S. Hrg. 104–883

SOCIAL SECURITY AND FUTURE RETIREES

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

MARCH 11, 1996

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

45–869—CC WASHINGTON : 1997

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-056297-X

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SOCIAL SECURITY AND FUTURE RETIREES

MONDAY, MARCH 11, 1996

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

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

Also present: Senator Nickles, Moynihan, and Breaux.

OPENING STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING, CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY

Senator SIMPSON. Well, good morning. I am pleased to convene this hearing of the Subcommittee on Social Security and Family Policy. It is nice also to greet Senator Daniel Patrick Moynihan of New York, who has been involved in this issue for many, many years in a most remarkable fashion, a lucid and articulate fashion, as is his wont, and who has assisted us in bringing this system this far since 1983.

Now we have so much to do, and we will try to focus on the future of the Social Security retirement program. The emphasis is on that word, future, the real future, because we are promising to millions of Americans that this program will have a future. We are here to examine just what kind of future that will actually be.

People are talking about this issue as never before. The Social Security program thus far has been, of course, an immense boon to current and past retirees. Small wonder that for years it has been touted as our Nation's most popular social program.

Why should it not be popular? The average worker who retired in 1960 got back a lifetime of Social Security contributions, plus interest, in less than 1 year. In the 1980's, retired individuals continued to get a real bargain on their investment in the Social Security program, recovering their contributions, plus interest, in 2 years.

Today, retirees can expect to recover their entire investment, plus interest, in about 8 years. Still a pretty fair bargain when you consider that the average mortality date for these new retirees is at least 10 years away.

Social Security has played a vital role in keeping the poverty level among senior citizens at the lowest rate in our history. I do understand those things. However, increases in life expectancy, an exploding number of beneficiaries, and decreasing fertility rates are quickly adding up to a sizable threat to the Social Security system.

As chairman of the Subcommittee on Social Security and Family Policy, I cannot stand idly by, nor can the Congress, and see this Nation default on its future pledges to current workers from whom it is presently asking so much in the way of current payroll taxes. I hope people are seeing what is occurring here.

Last year, the Social Security trustees—one of which is a witness today, Shirley Chater, the Commissioner, and I am very pleased to have her here and will greet her appropriately in a moment—served notice that the Social Security trust fund will be broke by the year 2029.

However, the real crash date for the trust funds will come much sooner. In the year 2015, just 19 years away, the cost of the program will exceed the taxes we are all paying into the program. That is when we will have to make the terribly tough and even ugly choices.

At that point, we will have to dip into the interest of the wholly fictional trust fund surplus, and by 2019 we will have to dip into the actual principal of the wholly fictional trust fund surplus in order to pay beneficiaries. That is a pretty tough thing to do, especially if it is not there.

We all know that everything is rosy now, and we will hear a lot about that. I am not talking about the rosy now, I am talking about the days to come. The problem is, we all know or should well know that there is actually no trust fund. I hope Americans can finally grasp that.

The trust fund is an accounting mechanism that merely transfers money from one generation to the next. It is a bookkeeping entry, a pile of IOUs. Everyone must know that. If we cannot get that to our craw, we will not make much progress.

We cannot put this money into a box to be parceled out at some distant future date. No, no. Future benefits will come from taxes paid by future workers, just as today's benefits are paid by today's workers and not by past contributions.

In 2015, where will the Government get the money to pay the benefit checks? Our choices are limited. Cut benefits, cut other spending, raise the payroll tax, raise other taxes, or borrow money from other financial markets.

In addition to shouldering the cost of the pending insolvency of the trust fund, today's workers will witness a dramatic decline in the money's worth of their investment, their benefits, even if those benefits are delivered in full.

For the average worker retiring in 2025, that is someone who is currently now about 36 years old, it will take 12.8 years to recover just the employee portion of the Social Security tax, plus interest.

Those figures reflect the huge payroll tax burden which has been placed on younger generations today. Today, retirees often have little or no conception whatever of how much more today young workers are forced to pay into the system than they, the elder, were ever required to do.

I dare say that many of today's retirees would have had a lot more trouble "putting away" for their own retirement had their own payroll taxes been 15 percent instead of the 2 percent that they put in, as it was for so long.

Figures are particularly distressing for today's worker who has earned the maximum level of earnings under the Social Security system. Disregarding any effect of taxation of benefits, it would take this worker 20.9 years to recover his or her investment in the system, plus interest.

This is longer than the projected life expectancy after attainment of age 65. If that same worker were faced with the maximum taxation of those benefits, the recovery period would be 37.1 years, almost twice the forecast life expectancy for persons after attainment of age 65.

So this individual is promised then only a negative return on his or her investment, at the best. So we are confronted then with two issues which are of great and serious concern for today's young workers. No. 1, how to pay for the benefits of the baby boomers; every 7.5 seconds since January 1, one of them turns 50. No. 2, how to pay for the benefits of the baby boomers with a trust fund that does not exist, the trust fund without the trust. And, No. 3, the inherent unfairness of a system that does not allow for a positive rate of return for everyone.

Is it any wonder why only 40 percent of workers today under the age of 55 have any confidence at all in the Social Security system? We have all heard of the public opinion polls that express a greater belief in the existence of flying saucers than the belief that today's young workers will ever see a payment from the Social Security system. These worries are hardly misplaced. These interviewed persons know well that the numbers simply do not add up. So, here we go.

All of our witnesses today have been asked to come here for a particular reason. First, we will have the Social Security Commissioner, Shirley Chater, here to explain the current status of the Social Security system and to help elucidate for us as to just how the Social Security Agency plans to cope with the challenges I have described.

I find Ms. Chater able and accessible, but I express an earnest, earnest entreaty that she would be more forthcoming with us since we have given her and her office totally independent status, free and clear of the influence of the executive department and the Congress. This is a rather vexing situation, in my mind.

Then we will have a panel representing views held by various people, all under the age of 50, to tell us, what are their expectations as future retirees, whether or not Social Security is a "good investment" for them, and what steps they feel we need to take to ensure the future well-being of the Social Security system.

More importantly, these are today's workers, who are tomorrow's seniors. All of them are under 50. I personally have heard time and time again from those over 60 and over 65. I want to hear from those who are paying the bills for those over 65.

Clearly, we need to keep the promises. That is what everyone talks about in this particular program. Keep the promises that have been made to current beneficiaries and to those who will be retiring in the near future. Please hear that.

This is about keeping promises. No one is going to suggest reneging on any benefits currently in the pipeline for today's retirees. I know that that will be good copy, but no one is suggesting that.

Yet it is our duty to look at the future of the Social Security system and the overall fairness of that system for everyone, all Americans, payors and payees. While we may not all, indeed, agree on the specific actions that will simply have to be taken to fix Social Security's problems, we need to begin addressing those issues now, immediately. The longer we wait to take corrective action, the greater the crisis will become and the greater the cost for today's workers and tomorrow's beneficiaries.

So I felt it very important to have this hearing to focus on the situation confronting today's young people. To you young people out in this vast land, I say you need to emulate our fine witnesses here and get in the game.

Social Security is supposed to be there for you, remember? It is supposed to be there for you. If you do not get involved, you will get only what you deserve, which is nothing. Take part or get taken apart.

We have a number of able witnesses to hear from today. I want to recognize Senator John Breaux of Louisiana, who is a delightful companion in this venture. I do not try to drag him too deeply into it. I find that these hearings often are like being in a bowling alley at 3 a.m.; there are very few in there. But he comes, and I admire his courage, because it is a political hot potato. We know that.

But I have worked with John Breaux in my entire time here when he came here, and I have great admiration for him and his work. He works very hard to seek bipartisan consensus. This is not a partisan issue. I can tell you, there is not one shred of partisanship in what I am doing here. Those of you who know me, I think, know that. But John works toward the bipartisan approach on health care, Medicaid, and Medicare and we thank him for his efforts there, with Senator John Chafee. It is nice to have him here. I appreciate your support.

OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator BREAUX. Well, thank you, Mr. Chairman. I want to recognize our Ranking Member of the full committee, but I will be very, very brief. Thank you for your comments.

I think you have said it very well. I congratulate you and I applaud you for having these hearings. Forty-three million Americans benefit from the Social Security, 30 million plus are on pensions. For many, that's the only retirement they have.

Yet constantly we see headlines in the papers about the threat to the system, and can retirees' safety net be saved, the *New York Times* article, proposals from many of the candidates about privatizing Social Security and getting the Government out of the business of providing a Social Security safety net for the millions of Americans who depend on it.

So I think there is a great deal of unrest and uncertainty in the American public's mind as to the future of Social Security and what truly needs to be done in order to make sure that this system of protection and security is available and that it is being run properly so that future generations can depend on it.

There are a number of suggestions, everything from tinkering around the edges to changing the way we determine how much of an increase should be given, things that Senator Moynihan has talked about, from the Consumer Price Index aspect of increases and entitlement programs, all the way to investing Social Security proceeds in the stock market on Wall Street, to completely privatizing the system and getting the Government out of it completely.

So, I think there is a lot on our plate, Mr. Chairman, that we can look at. I look forward to our witnesses. This is not the end of the process, this is the beginning of the process. We want to make sure that, when we have the time, we do it right. I look forward to the rest of the hearings.

Thank you.

Senator SIMPSON. Thank you, Senator Breaux.

I would like to have Senator Moynihan respond in any way.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. I would like to join my colleague in thanking you, Mr. Chairman, for having taken on this issue so well and ably with Senator Kerrey in the last Congress.

I would like to note that we did establish the Social Security Administration as an independent agency of Government for the purpose of hearing from the leadership there what it thinks, what Harry Ballantyne thinks—we welcome you, sir—quite independently of what the Office of Management and Budget might say. This has not been the case.

In 1977, we put the Social Security trust funds on a partially funded basis. We created a surplus which, over 30 years, would buy the New York Stock Exchange. Every penny has gone to current consumption expenditures by the Government, apart from that which paid for benefits. That whole surplus has been squandered, on a perfectly bipartisan basis, may I say.

One small point, Mr. Chairman. The OASDI funds are exhausted in the year 2013. You can reach out and touch it. In 16 years' time, we will be having to pay out more than we bring in, and you will have a real crisis on your hands.

This has led to two approaches to the problem. One approach proposed here in this committee was that we address a fundamental problem, as some of us think of it, which is that the Consumer Price Index overstates the increase in the cost of living.

I will not forget the moment when our commission reported to us on an interim basis last September. They said that CPI minus one would be a "best estimate" and conservative adjustment. Senator Dole stood right there and said, fine, we can do that if all join hands.

That was a moment in history, and I have a feeling it was lost. Senator Breaux just said it has passed. If it has passed, it is a disgrace to this generation. It is something we could have agreed to and instantly all of these problems would take on a very different quality. But, they have not.

In the meantime, we are about to get a report from the Quadrennial Advisory Council on Social Security which, for the first time ever, will talk about privatizing funds. Never before has this been mentioned. Then the Social Security trustees will report in May or early June. So, we are going to have a lot more of this. This is just the first of your hearings this year, sir, and I look forward to them.

Senator SIMPSON. Well, Pat, I look forward to having you participate because you are the mentor and certainly the one we should heed and listen to. I do share your distress that the CPI, which at one point we thought would be like falling off a log, has now been beautifully distorted as to what it will do. The distortion will come to roost 20 years from now. Was the figure not that, if we did minus one, in 10 years it would be $635 billion?

Senator MOYNIHAN. Yes, sir, $634 billion in 10 years. In 12 years CPI minus one would reduce the increase in the debt by $1 trillion. It takes the exhaustion date of the Social Security funds from the year 2030 to 2049. But it takes a certain amount of intestinal fortitude.

Senator SIMPSON. Well, we have that. I mean, we. I mean, that is what I keep saying, but I look around. Well, anyway. We shall proceed. We shall struggle forward into the swamps.

Now I want to greet Hon. Shirley Chater, commissioner of Social Security here in Washington; accompanied by Harry Ballantyne, the chief actuary, who is always very forthcoming to the members of the committee, regardless of majority or minority status, and we thank you.

Please, Ms. Chater.

STATEMENT OF HON. SHIRLEY S. CHATER, COMMISSIONER OF SOCIAL SECURITY, WASHINGTON, DC; ACCOMPANIED BY HARRY C. BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION

Commissioner CHATER. Thank you very much, Mr. Chairman. Let me start by saying that, of course, I would like to submit for the record my full written testimony, which answers the questions that you posed in your letter of invitation.

But I would like to talk with you very briefly today about the value of the Social Security program to all of the citizens of this country. As you know, Social Security makes a profound difference in people's lives, most particularly in protecting people from poverty.

Only one in eight elderly people are living below the poverty line today compared with one in three in 1959, and about 42 percent of beneficiaries age 65 and over are kept out of poverty by virtue of their monthly Social Security benefit.

I emphasize that this is a social insurance program. It spreads the cost of protection against the risk of lost income, due not only to retirement but to death or disability, over the entire population. So, it protects people of all generations.

As a result, many young families are today receiving value from Social Security decades before they will ever receive a retirement benefit check. The security provided by Social Security is, therefore, inter-generational.

We must not overlook the critically important protection provided by disability and survivor insurance. Over 30 percent of our Nation's Social Security beneficiaries are receiving disability and survivors' benefits, and those programs make up over 30 percent of the benefits that Social Security pays.

For example, and this is a point that I stress when I speak with some of the young people across the country, few people are aware that almost one-third of today's 20-year-old men, and almost one-fourth of today's 20-year-old women, will become disabled before reaching retirement.

The Social Security disability program provides the same value as a $203,000 disability insurance policy for an average worker with a spouse and two children. Last year, Social Security paid about $41 billion in benefits to almost six million disabled workers and family members.

Along these same lines, most of us do not realize that one in five of today's 20-year-old men and one in eight 20-year-old women will die before retirement. Survivors' benefits for an average worker are equal to a $295,000 life insurance policy. Social Security paid about $67 billion in survivors' benefits last year to more than seven million people.

So let me reiterate, the Social Security program is not just retirement benefits, it is protection against lost income as a result of disability, and it is survivors' protection for dependents of workers who die. Therefore, we cannot analyze Social Security's value to young workers strictly by projecting retirement benefits and return on investment.

Though I believe we cannot properly assess Social Security's value by looking exclusively at the relationship between benefits and contributions, you have asked about that relationship and, of course, I will discuss it.

But I want to preface this discussion by pointing out that Social Security has historically maintained a balance between the complementary goals of, first, individual equity, that is, providing benefit protection which is related to an individual's contribution, and social adequacy, which benefits society by alleviating poverty and allowing as many citizens as possible to enjoy a reasonable standard of living.

To achieve this social adequacy goal, for example, low-income workers receive a higher rate of return on their Social Security contribution than high-wage workers.

We know that past generations have benefited greatly from the program, and, until Social Security matured, benefits tended to be generous relative to contributions so that the program could offer adequate protection to as many workers as possible. Many of those workers did not have the opportunity to contribute to it for their entire lives.

We could look at a number of examples, some of which you already reiterated, but I will pass over that in the interest of time. But I do want to give you an example that brings us to the youngest working generation.

Senator SIMPSON. Ms. Chater, you may take a few more minutes there. When the light goes on, take 2 or 3 more minutes.

Commissioner CHATER. Thank you. I would like to.

Then let me give you some of these examples that we have calculated for three different age groups. If, for example, we look at someone who will become a beneficiary this year, a person with average wages who retires at age 65 this year will have paid $21,518 in the employees' share of the Old Age and Survivors Insurance contributions.

When the interest is factored in, the value of these contributions is $73,703. The worker will receive a monthly benefit of $890 and will recover full value of contributions, plus interest, in 8⅓ years. This worker can be expected to live nearly 10 more years past the break-even point.

Now, if we look at an average worker from the baby boom generation who retires in the year 2015 at the age of 66, or one who is born in 1949, the return, while less generous, will still be fair.

This worker will pay an estimated $59,000 in the employees' share of Social Security, or $258,000 when interest is factored in. He or she will receive an estimated $2,074 in monthly benefits—that is about $1,006 in today's dollars—and will recover those benefits in about 12 years, living another 6 years beyond the break-even point.

That brings us to the youngest working generation. If we look at an average worker born in 1968 who will retire in 2035 at age 67, he or she will receive a monthly benefit estimated to be almost $1,215 in today's dollars and it will take 10 years to recover the employees' share of payroll contributions, with an expected life span thereafter of 8 years.

Now, obviously we have to qualify these last figures because, as we all know, changes in the Social Security program will be required in order to ensure that the program has sufficient financing to pay the younger worker benefits.

Let me summarize for you by just making three points here. First of all, back to the money's worth issue. My first point is that we have a program today that can best be measured not by a strict rate of return analysis, but by the way it protects people of all ages, the way it allows the elderly, widows, widowers, the disabled, and children who have lost a parent, to live with dignity and independence.

My second point is that by dramatically increasing the extent to which retired and disabled workers, their dependents, and survivors of deceased workers are financially independent, Social Security has relieved younger generations of the burden of providing for the financial needs of older relatives at the very same time that they are raising their families or going to college.

My third point is that because the cost of administering the program is low (less than 1 percent of benefits paid), the public is receiving maximum value for its investment.

Now, I would just like to close with a quote from the March/April issue of the *Consumer's Digest Magazine*, which perhaps, you have seen. It is a well-respected publication which summarizes very insightfully the value of Social Security.

"Making a money's worth calculation is basically irrelevant. Do you get your money's worth from insurance that protects your home, health, and car if nothing catastrophic happens? Well, the same principle applies to Social Security, a social insurance fund that insures you, your family, and everybody else who pays into the system."

Thank you. I would be very happy to answer your questions.

[The prepared statement of Commissioner Chater appears in the appendix.]

Senator SIMPSON. Thank you very much. We will go in rounds of 5 minutes, first to Senator Breaux, then to Senator Moynihan.

In the article you authored, which was January 31 in *The Washington Times,* you argued that the Social Security program is solvent enough to provide benefits, even to those people who expect to retire in 2027. Now, those people would be in their mid-thirties right now.

I believe your article stated that these retirees would receive in excess of $5,000 per month in benefits. You used something called real dollars today, or something to that effect, but it was $5,000 a month, if I recall.

Commissioner CHATER. Yes.

Senator SIMPSON. Now, if we assume no present changes in the program, as you have consistently recommended none, what would those retirees receive who are eligible to collect benefits just 5 years later in the year 2032, and where does the money come from to pay the benefits of those who retire in the year 2027, or even 2017, if expenses exceed contributions in those years?

Commissioner CHATER. Well, as I have indicated before, we are counting on being able to collect the interest from the Social Security trust fund, as well as the principal, when the time comes.

Senator SIMPSON. Collect? I am asking the question, 5 years after this date where everything is just splendid, what happens in the year 2032 if no present changes are made in the system?

Commissioner CHATER. When I gave the example of someone who would retire in the year 2035 just now, I did qualify my statement by saying that changes will have to be made in the program to ensure that the money will be there for them. But in our calculations in the article to which I referred, we are assuming that we could utilize the trust fund interest, as well as the principal, as needed.

Senator SIMPSON. Well, I think that most would concur that we are going to begin to tap the interest in the year 2016.

Senator MOYNIHAN. Mr. Chairman, the interest payment is a transfer from the general fund.

Mr. BALLANTYNE. Senator Simpson.

Senator SIMPSON. I must say, there will not be anything by then to tap. If you can share this with us, please.

Mr. BALLANTYNE. Senator Simpson, perhaps I could help there. You are right, we will begin using interest in 2013 and the funds, the combined trust funds, would be exhausted in 2030. Now, at that point, though, the income to the trust funds would still amount to about 75 percent of the outgo, so the tax income is still coming in.

If nothing was done before that, some benefits could still be paid, but not the amount that is projected under present law. There would, clearly, have to be some changes in the program, as Commissioner Chater said earlier, in order for the benefits to continue to be paid at those rates.

Senator SIMPSON. I guess that is the frustration, to know that you, Commissioner, speak to high school groups through the land and tell them that everything is going to be all right until the year 2027 or 2030, and do not tell them that it is over the cliff after that.

I mean, completely over the cliff; there is nothing out there after that. Forget interest, forget who is paying what in. That is what is out there. We know that.

That is what you, as trustees, have told us in this forum, which everyone in America should read. It is very nicely, crisply written. It shows that the long-term condition of Social Security is total insolvency and bankruptcy.

So why this continual drawing of a scenario to lull people that all is well when it is not even starting to decline after that, it is just broke, flat broke, destroyed.

Commissioner CHATER. Senator Simpson, I just have to respond to that by saying to you that it really troubles me to hear people say that the system is broke. We know that even in 2030, when we will not have enough revenue to pay all of the benefits as we are paying them now, as Mr. Ballantyne just said, we still have enough money coming in through payroll taxes to pay 75 percent of the total benefits required.

I also want to say this. Yes, I do speak to many, many high school students, and college students as well. The purpose of my speeches is not to have them think that all is well. The purpose of my speeches is to talk with them about the need to have a long-term solvency solution for the Social Security program. I feel that, first of all, they have to understand what the facts are, and those facts are exactly what I share with them.

Senator SIMPSON. Well, if I sometimes present some things distressing to you, let me say that it is a two-way street because all you do is talk about the children, and the elderly, and the disabled. Those are good touch points, the usual Washington touch points. But these are the people who are going to be destroyed in the year 2035. These people that we speak of are the ones who will be most deeply affected.

The frustration is that you can go talk to these young people and tell them what is going to happen and then not recommend a single change to them as to what we should do now to assure that there is something there then. That is the true frustration.

Senator Breaux.

Senator BREAUX. Thank you very much, Mr. Chairman. Thank you, Ms. Chater, for your testimony. I just want to put a short statement in the record from Senator Baucus, who in that statement expresses his appreciation for you being out in his home State of Montana recently doing a number of forums to talk about the problem that we are talking about today. He is back in his State of Montana and could not be with us this morning, but wanted to have that as part of the record.

[The prepared statement of Senator Baucus follows:]

PREPARED STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

I would just like to take a moment to express my sincere thanks to Social Security Commissioner Shirley Chater for her recent visit to my home state of Montana. The Commissioner was the featured speaker at several Social Security forums and events last week and I continue to receive great feedback and rave reviews of her visit.

I appreciate the Commissioner taking time out of her official duties administering the Social Security program to come out to the Big Sky state to meet and talk with some of the seniors at the local senior centers. We are all lucky to have such a responsive and distinguished Commissioner of the Social Security system.

Commissioner Chater will always be welcome in Montana any time in the future.

Senator BREAUX. There have been a number of suggestions, and I think the discussion we are having is very good. I mean, I think that it is absolutely critically important for everybody to know in this country that the Congress is not going to allow the Social Security system to disappear, to collapse.

We now are faced with some very, very serious potential problems unless something is done. But that is the challenge that we have, to make sure that we do what is necessary now in order to fix the potential problem. There are a number of ideas that are out there and I would like you to maybe just give me your thoughts about a couple of them.

One that Senator Moynihan has spoken to, I have agreed with, and groups that we have been working with have suggested, is an adjustment in the Consumer Price Index, which many of us feel is overstated. We want to make sure that people who are involved in entitlement programs get what they are entitled to, but not any more or any less.

We had a commission that the Chairman had put together and asked to report. I think their preliminary report indicated an adjustment of the Consumer Price Index somewhere between 0.7 and 2.0 percent was about what was necessary to give an accurate reflection of what is needed in these entitlement programs.

How would that affect the program? If we were to adopt the lowest point of the recommendation, a 0.7 percent adjustment in the CPI, how would that affect the stability of the Social Security program?

Commissioner CHATER. I will call on Mr. Ballantyne to answer that question.

Senator BREAUX. Sure. Mr. Ballantyne.

Mr. BALLANTYNE. Well, if I understand the question, if you reduce the COLA by 0.7 of 1 percent below the measurement of the CPI increase, and if that were the only change and you were to do that forever into the future, I think it would reduce the long-range deficit by 1 percent of taxable payroll, from the current program deficit of 2.17 percent.

Senator BREAUX. What would that mean in terms of the projected years when we would have a shortfall and we would lose the surplus in the trust funds?

Mr. BALLANTYNE. It would extend the exhaustion date by several years into the future. I am not sure exactly what year, but it would be several years.

Senator BREAUX. When you say several years, are you talking a couple of years?

Mr. BALLANTYNE. No, more than a couple.

Senator BREAUX. It really has a compound effect, obviously, just like compounded interest, because it is with us forever. That adjustment would have an effect each year out into the future, would it not?

Mr. BALLANTYNE. That is right, yes.

Senator BREAUX. I guess I would ask someone to try and rate it. I mean, is that a potential partial solution, would it be a significant move in the right direction, or would it be just only a touch on the seriousness of the real problem?

Mr. BALLANTYNE. Well, I don't know that I want to comment on whether it would be a good idea. It would reduce the cost of the program.

Senator BREAUX. I am not asking about that. I am not asking right now for a recommendation on the solution, I am just asking, what effect would that type of an adjustment have; would it have a serious, positive effect in ensuring that the funds would be there, or would it not?

Mr. BALLANTYNE. Oh, yes. It would go a long way toward ensuring the funds would be there. As I said, 1 percent out of the total deficit of 2.17 percent, so it is approaching half of the deficit.

Senator BREAUX. Some have suggested as another alternative that the investments that we have with the Social Security trust fund should be considered to be, perhaps, invested in Wall Street. We have had some suggestions from notable scholars. Robert Ball has talked about this, saying, why should the trust funds earn just one-third as much as common stocks?

How would that type of suggestion, if it was carried out, affect the security of the Social Security system?

Mr. BALLANTYNE. Well, again, it would depend on not only how much was invested in equities but also how high the trust fund gets. So if you did it in combination with some other things that would ensure a higher trust fund, it could, as I think in Mr. Ball's proposal for the Advisory Council, reach a long-range balance.

Senator BREAUX. Give me your thoughts on the advisability of that. I mean, we could take it to Las Vegas and bet it all, we could invest it in Wall Street, we could keep it in the bonds we have now. Give me some of the thoughts about the wisdom of changing the way it is handled right now.

Mr. BALLANTYNE. Well, I think that investing in the stock market is more risky than investing in U.S. Government bonds. But, if you look back at past experience and project from that, as we have for this proposal, then it would increase the return on the investments of the funds significantly. But I think there are a lot of questions to look at.

Senator BREAUX. It is just a risk factor.

Mr. BALLANTYNE. I would think there would be some risk factor, yes.

Senator BREAUX. All right.

Mr. BALLANTYNE. But it may be worth taking, yes.

Senator BREAUX. The idea is not so farfetched that we should not consider it?

Mr. BALLANTYNE. It should be considered, I would think, yes.

Senator BREAUX. Thank you.

Senator SIMPSON. Thank you, Senator Breaux.

Senator Moynihan.

Senator MOYNIHAN. Senator Nickles is here, Mr. Chairman.

Senator SIMPSON. I was going to recognize in order of attendance.

Senator MOYNIHAN. All right. As you wish.

Senator SIMPSON. If you are ready. If not, I will go to Senator Nickles.

Senator MOYNIHAN. I am, indeed.

Senator SIMPSON. All right.

Senator MOYNIHAN. First, to thank the Commissioner and the most eminent actuary in that most eminent succession. I would say if I can, and this is perhaps mostly to you, Mr. Chairman—this is sort of anecdotal, but I hope it helps—I have been saying that anyone who pierces the veil of money rarely returns with their faculties altogether intact. This is a very dangerous thing to do; what is money, what is a trust fund?

But there is a history here, which is that we began in 1935 in the middle of the Depression on a strictly pay-as-you-go basis. Then the Congress got into the bad habit of bidding up Social Security benefits every other year, coinciding with an election year in the Congress.

In 1972, we said we will stop this and we would just index the increase in benefits to the increase in cost of living. Without much attention we said, well, what is the cost of living? Someone said, Consumer Price Index, right? Right. Then that was done.

Now, earlier, I joined the Kennedy administration in 1961. I was an Assistant Secretary of Labor and I had a nominal responsibility for the Bureau of Labor Statistics, by which I mean they would show me the unemployment rate 12 seconds before they showed it to the Secretary and they taught me what they could teach me, and they were tolerant and friendly. At that time, the CPI, which had begun as a war-time measure in World War I, was beginning to be used for many purposes in the economy.

The statisticians at the Bureau of Labor Statistics—which is older than the Department of Labor, and wonderful, the best organization in the world; we have the best statistics in the world—would tell you the Consumer Price Index is not a cost-of-living index, it is different. It tells how prices for a fixed basket goods change. It does not tell you by how much spending changes. Even so, in 1972 we did this. Later, in 1981 we indexed the income taxes, effective in 1985, to the CPI.

So the result is, in the judgment of economists across the country, we pay out more benefits in the way of retirement than we should and we bring in less revenue in the way of taxes than we ought.

The simple index is going to make the whole structure of social insurance instable and make the structure of Federal finances instable. Commissioner, you spoke of the funds as being exhausted in the year 2030, right?

Commissioner CHATER. Yes.

Senator MOYNIHAN. No, they are not. There is no money left in 2013. You can reach out and touch that. After that, in order to pay benefits you have to find additional general revenue, and it is an immense amount. We could correct it. Correcting the CPI, the Consumer Price Index, would make this a manageable problem right now.

In *The Washington Post* yesterday, Robert Cutler called them Super IRAs. He is talking about privatizing Social Security. It is

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right in front of you. Martin Feldstein, in *The Wall Street Journal* on Friday, said, "Time To Privatize Social Security."

May I put these in the record, sir?

Senator SIMPSON. Please. So ordered.

[The articles appear in the appendix.]

Senator MOYNIHAN. We are losing the whole notion of a government-based system because we will not address the simple question of measurement of something called Cost of Living Index.

If we do not have the capacity to do that, well, perhaps we do not have the capacity to carry on these programs. They are in jeopardy. The majority of non-retired adults do not think they will get their Social Security.

It does not help—and, Commissioner, you know how much we respect you—when you say that, for a worker born in 1968 and retires in 2035 at age 67, it will take 10 years to recover the contributions he or she has paid. That does not include the employer contributions, which means you agree, well, then we are not telling each other what we really need to know. It would take 20 years—not 10—or 2 years longer than the 18 years of life expectancy at age 67.

I just want to say, this system is in jeopardy. Not to know it is not to serve it well, and not to say up front it is. You are going to have from Bob Ball a minority report of the Advisory Commission that says, put some of this money in the markets. You are going to have, maybe, a majority report that says, get rid of most of it and everybody will have their own IRA.

Just think about that. If you want to talk about, you know, what portion of the American population deals in stocks and bonds? About 15 percent. How many cowboys in Wyoming have an IRA?

Senator SIMPSON. They read a lot of *Barron's* out there.

Senator MOYNIHAN. They do, I think. All right.

Senator SIMPSON. Per capita, the largest subscription of *Barron's* and *The Wall Street Journal*.

Senator MOYNIHAN. Well, you have more cattle barons, that is why. Sorry about that, Mr. Chairman. Thank you.

Senator SIMPSON. Yes, I will let that pass. Well, I thank you, Senator Moynihan.

Senator Nickles, now, please.

OPENING STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM OKLAHOMA

Senator NICKLES. Mr. Chairman, thank you very much. To our panelists, thank you as well. I really appreciate you having this hearing. I look forward to working with you and Senator Moynihan.

I want to compliment Senator Moynihan for his willingness with you, Senator Simpson, and others of us that feel like we should use an accurate cost-of-living adjustment. I think that is the only responsible thing to do.

Mr. Ballantyne, would you not agree with that as Chief Actuary? If you are going to have an adjustment for the cost of living for seniors, should it not be accurate?

Mr. BALLANTYNE. Oh, certainly I would agree with that. Yes.

Senator NICKLES. If there are savings to be involved, so be it?

Mr. BALLANTYNE. If there are savings, yes. Right.

Senator NICKLES. It is obvious, if these earlier estimates would be proven accurate, that there are significant savings?

Mr. BALLANTYNE. There could be, yes. Right.

Senator NICKLES. So I compliment Senator Simpson and Senator Moynihan for their willingness, and I think Senator Breaux is willing, and a lot of us who are willing to do what is right. I think what is right is using the accurate cost-of-living adjustment, and I hope it helps us reduce the deficit. But we should use an accurate adjustment. To me, it only makes sense.

Let me just ask you a question. I glanced through the report. I did not have a chance to study it.

What is the status of the fund right now? What is the, I want to say the amount of assets, but also the amount of liabilities, the amount of unfunded liabilities?

Mr. BALLANTYNE. Well, currently the assets are about half a trillion dollars, but of course in the long range there are both assets and liabilities, and the liabilities are clearly higher than the assets.

Senator NICKLES. I want a better answer than that. You have some assets, but you have a lot of promises.

Mr. BALLANTYNE. That is right.

Senator NICKLES. I was an actuary—not an actuary, I was a fiduciary and trustee of a private pension plan. Every year, you would have your actuaries give you your unfunded liability and you would have to pay that off over a period of time. What is the present value of the unfunded liability for Social Security?

Mr. BALLANTYNE. On what is called an open-group basis, which means that everybody who will be born in the future pays taxes in the future, and collects benefits, our estimate is that over the next 75 years the liability will be higher than the assets or the income of the program by about $2 trillion.

Senator NICKLES. If you were to take a snapshot, which is what the private sector does.

Mr. BALLANTYNE. Right. Well, yes, a snapshot today. Right.

Senator NICKLES. Well, you are taking a snapshot for future people. But I do not want to buy that either because we may change. As Senator Moynihan held up, a lot of us are talking about different methods of financing Social Security and we may want to put part of this in an individual account for the individuals to invest in and control.

Well, I am worried about the future, but I am looking at, if you are taking a snapshot of all the promises that have been made, you have got a lot of people in the system, you have got a lot of retirees, you have got a lot of people who are working that have been promised benefits, if you had that snapshot, what kind of unfunded liability do we have for the people in the system right now?

Mr. BALLANTYNE. Well, again, the program is not a fully funded program, as a private insurance system would have to be. You would expect to have a large liability for the people who are contributing or participating in it today. That figure is something we could get for you. But it is not consistent with the way the program is designed and financed.

Senator NICKLES. Well, I am not happy with your answer.

Mr. BALLANTYNE. All right.

Senator NICKLES. I am going to ask you to break it down. You have a large number of retirees. What is the present value of their promises that are out there?

Mr. BALLANTYNE. All right. Senator Nickles, there are different groups of people that you could be talking about. You could be talking about beneficiaries today or you could be talking about people who are, let us say, age 15 and over who might be working or beginning to work. Normally, when we talk about what is called the closed group, it is that age 15 and over group.

Senator NICKLES. All right.

Mr. BALLANTYNE. That is in the neighborhood of $8 trillion to $9 trillion unfunded liability.

Senator NICKLES. Eight trillion dollars to nine trillion dollars.

Mr. BALLANTYNE. But, again, as I said before——

Senator NICKLES. I understand. But let me move on, because I see my little light is going on and I would like to get into some issues. Social Security is comprised of the payroll taxes going in, and then theoretically the interest earned on the assets that are there.

Correct me if I am wrong, but the interest earned on the assets there are basically the Federal Government borrowing money out of current funds to pay that interest. Is that correct?

Mr. BALLANTYNE. Well, wherever the interest comes from, right. It is credited to the trust funds.

Senator NICKLES. All right.

Mr. BALLANTYNE. It does not have to be borrowed to be credited to the trust funds, it has to be borrowed when the benefits are paid. It would if we were spending interest, which we are not right now, but would be in the future, without changes.

Senator NICKLES. Well, I would like to pursue this a little bit further.

Senator SIMPSON. We will have another round of 3 minutes each.

Senator NICKLES. Then I will wait.

Senator SIMPSON. I want to do that, because I want to have these fine young people testify and have them have this opportunity. So, we will have a 3-minute round, one more for each.

I guess the problem for me is to hear a figure coming from a man I greatly respect, the actuary, saying that in 75 years the liabilities will exceed the assets by $2 trillion, and here we sit and get no recommendations to do anything about it.

It really has to be just Disneyland, total, especially since we have given this commission independent status and have gotten no answers as to what we should do, not even suggestions; well, we will wait till the advisory report, we will wait till this. We know how it is. It is an election year, so we understand that.

But I want to ask this. How do you respond to the expressed fears of these people who will soon testify, young Americans like the ones who will speak in a few moments, that the Social Security is a cruel hoax on them, a hoax. They are forced to pay into a system that, by all estimates, including that of the trustees, will not be around for them when they retire. What are they supposed to think? What kind of honesty and integrity is carried out when that is the situation?

If we make no changes, we know that it is gone. How do you honestly reassure these young people, especially going back to the date of 2032, 2035? Forget all this business about 2017 and 2027.

We are talking about, within the lifetime of every single person that testifies in a few moments and they are involved in a cruel hoax. How do you reassure those young people without just floating stuff about children, disabled, the poor, the destitute, and all that smoke?

Commissioner CHATER. Let me tell you how I reassure them, because I speak, as I said, to a number of universities and high schools as part of our Public Education Initiative, which we have been working very hard on these past years.

First of all, I say to them, do not assume that you are going to be covered, you are covered. I point out that the coverage includes disability and survivors' insurance benefits, as I have mentioned in my testimony.

You will be surprised how few people actually realize that they are covered as we speak, that they are covered now as 20-year-olds. They are covered because they have worked and paid into the system. They do not appreciate that, and they do not know it.

I do not know why they do not know it, except that if you remember when you and I got our Social Security cards we probably went, at age 16 when we started to work, to an office and we had a rite of passage, if you will. I remember well getting my card and being told to take good care of it; that I would need this Social Security card for the rest of my life. I still have it.

We do not provide that rite of passage now because, in our effort to be efficient and effective, we enumerate people at birth. So there is no basic understanding along the way of young people knowing what the Social Security program does for them.

Second, Senator, I point out to them that Social Security benefits them in the way that it is helping their parents and grandparents today. Were it not for that, these young people would have to help financially with their parents and grandparents. They perhaps would not have the advantage of going to college, or going into business on their own because of their other financial obligations.

Part of what I say to them is that I believe that Social Security will be there for you in 2030 because I cannot imagine that Congress and the Administration will not find ways to make the program solvent for the future. Of course we need to change it; we all know that we need to change it.

But the Advisory Council was asked quite deliberately a year ago to suggest to us some options for change. I look forward to the release of its report. I think it will give us some concrete examples, though perhaps not in a consensus form, that we can then study and take to the public, including the young people, so that we can enter into a nonpartisan dialog about what best to do for the future.

Senator SIMPSON. Well, I give up.

Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. The Third Millennium group that will testify later, Ms. Chater, makes some specific recommendations. I guess when we try to solve this problem, eventually we have got to talk about suggestions to improve the system.

I would like to ask either you or Mr. Ballantyne if you have any comments about their suggestions.

They say, "Each time we testify we tell our elected representatives to (1) raise the retirement age to 70; (2) means-test benefits on a scale recommended by the Concord Coalition; (3) transform the system over time to one of a private retirement account." I would add, the CPI adjustment of Senator Moynihan.

I would like to ask you to comment on those. Those are specific recommendations as to ways people have said to Congress that we should move toward ensuring the stability of this system. Can you comment on any of those suggestions?

Commissioner CHATER. Yes, I would be pleased to. I think one of the advantages of having an Advisory Council report come to us very soon is that it will lay out some of the advantages and disadvantages of each one of these considerations. I believe that my role will be to facilitate a dialog, asking the right questions, so that we can, in the end, make rational decisions about the choice among the options.

About the retirement age. Yes, it has been suggested that it increase to a higher level, some as much as the Kerry-Simpson bill, for example, to age 70. Others suggest 68, and still others suggest that we collapse the time period within which the retirement age, which is now scheduled to reach 67, so we would reach 67 more quickly.

One of the questions that I would ask about that is how does it adversely impact certain kinds of American citizens? For example, people who do very heavy labor, perhaps, cannot work until they are 70 years of age. We need to consider what that will do to that particular group.

Second, let me respond to means testing. I am personally opposed to means testing. I believe that the Social Security program retains its stability because everyone pays into it, and that if you pay in you get something out. The notion of means testing, I believe, would, in part, erode the basic equity principle of a social insurance program. So, I am not in favor of means testing because this is not a welfare program and has not, in the past, been judged by one's need.

In terms of the Individual Retirement Accounts, I am all in favor of Individual Retirement Accounts. I have one; my children have them. I think they are great and I think we should all encourage savings in addition to the Social Security program. As far as the relationship of an IRA to the Social Security program, again, there are questions that we must ask, if this is a recommendation.

Can all people do the investing; what would be the management costs; how would it be managed; would it be mandatory; would it be voluntary; and what would be the effects of those issues on the entire program—these questions need to be considered.

Last, let me say this about the CPI. When I talk to older Americans throughout the country—and I do a lot of it—I firmly believe that if the CPI were an objective study and we were told through an objective analysis, either through the report that you have requested that I believe will come out in June, together with the Department of Labor and the work that they are currently doing, I really believe that, if it recommends a difference in the CPI, that our elderly Americans would certainly accept it, so would the administration, and so would I.

Senator BREAUX. Thank you.

Senator SIMPSON. Thank you, Senator Breaux.

Senator Moynihan.

Senator MOYNIHAN. Well, that is encouraging news. I hope you had the goodness to let the American Association of Retired Persons know that that is what you think they will do.

The accuracy of the cost-of-living adjustment is right at the heart of public finance. It is not just the Social Security system, it is our whole revenue system. We are in a crisis. We closed down the Federal Government last winter for the 14th time since 1981, which was the first time.

We are talking about balanced budgets in which a "liberal administration" would cut discretionary funds in the Federal Government by one-third. We do not have the revenue we need for our Social Security system or from our general government system. It is because we have a flawed automatic adjustment at the heart of all our calculations.

None say this more emphatically than the Bureau of Labor Statistics. They put out a pamphlet that says, is the Consumer Price Index a cost-of-living index? The answer is, no, it is not. Either we have the courage to stand up now or, in time, this will dissolve in front of you.

You are going to get, in a few weeks a Quadrennial Advisory Commission on Social Security report, which, for the first time in the history of this system, will talk about privatizing it. It has never happened before, Mr. Chairman. I mean, it would not have been imaginable when I came on this committee 20 years ago. I mean, I knew Frances Perkins. She would be appalled that we would not trust our own government's securities better than the market's securities.

I fear this is coming. It will take courage and resolution to say what needs doing. Thankfully you have Harry Ballantyne at your side, because he will give you straight, honest advice.

I would like to submit for the record a question having to do with this baffling issue of, how do you deal with the year 2000 on your computers when computers only have two zeroes to calculate dates, and suddenly you do not know whether it is 1900 or 2000. You are working on that, I am sure.

Commissioner CHATER. I am very, very proud to tell you that we are not just working on it, I think we have solved the problem, and with years to go.

Senator MOYNIHAN. Have you?

Commissioner CHATER. We are one of the few Government agencies who anticipated what would happen with 00, which, of course, as you know, would be reflected as 1900. We have other government agencies consulting with our computer folks about just how to fix this.

Senator MOYNIHAN. Good for you. Could you tell us, perhaps in writing, a little bit about what you have done?

Commissioner CHATER. I would be very happy to provide that for the record, because I would like it to be very accurate in terms of the process.

Senator MOYNIHAN. Because others need to do it.

Commissioner CHATER. Yes.

Senator MOYNIHAN. Yes. Good for you, once again. Thank you.

Commissioner CHATER. Thank you.

[The following information was subsequently received for the record:]

QUESTION FOR COMMISSIONER CHATER FROM SENATOR MOYNIHAN

Question. Computer experts are growing more concerned, as the turn of the century approaches, about whether existing programming can be modified to correctly recognize the date on January 1, 2000. This is known in the trade as the "Y2K" problem—short for "year 2000 problem." It refers to the fact that existing computer programs use only two digits to register the date. For example, 1996 is registered simply "96." Yet the year 2000 will be interpreted by computers as "1900," since the first two digits are assumed to be "19." Many experts feel this will lead to a computer "meltdown" 4 years from now.

The Social Security Administration will surely be affected by the "Y2K" problem. What is the status of your efforts to cope with this? How is it going? And how much will it cost to fix?

Answer. The Social Security Administration is aware of the problems that will occur in data processing when the century changes. In fact, SSA began working on the problem in 1989. We have already changed the formats of dates in many of our files to include the century and have plans in place to change all of those which may be affected.

SSA is participating in an intergovernmental workgroup, chartered by OMB, that is addressing this problem for all government agencies. Kathy Adams, the Associate Commissioner for Systems Design and Development, Social Security Administration, is heading up that group. Representatives from approximately 15 Agencies have been attending meetings since November 1995 in an effort to raise the awareness level regarding the problem and discuss solutions to this complex issue. That workgroup will be sponsoring a Year 2000 seminar for all Government agencies on May 2, 1996 in Washington. Vendors that have Year 2000 solutions will be present to answer questions and distribute product literature.

SSA has 30 million lines of code in production. Our efforts thus far indicate that it will take 300–400 work years to change that code, validate those changes, and put the new code into production. Those results led to our decision to purchase a tool to assist in identifying date fields. We believe that this tool may result in a 10 to 15 percent work year savings. Of course, this problem is not confined to SSA's systems. We have been working with the Health Care Financing Administration (HCFA) since 1994. SSA has also briefed representatives from IRS, Commerce, Justice, Treasury, and HCFA on the problems and our work effort and will continue to provide information as requested. The workgroup mentioned earlier is currently engaged in discussions regarding the representation of date fields in data exchanged between agencies.

We plan to have all Year 2000 changes made by December 31, 1998.

Attachments.

From: Acting Deputy Commissioner for Systems

Subject: Year 2000 Project at SSA—Information

To: See Below

A unique event will take place on January 1, 2000. On that day we will experience the first century change of the computer era. This event poses enormous challenges for the data processing community around the world as public and private sector organizations prepare for the single largest integration feat since computers entered our daily lives. This is because most computer programs store the date as a two-digit year and assume that the century, which is absent, is 19. Any logic operations work fine as long as the dates in question are in the same century. Problems arise when the century changes. Subtracting 12/31/95 from 12/31/05 to determine someone's age does not produce the correct answer of 10. It actually produces a result of −90.

The solution for the problem is simple but labor intensive. Wherever we currently add, subtract, compare or sort using two digits we need to change that software and use four-digit years. There are two complicating factors. One is the size of the problem. SSA has 30 million lines of software in production. The other problem is that there is no automated way to accomplish this. Each one of these lines must be examined to see if a change is necessary. This will be a very labor intensive operation. Initial estimates indicate that we will take approximately 300 workyears in OSDD, OIM and OSR to make and validate these changes, and the entire effort throughout SSA could require many more workyears. We are working to firm up these estimates as we get into making the changes and have a better idea of exactly what it will take.

We are not alone in this effort. Every company in the world which uses computers, including every Federal and State agency in this country must address this very problem. I am reassured to know that SSA is in the forefront in planning—for and dealing with this issue.

The 1991, 1993 and 1995 MBR/SSR rewrites addressed the Year 2000 issue by changing our master file dates to include a century. We are now engaged in the process of scheduling the changes to our application software. Our plan calls for all changes to be in production and validated by December 31, 1998. This will allow us to run all cyclical operations once before the century actually changes.

Although there is no automated solution, there are tools available that will help with this problem. One of these, the VIA/ALLIANCE product from VIASOFT, was purchased in June 1995. Training has been conducted, and we will shortly begin using that tool to help identify date fields in our code. Use of this tool will also help with estimating our resources.

This problem exists for both mainframes and personal computers (PCs). All the PC based code that is currently executed in the regional offices and PSCs must be examined. If any of your employees have written code that is currently in use, you will need to assign someone to examine that code and determine if any changes are required. We will also need to contact all vendors, both mainframe and PC, with whom we do business and determine when their products will be Year 2000 compliant.

In addition to application software, this problem affects operating system software and some hardware. The BIOS chip in certain PCs may need to be replaced. Because of SSA's early activities to address this problem, OMB asked us to champion this project across government. OMB's concern is that many agencies have not recognized this as a problem or begun planning for it. Kathy Adams is heading a Year 2000 Interagency Committee to raise awareness across government and to address cross cutting issues such as data exchanges.

The Year 2000 project has been added as a tactical plan at SSA because of the magnitude of the effort. This project adds no new functionality or enhancements to our current systems. However, we should remember that it does allow us to continue processing. Unless the necessary resources are used to make these changes, all processing stops when the Year 2000 arrives.

If you have any questions please feel free to contact me. Staff may contact Judy Draper at extension 55314.

YEAR 2000 PROJECT AT SSA

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SSA has 30 million lines of code in production. Our efforts thus far indicate that it will take 300–400 work years to change that code, validate those changes and put the new code into production. Those results led to our decision to purchase a tool to assist in identifying date fields. We believe that this tool may result in a 10–15 percent work year savings. As of January 1996, SSA was the only Federal agency to have completed a procurement for a Year 2000 tool.

Of course, this problem is not confined to SSA's systems. We have been working with the Health Care Financing Administration since 1994. SSA has also briefed representatives from IRS, Commerce, Justice, Treasury, and HCFA on the problem and our work effort and will continue to provide information as requested. The workgroup mentioned earlier is currently engaged in discussions regarding the representation of date fields in data exchanged between agencies.

We plan to have all Year 2000 changes made by December 31, 1998.

Senator SIMPSON. Thank you very much, Senator Moynihan.

Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you very much. Mr. Ballantyne, I want to get your attention, and you or Ms. Chater can answer. The Social Security trust fund right now, as you mentioned, is largely pay-go. It is an income transfer between generations. You have a fund balance today, theoretically, of how much money?

Mr. BALLANTYNE. About half a trillion now.

Senator NICKLES. About $500 billion.

Mr. BALLANTYNE. Five hundred dollar billion.

Senator NICKLES. All right. That is not invested in any bank or anything, that is just basically a pay-per-entry. Is that correct?

Mr. BALLANTYNE. It is invested in U.S. Government securities, right.

Senator NICKLES. All right. Those securities have different maturing dates.

Mr. BALLANTYNE. Yes.

Senator NICKLES. All right.

Mr. BALLANTYNE. Spread out over the next 15 years.

Senator NICKLES. Spread out over the next 15 years. So, much of that $500 billion matures every year.

Mr. BALLANTYNE. Right.

Senator NICKLES. All right. When that matures, there is a debt. How is that paid when those Treasury notes come due? How are those paid?

Mr. BALLANTYNE. All right. The Government redeems the investments as they are needed, first, to pay for the benefits, then, if they mature in the future and they are not needed at the time of maturity to pay benefits, they are reinvested in another government bond.

Senator NICKLES. So the Government would issue you additional bonds.

Mr. BALLANTYNE. Right.

Senator NICKLES. It is basically the way we have always paid off that pay-per-entry that you have somewhere in your shop.

Mr. BALLANTYNE. We have always paid it off. In those years when taxes were lower than benefits, the interest was also paid and spent. So, it is not as though there is nothing there.

Senator NICKLES. Well, in my mind it is pretty close to being nothing. So you have $500 billion, and some of those mature. But, when they mature, you basically issue more government——

Mr. BALLANTYNE. Right. At maturity. Another feature of these government securities is that the interest that they bear is based on a formula that is in the law, so it is based on long-term marketable interest rates of U.S. Government bonds.

Another feature is that they are redeemable at any time at par value, so they are usually redeemed earlier than the maturity date.

If they are redeemed, it is in order to pay the benefits. Any interest that has accumulated at that point would be credited to the trust fund.

Senator NICKLES. Well, my concern—and I am running out of time before I have really begun—is you have the generation that is working right now, and not only are they paying very large payroll taxes which have gone up by a multiple of about 20 times between 1968 and today, when the maximum tax used to be a few hundred dollars and today it is several thousand dollars.

So you have an enormous tax increase for the generation if somebody is making $60,000. But, when they retire, not only will they be hoping to receive something, they are also, if they are taxpayers, are going to be paying for this debt, for these $500 billion. They will be the ones who will be financing the new bonds to pay off the old bonds. Is that not correct?

Mr. BALLANTYNE. Well, that is right. But I would say that if there were no Social Security trust funds from which the money would have been borrowed, perhaps the borrowing would have occurred from somewhere else, and you would still have those interest payments to be paid. So, I am not sure that the trust funds themselves result in more debt and more interest payments.

Senator NICKLES. Well, basically you have trust funds that have IOUs that the Government is going to have to start collecting on. Somewhere after the year 2013, they are going to have to start drawing down on the trust. To do that, they are going to have to borrow more money from the Federal Government to pay off the past IOUs.

So you have anybody, if they are still working beyond the year 2013, who will not only be paying a payroll tax, but also the Government will be borrowing more money from them to pay off past debt.

Mr. BALLANTYNE. That is right, or increasing income tax rates, or reducing other government expenditures. Right.

Senator NICKLES. All right. Mr. Chairman, thank you.

Senator SIMPSON. Well, I think that is fascinating. I think that gets pretty close to the nub of it. If the American people—and I think all of the panel—would approve of this observation, that all of the interest here, whatever, is paid from the general Treasury. It is not paid from some separate "Social Security trust fund," period. It seems to be a tough one to get across from people, but maybe we can.

Thank you, Ms. Chater and Harry Ballantyne. We appreciate it very much, and thank you for coming.

Commissioner CHATER. Thank you.

Senator SIMPSON. Now we will go to the second panel, consisting of Neil Howe, historian, economist, and author from Great Falls, VA; Alden B. Levy, member of the board of directors of the Third Millennium, New York, NY; and Matthew L. Miller, economics editor of *The New Republic*, Los Angeles, CA.

If you would please proceed in the order of the witness list. Neil Howe, please, with your remarks to share with us. Nice to have you here.

STATEMENT OF NEIL HOWE, HISTORIAN, ECONOMIST, AUTHOR, GREAT FALLS, VA

Mr. HOWE. Thank you, Mr. Chairman. I thank you for the opportunity to be here. The subject of this hearing could not be more timely. In my view, the politics of Social Security have changed enormously over just the past few years.

At the beginning of the decade, Social Security reform was practically unmentionable. Today, a rapidly growing number of voices from Federal commissions, and quadrennial councils, research institutes, public interest lobbies, universities, even the mainstream media, are openly weighing radical reform proposals.

Meanwhile, surveys show low and falling levels of public trust in Social Security as it now stands. Three-quarters of all Americans doubt that this program will be able to fulfill its promises to new retirees just 20 years from now, and about two-thirds agree that Social Security is "in need of major reform now."

Why is this happening and why now? Let me offer a few of my own observations. First, there is a growing concern that the system will become an insupportable burden on today's kids. According to the most plausible trustee estimates, the cost of OASDI as a percent of taxable payroll will rise by 6–10 percentage points over the next 40 years. This is not the first time we have faced such large projected imbalances, but before, we ignored them until they grew into an acute, short-term emergency.

Unlike the mid-1970's or early 1980's, however, Americans today are in a more sober mood. They are much more likely to take the long-term projection seriously and not assume we can grow our way out of them. They are also more aware of other dependency burdens, such as the exploding cost of health care benefits that will put a crushing extra pressure on living standards.

Second, if future benefits are cut there is a growing worry that the system will not provide sufficient support for today's mid-life adults when they retire. As Craig Karpel put it in his recent book, *The Retirement Myth,* there is only one thing that boomers fear more than the prospect that the Federal budget will never be balanced, and that is the prospect that it *will* some day be balanced.

To keep Social Security outlays from exceeding revenues in the year 2025 without raising taxes, we would in that year have to enact a 25 percent across the board benefit cut. Most boomers do not participate in a pension plan, have negligible financial assets, yet expect to retire early and comfortably.

They are not prepared for any substantial future benefit cuts, and they probably are not even ready for those already legislated to take effect for everyone born after 1935. I am referring, of course, to the benefit cut for early retirees.

As today's mutual fund boom attests, many boomers are responding by trying to save more on their own. Without a doubt, they constitute the leading edge of a growing public consensus about encouraging personal savings.

Our surveys show that people in their 40's are much more likely than other age groups to agree strongly with the statement, "Government should provide more incentives to save for retirement."

But this leads to my third point. The boomers' belated conversion to the virtue of thrift comports awkwardly with Social Security's pay-as-you-go structure which, entirely aside from its impact on the Federal budget, is widely believed to discourage personal savings.

This is not just a U.S. worry. A remarkable new World Bank study points out that policy reformers worldwide are turning away from unfunded retirement systems precisely because of their tendency to undermine private savings rates.

Fourth, there is rising disappointment about Social Security's declining rate of return on contributions. Today, for the first time in the history of Social Security, large categories of newly retiring workers, beginning with well-off single males, are due to get back less than their market value in benefits, and this includes, in response to the Commissioner's statement earlier, any payback for the insurance value of survivors' benefits on OASI.

Everyone is beginning to understand that, in future years, these market losers will comprise a steadily growing share of all beneficiaries. This is very bad news for a program predicated since the early 1950's on the chain letter notion that everyone can be a winner. Paul Samuelson's dictum about Social Security being the "greatest Ponzi scheme ever contrived" is now in disrepute.

By degrees, the public is again warming to the notion that Social Security ought to be, foremost, a safety net program, the notion that prevailed from 1935 to at least 1954. This, at least, is what I infer from the rising public support for means testing benefits and from the fact that this rise is coming mainly from Americans age 50 and under, according to our surveys, precisely those who are least likely to get their money back.

Many critics used to think that windfall rates of return were a good argument for reforming the system. Why not cut benefits in a way that would still leave everyone a winner? That argument fell on deaf ears. For the many years that I have been involved with this issue, no one took that argument very seriously.

Ironically, the opposite argument may ultimately turn out to be far more persuasive. Why not rethink a system that cannot hope to offer the same long-term rate of return as genuine economic savings?

I have some observations on generational trends which I am going to forego, but I will put in the record.

Let me just conclude by saying that these shifting attitudes, including attitudes toward dependency, deficits, personal thrift, and budget priorities, had better work on time.

Experts familiar with the projected budget costs associated with the age wave tell us we have got about 10 more years to start implementing major reforms, otherwise changes will come anyway, but maybe with unsettling speed.

Thank you, Mr. Chairman. This concludes my statement.

Senator SIMPSON. Thank you very much.

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

Senator SIMPSON. Now, Mr. Alden Levy.

STATEMENT OF ALDEN B. LEVY, MEMBER, BOARD OF DIRECTORS, THE THIRD MILLENNIUM, NEW YORK, NY

Mr. LEVY. Thank you, Mr. Chairman, for inviting Third Millennium to participate in this dialog on Social Security, a program 25 percent larger than the defense budget, and seven times larger than AFDC and Medicaid spending combined.

My name is Alden Levy. I am a member of the board of directors of Third Millennium, an entrepreneur, and an independent business consultant. Third Millennium is a national, nonprofit, nonpartisan group of Americans born after 1960. We are based in New York City.

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

Despite all of the hoopla surrounding the current campaign season, we remain focused on our ongoing mission to redirect America's attention from the short-term election cycle to the long-term health of the U.S. economy.

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

Suddenly and remarkably, Social Security no longer is the third rail of American politics. Proposals to overhaul it rather than defend it have, instead, ignited the campaign debate. Think tanks, business associations, and advocacy groups such as Third Millennium all have played roles in transforming the way Americans view Social Security.

What my generation in particular is finding, is a government program that asks us to contribute more than one-seventh of our income with each paycheck, while at the same time warning us that it will be bankrupt before we retire.

Not one Member of Congress has ever successfully explained to my generation how you expect us and our progeny to meet the pension and medical benefits needs of the soon-to-be-retired baby boom generation.

Worse still, no one has justified the fairness of requiring us to bear that remarkable burden, while we also make billions of dollars in interest payments on trillions in debt incurred on our behalf by older generations.

What are the Social Security Administration's answers to these massive problems? Commissioner Shirley Chater has implemented an educational program to mollify high school students by teaching them the virtues of a system that will be bankrupt by 2030.

This is inter-generational fraud, pure and simple. The majority of my generations pays more in total FICA taxes than in income taxes, and Ms. Chater fiddles while Rome burns around her.

Mr. Chairman, while Social Security has had its successes, this educational program is nothing more than a federally funded PR campaign to delude the next generation of suckers into anteing up for this Ponzi scheme.

Today's young adults may be the products of a declining educational system, but they are smart enough to realize that no amount of PR can obscure the fact that, in 34 years, an insolvent Social Security system will be of no use to them. I did not make this up. The system's honorable trustees, including Clinton appointees Donna Shalala and Robert Rubin, tell Americans the same story every year.

However, while the Social Security Administration shills for a soon to be financially bankrupt system, Third Millennium is exploring real solutions. Each time we testify, we tell our elected representatives to means test benefits, transform the system over time to one of partial privatization, and to raise the retirement age to 70.

The Social Security Administration has funded scientific research that found that seniors are living longer and healthier; disability among senior citizens is a fraction of what it was in 1982. Yet, the Social Security Administration still resists more than a token increase in the retirement age.

Many good ideas regarding Social Security reform have been put forth. Third Millennium is undertaking a unique academic study that will examine domestic success stories entitled "How State and Municipal Pension Plan Systems Offer Prototypes for Social Security Reform," our project will look at what works for public employees in specific States.

Many people do not realize Social Security is not a universal system. Not every worker in America contributes, and not everyone benefits. There are six state systems where tens of thousands of state workers are exempt from Social Security entirely.

During the New Deal era, Social Security was a wonderful idea. The country was experiencing an ever-increasing birth rate, and workers were dying soon after retirement, if they reached retirement at all.

Today, none of these factors remains true. We cannot afford to maintain Social Security in its current form. It is time for Democrats and Republicans alike to come clean and admit to the American people that this system is in dire straits and is destined to implode.

Mr. Chairman, I would like to thank you for taking the lead on Social Security reform, for giving Third Millennium and our generation a voice in the Social Security debate, and for not backing down when President Clinton and your party leadership would not listen to reason.

Third Millennium will miss your common sense and your willingness to stand up for the unrepresented and the under-represented, as well as the country as a whole, even when it means you stand alone.

With all the talk of generational warfare, it is refreshing to know that you repeatedly offer us the opportunity to help prevent it. Thank you.

Senator SIMPSON. Well, thank you very much, indeed.

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

Senator SIMPSON. Matthew L. Miller, please.

STATEMENT OF MATTHEW L. MILLER, ECONOMICS EDITOR, THE NEW REPUBLIC, LOS ANGELES, CA

Mr. MILLER. Mr. Chairman and members of the committee, I would like at the outset to thank you for this chance to offer some thoughts on Social Security's future, and to also acknowledge, Mr.

Chairman, your continued leadership on these issues, which will be sorely missed after you retire.

I thought my remarks would be most useful if——

Senator MOYNIHAN. May I just say, this is not a retirement party. He is going to be here for a long while.

Senator SIMPSON. That is right. I am retiring from the Senate, not life, for heaven's sake. [Laughter.]

Mr. MILLER. I thought my remarks would be most useful if they combined my perspective as a former OMB official, where I worked for Alice Rivlin for 2 years, as well as those gleaned from my more recent descent into journalism, where I now write for *The New Republic*, *Time Magazine*, and just started a syndicated column.

As someone who has seen from inside how both government and the media deal or do not deal with these complicated and politically explosive issues, I am convinced that a big piece of solving our long-term problems involves finding creative ways to get the media routinely to hammer home the facts so the public understands the stakes. Only once citizens get it can they help make the world safe for politicians to do the right thing.

Let me address, then, some of the economic questions the committee has raised. I will try and tick through them quickly and not duplicate material that has been covered by some others on the panel, and then offer a few concrete policy suggestions, as well as some ideas for making the issue more media-friendly.

When it comes to the returns each generation receives on its investment in Social Security, the short story is simple. Social Security used to be a fabulous deal. For today's retirees, it is largely a good deal, but, in the future, it will increasingly become a bad deal.

Let us just tick through quickly, again, the reasons why. In the program's early days, workers paid into the system for very few years before becoming eligible for benefits, and it combined employer and employee tax rates of 3 percent, as opposed to more than 15 percent today, as you know, including Medicare and disability.

The payback on these taxes was, thus, enormous and, contrary to popular myth, went far beyond any notion of getting back what you paid in. An average one-earner couple retiring in 1960, for example, got back in benefits about 11 times what it paid in, and that's after accounting for inflation and a 2 percent real rate of return, which is appropriate for this kind of risk-free investment.

As the system matured, ever-increasing payroll taxes—which have risen about three points per decade, as you know—along with workers paying into the system for many more years helped push these returns downward.

However, offsetting these higher contributions has been a benefit structure that offers higher and higher real benefits to each successive cohort or retirees.

The result is that beneficiaries who retired in the 1980's, i.e., many of today's beneficiaries, are getting the best deal Social Security will ever offer in terms of absolute dollars.

For example, an average wage one-earner couple that retired in 1980 gets back, in 1993 dollars, an astonishing $210,000 in benefits on payroll taxes of $50,000, for a net windfall transfer of $160,000. That is about twice the windfall in constant dollars as a couple retiring a generation before them. If you add Medicare, of course, the windfall becomes significantly higher.

In addition, Social Security has for decades bestowed its biggest such windfalls on beneficiaries with the highest incomes. Now, this fact that Social Security is regressive within generations is not well-understood. It is commonly argued that Social Security is a progressive system because the regressive payroll tax through which it is financed is more than offset by the progressive structure of the benefit formula.

Now, while the benefit formula is, indeed, progressive, the system still transfers larger amounts of money to better-off recipients. This is not as paradoxical as it sounds because the formula, you will recall, is based on wages. A high-earning worker who gets, say, a 26 percent replacement rate on his wage will collect more absolute dollars over the course of his retirement than a worker who gets 50 percent of a much lower wage.

In this respect, Social Security resembles our other great regressive entitlement, the mortgage interest deduction, which offers a bigger housing subsidy to Americans the richer they are.

Looking ahead to when the boomers and X'ers hit their rocking chairs, the glory days for returns are over. These workers, especially the X'ers, will have paid higher payroll taxes into the system for their full working life. For boomers who retire in 2010, average and higher earning single persons, as well as upper-income couples, will pay in far more than they receive back; the story for Generation X'ers who retire in 2030 will be dramatically worse.

As you know, this Social Security outlook for younger generations exacerbates Federal budget priorities that already favor elderly consumption at the expense of investment in children and in economic growth. We have already talked about $14 trillion in unfunded liabilities.

It is worth noting also that seven times more Federal spending goes to the elderly today than to children under 18. The budget deficit itself is a drain on savings and growth, which lets the next generation face a double-whammy of a more stagnant growing pie out of which higher tax burdens must be faced.

Indeed, the tax burden on young families today is much higher than on elderly couples with identical incomes, which is a strange situation to find ourselves faced with, considering that the elderly have most of their child-rearing and house-buying expenses behind them.

Just to touch for a couple of seconds on some solutions. I would urge you to consider serious means testing for today's better-off retirees, even on a temporarily high basis for 5 or 10 years, because they are receiving the largest windfalls that the system will ever offer, and all generations should share in the solution.

Next, I would suggest you may want to reconsider the use of the trust fund accounting, since, as we have talked about, it is fictional and often obscures debate about broader resource allocation in our society in the service of a very technical-sounding fight.

I have included some other thoughts in the testimony about how to improve media coverage on this, one of which might be to actually try a monthly release, not unlike the trade deficits, on the unfunded liability status of the Federal Government, because if we

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had someone like Tom Brokaw or Peter Jennings every month saying, today the unfunded promises of the Government continued at an astonishing $14 trillion, that might be a more frequent news hook that is useful for encouraging public debate. I would be happy to discuss these ideas further.

Thank you.

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

Senator SIMPSON. Well, there is a press release every month, that is for sure. That is very interesting. All three of you present very, very provocative material. So, quickly, questions.

Mr. Howe, a question. You state, "Two-thirds of Americans agree that Social Security is in need of major reform." Do you have any sense of what kind of reforms those people would support? What changes do you think would gain the greatest support from young adults among those changes that could significantly restore confidence and a sense of fairness in the future?

Mr. HOWE. Well, the surveys that I have helped design and carry out, both with the National Taxpayer's Union Foundation and the Concord Coalition, indicate that means testing, or what we sometimes call affluence testing, continues to be actually a quite popular solution, even though it is one of the newest to have been proposed.

I do not think anyone was really talking about it much more than about 3 years ago for most Federal benefits. In fact, I started working on the data on this back in 1990 when practically no one was interested in it.

The other often proposed solutions are much less popular. Increasing the retirement age, for all that policy experts propose it, remains unpopular with most of the public, even those who do not intend to retire early. COLA adjustment, it is hard to say, because most of the public finds that are hard to evaluate, particularly when you are talking about the CPI not actually reflecting inflation. It is difficult for the public to evaluate that. Affluence testing, or means testing, however, remains popular.

The question that some skeptics raise is the public support that depends on where you actually choose your threshold; where do you begin to means test? Do you means test at the median household income, at twice the median income, are you talking about $30,000, do you start at $60,000, beginning to shave off 5–10 percent per $10,000 of income? Where do you do it?

In theory, this is surprisingly popular among most of the different age groups and most of the different income groups of the public that we have polled.

Senator SIMPSON. Mr. Levy, I continue to tell people about the Third Millennium. I just go ahead and boost it. Now, to do that, how many members do you have? I know it is a meager lot.

Mr. LEVY. It is a few thousand.

Senator SIMPSON. A few thousand. How much are the dues? Hopefully $8 a year, like the AARP.

Mr. LEVY. It is $9, actually.

Senator SIMPSON. Nine dollars a year. Well, that is tragic. It should have been $8 a year, then that would have matched the AARP. But, at some point in time, it is my opinion, in my lifetime, that you will be able to walk into a Congress person's office and say, I am from the Third Millennium, and we are now merged with this group or this group, and there are 10 million of us, and we vote.

Mr. LEVY. I hope so.

Senator SIMPSON. Sadly, that is the only way you are going to get this done, because all of us have to sit under the daily hammering of people from our States saying, we are from the AARP, and there are 33 million of us. I understand there are three million less now, which is certainly good. I hope we can get another 10 million less if we keep whacking on them.

But they walk in and say, there are 33 million of us and we vote, at which time we are supposed to just pitch forward on the carpet and crawl out on our hands and knees. That is tedious. When are you going to be able to get the horses together of your generation? We gave you the right to vote; very few of you use it. How are you going to do that?

Mr. LEVY. Well, we actually are in the midst of initiating a program called Adopt a Voter and we are trying to work with older groups, to get older Americans to help get their younger grandchildren or neighbors out to vote. It is true that, after next year, people born after 1960 will be the largest potential voting block. So, if we just increase, if we could double our numbers, we would be a force to be reckoned with.

Senator SIMPSON. There was interesting testimony there from one of you, I do not recall which, about this generation, which would be mine, really, from the 1950's, the fortunate, the lucky. Whose testimony was that? It was Mr. Howe.

These people do feel that it is time for them to realize that they have to do something to help the young people, that they are not there just holding on, saying, you cannot cut anything. That is very interesting. I believe that is true among the people of my vintage.

Just a quick question of Mr. Miller. You provided us ample evidence that the payback has been more than generous. You State the baby boomers and Generation X'ers will get a comparatively raw deal, paying far more in payroll taxes than they can expect to receive.

From a public policy point of view, is it important for a program such as Social Security to ensure fair treatment between generations, and if so, what change would you suggest to ensure that future retirees get a deal that is comparable to today's retirees?

Mr. MILLER. Well, to answer your first question, first, I think it is important for the long-run sustainability of a social insurance program for everyone in the society to feel they have a stake in some kind of equal treatment. So, I would suggest reforms like phasing in a higher retirement age at a much faster pace than has been discussed now.

There will probably have to be some increase in payroll taxes and some kind of greater means testing on the benefit side, as well as indexing, perhaps, the amount of years that someone can expect to get benefits, so that the retirement age even further on into the next century continues to rise with life expectancy.

Senator SIMPSON. My time has expired.

Senator Breaux.

Senator BREAUX. Thank you very much. I thank the panel for their presentations.

Mr. Howe, you have outlined the problems. I mean, we have so many people that do that, but I do not see any solutions in your comments. One of the disturbing things you said on page 3, and maybe I missed the point of it, is that we have got about 10 years to start implementing some major changes. I do not think we have that much time.

I do not see any suggestions. I mean, Mr. Levy has proposed some specific suggestions. We all know we have a problem, we all know when it is going to go bankrupt and busted, and when we are going to run out of money. What we are really looking for is helpful solutions as to, what can we do to solve the problem. If you had to summarize what you think the solutions are, if you can, could you give us some ideas?

Mr. HOWE. Well, I believe strongly that, under the rubric, if you will—and that is perfectly all right with me—of Social Security broadly construed, we should allow much of the potential support from Social Security benefits to come from privately invested, portable, defined contribution accounts.

Senator BREAUX. So you would move toward privatizing.

Mr. HOWE. I would. I believe the transition should work by some sort of reduction in the current law projected benefits through higher retirement age, some affluence testing of benefits.

At the same time, we need to raise the share of payroll that workers will take out and basically, if you will, have a mandatory retirement increment that would be contributed into these personal plans.

You have to realize that to transition any part of Social Security toward a funded system requires some generation paying for two retirements, some extra burden that is going to have to be spread out.

I believe we need a transition like that, and I believe that both finding ways of paring back equitably on projected benefits over the next 20 or 30 years, as well as requiring some sort of increased sacrifice on the current workers, will be necessary to do that.

On the other hand, I think Social Security will always be necessary to provide a safety net, even a better safety net than we now provide with Social Security and Supplemental Security Insurance.

Senator BREAUX. Ms. Chater spoke of opposition to the means testing because this is not a welfare program. Can any of you comment on that?

Mr. HOWE. Well, she was somewhat inconsistent on that, because at one point she talked about the balance between equity and adequacy, the great slogan of Social Security that started back in the early 1950's.

She means, equity and adequacy with the payroll taxes and the benefit formulas, but obviously that does not extend to the idea of equity and adequacy on the means testing, that is, actually looking at the income you are actually getting in retirement when you are receiving the benefit.

I do not understand why the rationale that would justify the particular kind of benefit formula would not also justify looking at the income you are receiving when giving out the benefit.

Mr. MILLER. If I can add, Senator, also, we are already redistributing income, sometimes in crazy ways, through the Social Security system today. The benefit formula is progressive, but, as I have tried to lay out, in absolute dollar terms we are actually getting bigger total windfalls the higher someone's income is.

With the spousal benefit, which is 50 percent of the worker's benefit, that is the same thing. Spouses who were better off get more Social Security. So we should put aside the idea that we're worried about changing it into a redistributive system, because it is already, and talk about which way we wanted to.

Mr. HOWE. I just wanted to add, one economist once had the following illustration. Which is a better deal, someone who came up and offered to give you back 20 cents for one penny that you give him, or $10 for $1.00 that you give him? You can say that the 20 cents to one penny is a better deal in terms of its rate of return, but obviously the $10 to $1.00 is actually what more affluent participants in the Social Security are getting.

Senator BREAUX. Thank you. Mr. Levy, let me ask you a little bit about the concept of the generational warfare. I think there are a lot of folks in Washington that feel that there really is a basic difference of interest between folks in your generation and those who are retiring.

I mean, is there not a real distinct benefit for people in your generation to know that your parents and grandparents are being adequately taken care of through Medicare and hospitalization insurance? I mean, I do not think out there in the world there is that much of a battle.

I mean, we have got to be working together to solve these problems. I am disturbed that it seems like in Washington we are putting more and more generations battling each other when we should be trying to find out how we can make them work together for mutual benefit.

Mr. LEVY. Well, it is great that senior citizens have a low poverty rate, that they are covered by medical care. My generation is the poorest generation; we have no medical care. We have the highest uninsurance rate. We have welfare for the poor. We can extend that to the elderly poor.

We can transition Social Security so that there are private retirement accounts and provide the safety net, like my colleagues have said, to those who cannot afford to live on their own. We do not want to bankrupt senior citizens. We have no intention of putting them out on the street and taking away their insurance. At the same time, we are asked to pay exorbitant amounts of interest and income tax that previous generations did not have to pay and we have no future benefit.

Senator BREAUX. Thank you, Mr. Chairman.

Senator SIMPSON. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, first, what refreshing and invigorating testimony we have had, and the written testimony even more so. I was putting some pressure on Commissioner Chater, and I would like to do the same here.

On the question of means testing, Commissioner Chater took a position that has been very clear with the Social Security community from the beginning which is, once you make this a charitable exercise it will begin to crumble. I observed that Social Security is simply title II of the Social Security Act of 1935, and title IVA, is the provision for children. Mr. Miller, you are, I guess, citing Mr. Howe on the difference between what we spend on seniors and on children is dramatic.

This Congress is quite prepared to abolish the Social Security for children and had voted to do so; only a Presidential veto stopped it. But, I mean, they do not vote and it is, after all, charity.

Keeping that principle of, you paid for this and it is yours, may seem almost a selfish view, but it has durability in politics.

But also this. You are all talking now about moving retirement benefits collected by the Government into the private market. Does that not put things in jeopardy? The 1990's have been great; the 1930's were not so good. Does that not ask of individual citizens who have no familiarity with market systems—only about 15 percent of American people actively buy a stock or such—in a marginal position as well, I ask you all?

Mr. MILLER. Well, let me start. I did not advocate privatizing Social Security, so it is still an open question in my mind of whether we should divert some portion of the payroll tax. But, when it comes to means testing, you raise a very important consideration. I guess my perspective is, if we already do some kind of means testing through the program——

Senator MOYNIHAN. Some kind of redistribution.

Mr. MILLER. Some kind of redistribution in Social Security. If, especially once you add in Medicare to the whole broader question of the baby boomers' retirement, to not do some kind of means testing means that the only other option is sharply higher taxes on the rising generation of workers.

It is not clear to me, first, that that is something that anyone in the political debate is talking about as something that is at all in the offing in the next 5 years, let us say. If we do rule that out, then we are just postponing the day of reckoning even further.

I guess that, given both what polls show about the acceptability of some concept of means testing and the common sense equity principles it honors, I think is a direction that we have to move in. I share your concern about the low-income entitlements.

I think it is appalling that both parties were talking about abolishing low-income entitlements, especially at the same time as we have touched on here. Some many entitlements for upper income people were off the table by both parties' assent in this year's budget debate, and that should be something that is shocking to everyone. But I think, at least, we have to move somewhere in that direction, given those concerns.

Senator MOYNIHAN. Thank you, Mr. Miller.

Mr. HOWE. Senator, maybe I could answer your question. I am in favor of moving toward a system of Social Security which would include portable, defined contribution, personally-owned accounts. I do not like to call that——

Senator MOYNIHAN. Mr. Levy is agreeing with you.

Mr. HOWE. Yes. I do not like, actually, to call that privatization. Privatization implies, of course, that we do not care anymore, that publicly, as a country, we do not care anymore what happens to retirees. It also implies that the Government should not play any sort of paternalistic role in governing, determining, placing boundaries on what people can do with these accounts. I think, obviously, we will have to do that.

People will not be allowed to simply save up their account and, in a mid-life crisis, spend it all on a Ferarri. That is not what we have in mind here. We have in mind an account on which there will be certain limitations, certain regulations.

Obviously people will be allowed to invest in the same risk-free government bonds that the Social Security trust fund now invests in, so if they want they can be as risk-free as the Social Security trust funds themselves.

Mr. LEVY. We have looked at this already. If you look at Senators Kerrey's and Simpson's PIP plan, to put aside 2 percent into private retirement accounts. If you want, we can look at Chile, who has a fully privatized system, which we are not advocating. But there are government-sponsored or government-regulated mutual funds that people can put money into.

Senator MOYNIHAN. I grant you that. I thank you for excellent responses. I would suggest, if you want to look at Chile, look at the amounts of money you get in Chile. I think it would surprise you how small it is. But they did innovate, and we find ourselves with a new idea, to look at Chile for our social policy. But it is a welcome one.

Thank you, Mr. Chairman.

Senator SIMPSON. Certainly we could pierce that veil some day. We shall, because the Government is still in that game in Chile, too. They are not completely out of there.

Senator MOYNIHAN. It is about 10 years old. I think that is about right.

Senator SIMPSON. Well, thank you, Senator Moynihan. Let me just say a couple of things in summary, and if Senator Moynihan has any questions. I have a couple. It is very interesting, we must keep in mind the number of people in America who are over 65. It is in the testimony, but it needs a swift commentary.

Right now, there are 34 million people out of our 260 million who are over 65, one in eight. In the year 2025, by Labor statistics, other statistics, there will be 61 million people out of approximately 300 million people. That will be one in five.

So, coming from one in eight to one in five is automatically a crush right there, without question. Young people are not paying attention, and maybe they do feel, well, my parents are going to be all right.

I mean, I have three children; a daughter, 33, a son, 37, and a son, 39. All three of them are still smiling as they pour money into the Social Security system, knowing that they will get nothing back. They say this. The boys have an IRA, and Susie and her husband. They just chirp along. They are wonderful people. They are very bright, very thoughtful.

They just know there is going to be nothing there, so they have their own 401(k) type things, their own IRAs. But I say to them, but how do you feel about the money going down the hole? Well, it goes to you, goes to someone. But that is an interesting reaction, and I do not know where that will suddenly change.

I really regret that the President did not include in his last budget what he had in his first one, which was the issue of generational accounting. It was a very appropriate, thorough, honest scenario as to what was going to happen.

Then it was left out of the next one, just left out, omitted. I asked people in the Administration why, and they just kind of winked and said, well, you know, it is too hot. Election is coming, and so it is left out.

But the media is involved here. You knew I would get to that. You mentioned, Mr. Miller, that there were several things we could do to get the media to confront this issue as a matter of routine.

Tell us some of the things you would propose, because it will not get done. All we ever read about is that the seniors are getting short-sheeted and the safety net had a hole in it, and everybody fell apart, and the children are dying, and the disabled, and that is all you get.

It is a pretty generous country, else we would not be spending $1.506 trillion this year for 1 year's budget in the United States. And, as we cannot deal with the entitlement programs, guess who gets hurt in the process? Pat Moynihan has described this through the years. The people who will be hurt are the poor, and the elderly, and the children because those are some of the discretionary programs.

So how do we get them to confront this issue? They choose to simply go through a remarkable bias that somehow all seniors are truly, truly the destitute in our society, and we know that is not true. What do we do?

Mr. MILLER. Well, for starters, the best thing for public officials to do is talk about it more, as you are doing with these hearings. Despite the media's self-image as tough and independent, they typically function as stenographers to public officials like yourselves, and news typically ends up being what public officials say or do.

So the more the public officials talk about it and, more importantly, the candidates—including, hopefully by the year 2000, a Presidential candidate—campaign on these issues we will get a lot more coverage. *The New York Times* would not have run a full-week series on economist angst if Pat Buchanan had not been in the campaign, for example.

Apart from that, I think there are things Congress can do to scrutinize the news hooks that the media needs to make these issues more accessible, and also an excuse to call them news. I do think, bereft sometimes as the media coverage is on this, it is a lot better, and reporters, editors, and producers are much more attuned to these issues than they were even 3 or 4 years ago.

If a steadier stream of news hooks can be provided, thus my idea for some kind of monthly release or statistics describing the unfunded promises in our Social Security and Medicare systems which are so huge and might provide a routine, galvanizing hook for interested media to then go off and do longer pieces on.

The trade deficit figures, which are not that important economically, as you know, end up generating a fair amount of coverage all the time and become the hook for lots of pieces.

Another idea might be to require or condition the use of the congressional frack on each Member of Congress having, say, five town meetings in his district each year on the future of these pension and retirement entitlement programs.

Now, cynics may say that did not help Marjorie Masvinsky very much, but it still amounts to 2,000 meetings a year, which does generate tons of local spin-off press and other local education efforts and may be something worth starting as the price of letting Congressmen communicate in this free way with their districts.

I guess the last thing would be my fantasy suggestion, and I suppose you may not take it too seriously, but I am a big fan of the generational accounting numbers myself.

My dream has always been that it would be stamped, like a Surgeon General's warning, on the front of the President's budget each year so that it would say, "Warning, the policies contained herein could result in lifetime tax rates on the next generation of 82 percent; details inside." So these are at least some of the thoughts that may spark some creative thinking in trying to get this more media friendly.

Senator SIMPSON. Well, these are two very creative thinkers here of our generation sitting here before you. I am going to ask a final question, and Pat, if you have any, you may do that.

I will ask each one of you, how are we going to educate today's senior citizens to show them that you are not after them, you are not trying to punish them, that we are not trying to punish them; that they have truly received a most fantastic deal, especially in the 1980's, the ones you described. There will be another one. It is like parity. The best Christmas you ever had when you farmed was 1914, and the best deal you would ever have in Social Security is retiring in 1980, if I am not missing the point.

How do we tell them we love them, we care about them, we are not interested in whacking on them, that they have a tremendous deal, tremendous benefits, not just Social Security itself, but all the rest of it? How do we convince them that they must share in the solution to ensure that the beneficiaries of your generation receive a fair and honest return from the system?

Mr. LEVY. I would have to say, honestly, the first thing we have to do, with all due respect, is get Congress to come clean. I have seen on C–SPAN and other networks Congressmen standing in front of groups of senior citizens and saying, "This group is trying to gut your benefits, they are trying to send you to the poorhouse." Until people stop misquoting, or lying, or whatever you want to call it, this problem is going to persist.

Somebody needs to sit down with a reasoned approach and say, "You are getting benefits in excess of what you got. We do not want to put you out on the street, however, there is going to be nothing left for anyone else unless you do something now."

Senator SIMPSON. Yes. Mr. Miller.

Mr. MILLER. I guess I think it will take talking more in the spirit of a family confronting its problems, just like any family would have to individually. The big problem we have, or one of the big ones that we have to solve if we are going to address or ever have any ability to have progressive government again, or have any resources in the Government devoted to new national needs, is to talk about, how do we afford the baby boom's retirement while at the same time not placing a crushing burden on tomorrow's working families, and without crushing the economy. Until we can put the debate in those terms and have it honestly, I think we are always going to be subject to those who would try to be very divisive.

Now, we have to be realistic also. It may be, like in many issues that galvanize constituencies, it may require a little bit of demagogic campaigning at some point over the next 5 years by some younger troupe of warriors who come in and try and make the age-old political argument, that you are being robbed, as a way to get some people excited about what the future is and what the stakes are for their future.

But I think what we always want to be mindful of, is this is about making decisions as a family about the retirement of elders without starving those who are coming up of their own opportunity.

Senator SIMPSON. Mr. Howe.

Mr. HOWE. Maybe I can make a suggestion. Having looked a lot at a lot of cohort differences—attitudes, personality, and behavior—I know that now Robert Putnam's new work has brought up the whole subject of the so-called "long civic generation" or the decline in civic attitudes among many Americans today. He has discovered a real cohort gradient, that it depends on when you were born. Who you are is when you were, so to speak.

I think one thing that is very important that can be taken from this to educational efforts, is to make many senior citizens, those who now call themselves senior citizens—what we call the GI generation, those who weathered the Depression and participated in World War II—realize that one very important element that was part of their entire upbringing and their coming of age experience was their positive connection with public life and government activity.

This started when they were young. It started with the Boy Scouts and Girl Scouts, and 4-H'ers and Campfire Girls. It started with the CCC programs. It started with their experience in the military, with the GI bill.

It started with a lifelong, positive relationship with a government that was always looking out for them. It was protecting them from drugs, it was protecting them from alcohol, it was piling up unused fiscal resources that could be used on their behalf.

I think that one important element to remind today's senior citizens is that if they want a new generation to mirror their virtues, to be brought up like they were, that government is going to have to be more of an agent for the young and for the future, almost on a crusading basis, which it was during the era between World War I and the New Deal, as it was for today's GI generation senior citizens.

I think they will resonate with that. I think they understand that, that there is something different about the relationship between government and children today, although, of course, it may be changing and it may be changing for the better.

Senator SIMPSON. Do you have any questions, Pat? Do you have anything you want to add?

Senator MOYNIHAN. I just would like to thank the committee, and thank you, Mr. Chairman, and thank our panel. I was in the Navy 52 years ago and I do remember that they did an awful lot of things for you. I was on an LST that was not going to get back from Keiushu, and thank God for the atom bomb. That is a view I have had which has put me a little bit aside from the generations that followed. A fair point.

But let us please remember, we are talking about how to deal with good problems, not bad ones. It is not a bad thing that people live longer and better. We are talking about how to make that something to celebrate and reward our lives, and enrich them, as I think we can if we have more conversations like this.

Senator SIMPSON. Another little garland strewn in the way with Senator Moynihan. Remember his amendment. I think this year about five million people will pick up that little sheet of paper from the Social Security Administration and find out what they have paid in and what they are going to get out, and there are 19 million of those that went out in the last couple of years, or whatever. Anyway, that is having a sobering effect.

I go to town meetings and they are out there, and they say, we have put it in from the beginning and we want it all out. I give them the form, or they are getting it in the mail.

They do not come to the town meeting anymore; they are embarrassed because they see what they have put in: $5 in 1945, $20 in 1950, $32. These are people who are my age. As I told you, the most productive time of my life, practicing law in Cody, WY, in 18 years I never put in over $874 a year, and neither did any other grey-haired cat my age. Not one of them.

I have to sit and listen to them shoot the vapors full as to the fact, and then they are going to get $800 a month. Putting in $800 a year and getting $800 a month. With me alone, if I hold off till 70, I will get $1,550 a month. If I take it at 65, I will get $1,140.

Senator MOYNIHAN. Mr. Chairman, you give me hope.

Senator SIMPSON. I know. It just makes your heart sing, doesn't it? Now, this is not a question, this is something for the record. This is interesting, Pat. The post-baby boom generation is the one that should be the most concerned. These are the people born between 1965 and 1977. There are 41 million of them.

Now, they are preceded by the baby boom generation, between 1946 and 1964, and there are 78 million of them. So Generation X has 44 million. Then right after them, the people born between 1978 and 1995 has 72 million members.

Now, you know what is going to happen. This is the fear, and it will come to pass. The Generation X'ers have the least political clout among those three groups. Taxes will be raised on the Generation X'ers to maintain benefits for the baby boomers, and when the Generation X'ers start to receive benefits, the larger generation right after them will be out to pressure Congress to cut their benefits. So the Generation X'ers are the people who are, I guess, the least involved, who face the worst scenario from both the front and the back.

Senator MOYNIHAN. Mr. Chairman, I am prepared to accept the proposition that demography is destiny, but that is much too Darwinian an interpretation of the future, surely.

Senator SIMPSON. Well, we are not into the survival of the fittest yet, but we are involved in a struggle for these young people. I thank you for presenting yourselves in such fine and articulate fashion. I thank Senator Moynihan for his participation. It is very helpful and very meaningful.

Thank you all. I appreciate it. The hearing is concluded.

[Whereupon, at 12:08 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Shirley S. Chater

Mr. Chairman and Members of the Subcommittee:

I appreciate your invitation to discuss the question of whether future beneficiaries will get a fair return on their contributions in terms of the benefits they will receive from Social Security. You also asked me to address the question of whether young workers should expect to receive their full benefits and what changes will be required to ensure that future retirees are treated fairly.

As we begin to discuss and analyze the changes that may be necessary to ensure that Social Security continues to serve the needs of America, it is absolutely essential to understand the role that Social Security has played in the past and recognize the positive impact it has had on the economic well-being of the country. Social Security allows almost 42 percent of the elderly--10 million people--to live out of poverty.

Unfortunately, many critics of the program judge its value from much too narrow a perspective. They view it from the perspective that Social Security is only a savings plan for retirement and that the return on investment is the sole criterion against which it should be assessed. Some people believe that if they were allowed to invest their Social Security taxes in private investments, such as stocks and bonds, they would receive a higher rate of return--in their view, a fairer return--on their Social Security taxes than Social Security currently provides. Thus, I would like to begin today with a brief look at the purpose of the program before I discuss some specific comparisons of contributions and benefits.

<u>Social Security Offers Families Protection</u>

The success and popularity of Social Security is based on the fact that it strikes a balance between the complementary goals of individual equity--providing benefit protection which is related to an individual's contributions--and social adequacy--providing advantages to society as a whole by alleviating poverty and allowing as many citizens as possible to enjoy a reasonable standard of living. In other words, the social adequacy aspects of the program look beyond the individual to how Social Security can benefit society as a whole. These features, which I will describe later in my testimony, are designed to provide a measure of financial independence to all workers, including lower paid workers and their families. One of the key elements of Social Security is that because it is not means-tested, it maintains the collective nature inherent in this social insurance program.

As a social insurance program, Social Security spreads the cost of protection against the risk of lost income due to retirement, death, or disability over the entire working population, with more protection, per dollar earnings, for lower paid workers and for workers with dependents. Consequently, the value of benefits for any given worker depends on his or her individual circumstances--whether the individual has high or low earnings, is married, may have children, becomes disabled or dies at a young age, or receives benefits beyond average life expectancy. For example, in an extended family, retired beneficiaries may be receiving benefits while their adult children, still in the workforce, and grandchildren have the assurance that Social Security benefits will be there if one of the working parents becomes disabled or dies. The security provided by Social Security is inter-generational.

Those who limit their analysis of the value of Social Security to the retirement program ignore the vitally important disability and survivor programs. Over 30 percent of our Nation's Social Security beneficiaries are receiving disability and survivors benefits, and those programs make up over 30 percent of the benefits Social Security pays. This protection can be extremely valuable, especially for young families that have not been able to sufficiently protect themselves against the risk of the worker's death or disability. In 1994, Social Security paid $15.2 billion in benefits to children. Without Social Security's protection, an increased burden would be placed on families, other government programs, and private charities to support those who would be left in financial need due to the unexpected death or disability of the worker.

One way to gauge the value of Social Security disability benefits is to express their value as insurance. The Social Security disability program provides the same value as a $203,000 disability insurance policy for a worker aged 27 with a spouse and two children and with average earnings. Last year, Social Security paid about $41 billion in benefits to about 6 million disabled workers and family members.

Similar value applies to the Social Security survivor program. Survivor benefits for a worker aged 27 with a family and with average earnings are equal to a $295,000 life insurance policy. Social Security also paid about $67 billion in benefits to more than 7 million survivors of deceased workers last year. Again, we tend not to focus on the fact that one in five of today's 20-year-old men and one in eight 20-year-old women will die before retirement.

Social Security has had another important beneficial impact that critics of the program often fail to acknowledge. By dramatically increasing the extent to which retired and disabled workers, their dependents, and survivors of deceased workers are financially independent, Social Security has relieved younger generations of the burden of providing for the financial needs of older relatives at the same time they are trying to raise their own families.

Finally, because the cost of administering the program is less than one percent of contributions paid, the public is receiving maximum value for their investment. More than 99 percent of the Social Security contributions paid by workers is returned in benefits paid to them or their survivors. That's better than anything you can get in the private market.

Individual Equity and Social Adequacy

Because Social Security is designed to meet certain social adequacy goals, we should not measure its worth simply by comparing contributions paid and benefits received. Certain features of the program are geared toward meeting broad-based social needs in addition to providing retirees with a specific rate of return.

The basic benefit formula is designed to replace a higher proportion of earnings for low earners than for high earners. This is in part because higher income workers are more likely to have accumulated greater savings or investment income than lower income workers. Also, it assumes that lower earners need to have more of their earnings replaced because they spend a higher proportion of their earnings for basic needs. Such workers generally are not able to accumulate savings or generate investment income to the extent that higher earners can.

Additionally, many low earners have worked in jobs that have not provided pension coverage. Thus, the benefit formula provides lower income workers with a measure of financial independence without the requirement to establish need.

Social Security is the major source of income (providing 50 percent or more of total income) for 63 percent of beneficiaries aged 65 and older, and contributes 90 percent or more of income for about 25 percent. As the program has matured, it has more effectively met its objectives. Only 1 in 8 elderly people are living below the poverty line today, compared to 1 in 3 in 1959. And about 42 percent of beneficiaries age 65 and over--more than 10 million people--are kept out of poverty by their monthly Social Security benefits.

Social Security was never intended to serve as the sole source of income to retirees. When combined with pensions, private savings, and investments, however, Social Security benefits were intended to give workers some measure of economic security. Benefits are based on the amount of earnings subject to Social Security contributions, rather than individual financial circumstances. Generally, the higher the lifetime earnings, the higher the monthly benefit.

Benefit and Contribution Comparisons

Let me now discuss some specific comparisons of contributions and benefits. As stated earlier, the value of the Social Security program should not be measured solely on the basis of individual equity. Any analysis of the Social Security program shows that past generations have benefited greatly from the program. This is because, until the program matured, benefits tended to be generous relative to contributions so that the program could begin to offer adequate protection to as many workers as possible, including those who did not have an opportunity to contribute to it during their entire careers.

As the program has matured, the return on contributions has decreased but remains generous. For example, to illustrate the return for persons now becoming beneficiaries, we may consider a person with average wages who retires at age 65 in 1996, who paid $21,518 in the employee's share of Social Security OASI contributions. When interest on those contributions is factored in, the resulting value is $73,703. This worker will receive a monthly benefit of $890, and will recover all contributions, with interest, in 8 and one-third years. This worker can be expected to live nearly 10 more years beyond the break-even point.

In the future, the rate of return, while declining, will continue to be fair, especially when viewed within the context of the broad social objectives of Social Security. For example, a "baby boom" worker with average wages who retires at 66 in 2015 will pay $59,562 in the employee's share of Social Security contributions ($258,824 with interest). This worker will receive $2,074 in monthly benefits or $1,006 in real terms, and recover those contributions in about 12 years, and can be expected to live 6 years beyond the break even point based on life expectancy projections for 2015.

For a worker born in 1968 with average earnings who retires in 2035 at age 67 it will take 10 years to recover the contributions he or she paid. This worker will receive a monthly benefit of $1,215 in today's dollars and can be expected to live an estimated 8 years after the break-even point.

Having given you these calculations for those individuals born in 1968, however, I must qualify their significance. As we all know, we cannot project what lifetime benefits for those retiring 20 to 40 years from now will be. We all recognize that changes to the program will be required to sustain Social Security in the long term.

As you know, the Congressionally mandated Advisory Council on Social Security is very close to completing its assessment of long-range solvency options. Once the Council's options and recommendations are made public, the Social Security Administration, Congress and the public will carefully evaluate them and assess their impact on current and future beneficiaries. Until the public discussion has progressed further, it would be premature for me to take a position on specific options or ideas.

Conclusion

Mr. Chairman, for 60 years Social Security has been one of the most important and successful government programs. It was conceived not only to protect individuals, but also to protect America as a whole from the kind of economic uncertainty and need that existed during the Great Depression. The value of Social Security must be judged in terms of the protection it provides--not only for the individual but for society as a whole. Thus, those who seek to measure its value must consider the design of the program and the elements that support its design, rather than restrict their analysis to a simple measure of a rate of return on contributions.

According to the 1995 Trustees Report, beginning in 2013 Social Security expenditures will exceed revenues. The Trustees Report estimates that the Social Security Fund will be exhausted in 2030. Clearly, considering the crucial role that Social Security plays in our society, its future solvency is of critical importance to the nation.

As past successful efforts to reform Social Security have shown, changes to the program should occur only after bipartisan debate and public discussion. The Advisory Council is an important element in the development of this bipartisan consensus. I look forward to sharing the Council's work with Congress and the public, and to working with you and the American people to ensure that there is sufficient funding of the Social Security program for all future generations.

STATEMENT BY

NEIL HOWE
(AUTHOR; CHIEF ECONOMIST, NATIONAL TAXPAYERS UNION;
SENIOR ADVISOR, THE CONCORD COALITION)

AT HEARING OF THE SENATE SUBCOMMITTEE
ON SOCIAL SECURITY AND FAMILY POLICY
MARCH 11, 1996

Mr. Chairman and Members of the Subcommittee:

I thank you for the opportunity to be here.

The subject of this hearing couldn't be more timely. In my view, the politics of Social Security have changed enormously over the past few years. At the beginning of this decade, Social Security reform was practically unmentionable. Today, a rapidly growing number of voices--from federal commissions, research institutes, public-interest lobbies, universities, and even the mainstream media--are openly weighing radical reform proposals. Meanwhile, surveys show low and falling levels of public trust in Social Security as it now stands. Three quarters of all Americans doubt that this program will be able to fulfill its promises to new retirees just 20 years from now--and about two thirds agree that Social Security "is in need of major reform now."[1]

Why is this happening? And why now? Let me offer you my own observations.

First, there is a growing concern that the system will become an insupportable burden on today's kids. According to the most plausible trustee estimates (projections 2 and 3 in 1995), the cost of OASDI as a percent of taxable payroll will rise by 6 to 10 percentage points over the next 40 years.[2] This is not the first time we've faced such large projected imbalances--but before we ignored them until they grew into an acute short-term emergency. Unlike the mid-1970s or early 1980s, however, Americans in the 90s are in a more sober mood: They are much more likely to take the long-term projections seriously--and not assume we can "grow our way" out of them. They are also more aware of other dependency burdens (such as the exploding cost of health-care benefits) that will put a crushing extra pressure on living standards.[3]

Second--if future benefits are cut--there is a growing worry that the system will not provide sufficient support for today's midlife adults when they retire. As Craig Karpel put it in his recent book, _The Retirement Myth_[4], there is only one thing Boomers fear more than the prospect that the federal budget will never be balanced, and that is the prospect that it _will_ someday be balanced. To keep Social Security outlays from exceeding revenues in the year 2025, without raising taxes, we would in that year have to enact a 25 percent across-the-board benefit cut.[5] Most Boomers don't participate in a pension plan, have negligible financial assets, yet expect to retire early and comfortably. They are not prepared for any substantial future benefit cuts; they probably aren't ready for those that are already legislated to affect everyone born after 1937.

As today's mutual-fund boom attests, many Boomers are responding by trying to save more on their own. Without a doubt, they constitute the leading edge of a growing public consensus about encouraging personal savings. Our survey shows that people in their 40s are significantly more likely than other age groups (79 versus 66 percent) to agree strongly with the statement, "government should provide more incentives to save for retirement." But this leads to my third point: The Boomers' belated conversion to the virtue of thrift comports awkwardly with Social Security's pay-as-you-go structure, which (entirely aside from its impact on the federal budget) is widely believed to discourage personal savings. Nor is this just a U.S. worry. As a remarkable new World Bank study[6] points out, policy reformers worldwide are turning away from unfunded retirement systems precisely because of their tendency to undermine private savings rates.

Fourth, there is rising disappointment about Social Security's declining rate of return on contributions. Today, for the first time in the history of Social Security, large categories of newly retiring workers (especially well-off single males) are due to get back less than their market value in benefits, even when that value is computed at the lowest plausible discount rate.[7] Everyone is beginning to understand that in future years these "market losers" will comprise a steadily growing share of all beneficiaries.

This is very bad news for a program predicated, since the early 1950s, on the chain-letter notion that everyone can be a winner. Paul Samuelson's dictum about Social Security being "the greatest Ponzi game ever contrived"[8] is now in total disrepute. By degrees, the public is again warming to the notion that Social Security ought to be foremost a safety-net program--the notion that prevailed from 1935 to at least 1954.[9] This, at least, is what I infer from the rising public support for means-testing benefits[10] --and from the fact that this rise is coming mainly from Americans age 50 and under (precisely those who are least likely to get their money back). Many critics used to think that windfall rates of return were a good argument for reforming the system: Why not cut benefits in a way that would still leave everyone a winner? That argument fell on deaf ears. Ironically, the opposite argument may ultimately turn out to be far more persuasive: Why not rethink a system that cannot hope to offer the same long-term rate of return as genuine economic savings?

Finally, there is the changing generational constellation of the 1990s.

From the late 1960s to the late 1980s, any public discussion of Social Security was shaped by several key generational assumptions.[11] One was that the retiring members of the "G.I. Generation," those who weathered the Depression and won World War II, were entitled to everything they could get. All their lives, they had always been regarded by others as uniquely deserving of public reward; in retirement, they're the ones others started calling "senior citizens." And they've thought the same of themselves; in recent decades, they're the ones who turned the various senior groups into lobbying giants. Another widespread assumption was that a postwar generation of indulged "Baby

Boomers" was destined to inherit a wondrous prosperity that they probably didn't appreciate and might not even deserve. Thus, they weren't expected to bear higher tax rates, and even if that happened, well, who were they to complain? The final assumption was that children weren't an issue. The future looked bright for them, and at the time they didn't figure much in any public policy debate.

Needless to say, this constellation gave rise to an era in which it was very easy to expand and raise Social Security benefits and very difficult to shrink or reduce them. Also, needless to say, this constellation is now rapidly shifting.

Who are today's new elders? The so-called "Silent Generation" born in the late 1920s to early 1940s. Known to demographers as the "Lucky" or "Fortunate" cohorts, this is the group who came of age after the Depression and World War II and whose typical lifecycle has been an escalator of unparalleled upward mobility. Unlike the GI's, these new Silent retirees don't feel automatically entitled. They are beginning to shed the "senior citizen" label, feel uneasy about the senior lobby's massive, one-size-fits-all institutional presence, and often express guilt or worry about the economic problems of their grown children. And as for these "Buster" or "Generation X" young adults, surveys show that older Americans no longer assume they'll do better than their parents. Nor do these young adults hide the fact that economic success is very important to them.

Meanwhile, children are no longer invisible. They are rushing back to become the rhetorical centerpiece of just about every major crusade in Washington these days--from balancing the budget, to protecting the environment, to reforming welfare, to cleaning up the culture. Americans in the 1990s no longer accept any policy that doesn't guarantee that this new generation of kids will (at the very least) be held harmless from the resource allocation choices of older Americans.

As it reshapes the social mood, this shifting generational constellation may be driving many of today's changing attitudes toward dependency, deficits, personal thrift, and future-oriented budget priorities. Let's hope it works in time. Experts familiar with the projected budget cost associated with the impending "age-wave" tell us we've got about ten more years to start implementing some major changes.[11] Otherwise, the changes will come anyway--but with unsettling and perhaps catastrophic speed.

Mr. Chairman, this concludes my statement. I'll be glad to answer any questions.

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[1] Unless otherwise noted, all opinion figures refer to the Entitlement Survey (1995) commissioned by the National Taxpayers Union Foundation and the Congressional Institute for the Future, and carried out by Mathew Greenwald and Associates.

[11] See the 1995 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds (1995), pp. 109-110.

[3] See Neil Howe, Why the Graying of the Welfare State Threatens to Flatten the American Dream--or Worse (December 21, 1994; Policy Paper No. 10, National Taxpayers Union Foundation).

[4] Craig S. Karpel, The Retirement Myth (1995; Harper-Collins).

[5] See note 2.

[6] Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth (1994; World Bank).

[7] See, for instance, C. Eugene Steuerle and Jon M. Bakija, Retooling Social Security for the 21st Century (1994; Urban Institute Press), Appendix. These trends are corroborated by the most recent Greenbook of the U.S. House Committee on Ways and Means and by the Congressional Research Service. See also the hearing before the U.S. Senate Committee on Finance ("'Money's Worth' of Social Security"), March 11, 1993.

[8] See Paul Samuelson's column in Newsweek (Feb 13, 1967), which popularized a thesis first advanced in an article, "An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money," Journal of Political Economy (December, 1958).

[9] The popular Title I of the original Social Security Act of 1935 was the means-tested Old Age Assistance (transformed into Supplemental Security Income in 1975). By contrast, Title II, "Federal Old-Age Benefits" (later to become payroll-tax funded OAI, then OASI, then OASDI) was the least-understood and most controversial part of the original act. Until the early 1950s, total federal benefits through Title II were still dwarfed by means-tested benefits through Title I, "double-decker" reforms of Title II were still being suggested by federal commissions, and public opinion still identified Social Security with poverty relief. On the SSA crusade to define Social Security as a non-means-tested program, see Arthur Altmeyer, The Formative Years of Social Security (1966; U. of Wisconsin); Edwin E. Witte, The Development of the Social Security Act (1962; Univ. of Wisconsin); and Jerry R. Cates, Insuring Inequality: Administrative Leadership in Social Security, 1935-54 (1983; U. of Michigan). On public opinion, see Michael E. Schiltz, Public Attitudes Toward Social Security, 1935-1965 (1970; Social Security Administration).

[10] See the yearly "Retirement Confidence Index" surveys commissioned (starting in 1990) by the National Taxpayers Union Foundation and now carried out by the Employee Benefits Research Institute.

[11] For more discussion of how to define and describe generations, see Neil Howe and William Strauss, Generations (1990; William Morrow) and The Fourth Turning (forthcoming; Bantam-Dell-Doubleday).

[12] For the early and still-classic description of this policy window, see Richard Jackson, America's Indian Summer: The Economic Impact of Aging in the 1990s and Beyond (May 1991; The Hudson Institute).

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Testimony of Alden Levy

Third Millennium Board Member

U.S. Senate Finance Committee's Subcommittee on Social Security

Monday, March 11, 1996

Thank you, Mr. Chairman, for inviting Third Millennium to participate in this dialogue on Social Security, a program 25 percent larger than the U.S. defense budget.

My name is Alden Levy. I am a member of the Board of Directors of Third Millennium and an independent business and software consultant. Third Millennium is a national, non-profit, non-partisan group of Americans born after 1960. We are based in New York City.

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

Despite all of the hoopla surrounding the current campaign season, we remain focused on our ongoing mission: to redirect America's attention from the short-term election cycle to the long-term health of the U.S. economy.

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

Suddenly and remarkably, Social Security no longer is the third rail of American politics. Proposals to overhaul it, rather than defend it, have ignited the campaign debate. Think tanks, business associations and advocacy groups such as Third Millennium all have played roles in transforming the way Americans view Social Security. And what my generation in particular is finding is a government program that asks us to "contribute" more than one-seventh of our income with each paycheck, while at the same time warning us that it will be bankrupt before we retire.

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

Of great curiosity to us is the Social Security Administration's peculiar answer to these massive problems. Commissioner Shirley Chater has implemented an educational program to mollify high school students by teaching them the virtues of a system that will be solvent only until 2030.

Mr. Chairman, while Social Security has had its successes, this PR campaign is nothing more than a federally-funded hoax to sell my generation the functional equivalent of an Edsel. America's young adults are capable of calculating how old they will be in 34 years, and no amount of PR can obscure the fact that when my generation hits middle age, this system will be broke. I didn't make this up. The system's very honorable trustees tell Americans the same story every year.

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

What should a new system look like? For years, management expert Peter Drucker has been analyzing institutions large and small. And he asks the following question: if a given organization didn't exist already, would someone create it from scratch now? And if so, what should it look like? Perhaps we'd be well advised to use his intellectual model as we begin the long journey toward Social Security reform.

There are many good ideas out there, some borrowed from abroad. While these are further researched, Third Millennium is undertaking a unique academic study that will look at domestic success stories. Entitled "How State and Municipal Pension Plan Systems Offer Prototypes for Social Security Reform," our project will look at what works for public employees in specific states. Many people don't realize Social Security is not a universal system. Not every worker in America contributes, and not everyone benefits. There are six state systems, including those in Colorado, Nevada and Ohio, where tens of thousands of state workers are exempt from Social Security entirely.

We are researching the structure of these systems and their respective returns to participants. We are just beginning our investigation, but several leading pension experts agree that we may be on the right track. An early draft of our study will be available by September 30, with the final draft due out between the election and the inauguration.

Mr. Chairman, I would like to thank you for taking the lead on Social Security reform, for giving Third Millennium and our generation a voice in the Social Security debate and for standing firm when neither President Clinton nor your party leadership would listen to reason.

Third Millennium will miss your common sense and your willingness to stand up for the unrepresented and the under-represented as well as the country as a whole, even when it means you stand alone. With all the talk of generational warfare, it is refreshing to know that you repeatedly offer us the opportunity to help prevent it.

Thank you.

STATEMENT OF MATTHEW MILLER
Economics Editor, *The New Republic*

Mr. Chairman and Members of the Committee:

I'd like at the outset to thank you for this chance to offer some thoughts on Social Security's future, and to also acknowledge, Mr. Chairman, your continued leadership on these issues, which will be missed when you retire. I thought my remarks would be most useful if they combined my perspectives as a former OMB official, where I served as senior advisor to Alice Rivlin from 1993 to 1995, as well as those gleaned from my more recent descent into journalism, where I'm now the economics editor of *The New Republic*, a contributor to *Time* magazine, and a new syndicated columnist for King Features. As someone who's seen from inside how both government and the media deal -- or don't deal -- with these complicated and politically explosive issues, I'm convinced that a big piece of solving our long-term problems involves finding creative ways to get the media routinely to hammer home the facts so the public understands the stakes. Only once citizens "get it" can they make the world safe for politicians to do the right thing. For the rising generation (I'm 34), building such public awareness and "followership" is probably more productive than keeping our fingers crossed for courageous leadership, especially given the bipartisan incentives for evasion and delay.

Let me address, then, the economic questions the Committee has raised, before offering a few concrete policy suggestions and ideas for making these issues media-friendly.

Social Security returns are declining

When it comes to the returns each generation receives on its payroll tax "investment" in Social Security, the short story is simple: Social Security used to be a fabulous deal; for today's retirees, it's largely a good deal; but in the future, especially for upper income retirees, it will increasingly become a bad deal. As you know, demographics are the culprit.

In Social Security's early days, workers paid into the system for very few years before becoming eligible for benefits, and at combined employer and employee payroll tax rates of 3 percent, as opposed to more than 12 percent today (or 15 percent, including Medicare and disability). The "payback" on these taxes was thus enormous, and, contrary to popular myth, went far beyond any notion of "getting back what you paid in." An average one-earner couple retiring in 1960, for example, got back in benefits about 11 times what it paid in (after accounting for inflation and a two percent real rate of return); even high-earning two worker couples got back more than five times what they paid in. (See charts attached from Steuerle and Bakija, *Retooling Social Security for the 21st Century* (Urban Institute Press, 1994), from which these findings are drawn. Also attached are related charts based on the same data, prepared by Neil Howe for the National Taxpayers Union Foundation).

As the system matured, ever-increasing payroll tax rates (which have risen roughly 3 percentage points per decade), along with workers paying into the system for many more years, conspired to push these returns downward. Offsetting these higher contributions, however, has been a benefit structure that offers higher and higher real benefits to each successive cohort of retirees. The result is that beneficiaries who retired in the 1980s -- i.e. many of today's beneficiaries -- are getting the best deal Social Security will ever offer, in terms of absolute dollars. For example, an average wage one-earner couple that retired in 1980 gets back about four times what they paid into the system. In absolute dollars, they get back, in 1993 dollars, an astonishing $210,000 in benefits on payroll taxes of $50,000, for a net windfall transfer of $160,000. (By comparison, the same couple retiring in 1960 got a transfer of $90,000 in 1993 dollars. Note that if Medicare is added, the windfall becomes significantly larger).

In addition, Social Security has for decades bestowed its biggest such windfalls on beneficiaries with the highest incomes. This fact -- that Social Security is regressive within cohorts -- is not well understood. It's commonly argued that Social Security is a progressive system because the regressive payroll tax through which it is financed is more than offset by the progressive structure of the benefit formula. But while the benefit *formula* is indeed progressive, the system still transfers *larger amounts of money* to better-off recipients. This isn't as paradoxical as it sounds, because the formula, you'll recall, is based on wages. A high-earning worker who gets, say, a 26 percent replacement rate on his wage will collect more absolute dollars over the course of his retirement than a worker who gets 50 percent of a much lower wage. This regressive windfall is compounded by the spousal benefit calculation, which gives spouses 50 percent of the worker's benefit regardless of income level, so that more absolute dollars go to better-off spouses. In this respect, Social Security resembles our other great regressive entitlement, the mortgage interest deduction, which offers a bigger housing subsidy to someone like Steve Forbes than it does to Forbes' maid, who is presumably in a lower tax bracket. If the maid rents, of course, she gets no subsidy at all.

Looking ahead to when the Baby Boomers and "Generation X'ers" hit their rocking chairs, the glory days for returns are over. These workers -- especially the X'ers -- will have paid higher payroll taxes into the system for their full working life. For Boomers who retire in 2010, average and higher earning single persons, as well as upper-income couples, will pay in far more to the system than they receive back; for higher earning single males, for example, the net negative transfer in 1993 dollars will be $135,000. (High earning single males retiring even in

1995 also will experience a slight loss). Thanks to rising real benefits and the spousal entitlement, however, one-earner couples retiring in 2010 will still get a net transfer of about $100,000 more than they paid in, though the windfall multiples will shrink to one to two times contributions. Better-off two-earner couples, however, because of their bigger combined tax contribution, will get negative returns.

Generation "X'ers" who retire in 2030 will face the worst scenario. High earning Americans, both single and two-earner couples, will face losses in the $200,000 range (in 1993 dollars). Single males lose at all income levels; while only the lowest earning single females come out slightly ahead. Average one-earner couples, however, continue to receive a positive return. But such one-earner families may not be that common in 2030.

Generational priorities of the federal budget

This bleak Social Security outlook for younger generations exacerbates federal budget priorities that already favor elderly consumption today at the expense of investment in children and economic growth for the future. There are many ways to illustrate these trends; here let me catalogue a few:

--There are an estimated $14 trillion in unfunded liabilities in in our entitlement programs, primarily in Social Security and Medicare. Honoring these obligations as currently legislated would require big tax increases on the tomorrow's workers. The declining returns to Social Security discussed above come *before* any future tax hikes are added in.

--Seven times more federal spending goes to the elderly today than to children under 18.

According to estimates by Neil Howe, the 12 percent of Americans who are 65 and over get 63 percent of federal benefits; the 26 percent who are under 18 get 9 percent (see chart attached). Even when state and local expenditures for public education are taken into account, the elderly are still the focus of about three times more spending than the young.

--The overall budget deficit, a function of these expenditure patterns and our collective unwillingness to pay for them, has absorbed the lion's share of our already meager national savings for fifteen years. This has reduced private investment, thus helping explain why productivity and wage growth have been stagnant. The legacy for the rising generation will be a double whammy: slower economic growth, plus a sharply higher tax burden coming out of this slower growing pie.

--The tax burden on young families is much higher than on elderly couples with identical income, thanks to regressive payroll taxes and the fact that much elderly income is exempt from tax. This seems especially unfair, given that young families have much larger child-rearing and housing expenses, which the elderly typically no longer have.

--Because both parties agreed for political reasons to take half the budget off the table this year -- defense, Social Security, and much "welfare for the well-to-do" -- a disproportionate share of both parties' proposed spending cuts came in the domestic discretionary accounts, which fund such public investments as R & D, infrastructure and education, areas that underpin economic growth and where we've trailed other advanced nations for years. These wrongheaded priorities needlessly shortchange the future, since, as both parties know, the domestic discretionary part of the budget is not where our long-term problems reside.

A few thoughts regarding solutions

"The only thing comforting about an unsustainable trend," says economist Herbert Stein, "is that it can't go on forever." Still, it's essential that we address these problems sooner rather than later, when the required policy changes become more sudden, and may be debated against a backdrop of unprecedented generational strife. The proposals you and Senator Kerrey offered last year are a critical point of departure for reform. Here are two other ideas with a generational perspective that I'd urge you to consider:

-First, serious means-testing for today's better-off retirees, even on a temporarily high basis for five or ten years. Why? All generations should have to take part in a long-term solution, and today's retirees are enjoying the largest windfalls that will ever be given by the system. If we take the political path of least resistance and "grandfather" all of today's grandparents, we'll violate the spirit of equity between generations that ought to be honored.

-Next, it's time to jettison the fiction of the "trust funds" and focus on a broader budgeting of government's assets and liabilities as a whole. Many younger Americans have come of age paying more in payroll taxes than in income taxes, and (polls tell us) more likely to believe in UFOs than that Social Security will be there when they retire. As far as they're concerned, the money isn't "earmarked" at all -- taxes go into one big "cigar box" that finances whatever government does. Relying on the trust fund fiction skews public debate by ruling out questions of overall resource allocation and tax burdens from the start. Today's technical-sounding fights over restoring trust fund "solvency" disguise the real dialogue Americans need and are ready for: how do we pay for the baby boom's retirement without crushing the economy, or placing unfair burdens on tomorrow's workers?

When it comes to improving media coverage and thus public awareness of these issues, I'd offer a few quick thoughts. Despite its "tough" and "independent" self-image, the media typically function as stenographers to power, with "news" being defined as what public officials say or do. That means when both parties are in cahoots to sweep problems under the rug, there's no story -- as was the case when our avoidable S & L problems simmered for years. But when officials or candidates talk, there's no end to the media possibilities. Does anyone think the *New York Times*, for example, would have just run a weeklong series on economic anxiety if Pat Buchanan had not been in the race? Naturally, that means the way to get an honest airing of Social Security and related entitlement issues would be for a presidential candidate run on them. That won't happen this year, though my hunch is that by 2000, if we've continued to punt between now and then, it will.

In the meantime, Congress should consider creative ways to help routinize coverage of these issues by creating more official news "pegs" that offer interested media a vehicle they can use to educate the public. Reporters, editors and producers are far more attuned to these issues than they were even a few years ago, but they need official data that makes it "sexy" and regular excuses to call it "news." I'm thinking of things that build on your own proposal, Mr. Chairman, to institutionalize 30 year projections as part of the annual budget process. What else might

Congress do?

-Require an official monthly release updating the government's unfunded liabilities. Today, monthly trade deficit figures generate lots of press, and frequently become the "hook" for in-depth pieces on television and in print. Yet, as you know, the overall trade deficit has little economic significance, except as a roundabout way of saying we're investing more than we save domestically. Imagine, instead, if we had Tom Brokaw or Peter Jennings reporting, "The government's unfunded promises in Social Security and Medicare held steady at a colossal $14 trillion this month, meaning huge tax increases on our kids or sharp benefit cuts loom ahead. More on what it all means -- and why neither party took action this month -- from NBC's Lisa Meyers..." Even better, require the President and the Congressional leadership to announce these numbers in a news conference each month.

-Condition the use of the frank on each member of Congress having five town meetings yearly on the future of health and pension entitlements. Cynics will say this didn't help Marjorie Mezvinsky; but such meetings can become a galvanizing event locally, generating all kinds of spinoff press and educational efforts. And this means more than 2000 annual town meetings nationwide.

-Require the generational accounting figures to be stamped in big type like a surgeon general's warning on the front of the president's budget. I.e.: "Warning: the policies contained herein could result in lifetime net tax rates of 82 percent on the next generation....details, page 842." I'll confess this has been a fantasy of mine for some time, so I couldn't come before you without offering it up. Yes, the generational accounting measures are imperfect. Yes, this is gimmicky. But you get the idea.

When I worked at OMB, and the tough entitlement options were invariably taken off the table, I used to say to my colleagues that "after the generational war, this whole conversation will be different." I was joking, but the stakes, as you know, are high, and perhaps these and other unconventional ideas could help get them on the radar screen more often.

Thank you again for having me. I would be pleased to answer any questions.

* * *

Attachments

Table 5.3 LIFETIME OASI BENEFITS, TAXES, AND TRANSFERS (IN THOUSANDS OF CONSTANT 1993 DOLLARS)

Year cohort turns 65		Single Male			Single Female			One-earner Couple			Two-earner Couple		
		Low wage	Avg. wage	High wage	Low wage	Avg. wage	High wage	Low wage	Avg. wage	High wage	Low & Low	Avg. & Low	High & Avg
1960	Benefits	30.1	45.5	50.6	45.7	69.0	76.7	66.3	98.9	111.0	76.8	102.0	122.1
	Taxes	4.0	9.0	13.8	4.3	9.6	14.6	4.0	9.0	13.8	8.4	13.3	23.4
	Net Transfer	**26.1**	**36.5**	**36.8**	**41.4**	**59.4**	**62.1**	**62.3**	**89.9**	**97.2**	**68.4**	**88.7**	**98.7**
1980	Benefits	54.3	90.2	114.6	80.8	134.3	170.5	129.3	209.9	264.3	146.9	208.4	273.2
	Taxes	22.9	51.0	71.9	24.2	53.9	76.1	22.9	51.0	71.9	47.2	75.2	125.7
	Net Transfer	**31.4**	**39.3**	**42.7**	**56.6**	**80.5**	**94.4**	**106.4**	**158.9**	**192.4**	**99.7**	**133.3**	**147.5**
1995	Benefits	58.0	95.7	133.6	80.6	132.9	185.5	134.9	223.4	305.4	155.2	226.6	312.6
	Taxes	45.4	100.8	170.7	47.2	104.8	179.0	45.4	100.8	170.7	92.5	148.0	275.5
	Net Transfer	**12.6**	**-5.1**	**-37.1**	**33.4**	**28.1**	**6.5**	**89.5**	**122.5**	**134.7**	**62.6**	**78.6**	**37.1**
2010	Benefits	69.0	115.2	175.9	93.6	156.1	238.4	154.6	258.3	388.6	178.9	261.7	394.2
	Taxes	68.2	151.5	310.8	70.4	156.5	322.4	68.2	151.5	310.8	138.6	221.9	467.3
	Net Transfer	**0.9**	**-36.3**	**-135.0**	**23.2**	**-0.4**	**-84.1**	**86.5**	**107.3**	**77.7**	**40.3**	**39.8**	**-73.1**
2030	Benefits	84.0	139.6	220.3	113.7	189.0	298.1	187.4	312.8	493.0	215.9	316.5	498.1
	Taxes	88.1	195.8	468.8	91.3	202.8	485.4	88.1	195.8	468.8	179.4	287.1	671.6
	Net Transfer	**-4.1**	**-56.2**	**-248.5**	**22.5**	**-13.8**	**-187.3**	**99.3**	**117.0**	**24.2**	**36.5**	**29.4**	**-173.5**

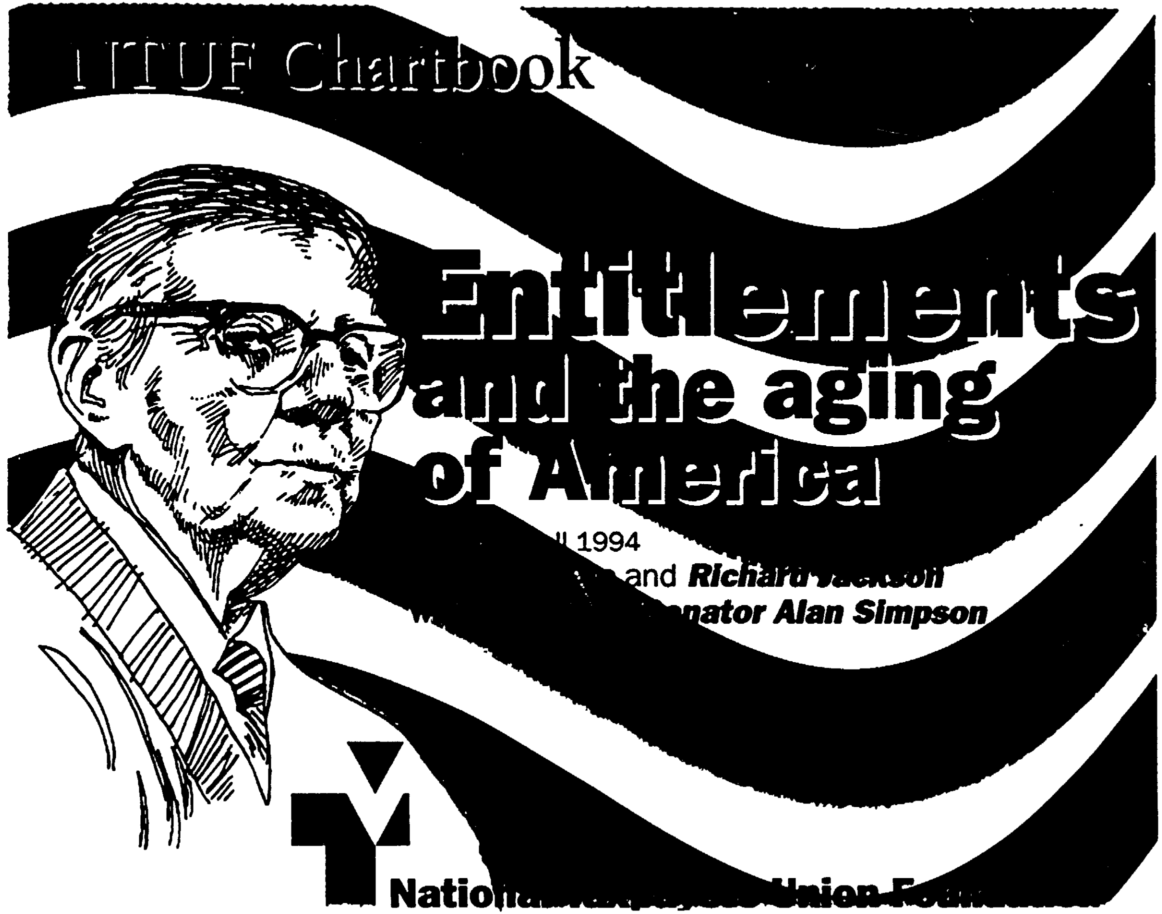
Notes: All amounts are discounted to present value at age 65 using a 2 percent real interest rate. Adjusts for chance of death in all years after age 21. Includes actuarial value of all OASI workers, spousal, and survivors benefits payable over a lifetime. Includes both employer and employee portions of OASI payroll tax. Couples are assumed to be the same age and to have two children born when parents are aged 25 and 30. Assumes retirement at the OASI Normal Retirement Age. Projections are based on the intermediate assumptions from the 1993 OASDI Board of Trustees report. OASI tax rate is assumed to be set at 10.65 percent after 1992.

Table 7.2 EFFECTIVE RATES OF SOCIAL SECURITY TAX AND FEDERAL INCOME TAX FOR FOUR-PERSON FAMILIES AT VARIOUS INCOME LEVELS, 1955–91

Year	Half Median Income			Median Income			Twice Median Income		
	federal income tax	social security tax	total	federal income tax	social security tax	total	federal income tax	social security tax	total
1955	0.0	4.0	4.0	5.6	3.4	9.1	10.8	1.7	12.5
1960	0.2	6.0	6.2	7.8	4.6	12.4	12.1	2.3	14.4
1965	2.2	7.3	9.4	7.1	4.5	11.6	11.1	2.2	13.4
1970	4.7	9.6	14.3	9.4	6.7	16.1	13.5	3.4	16.8
1975	4.2	11.7	15.9	9.6	10.4	20.0	14.9	5.2	20.1
1980	6.0	12.3	18.3	11.4	12.3	23.7	18.3	6.5	24.8
1985	6.6	14.1	20.7	10.3	14.1	24.4	16.8	8.5	25.3
1990	5.1	15.3	20.3	9.3	15.3	24.6	15.1	9.5	24.6
1991	4.8	15.3	20.1	9.2	15.3	24.5	15.0	10.6	25.6

Sources: U.S. Department of Treasury Office of Tax Analysis (Allen Lerman), U.S. Census Bureau *Current Population Reports* (various issues), U.S. Internal Revenue Service Statistics of Income (various issues), and authors' calculations.
Notes: Effective tax rates are expressed here as the total amount of tax paid as a percentage of cash wages. Table includes both employer portions of the Social Security tax. All amounts are rounded to the nearest tenth of a percent. The median income among four-person families was $43,056 in 1991. Table assumes all income is earned by one spouse. Itemized deductions are assumed to equal 23 percent of income through 1986 and 18 percent thereafter.

postwar tax changes have placed a particular burden on low- and moderate-income working families with children, who have also fared poorly in the income tax. A four-person household earning about one-half the median income for that size family (about $21,500 in 1991) faced a federal income tax and employer-employee Social Security tax bill equal to more than 20 percent of its income in 1991 (see table 7.2). This represents a dramatic increase from 1955, when the two taxes consumed only 4 percent of such a family's income. For a four-person family of median income (approximately $43,000 in 1991), the combined federal income tax and Social Security tax rate rose from 9.1 percent in 1955 to 24.5 percent in 1991. Such a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Entitlements
and the aging
of America
1994
and Richard
Alan Simpson

Chart 4-27

Benefit Payback on Social Security and Medicare Contributions for Average-Earning Workers Retiring at Age Sixty-Five in 1995

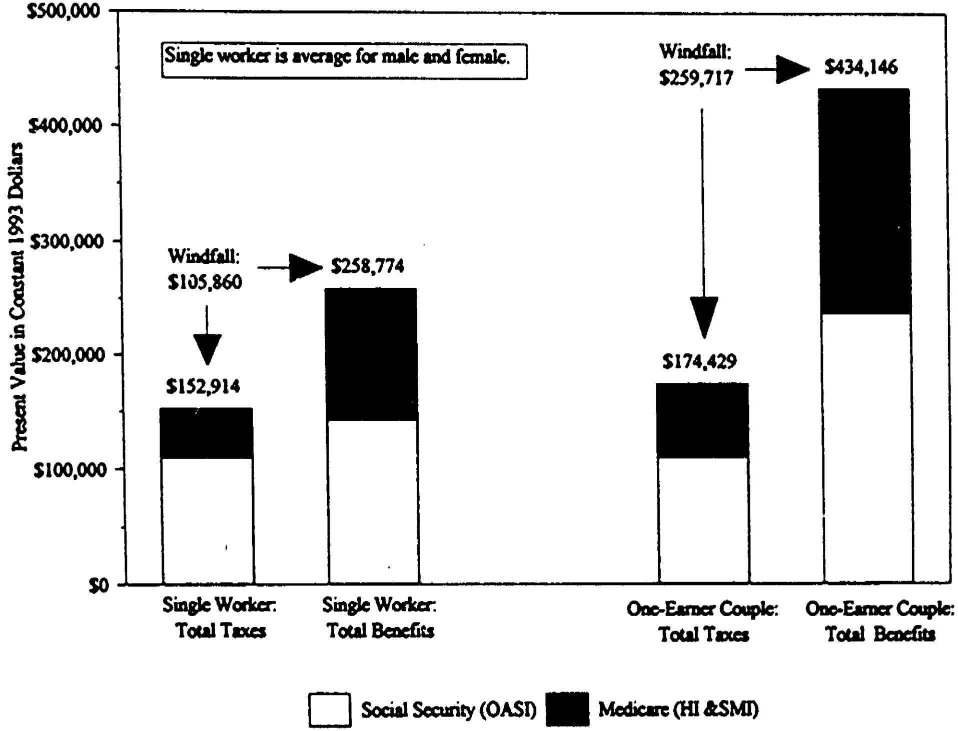


Chart 4-28

Net Lifetime Social Security Transfer to Average-Earning Workers Retiring at Age Sixty-Five, in Constant 1993 Dollars, by Birth Year

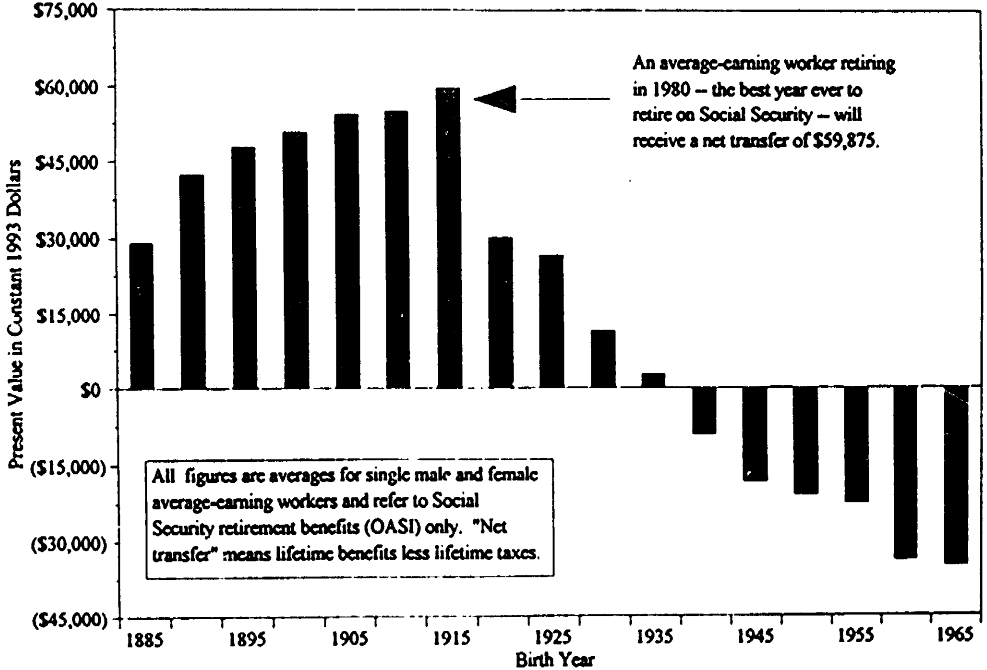


Chart 4-29

Real Annual Social Security Rates of Return for Average-Earning Workers Retiring at Age Sixty-Five, by Birth Year

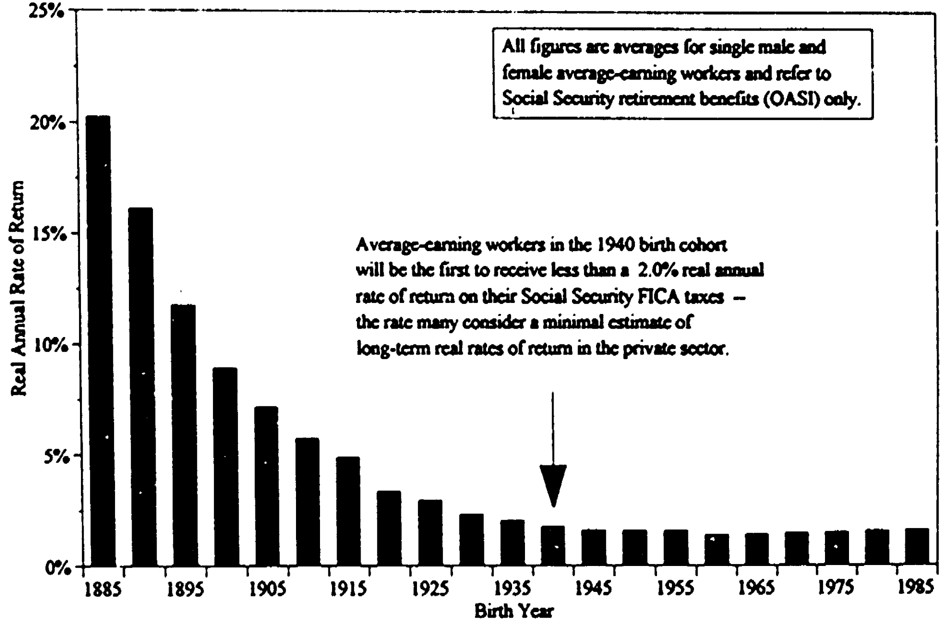
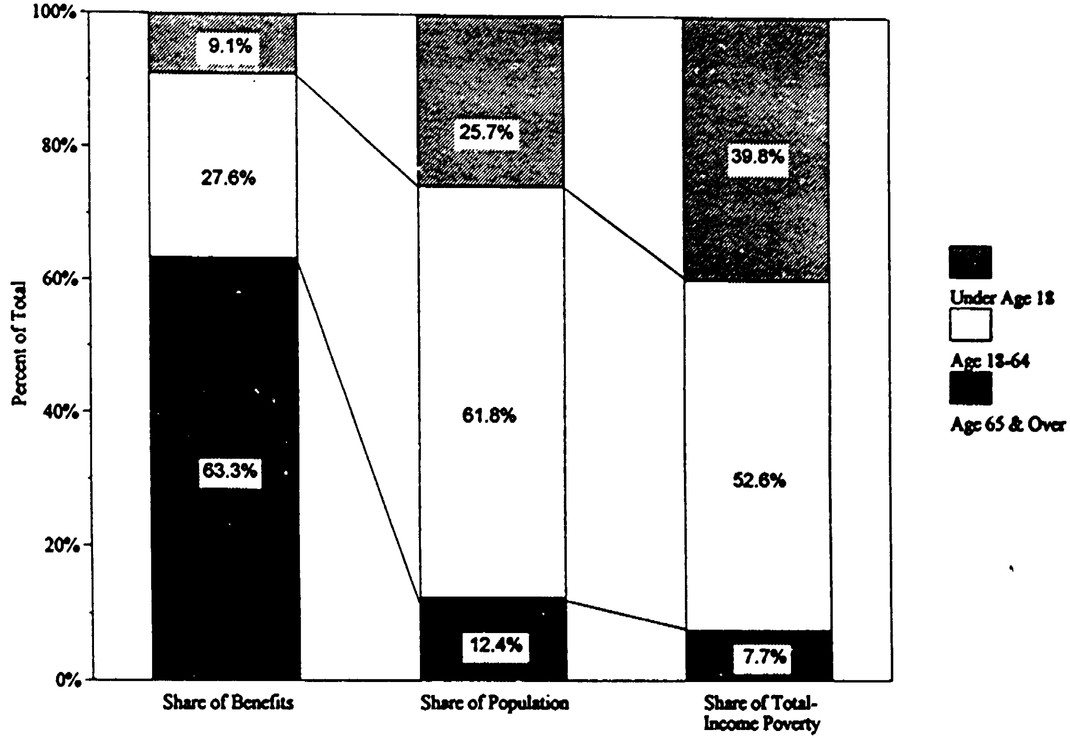


Chart 4-25

Federal Benefits, Population, and Persons in Poverty, Age-Group Shares as a Percent of Total in FY 1990



COMMUNICATIONS

STATEMENT OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons (AARP) submits the following statement for the record of the Senate Finance Committee's March 11 hearing on Social Security benefits for future retirees. Until recently, the value of Social Security to specific individuals and generations was largely of interest to economists and social insurance scholars. Now, however, the issue is discussed more widely because "money's worth" arguments are used to justify significant changes in the program, most notably some type of privatization.

There is no question that evaluating the cost/benefit ratio of Social Security has merit. However, most money's worth analyses underestimate the value of Social Security because (1) they exclude the full range of disability and survivor protections provided, and (2) they ignore the goals the program is designed to achieve, such as providing low wage earners with a higher rate of return.

Omitting survivor and disability benefits diminishes the value of the program, particularly among younger workers, who often express the view that they will not "get anything back from Social Security." Even money's worth analyses that go beyond a pension benefit are likely to overlook another aspect of the program -- Social Security is social insurance. Its benefits reflect a blend of equity (a relationship between contributions and benefits) and adequacy (a floor of income protection) that is embodied in its progressive formula. Thus, Social Security should not be evaluated without regard to the other purposes it is designed to achieve. When those broader factors are taken into account, the value of Social Security becomes apparent.

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

The Association hopes the money's worth issue will not be misused to undermine public support for this important program. Social Security is immensely popular because people of all ages gain from its direct and indirect benefits. It provides the foundation of economic security for workers and their families when the breadwinner retires, becomes disabled, or dies. And, the benefits that older family members receive help relieve workers of the financial responsibility of providing for their parents and grandparents. The peace of mind this security "buys" is irreplaceable.

I. Looking at Individual Equity

All money's worth studies include retirement benefits, but few factor in survivor benefits, and even fewer incorporate disability benefits. Some analyses exclude the value of the survivor protection because the benefit is not funded separately but included in the 5.26 percent of taxable wages credited to the Old Age and Survivors Insurance (OASI) trust fund. In addition, data on the distribution of survivor benefits are not readily available. Other analyses include the survivor contributions but ignore the benefit side. Disability benefits (and disability contributions) are consistently omitted from money's worth studies because the value of this benefit is difficult to gauge; yet, comparable protection is not available elsewhere at anywhere near Social Security's cost.

The exclusion in money's worth calculations of disability and survivor benefits not only reduces the perceived value of the Social Security benefit, but it leads younger workers to focus only on retirement benefits. Yet, a disabling accident or illness or even a premature death can strike anyone regardless of age, educational attainment, or level of earnings. The Social Security actuaries estimate that over 40 percent of male workers and 30 percent of female workers will become disabled or die before retirement.

Social Security is the only disability insurance for 3 out of 4 workers, and its life insurance feature provides income protection for 98 percent of the children in this country. These disability and survivor benefits are extremely valuable to both the individual and his or her family. According to the Social Security Administration, if a young worker has a permanent disability or dies, he and his family could receive the equivalent of an insurance policy worth $400,000 -- a policy he would have been unable to purchase in the private market without incurring substantial cost. In addition, Social Security provides disability and survivor benefit coverage for workers with pre-existing physical conditions, whereas in the private market they could have been excluded.

A money's worth analysis is also affected, to a great degree, by the underlying assumptions. Decisions are made about a range of items such as the value of the contributions, the value of the benefits received, interest rates, and longevity. These underlying assumptions significantly influence the outcome of the money's worth studies, either positively or negatively.

Another caveat regarding money's worth analyses is that most workers' situations change over the course of a lifetime. Few workers have exactly average earnings throughout their lives, and some workers may be single for only part of their lives. None of the studies allows for such variations.

AARP's Public Policy Institute (PPI) has conducted its own analysis of the money's worth of Social Security's Old-Age Insurance (OAI) program. The study, a summary of which is attached, estimates the length of time it takes to recover one's OAI contributions, taking into account the employer's share of payroll taxes and its deductibility from the corporate tax. The study found that most of today's workers will recover the value of their contributions, but at a less favorable recovery rate than current and past retirees. The variation in recovery rates for different generations is understandable. Since current and past retirees contributed to a Social Security system that was not fully mature, they are likely to receive back more in benefits than they contributed. New and future beneficiaries will have contributed at a higher rate and on a larger wage base than when the program began. The only way to avoid the more favorable rate of return for early recipients of benefits, which holds true for private, defined benefit pension plans as well, would be to deny some or all benefits to those who had not participated in the system for their entire working life. (The AARP study also assesses the impact on the recovery rate for contributions if certain changes -- such as raising the normal retirement age and adjusting tne benefit formula -- are made to the program. This information is available in the full study.)

II. Looking at Social Adequacy

Social Security is social insurance; it was never intended to be a personal investment plan. In a social insurance program, workers pool their resources in a government-sponsored program to "buy" protection that they might not otherwise have purchased (or afforded) on their own or have received from their employer. The program is shaped by societal decisions about who should receive benefits and their size relative to a worker's contributions.

The social goals woven into Social Security's structure inevitably will advantage some people. For example, the progressive benefit formula was designed to partially offset economic realities in society. Many workers, despite years of full-time employment and hard work, earned only modest salaries and were unable to set aside sufficient assets, if any, to help them and their families upon their retirement. Consequently, the benefits of lower-earning workers represent a greater portion of their pre-retirement wages than those of higher earners.

Social Security's original goal -- to provide a base of economic independence for retired workers and their dependents and for the survivors of deceased workers -- was expanded to include those with disabilities. Thus, a worker with a disability that begins early in her working life could get a better rate of return than others who collect only retirement benefits. While this is a valuable benefit, few would want to "profit" in this way.

Since providing benefits to those who are dependent on the worker is deemed another important social goal, workers with dependents receive a better rate of return on their contributions than those without dependents. Spousal protection has been part of Social Security since it began, but benefits for certain other dependents were added in response to a perceived need. As a result, some additional categories of dependents now receive income protection that does not exist elsewhere. For example, a worker's child who became disabled before age 22 can collect benefits even as an adult, provided he remains disabled and dependent on the worker. Also, a divorced spouse who does not remarry and whose marriage lasted at least ten years is entitled to benefits. These protections are seldom factored into a money's worth analysis.

Similarly, Social Security was designed to protect individuals from outliving their assets. Thus, benefits are provided to retired workers and their spouses even if they live a very long time. This income protection is supported by annual cost of living adjustments that help even the oldest beneficiaries to keep up with inflation.

III. The Three-legged Stool

Retirement income security is often described as a 3-legged stool: Social Security, pensions, and savings. Social Security was intended as a base that would be supplemented by the other two legs. Despite this goal, for many retirees, the other two legs are weak or nonexistent for many retirees it remains the predominant source of income. Today, more than 3 in 5 older Americans count on Social Security for at least 50 percent of their total income.

The three legs of the system are constructed differently. This diversity is a source of strength. Social Security, the first leg of the retirement income stool, is a social insurance program, with a guaranteed benefit and compulsory and near universal participation. Social Security's benefits are intended as the base of retirement income and were to be supplemented by the other two legs of the stool. 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. Each of these legs is subsidized in whole or in part by taxpayers.

In order to "improve" an individual's rate of return, some have suggested individual accounts for workers to invest some or all of their payroll taxes. AARP recognizes the need for increased national savings and the importance of a financially secure retirement, but we believe these goals should be achieved in a way that does not interfere with Social Security's basic purpose or in a manner that places low wage workers and their families at risk.

Individually controlled private 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, guaranteed 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 reliable and predictable. Indeed, the distinction between Social Security and the other legs of the retirement stool would be blurred, and the underlying purpose of the Social Security leg could be jeopardized.

The shift to individual accounts poses special risks for low wage earners. First, if all individuals received back a sizable portion, or all, of their contributions, less revenue would be available to finance the more generous rate of return that low wage workers currently receive. Furthermore, since low earners would be investing relatively small amounts, they would be unable to adequately diversify their holdings to shield against risk, and they also would face higher administrative costs.

Moving from the current system to a partially privatized one poses large transitional problems. If current benefit levels are protected, then workers will have to pay to finance two benefits: those of current recipients and their own. Current beneficiaries and those nearing retirement, however, could face added risks. The deterioration in the trust funds' financial condition resulting from a rebate to finance individual accounts is likely to generate pressure to cut benefits for current retirees and those nearing retirement. Yet, for those nearing retirement the opportunity to offset any lost income with individual investments is limited. Similarly, younger workers who become disabled or die shortly after individual accounts are inaugurated could be disadvantaged. They will not have accumulated adequate amounts in their individual accounts, which will result in benefits that are considerably smaller than they would receive under current law.

The rates of return for individual accounts are often overstated. Workers, particularly those with little savings, lack knowledge and experience in investing. Often, people without other resources invest conservatively and therefore are likely to see more modest returns. Encouraging workers to invest in riskier ventures, however, only invites hardship for those who invest unwisely, particularly if they retire in a down market. (These hardships might have to be offset through other government programs).

Still another pitfall with individual accounts is that unless early withdrawals and borrowing from these accounts are prohibited, workers will not wait until they retire before tapping into these accounts. Most individual private accounts currently permit access to funds before retirement. In fact, most private sector lump-sum pension payouts are currently cashed-out.

Furthermore, private sector pension plans themselves are currently undergoing a design change, with responsibility and risk being shifted from employers to employees. Despite this shift, employees too often have insufficient tools or inadequate information on how to best handle this responsibility and risk. The impact on long-term retirement security is as yet unknown, but the pitfalls have raised many questions for future economic security. 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. While individual accounts have a large role to play in retirement income security, these accounts are best left for the two private legs of the 3-legged stool. 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 <u>in addition to</u> the benefit Social Security provides.

IV. Conclusion

AARP believes the social insurance goals of adequacy and equity together transcend calculations of which individuals or generations gain or lose under Social Security. Implicit in the social insurance concept is the idea of benefit protection spread across the population and across generations.

Social Security, as its name suggests, is of social value. We all benefit from living in a society that cares for its aged, its disabled, its widows, and orphans in a decent, dignified, and compassionate manner. The true value of Social Security must include the higher values of dignity, independence, and social compassion that the program embodies and should not be measured solely by the individual return on dollars contributed.

PUBLIC POLICY INSTITUTE

FACT SHEET

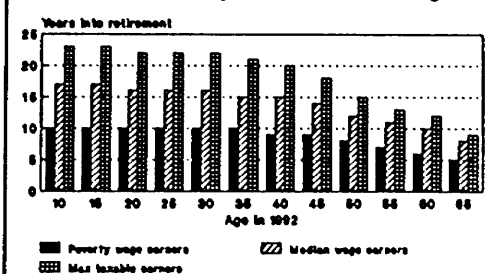
OLD-AGE INSURANCE: WHO GETS WHAT FOR THEIR MONEY?

Social Security (OASDI) provides old-age insurance for retirees and their survivors and disability insurance for workers. It is funded by matching contributions from employers and employees. Employees currently pay 6.2 percent of their earnings for OASDI; 5.6 percent is for Old-Age and Survivors Insurance (OASI) and 0.6 percent is for Disability Insurance. We estimate below who gets their money's worth from Social Security's Old-Age Insurance (OAI).

This analysis does not include Survivors Insurance or Disability Insurance, and therefore underestimates the value of the total Social Security system. Furthermore, as social insurance, OASDI is meant to do more than provide a base of income for the retired worker; it consciously redistributes wealth to adjust for other inequities in society, and also provides financial relief to many who might otherwise have to provide full support to their aging relatives.

Figure 1 depicts three different salary levels and the corresponding number of years necessary to recover employer and employee contributions plus interest after retirement. The figure reveals that Old-Age Insurance is a good deal for all current retirees, but the money's worth of OAI is deteriorating over time.

Figure 1
Years into Retirement to Recover OAI Contributions by Income Level and Age



Females can expect to live approximately 19 years into retirement, and males 15 years into retirement, assuming normal retirement age. All persons earning poverty wages and all persons currently 50 and older can expect to recover within their lifetimes all monies contributed. Females with a median wage or lower salary history can expect to recover all their contributions within their lifetimes, while among females with a wage history of maximum taxable earnings, only those currently over 40 years of age will recover all their contributions. Median earner males 35 and older and maximum taxable earners 50 and older will recover all contributions.

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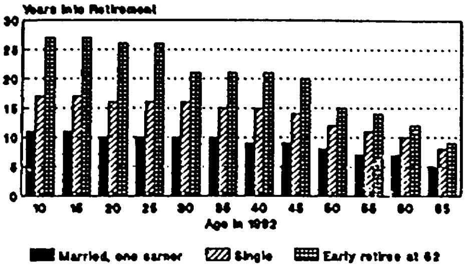
Figure 2 shows the case of a median wage earner under three different scenarios using the same assumptions as in Figure 1. A married couple with one wage earner receives in benefits 150% of what a single earner receives and will thus recover taxes contributed at a much faster rate than the single individual. Married couples with two wage earners may receive the higher of two benefits--either the benefits of two single earners or of a married couple with one earner. The years to recover OAI contributions will vary accordingly.

Figure 2
Years Into Retirement to Recover OAI Contributions for Median Earners by Age



An early retiree will have a lower annual benefit retiring at 62 rather than at the normal retirement age and thus can expect to take as many as 10 more years to recover all of the taxes contributed. It is clear from the figure that the early retiree is at the greatest disadvantage in terms of recovering contributions.

Changing the Social Security system can affect the number of years it takes to recover contributions. Examples of three policy changes that have been under consideration are:

♦ Raising the normal retirement age incrementally from the current 67 years in the year 2027 to 69 years in 2027. This option will most adversely affect early retirees and can expect to add as much as 19 years to the time it takes them to recover their contributions.

♦ Raising taxes by 3 percentage points over what they are now (8.2 percent, on average for elderly persons) would increase the maximum payback time for a single median-income earner by one year.

♦ The formula for computing benefits currently replaces 90% of the first $387 of monthly earnings, 32% of the next $1,946 in earnings and 15% of earnings above $2,333. Changing these "bracket rates" to 95%, 32%, and 10% will increase the time it takes maximum taxable wage earners to recover their contributions by one year and lower the number of years it takes poverty wage earners to recover their contributions by one year. Median wage earners would be affected minimally.

For a full report, see "Old-Age Insurance: Who Gets What For Their Money," Issue Brief #15. For more information, contact Lee Cohen or Alisa Male at AARP's Public Policy Institute (202) 434-3870.

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