain a desired standard of living in retirement. Delay will limit the options for change and require that such changes be made with less notice, causing economic dislocations and resentment, and making the benefits less predictable.

STATEMENT OF THE NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

(SUBMITTED BY MARTHA MCSTEEN, PRESIDENT)

Mr. Chairman and members of the Committee. On behalf of the members and supporters of the National Committee to Preserve Social Security and Medicare, we want to thank you for scheduling this hearing. We appreciate an opportunity to affirm our faith in the Social Security system and our confidence that reasonable and modest changes can assure the long term solvency of Social Security.

In our testimony, we wish to make the following points.

- Social Security is the foundation of retirement income on which other retirement instruments are to be built. Half of the U.S. work force has no other work-related retirement income protection and that situation is not expected to improve. For this reason, if no other, the future of Social Security and the changes which will best enhance and preserve this essential program into the next century deserve calm and reasoned debate before major changes are made.
- Social Security is not responsible for any part of the national debt or interest on that debt. The debt and deficit are caused by general revenue spending in excess of general revenue receipts. Social Security is running a surplus which partially masks the extent of the Federal deficit. The greatest threat to Social Security is not its long-range financing needs, but those who insist on using Social Security payroll taxes to finance deficit spending and deficit reduction. If Congress' only response to budget-driven pressures is benefit cuts, current deficiencies will be worsened, leaving an even greater percentage of seniors in poverty.
- Restoring long-term solvency is essential, but it is not so urgent that the Congress should let itself be pressured into premature action. There is time to address Social Security's needs. It is not procrastination to go slowly and carefully. Major changes should await the findings and recommendations of the Social Security Advisory Council.
- Alternative investments which offer the promise of higher real rates of return on a portion of the trust fund receipts could be a viable option. However, alternative investments can be accomplished without establishing privatized accounts which would entail increased administrative costs and would distort Social Security's adequacy and equity balance.
- Measured changes in the retirement age, benefit computation formula and payroll tax rates could be part of a final proposal after a thorough review. The proposal must be balanced, provide needed improvements where appropriate, not create or exacerbate inequities, avoid worsening poverty rates and not rely solely on benefit reductions. National Committee members will support a balanced proposal which protects Social Security for their children and grandchildren.

SOCIAL SECURITY FINANCING AND THE FEDERAL DEFICIT

The National Committee is not opposed to revisions in Social Security necessary to secure its long-term stability, but we are strongly opposed to consideration of reforms in the context of balancing the budget. Unfortunately, Social Security financing and the federal deficit are intertwined since Social Security continues to be used to mask the size of the deficit.

Although we have succeeded statutorily in removing Social Security from the budget and from federal deficit calculations, this victory is pyrrhic given continued focus by policy makers and the press on the "consolidated" budget. Given the overall deficit, Social Security "savings" are illusory. In effect, regressive payroll taxes rather than progressive income taxes are being used to finance the deficit. This is why the National Committee advocates returning Social Security financing to "pay-as-you-go" and collecting only what is necessary in Social Security payroll taxes to provide current benefits and allow a contingency reserve. National Committee members are concerned that some proposals to cut benefits, allegedly to improve Social Security's long-term financing, will be given undue weight because they will increase the reserve in the short-term, which will be used to further mask the deficit.

Given the avalanche of complaints about Social Security spending, few people realize that Social Security is a creditor, not a debtor. The "net interest" category of the budget counts only interest paid to the public and completely ignores interest owed to government trust funds like Social Security. Debt held by government accounts is treated as if it was second class debt.

It seems that the only way to take Social Security off-budget is for Social Security to find alternative investments for a portion of the trust funds. While there are concerns about managing alternative investments, we believe alternative investments deserve further study.

When the trust fund was small, a higher return would not make much difference in Social Security financing. Given projected reserves, investment policy can make a material difference in financing Social Security. For example, an 0.5 percent increase in the real interest rate earned could mean a reduction of the OASDI payroll tax rate from 6.2 percent to 6.05 percent without affecting long-term Social Security financing.

AVOID OVERREACTION IN LOOKING TO THE FUTURE

Efforts of the Concord Coalition and other like-minded organizations together with the report of the Entitlement and Tax Reform Commission have raised unwarranted public apprehension over the future of Social Security. There are legitimate issues to consider and they must be addressed in a timely and responsible manner. In the process, however, it is important not to give credence to distortions and exaggerations by a legislative response that is too hasty or that relies solely on unnecessary, unfair or excessive benefit reductions and/or means testing.

Social Security's future needs are not unanticipated. Congress understood in 1983 that as the baby-boom aged, the long-term balance would have to be revisited. Although the long-range outlook worsened recently, it must be recognized that a program as large as Social Security will need periodic fine tuning and that the long-range outlook can improve just as quickly as it worsened. Cutting or capping cost-of-living adjustments or taxing a greater share of Social Security benefits of current taxpayers has more to do with the general revenue deficit than it has with protecting Social Security's long-range actuarial balance.

Social Security was not intended to be a sole source of retirement income. Pensions and savings were to be the other two legs of the proverbial three-legged retirement income stool. For far too many workers, pensions have been non-existent and the lower the worker's average lifetime earnings, the less likely he or she is to have sufficient savings to provide a meaningful retirement. Up to now, Social Security has been the one leg on which retirees could count.

The public hearings and meetings of Social Security Advisory Council have been helpful in focusing public debate with regard to Social Security's present and future needs. The Council's final recommendations should be equally helpful to Members of Congress who have the responsibility for analyzing those recommendations and formulating public policy.

NEED FOR A BALANCED BILL

Public attention has been focused on a perceived need to cut benefits, but benefit improvements also are required.

One step that can be taken to protect and enhance the Disability Insurance trust fund is to provide sufficient administrative appropriations to permit continuing disability reviews so that persons no longer disabled will be removed from the benefit rolls. But that is only part of the task. This nation must not accept unchallenged the increase which has occurred in the incidence of disability. The causes of disability must be attacked from both public health and work place safety standpoints. Rehabilitation and job placement must facilitate a return to the work force for those who are able to return. If these avenues are vigorously pursued, financing insurance benefits for those who are unable to work will not be as costly.

There is no reason to means test benefits so as to reduce, year after year, the purchasing power of retirement benefits. Before Social Security retirement benefits are cut or the retirement age raised, attention should be given to the twin forces of stagnant wages and premature departure from the work force which are reducing Old Age, Survivor, and Disability Insurance receipts. The national interest and trust fund receipts might be better served by increased attention to the need for job training and retraining and other proposals which lay the groundwork for long-term growth in productivity.

REACTIONS TO PROPOSED CHANGES

Preservation of Social Security for current and future generations is a primary purpose of our organization. We are concerned about long-range solency, but cannot support quick fixes which are more designed to offset general revenue deficits than to assure a foundation of retirement income.

We could support some elements of S. 825 as part of a balanced bill to assure Social Security's long-term stability-for example, letting the retirement age rise sightly faster than current law provides; we would oppose unwarranted immediate reductions such as a reduced or capped COLA. Our detailed comments follow.

PRIVATIZATION OF SOCIAL SECURITY

The National Committee disputes whether a privatized retirement or partially privatized system, as included in your legislation, can duplicate Social Security's protection. Social Security protection includes:

- Disability insurance throughout a worker's career. Currently insurance companies do sell disability insurance, but individuals with a prior history of medical problems or who work in industries with a high rate of injury frequently find it prohibitively expensive or impossible to obtain coverage.
- Dependent and survivor insurance protection for a worker with dependents. Some conservatives in fact embrace Social Security because it values families. Jack Kemp has said that privatizing Social Security "would hit families with children the hardest." Workers with families do not pay more than others for the added protection for dependents and survivors. According to the Social Security Administration, survivors' protection under the Social Security program is worth more than the value of all private insurance combined in the United States—$12.1 trillion for Social Security in 1993 versus $10.8 trillion value of all private life insurance in force at that time.[1]
- COLAs which are not available in the private sector. Whatever the level of initial benefits, it makes sense to maintain their purchasing value. Eliminating COLAs or reducing them below the change in the Consumer Price Index would exacerbate the problem of income declining with age.
- Protection for low income workers. High income workers subsidize higher benefits for low income workers who cannot save and don't have pensions. Privatization would undermine progressivity and likely require expanded safety net programs financed by general taxes. The progressive benefit structure does the same thing as a means test without the stigma of welfare.

Another concern is that partial privatization may increase the tax burden on current workers to pay extra taxes to keep the commitments to current retirees and those close to retirement age while funding a privatized account. The plan you propose, Mr. Chairman, would reduce the Social Security trust fund revenue because a portion of the Social Security payroll tax would be earmarked to individual accounts. Because part of the payroll tax would be diverted, Social Security primary benefit amounts would decline, meaning lower benefits to disabled workers, dependents and survivors.

PROTECTING SOCIAL SECURITY TRUST FUNDS

The National Committee is very sympathetic to measures which would segregate the Social Security surplus from government finances, but supports other ways to take Social Security out of the budget, besides privatization.

Rather than give the federal government easy access to borrow money from the Social Security trust to finance the deficit, the National Committee has argued that Social Security should return to a pay-as-you-go system. Currently, trust fund

[1] *Social Security Courier* (June 1995), p. 4.

money is not "saved" for the baby boomers as some would have us believe. The money is borrowed and must be redeemed with interest by the next generation of taxpayers. As long as trust fund reserves are invested in government securities, there will be doubts about the willingness of taxpayers to pay a second time to redeem those bonds when needed to supplement payroll tax revenue.

An alternative, however, would be to invest some of the Social Security reserves in the private sector. The first advantage of this would be to truly separate Social Security financing from government financing. This would increase the security of Social Security's investments. The second advantage would be increased investment earnings which would improve Social Security's long-term financing. Mechanisms such as competing investment managers or an indexed fund would have to be devised to prevent the politicization of Social Security investments. Alternative investment does not require individual privatized accounts, but in any event, the investment obligation should remain with the Social Security Administration, not be transferred to the individual. Individual workers should not be exposed to investment risk for the cornerstone of their retirement income.

COLAS ONE-HALF PERCENT BELOW THE ANNUAL CPI-W RISE

The accuracy and integrity of the Consumer Price Index is an issue much too serious to be politicized, yet that is what is happening. It has been suggested that substantial budget savings could be achieved if only the Congress recognized and eliminated a purported upward bias of as much as a half to 1.5 percent per year in the Consumer Price Index. If public confidence in the integrity of the CPI is undermined, future Social Security COLAs could be diminished while Federal income taxes could be allowed to rise. And over the next five years $50 to $150 billion additional in Social Security trust funds would be available to help mask the Federal general revenue budget deficit.

The problem with this scenerio is that seniors keep telling us their checks aren't keeping up with inflation-that COLAs don't compensate for the price increases of the prior year. Over the 11 year period from December 1982 through December 1993, the BLS found the experimental index increased 53.8 percent while the CPI-W which is used to calculate annual COLAs increased by 46.2 percent.[2]

The Congressional Budget Office, analyzing the difference over the same eleven years reported that the experimental elderly index rose an average of 4 percent per year while the CPI-W rose only an average of 3.5 percent.[3] Had the senior index rather than the CPI-W been used to adjust Social Security benefits from 1983 through 1994, cumulative benefits to the average worker retiring in December 1982 would have been $2,249 higher. Applying the same half percent variation to the 2.6 percent December 1994 COLA, 1995 benefits to the average worker retiring in December 1982 would be $709 if they had been increased using the experimental elderly index. Based on the smaller rise in the CPI-W, benefits actually are $670 per month.

Conversely, had annual COLAs been cut a half percent, as is proposed in your legislation Mr. Chairman, a worker who retired in December 1982 would have received $ 1,893 less over the past 12 years and today's monthly benefit check would be $632. Average annual Social Security income would be $7584, only $114 above the 1995 poverty guideline of $7470.

LIMITING COLAS TO THE 30TH PERCENTILE OF BENEFITS

The National Committee is adamantly opposed to the means testing provision in S. 825 which would cap cost-of-living adjustments to an amount equal to the COLA due a beneficiary at the 30th percentile of benefits. If the Members of this Congress wish to insure that a majority of hard working seniors gradually sink towards poverty as they advance in age, capping cost-of-living adjustments is a very useful tool.

By design, Social Security benefits are a balance of equity and adequacy. While high earners receive higher benefits, the computation method provides a proportionately higher level of benefits to low-wage workers than average wage workers who, in turn, receive a proportionately higher benefit than high-wage workers. In fact, the 1979 Social Security Advisory Council noted that, under the current formula, lifetime high income earners would not receive an equitable rate of return on additional taxes paid.

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[2] Nathan Amble and Ken Stewart, "Experimental Price Index for Elderly Consumers," *Monthly Labor Review* (May 1994) p. 16.

[3] Is the growth of the CPI a biased measure of changes in the cost of living? *CBO Pabers,* (October 1994), p. 25.

Means testing, such as the proposed flat rate COLA in S. 825, would compress benefits, further reducing the equity and adequacy balance. With flat rate COLAs, over time, average and upper-income retiree replacement rates would fall below the percentage of pre-retirement income that current law intended. Proponents of these proposals also must believe that retirees with high benefits have other sources of income. While this frequently is the case, it is not universal, especially for older widows.

RAISING THE RETIREMENT AGE TO 70

The Social Security Amendments of 1983 increased normal retirement age from 65 to 67 in two steps beginning with persons born after 1938. If long-term solvency requires it, accelerating the second step is not unreasonable. In view of the increase in life expectancy from age 65, a future rise in the normal retirement age to 68 also may be warranted. But a rise to age 70 by 2028 may be too precipitous. This is an area where Congress has both the time and the responsibility to go slowly and carefully.

Heavy investment in health research and an improved business climate can make later retirement a feasible option. Individuals entering the work force today may be eager to work longer if they are not impaired by the chronic ailments from which many of today's elderly suffer and are not impeded by business practices that push them out the door rather than provide part time or flexible options.

Your legislation, Mr. Chairman, increases both the normal retirement age and the age at which early retirement benefits can begin. While we think an increase in the normal retirement age is reasonable, raising the earliest age of retirement creates problems for which solutions have not yet been devised. Individuals who find it difficult to find employment would have to wait additional years before Social Security could begin. On the other hand, if the normal retirement age rises significantly and individuals continue to retire early, steeper benefit reductions for early retirement could mean more seniors requiring Supplemental Security Income to buttress inadequate retirement income. The problem would be most severe for workers physically unable to continue working.

Former Congressman J. J. Pickle, in testifying several months ago before the Social Security Advisory Council also supported raising the normal retirement age to 70, but recognized that this would lead to a rapid increase in the number of older workers applying for disability insurance benefits. Mr. Pickle's recommendation to offset the added cost to the Disability Insurance program was to limit disability benefits to an age 65 benefit as the normal retirement age rose.

Mr. Chairman, financially penalizing disabled individuals for the misfortune of becoming disabled to keep others from filing for disability benefits is not a solution to pushing the retirement age beyond the physical capability of workers unable to continue working to a higher age.

Fifty-seven percent of current retirees begin benefits before age 65. Many of these workers have already been out of the work force for two or more years before applying for reduced, early retirement benefits. Not all of the departures were voluntary. Some of these workers were forced out by disability, others by corporate policy and still others by technological changes which made their skills obsolete. Others left early voluntarily, many after having spent a lifetime in physically demanding jobs.

A review of the earnings records of workers retiring early from physically demanding jobs might reveal that many of these workers have already been on the job up to 45 years. Other workers retiring at later ages may well work fewer years before retirement, yet not face actuarial reductions when they do retire. A longevity factor in the computation of benefits could be an appropriate counter-balance to lower benefits for retirees who continue to elect early retirement in spite of increases in the normal retirement age.

The 1983 Social Security Amendments required the Secretary of Health and Human Services to study the implications of increasing the retirement age for older workers in physically demanding occupations or ill health. The 1986 report, in summation, found:

> it appears that there will be some decline-but not a dramatic decline-relative to today in the proportion of retirement age workers who could find it difficult to extend their work lives a year or two in response to the increase in the age at which full Social Security retired-worker benefits are payable. If workers do not delay retirement and if there are not offsetting increases in other income sources, it appears that the average reduction in total income at retirement for workers in physically demanding jobs and/or ill health will be on the order of 6-7 percent when the new retirement age is fully phased in in 2027.

The significance of the anticipated income reduction is important in that the study found these retirees "tended to have median income equal to about three-fourths that of other new retirees . . . (and) Relied on Social Security for just more than half their total income on average . . . ."

The report did not offer recommendations for legislative changes because it would be many years before the provision became fully effective during which time more could be learned about the work ability of older persons, especially those in physically demanding jobs or ill health. If the increase in the normal retirement age is to be accelerated or advanced further, Congress has a responsibility to revisit the impact of reduced benefits on workers for whom continuing in the work force is physically burdensome if not life-threatening.

REDUCED SPOUSE BENEFITS

We are concerned about S. 825's provision gradually reducing spouse benefits to one-third of the wage earner's primary insurance amount, particularly because there is no provision for an offsetting benefit improvement for separated and divorced spouses. Recent research has disclosed that separated and divorced women are among the most impoverished of all the elderly living in poverty.

The entire area of benefits to couples-one-earner, two-earner, divorced spouses and surviving spouses-has been debated for years. Other than the recommendation for reduced spouse benefits, these problems are not addressed in your legislation. These issues must be addressed and resolved in a manner that is accepted as equitable by married and unmarried workers.

We raise the one earner/two earner issue because in addition to the problem of separated and divorced spouses, there is the equally significant problem of more adequately providing for survivors. One recommendation which has been advanced is to reduce primary insurance amounts for all workers to finance higher benefits to surviving spouses. An alternative recommendation is to permit couples to voluntarily accept a reduction in spouse benefits or combined benefits as a means of financing increased survivor benefits. Before spouse benefits are reduced and the savings used for other purposes, perhaps the debate should be broadened to include how improved survivor benefits can best be financed.

SOCIAL SECURITY COVERAGE OF STATE AND LOCAL EMPLOYEES

As advocates of universal Social Security coverage, we support mandating coverage of all newly hired state and local employees and are pleased that your legislation includes this proposal. Requiring future State and local hires to come under Social Security is frequently viewed as a way to raise revenue, especially in the short-run, but it is equally important for insuring adequate retirement income protection for everyone. Many state and local pension plans offer inadequate retirement protection, especially to low wage or part-time employees.

Concurrent with this proposal to ultimately assure universal Social Security coverage, it would be timely to review current Windfall Elimination, Government Pension Offset and disability provisions to ameliorate excessive reductions to persons eligible for both Social Security and an annuity from non-covered employment.

REVISED BENEFIT COMPUTATION

Social Security benefit computation methods have changed many times since 1935 and will change again in the future in keeping with income, productivity and economic forecasts. A balanced Social Security bill may call for smaller initial benefits to persons becoming eligible to retire early in the next century, but it does not seem necessary to establish in law revised computation formulas for workers reaching retirement age 50 to 60 years in the future. Long-term reduction in benefits to high-income earners, as in S. 825 for example, would threaten support for Social Security on the part of young persons entering the work force.

INCREASED FICA TAX RATES

The 1983 amendments balanced Social Security financing over 75 years but made no provision for future years. A majority of the public believed that Social Security's financing had been resolved into perpetuity. The public was not made aware that future increases were to be expected.

With regard to OASDI tax rates, the National Committee continues to support a pay-as-you-go system with a contingency reserve and an automatic tax rate trigger-mechanism to insure that trust funds maintain a safe level. A comprehensive bill should project short-term FICA tax rate increases, but it is unnecessary for current legislation to set rates for the second half of the next century. That is a responsibility best reserved for legislators serving in the second quarter of the next century who will have the benefit of more up to date economic forecasts.

CONCLUSION

We trust that Congress will proceed with care and caution. It is essential that we maintain this great, intergenerational, social insurance program. Millions of Americans depend upon it as a financial base for retirement, disability, and survivor benefits and these millions want the system sound for the millions who will follow.

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