IDEAS FOR ADVANCING THE UPCOMING DEBATE ON SAVING THE SOCIAL SECURITY SYSTEM

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

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THURSDAY, NOVEMBER 19, 1998

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

The Committee met, pursuant to call, at 11:05 a.m., in room 1100, Rayburn House Office Building, Hon. Bill Archer (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263

November 4, 1998

No. FC–14

Archer Announces Hearing on Saving Social Security

Congressman Bill Archer (R–TX), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on ideas for advancing the upcoming debate on saving the Social Security system. The hearing will take place on Thursday, November 19, 1998, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 11:00 a.m.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses include representatives of the Administration, former Members of Congress, and other notable experts. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

With the elderly living longer and the advent of a larger retired population from the baby boom generation, the financial problems of the Social Security system will be felt as soon as 2013. At that time, the program will expend more than it takes in from payroll taxes and the Government will have to increase borrowing, reduce spending, or raise revenues to honor its commitments to the Social Security Trust Funds in order to pay benefits. Without reform of the system, Social Security will be unable to pay full benefits in 2032, according to the latest report of the Social Security Board of Trustees.

Social Security has faced financial difficulty on a number of occasions since the mid-1970s. In certain instances, Congress and the President were facing a more immediate crisis unless action was agreed to, benefit payments were not going to be issued. Ultimately, a bipartisan agreement was reached by the legislative and executive branches of Government. Lessons learned from these past reform efforts are critical in creating an environment within which Social Security reform can successfully take place.

In announcing the hearing, Chairman Archer stated: "History shows that without a climate of bipartisan cooperation and true statesmanship, there will be no hope of truly saving Social Security. That is why I have decided to hold this hearing on ideas for addressing the debate on saving Social Security. Because of the historic window of opportunity before us, I am inviting the Administration and others to testify now before the opening of the new Congress."

FOCUS OF THE HEARING:

The Committee will seek guidance from the Administration, former Members and other notable experts on what can be learned from the experiences of past Social Security reform efforts, as well as recommendations on the best strategic "road map" to result in a solid and fair plan to save Social Security for all Americans.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Thursday, December 3, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

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

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

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

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

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman ARCHER. We are going to have a little competition across the street in the Rayburn Building this morning, but hopefully the country will be as interested, I would hope more interested in the most important issue to affect all of us, namely Social Security, than in the issue that is going on over in the Judiciary Committee this morning. But surely we need to convey to the American people that the President's questions are not going to deter us from doing our job, particularly on the big issues that affect all of us to such a high degree.

Before I make my remarks this morning, I want to—well, not only want to, I am going to express my strong fondness for Barbara Kennelly, as well as appreciation and respect for the work she has done on this Committee, inasmuch as this is a lame duck session of this Congress and will be her last meeting on the Ways and Means Committee. I hope we will have no more this year. And so, Barbara, I think all of us are sad to see you leave, wish you well, will miss you, and hope that you will come back often and give us the benefit of your counsel and your advice.

[Applause.]

And I am sure there are Members of the Minority party who would like to also express their feelings about Barbara Kennelly, and I think Mr. Levin has asked to be recognized.

Mr. LEVIN. Unless, Mr. Coyne, would you like to go first?

Mr. COYNE. Well, thank you.

Mr. Chairman.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. I too want to express my deep appreciation for the service that Mrs. Kennelly has given to the country and the friendship that she has provided to all of us here, and particularly her leadership on an issue that is very important to the American people, and that is Social Security. Being the Ranking Member of the Social Security Subcommittee was not always an easy task for anyone to assume, but Mrs. Kennelly did it well and with great dedication, and I pay tribute to her here today and wish her well in the future.

[The opening statement follows:]

Opening Statement of Hon. William J. Coyne, a Representative in Congress from the State of Pennsylvania

We are here today to discuss the future of Social Security. While Social Security's long-term financial problems are serious, we should not forget what the program has achieved.

Social Security provides benefits to over 27 million retirees. In my Congressional district, almost half of retirees depend on Social Security for all of their income, and many others would be extremely poor without it. Social Security's guaranteed benefit is particularly critical to women, minorities, and low-wage workers, who are less likely to have any kind of private pension.

Social Security also provides benefits to 4.5 million disabled workers and over 12 million dependents and survivors. We often think of Social Security as a retirement program, but over a third of its payments go to workers and families who lost their main income because of death or disability.

It may take a while to come to consensus about the best way to strengthen Social Security. I welcome a thorough discussion of the options, which will result in a better solution for Social Security. However, I am concerned that some will see this period of discussion as an opportunity to squander the short-term surplus in the Trust Fund on tax cuts. I believe we can work in a bipartisan way to improve Social Security for the future. An important first step is to agree that there will be no further attempts to violate budget rules and raid the Trust Fund for tax cuts.

It is important to deal with Social Security's future financing problems. But we also need to protect its Trust Fund in the present and build on the successes of the past. Many of the people who depend on Social Security have no where else to turn. They are counting on us to address these problems without putting them at risk.

Chairman ARCHER. Mr. Levin.

Mr. LEVIN. Thank you very much, Mr. Chairman.

We have had the honor of serving with Barbara Kennelly. She has been one of our leaders on many issues as Vice Chair of the Caucus. She has been a special leader on the Ways and Means Committee on so many issues; Social Security perhaps the most important, but so many others. On child support, I remember we all drew from her emphatic leadership on that, and so many other issues relating to taxation and human resources.

I have had the privilege, Barbara, of serving with you on the Social Security Subcommittee, and you will truly be missed. Your depth of knowledge and commitment has meant a lot on our side and I think, as expressed by our Chairman, it cuts across the aisle.

This is a lame duck session but we are entirely certain, Barbara, that you are not a lame duck. Your public service has been exemplary, and we expect in one way or another to continue our friendship and, hopefully, our relationship. The State needs that, the Nation does, and we, as your friends, do. So we say bon voyage, but just temporarily.

Mr. LEWIS. Mr. Chairman.

Chairman ARCHER. Mr. Lewis.

Mr. LEWIS. Mr. Chairman, I would like to join you and my colleagues in wishing a friend and a colleague, the gentlewoman from Connecticut, Mrs. Kennelly, the very best.

I have had an opportunity since being here in the Congress to work with Barbara Kennelly, and she is always there. She is a person of strength, a person of courage, a person of vision. I have had an opportunity to visit her district, to get to know her family, and to stay in her home. We served together for a while as Chief Deputy Whips. This one Member will greatly miss Barbara Kennelly, and I just want to thank her for her great service to this Committee, to the Congress, and to the American community.

I think when historians write about the Congress during this period, pick up their pens and write, they will have to say that Barbara Kennelly made a difference not just for the people of Connecticut but for the people of America. Thank you, Barbara.

Mr. STARK. Mr. Chairman.

Chairman ARCHER. Mr. Stark, you have been demoted.

Mr. STARK. I just wanted to say, Mr. Chairman, thank you for having the vision to see me here.

Barbara sits in a chair that is normally occupied by Mr. Rangel, our Ranking Member, and it would be remiss for me not to say how much we will miss Barbara on this Committee, in the Congress.

As John Lewis said, many of us have visited Barbara in her home and know her family and know her record. I think that she will be with us for many years to come in one capacity or another. And I look forward to continuing to work with her, because her spirit, her determination, and her concern for all Americans, particularly the people in Connecticut, has been evidenced for a long time, and we will miss you, Barbara.

I know we will continue to work together, and I like seeing you snuggled right up there next to Chairman Archer. I hope in your future years you continue to do so as he needs some help on the Social Security issue, and I know you will be able to continue to do that. Thank you.

[The opening statement follows:]

Opening Statement of Hon. Pete Stark, a Representative in Congress from the State of California

Most Americans living today were born well after the Great Depression. They are not marked by the fear of economic loss because—as a society—they have not experienced it.

It may well be that those who have not lived through the Depression do not appreciate the need for a social safety net, such as the one provided by Social Security.

It's true that by historical standards, the United States has enjoyed very good economic times for the past 30 years with only short recessions. Today's adults almost assume that a good economy will last forever.

In such a climate, more people may be less appreciative of safety nets, like Social Security, and more convinced that self-reliance will suffice.

But economic self-reliance is only workable for those who are reasonably well off and who understand the value of savings. Nobel prize winning economist Modigliani, my economics professor at Massachusetts Institute of Technology, taught me this lesson: people save only when they have money to save and perceive the need to save. With our national savings rate at an all time low of 3.8% of disposable income. I cannot help but conclude that Americans today do not perceive the need to save for the future.

Self-reliance also assumes a certain level of sophistication to ensure that invested savings will grow. That requires knowledge about how to balance investment opportunities and risks. Most Americans do not have this type of advanced knowledge.

Although privatization of Social Security is the topic de jour, we have an example of a safety net that has worked—and worked well—for over 60 years. We should focus on maintaining its solvency past 2032, not dismantling the program. The Gramm-Felstein proposal would lay the foundation to do just that—dismantle Social Security.

Social Security replaces about 40% of pre-retirement wages for average earner and 57% for low-earners. By design, it cushions those who have fewer resources to save. In 1996, Social Security lifted 11.7 million elderly people out of poverty. Proposals have been made to redistribute the progressive payment system of Social Security in order to subsidize individual private accounts.

Two-thirds of elderly receive most of their income from Social Security. Without Social Security, one-half of older Americans would live in poverty. In addition to the elderly, 3.5 million non-elderly adults and 800,000 children were lifted out of poverty by Social Security in 1996.

Its mandatory nature assures that all workers start their retirement nest egg with their first paycheck and increase their savings amounts automatically as their wages increase. Its social insurance component shields families from a wage earner's untimely death or disability, and subsidizes the lowest paid wage earners with the earnings of others.

Social Security works because it is more than an savings account for individuals—it is a commitment that our society makes to its members that there will be a safety net for workers and their families in the event of their disability or death during wage earning years.

Individual accounts take care of those who are sophisticated enough to invest their funds well; they leave the low wage folks, the unsophisticated, the disabled, the widows with young children out in the cold. Is that what America is about?

Has the "responsibility and self-reliance" mantra erased any trace of collective responsibility for the less fortunate in our society? I think not.

I encourage my colleagues to work together in a bipartisan fashion to save Social Security for future generations. Most Americans need a sound retirement system they can rely on more than they need some fast talking Wall Street broker.

Chairman ARCHER. Mr. McNulty.

Mr. MCNULTY. For all of the reasons outlined by the other Members, I am sorry to see Barbara leave the U.S. House of Representatives, but I would remind everyone that while Barbara will no longer be a colleague, she will still be a friend, and that is so much more important.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman. The gentlewoman from Connecticut and I have pretty well paralleled our time on this Committee and, as is the case with many Members of this Committee, there are quality people in the House and at some time or another they often seek higher office. So we were going to lose her either way and it was going to be our loss.

But the thing I remember most in dealing with Barbara was that, in the highest tradition of this Committee, although oftentimes we would come from opposite sides of a point or an argument as we attempted to do the people's work, it was always done in a very pleasant, very civil way, because that is who she is. This Committee will suffer her loss in more ways than most people will realize, because what she did was quietly and constantly knit the fabric of the Ways and Means Committee together, and someone else is going to have to do that now. It is our loss.

Mr. TANNER. Mr. Chairman.

Chairman ARCHER. Mr. Tanner.

Mr. TANNER. Thank you, Mr. Chairman. I had the privilege of serving with Barbara on the Subcommittee over the last 2 years, and in my opinion she is the personification of one of the highest compliments one can pay another, and that is simply she looked for the best in others and gave the best she had, and we are going to miss her.

Chairman ARCHER. Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

This is a very important Committee, and I respect the Members on it tremendously: Very bright people, articulate, legal craftsmen. But the element I think we prize the most, particularly as we strive for bipartisanship, is fairness, and I don't think there is anybody that I have known in this Congress who represents that element of fairness the way Barbara does. Thank you.

Chairman ARCHER. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman. I would like to associate myself with all the remarks that have been made and, Barbara, only to add that we will miss you. You have left us with a paradigm of statesmanship which I hope will hold us well into the future, and I thank you for your service.

Chairman ARCHER. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Senator Gramm, these accolades to Barbara are two-edged. One is that we want to say goodbye to her, and we are going to miss her an awful lot, but we also want you to know how much we think of her, if she should by any chance be appointed by the White House to something and needs Senate confirmation.

Senator GRAMM. Well, fortunately, she has always been very sweet to me.

Mr. MCDERMOTT. I am pleased to hear that you will whistle her confirmation through without any problem whatsoever. We are sure the White House will find something, Barbara, to use your extraordinary talents toward, and it has been a real pleasure to serve with you. Thank you.

Chairman ARCHER. Mrs. Thurman.

Mrs. THURMAN. Barbara, I have to say to you publicly that I would not be on this Committee had it not been for your encouragement. You became a friend early on. You continued to guide me through this. I will miss your wisdom and your insight.

I think this country owes you a debt of gratitude for what you have done in articulating better than anybody the importance of families in our country and the struggles that they go through. I think you also have been a model for women across this country. You have given hope to every woman who wants to come to political life as an example that we should all follow, and you have given us that opportunity to serve after you.

I only wish you the best, and I hope you will let me make that phone call when I need your wisdom and guidance again.

Chairman ARCHER. The Chair plans to recognize Mr. Kleczka and then Mrs. Kennelly for any comments that she might like to make, and then would encourage other Members to place any comments about Mrs. Kennelly in writing in the record.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Chairman, I would like to add my voice of thank you to Barbara Kennelly, not only for her work on the Committee but also for her work as part of our leadership team which brought issues to the forefront of national debate, and she did so very well.

After Jim McDermott's remarks, I don't know, Barbara, if I should call you Ambassador Kennelly, or is that letting something out of the bag? But, nevertheless, it is amazing, Bill Thomas indicated that over the years that you and he have been on the opposite sides of many issues and arguments. But in my tenure on the Committee I always found that you were on the right side. So, Barbara, we are going to miss you, and Godspeed.

Chairman ARCHER. Mrs. Kennelly.

Mrs. KENNELLY. Thank you, Mr. Chairman. And I certainly didn't expect this, but I wanted to be at this meeting, a meeting on Social Security, an issue that is incredibly important to me.

First let me thank the Members for those very, very kind words. And please excuse us, Senator, for holding this up. We will be almost ready to go. And, Mr. Chairman, thank you very much for letting this take place. This was not planned and it moves me greatly.

I want to thank the staff for always being so incredibly nice to me. Janice Mays has been wonderful to me. When I first came on the Committee in 1984, I knew nothing, and she taught me a great deal of what I know today and made me the success I was able to be in legislation. And Sandy Wise, I want to thank you very much for taking me through the whole picture of Social Security.

I love the nice words, I love the compliments, but I am asking you for something else. And I look right down at the testimony that I am about to say, and I pick one paragraph out and say to you, the Social Security Program has some built-in protections to benefit those who are most vulnerable. Women, in particular, benefit greatly from Social Security. Sixty percent of Social Security beneficiaries are women, and Social Security is often the only source of retirement income for a majority of these women.

I am saying to you, I love the kind words, but promise me that you will remember in any changes in Social Security to remember the women. Women, widows, people left with children alone, people in great need, older women, the majority of older women in this country have depended on Social Security. Social Security has kept hundreds of thousands of older women out of poverty.

And as we in the new Congress, the 106th Congress, begin the venture into reforming Social Security and protecting it and keeping it for future generations, I ask every one of you who said kind words about me this morning and those that feel them, promise that you will remember the women as you reform Social Security. Think about someone who has never worked. How do they have an individual retirement account? Think about someone left with three children and no money. What happens to them in a new plan? Remember them, I ask you, in memory of Barbara Kennelly, who has served many years on this Committee.

Thank you, Mr. Chairman.

Chairman ARCHER. The Chair believes it is very, very good for us to enter into what is the end of this Congress and, in effect, the beginning of the next Congress with what is a spirit of cordiality, a spirit of civility, a spirit of cooperation to work on a very, very bipartisan basis on the major issue that will face the Congress, the next Congress, and the next generation in the next century, namely Social Security. This cannot be solved on a partisan basis, it can only be solved on a bipartisan basis, and today marks the beginning of our effort to save and strengthen Social Security.

It is my sense, from having talked to Members on both sides of the aisle, that there is a strong commitment by all Republicans and all Democrats to succeed in this effort. And to start off our hearing this morning, my friend and colleague from the State of Texas, the senior Senator from the State of Texas, is appearing because he has given a lot of thought to Social Security and has asked to be able to make a presentation to the Committee this morning.

And we more than welcome you here and we will be glad to here your comments, Senator Gramm. So welcome to the Committee.

STATEMENT OF HON. PHIL GRAMM, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator GRAMM. Thank you, Mr. Chairman.

Chairman ARCHER. You are our leadoff hitter. I hope you end up crossing on base before it is all over.

Senator GRAMM. Well, Mr. Chairman, first of all, I appreciate you and the Committee giving me this opportunity. What I wanted to do this morning was to try to make five points that I think are relevant to this debate no matter how you come at the debate, and I think they are basically points that ultimately there will be an agreement that these are all relevant. In the final analysis, there will be disputes about them as to how we deal with them.

The first point is that this is not just an American problem, this is a worldwide problem. Our Social Security system is really a follow on to a program that started in Germany under Chancellor Von Bismark in the 1880's. Bismark was a political genius who united the country, and one of the uniting principles was the recognition that it was possible to bypass a generation of effort in accumulating, saving and creating wealth by taxing current workers to pay benefits to current retirees. And in doing so, Bismark established a system whereby the foundation of the funding of the system was a commitment to tax generations yet unborn.

This system started in Germany in the 1880's. It spread all over Europe, was in Australia by 1909, and came to the Americas in Chile in 1925. The United States was one of the last major industrial nations to adopt it in 1935.

But all of these programs have two things in common: The first thing is, none of them accumulate any wealth, none of them make any investment, none of them accumulate any real rate of return, and therefore a fundamental problem that all of these programs worldwide have is they do not benefit from what Einstein called the most powerful force in the universe, and that was the power of compound interest.

The second problem with all of them is, they are all victims of demographics. They work great when you have a very young population, when you have massive numbers of people coming into the labor market, but they all begin to break down when you have large numbers of retirees and relatively low numbers of workers. We all know that America is looking 25 years from now at having two workers per retiree, but the important thing to note is, it has already happened. It happened in Japan.

One of the fundamental economic problems in Japan is their aging population and the fact that the payroll tax in Japan to fund their basic retirement programs is now over 30 cents out of every dollar earned by every worker in Japan. Germany is facing the same problem. They are about 20 years ahead of us. We are looking at the certainty, if we do not change the current system and if we preserve current benefits, that we will have to double the payroll tax over the next 30 years to pay for Medicare and Social Security.

The second point I want to make is that there is no Social Security Trust Fund. I think one of the things that distorts this debate is that every day we pick up a newspaper and we read about money going into the Social Security Trust Fund. But, in reality, if we are to reform the system and strengthen it, I think we have got to begin by admitting that there is no Social Security Trust Fund today. There are no investments. There is no compound interest. Nothing is paying for Social Security benefits except payroll taxes.

Now, I can explain it in two ways, and let me try to do it. First of all, the Social Security Trust Fund is not a debt of the Federal Government. When interest is paid to it, it is not an outlay of the Federal Government. If you think of it in terms of a family, let's say that you are throwing the newspaper and you give your mama money to set aside for you and you assume she is putting it in the cookie jar.

If she actually puts it into the cookie jar, it is an independent trust fund because she can take money out of it to let you spend it without affecting the family budget. But if she simply takes the money and makes it part of the family budget, then there is no money available, and the only way she can give you your money back is if she takes it out of the family budget, works more, earns more, spends less, or borrows more.

The reality of the situation today is that while we have piled up a paper debt to the Social Security Administration since 1983, in reality no expenditure can be made out of that trust fund unless we raise taxes, unless we cut spending, or unless the Federal Government borrows money. And those are all the things we would have to do if there were no trust fund. So, in reality, the trust fund represents a moral obligation which we all share but it represents no resource that can be used to fund Social Security.

The third point is that ultimately, if we are to have a real trust fund, a decision is going to have to be made as to who invests the money. And I believe that ultimately, on a bipartisan basis, we are going to decide that government cannot invest the money. I believe that we have had, in essence, a system since 1935 where government was supposed to invest the money.

It is very instructive, and I would urge people interested in this subject to go back and read the debate on Social Security in 1935 and to look at the structure we established. And what you will find is that we were supposed to raise payroll taxes in 1937–41 to build up a trust fund which could be invested, but Congress never raised the payroll tax. No trust fund was ever built up.

No balances were ever really established until 1983, when we had the legislation to try to deal with the crisis in Social Security. That created a surplus. But every penny of that surplus since that date has gone into the general government fund and has made it possible for us to spend more, tax less and borrow less than we would have in its absence.

The fourth point that we are going to have to look at is how should we integrate any new investment-based system with the old system. There are really two approaches to it. One is to cut benefits in the old system and count on investments to make up for those benefit cuts. There have been several proposals that have been made along those lines. I think when reasonable people look at it, we are going to decide not to do it that way. The problem is you almost always have one group of people who are losing benefits, another group of people who are gaining from the investment, and they are generally not the same people.

I think we will decide in the end to integrate investment into the system and use the benefits from an investment-based system to pay benefits that are guaranteed under the old system. And I think the good news is that we have a sufficient surplus now and projected into the future as to make it possible for us, if we are willing to plow back most of the benefits of an investment-based system to paying benefits to people who are already in the system, that we can for all practical purposes avoid any changes in benefits for people who are already in the system.

The final point I would like to make, Mr. Chairman, is the President in his State of the Union Address said "Save Social Security First." We all stood and applauded. It was a great line, but to this point it is just a slogan. At some point the President is going to have to come forward with a proposal.

My own opinion is that unless the President does that very quickly, that one of two things is going to happen: One, we are going to have to go on and try to move with a program in the absence of a Presidential or executive branch proposal; or, second, there are going to be many people who are going to conclude that this was all a ruse to prevent Congress from cutting taxes. And I think at that point we are going to see a movement toward having a very substantial tax cut.

Certainly, our experience in the last week of this session of Congress was a very disappointing experience because, in the end, despite the fact that the administration had said all year do not use the surplus, do not spend it, do not use it for tax cuts, the President had opposed a tax cut that would have taken $6.6 billion of that surplus this year, but in reality in the last week of the Congress we spent $21 billion right out of the surplus, every penny of which was taken away from Social Security, and every penny of which we will wish we had next year when we get ready to try to fix Social Security.

So I think these are the key points that we are going to have to address. I think we have a historic opportunity to make the system better. I don't think anybody in the end will be able to defend the status quo, because the status quo is going to mean benefit cuts that no one can live with. The status quo is going to mean increases in taxes that no one is going to be willing to impose. And I think there is only one thing we can do in the end that can work, and that is to try to build investment into the system. And I think if we do it right, we can do it on a bipartisan basis. And I thank you, Mr. Chairman.

Chairman ARCHER. I thank you for your input, Senator Gramm.

Are there any Members of the Committee who would like to inquire of the Senator?

Mr. Crane.

Mr. CRANE. Senator, you mentioned Bismark starting the Social Security system in Germany. What was the average lifespan at that time in Germany, and at what age did you qualify for your benefits?

Senator GRAMM. Well, it was pretty similar to ours. I am not sure what the numbers were in Germany, but when we paid the first benefits in 1937, the average life expectancy was 61. There was no early retirement. You did not get benefits until you were 65.

So we literally had a situation where we passed the hat around, workers put in 2 percent of the first $3,000 they earned, and that paid benefits to one retiree. I think there were 42 workers per retiree. Today when we are passing the hat, we have 3.3 workers per retiree and they are paying 12.4 percent out of the first $68,500 that they earn to support one retiree.

You do not have to be a mathematician to look at the demographics to understand that there are two powerful forces at work: One is people are living much longer. And as we all get older, we appreciate it. And the second thing is people are having fewer children. Even with our massive immigration, legal immigration coming into America, we are looking at two workers per retiree 25 to 30 years from now. And the arithmetic of that is obviously frightening.

Mr. CRANE. My recollection is that the average lifespan was in the midfifties.

Senator GRAMM. Probably was.

Mr. CRANE. And the eligibility date was in your midsixties. So we could solve it by the way Bismark did, by raising the age for eligibility to 85.

Senator GRAMM. Well, I know you are joking, but let me respond to that by saying I hear people talking about raising the retirement age to 70. I have what I call a calluses test on raising the retirement age to 70. You show me somebody with calluses who believes it is workable, and I would take it seriously.

The problem is, while we look at the fact that people are living longer and we think since we have white collar jobs that we could all, like Strom Thurmond, work indefinitely, the plain truth is if you go out in the real world, you do not see people up on scaffolding or using jackhammers that are 70 years old. And I think, in the end that if we do that, that what we are going to do is end up with a huge number of people on disability. If you look at Sweeden, which has taken that approach, they end up with 24 percent of their people on disability.

So I think in the end, obviously the attractiveness economically of raising the retirement age is you cut benefits by about $46,000 per couple by raising the retirement age to 70. The problem is, for white collar workers it might work. I am just doubtful you are going to see people 70 years old able to do blue collar work.

Chairman ARCHER. Anyone else wish to question?

Mr. MCCRERY. Mr. Chairman.

Chairman ARCHER. Mr. McCrery.

Mr. MCCRERY. Senator Gramm, you said if we do nothing we will have to double the payroll tax to finance benefits. Now, some of the later witnesses are probably going to tell us that that is not true, we can just increase the payroll tax now by 2 percent and that will take care of the problem.

Would you agree with that analysis, and in any event, would you recommend that as a course of action?

Senator GRAMM. Well, there is no way a 2-percent increase in the payroll tax will take care of the problem because every penny of it would go into a phony trust fund and we would still have massive tax increases 20 years from now. Nor do you gain a whole lot by raising the wage base that you apply to—I think it is very tempting to sort of portray every debate as we can just tax rich people a little more to pay for it. The plain truth is that to generate the kind of revenues you need, the burden is going to have to be borne basically by middle income workers. The more you raise the wage base, the more unfair the system gets in terms of people putting money into it.

If you look at the demographics of two workers per retiree 25 or 30 years from now, I think that really dictates the arithmetic. When you figure out that you have two workers paying for Social Security benefits and for Medicare benefits for one retiree, then I think you start to look at how difficult that is going to be, and the attractiveness of some kind of investment system where you can get the power of compound interest working to help pay those benefits, to lessen the burden on the worker, starts becoming more attractive.

But I think one of the things that we are going to have to do in the debate, and I think it is really happening in the Senate, is that the more people have looked at the problem, the more sobering it is and the more bipartisan the whole debate becomes. Because I think people have realized that have really looked at these cuts, really looked at raising the retirement age, really looked at means testing and benefit cuts, have realized that in the end that is probably not going to be doable given the social fabric of society, and raising the payroll taxes is not going to be doable.

One of the reasons Japan has this terrible structural problem is they are becoming noncompetitive with the 30-percent-plus payroll tax. We talk about stimulating their economy, but the reality is that they have some very real structural problems, and this aging population and the cost that imposes through the payroll tax is one of their huge unsolved and, in the short run, unsolvable problems.

Mr. MCCRERY. Thank you, Mr. Chairman. Thank you, Senator.

Chairman ARCHER. Mrs. Johnson.

Mrs. JOHNSON of Connecticut. In view of the number of panelists we have ahead of us, Senator, let me make a brief comment.

You are absolutely right. The more you look at the numbers, the more awesome the problem. I would just like to urge you, as one of the people in the Senate who has given this a lot of attention and is going to continue to give it a lot of attention, to think about the reforms that we have to think about at the same time we think about saving Social Security. Because one of its odd flaws is that it looks at your 30-year average, and if you have a zero earning year in that 30 years, it is counted in because they want consecutive years.

This is a big disadvantage, particularly to young women who typically now have a career for 8 or 10 years. Many more of them are choosing then to stay home with their children, so they will have those zero years. I think we really have to look at the kinds of reforms that say your 30 consecutive earning years and do not penalize people for dropping out of the work force to stay home to take care of their kids.

So I think there are some new sort of value challenges in this reform that were not as much a problem in 1982, and we should be sure to get them on the table so that we know both what the cost and the benefit of those would be.

Senator GRAMM. Well, let me just respond with two points. Number one, I think whatever you do in the system, you have to have a minimum benefit where people get to the end of their work lives, and because they have taken time out to have children or because they have been sick or because they have been unemployed, I think everybody has got to know if they get to the end of their lifetime with their glass half full, that up to some minimum we are going to fill it up. Also, one of the benefits of an investment-based system is that during the 8 to 10 years that woman is out of the work force, her investments will continue to grow.

Second, there are terrible inequities in the current system. The child of a poor family that goes to work when they are 16 or 17 years of age only gets benefits on their 35 years of earnings, so everything they do before they are 30 years of age, they get no benefit for. Whereas the child of a rich family goes to college, goes to graduate school, goes to law school, travels in Europe, finds themselves, and then starts to work at 30, every penny they pay into the system they get credit for.

So there are terrible inequities in the system. The system is very anti-blue-collar worker, because blue collar workers tend to start working sooner and demographically they do not tend to live as long. And I think those kind of problems, which nobody ever foresaw when the average life expectancy was 61, I think now that we are going to go back and restructure the system in some form, these are things we need to fix.

Mrs. JOHNSON of Connecticut. Thank you.

Chairman ARCHER. Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

Senator, we talked about this last year, about using 90 percent of the surplus we expect over the next decade for Social Security and 10 percent for tax relief. I frankly think that it was unwise of us to have moved off that position, but I specifically wanted to ask you, Senator, if you could go into specifics so that everybody would understand, when we talk about using the surplus to save Social Security, how would you see that surplus expended in bolstering up the system?

Senator GRAMM. Well, first of all, I think we need to admit to ourselves that, number one, just running a surplus does nothing to benefit Social Security. Just running a surplus, assuming we can do it, remembering we spent a quarter of the surplus this year, but just running a surplus reduces the indebtedness of the government relative to what it would be otherwise. But none of that money goes to Social Security, none of that money is invested in Social Security, and no earnings from it are available to Social Security.

The only way you can invest in Social Security is to actually have the money invested in real assets. If you are going to pay real benefits at the end, you can pay for them only in two ways: One, at that point taking the money away from workers in a payroll tax; or, two, building up real assets in the interim to help pay for some of those benefits.

So what I am talking about, and what I think increasingly people are talking about, is a system where part of the payroll tax would be invested. Under the proposal that I am for, the worker would own it but the worker would not directly participate in the investment. They would choose a qualified company that would do it under the supervision of a Social Security Investment Board, and they would, in their working lives, build up assets.

If at the end of their working life they do not have enough to pay for their benefits, then part of the payment would come out of the old system, part of it would come out of their investment. If they have enough to pay for it, then we would not have to pay for it by payroll taxes at that point.

It can be structured in many different ways, but the point is that in the end, unless we bring some new force into Social Security like the power of compound interest, there is no way you can avoid either cutting benefits or raising payroll taxes and doing it dramatically. And that is what is going to produce the bipartisanship, in my opinion, because when people look at these cuts and look at these payroll taxes, they are going to decide that is something they do not want to do or cannot do.

And when you start looking at alternatives, there is really only one alternative, and that is what Franklin Roosevelt envisioned the system as being to begin with. When you go back and read the debate and you read the proposals coming from the administration in

1935, the President envisioned an annuity. He used the term all the time. And the idea was that workers would build up investments that would accumulate earnings, and they would have the knowledge and satisfaction and guarantee of knowing they helped fund their own retirement.

The problem is we never set up the system like that, and I think in the end we will decide to move in that direction. But what we have got to do is decide how to mix the new system with the old system, and how to do it in such a way as to get people to accept it. And quite frankly, in the end I believe that to get it accepted during this transition period for the first 30 or 40 years, almost all the benefits of the investment will have to go to paying off the debt of the old system.

Ms. DUNN. Thank you.

Chairman ARCHER. Thank you, Senator. You have given us a good start in our discussion on moving forward on saving Social Security.

The Chair at this time would invite David Wilcox to take a seat at the witness table. And while Mr. Wilcox is moving to the witness table, the Chair will make his opening statement.

I believe that today's hearing is exceedingly important as we move into finding a bipartisan solution for Social Security. It is the beginning of this effort, and this Committee will be the focal point for the determination in the end as to what we do on a bipartisan basis for Social Security.

Social Security is a vital thread in our Nation's moral and economic fabric. It has reduced poverty for seniors, it has protected seniors, and it has given greater freedom to the continued working generations in knowing that their parents and their grandparents at least have a modicum of dependable income. It has helped to make this strong Nation a great Nation, and thanks to it, we are all better off.

I welcome President Clinton's commitment to saving Social Security, and I look forward to undertaking the serious and bipartisan effort. Mr. Wilcox is with us today representing the Treasury. I welcome you and I look forward to your answers on behalf of the administration.

But I must say that I was troubled and terribly disappointed that Secretary Rubin refused to accept my invitation to be with us today. He is the Chief Trustee of the Social Security system. He should be here to set the tone for a bipartisan beginning and reaching a solution. It must be bipartisan and it must be fair. The Secretary's absence begins the process on the wrong note and on the wrong tone, and I regret his decision.

In all cases, I intend to proceed in a bipartisan manner. I am fully prepared to help President Clinton get a bill through the Congress. The American people expect us to work together, and that is what I intend to do. But make no mistake, this job will be one of the most difficult undertakings that the Congress has ever begun to work on.

Social Security is not going to be technically broke for 34 years, so current beneficiaries and beneficiaries to come over the next 10, 20, 30 years will have their benefits and will receive them. They are protected even if we do nothing. But we owe it to the next generation in the next century to move on this now. The longer we wait, the more difficult it will be.

I believe that President Clinton faces a test, perhaps the greatest test of his leadership, to see if he can fashion a solution to the problem this far away from the crisis. To his credit, the President made this our Nation's number one priority almost 1 year ago. And having done so, it is fair to ask the President now what he intends to recommend to the Congress in a specific proposal to solve this problem. Will he submit a specific plan? If so, when? And if not, why not?

We understand that this year has been absorbed with a national dialog on Social Security to attempt to let all the American people have their input across this great Nation. The President will culminate this with a White House Conference next month. At the conclusion of that bipartisan White House Conference, the time will be there for the President to step up and accept the leadership mantle and send to us a proposal as his recommendation for the solution of the Social Security problem, and we will accept it happily and readily and begin to move on it.

Without a specific plan from the President, a very difficult job will become much, much harder. Some might say it will even be impossible. The Congress, with all of its varied ideas, varied approaches, one from another, Democrat and Republican, will have a very, very difficult time coming together internally on an ultimate solution.

This issue is so electric and so sensitive that I expect that there will be, in spite of the efforts on the part of constructive people on both sides of the aisle, there will be efforts on the part of individual Members to get political advantage out of the issue going into the next election. The one way to override that is for the President to submit a proposal, defuse the issue, and give us a chance to go to work on it.

I felt during this year that we needed a bipartisan proposal—specific proposal, not a group of alternative options—that would be designed by commission of bipartisan individuals who would get together and be forced, in the end, to submit one proposal, again with a majority of the commission on both sides, or all sides, on a bipartisan basis, standing behind the focus of that proposal, and let the Congress begin to work on it. That is what happened in 1982.

I was personally a Member of President Reagan's National Commission on Social Security Reform. Without that Commission, I know, from having been at that time a Member of the Social Security Subcommittee on the Ways and Means Committee, no resolution would have occurred.

But unfortunately, the White House felt that the creation of a Commission was not the right way to go, and I respect their decision. But having defeated that Commission and said that we should have this national dialog with a White House Conference, I think it behooves the President more than ever to submit a specific plan at the end of that White House Conference.

Not simply to bundle up all of the varied proposals and inputs from the people who attend the conference, send it up to Capitol Hill, and say go to work on it, we will try to help you. That will not solve this problem.

America needs leadership today from the one individual who was elected by the people of this country to provide that single leadership. And, again, I say I stand ready to roll up my sleeves and to work with the President when we receive that proposal.

If President Clinton believes that we can get this job done without his leadership or without a specific plan, I believe he will be making the biggest miscalculation of his presidency. General principles will not get this job done, and history has shown that to be true when we deal with the highly sensitive issue of Social Security.

Let it not be again that what we learn from history is that we never seem to learn from history. Let us learn from history and proceed, having learned from it. Broad outlines will not work. It will take presidential leadership. It requires specifics. In short, it takes a President.

If President Clinton were here today, I would close with this message to him: Mr. President, as you and I first discussed when we met together privately in the Oval Office in December 1996, we cannot miss this opportunity to do this for future generations. I know you agree with that because you spoke to it strongly in that first meeting. Mr. President, do not miss this opportunity.

Just as only President Nixon could go to China as a Republican, no Democrat President could have gone to China and gotten away with it, you, Mr. President, you alone as a Democrat can change the course of Social Security. When good presidents lead, great nations follow. Lift up our Nation, Mr. President. Put principles before politics and ideas before ambition. If you lead, we can be successful. Like no other issue, this one will test your presidency. I think you are willing to lead. Will you be specific? I commit to you that I will do everything necessary to strengthen and save Social Security and to work with you.

[The opening statement follows:]

Opening Statement of Hon. Bill Archer

Today's hearing marks the beginning of our effort to save and strengthen Social Security.

Social Security is a vital thread in our nation's moral and economic fabric. It has reduced poverty, protected seniors, and enriched our families. It has helped make a strong nation a great nation. Thanks to it, we are *all* better off.

I welcome President Clinton's initiative to save Social Security first, and I look forward to undertaking this serious and bipartisan effort.

Mr. Wilcox, I welcome you and look forward to your answers on behalf of the Administration. I must inform you, however, that I am troubled that Secretary Rubin declined my invitation to testify. If we're going to work on Social Security together, it must be bipartisan and it must be fair. The Secretary's absence begins the process on the wrong note and I regret his decision.

In all cases, I intend to proceed in a bipartisan manner. I am fully prepared to help President Clinton get a bill through the Congress. The American people expect us to work together and that's what I will do.

Make no mistake, this job will be difficult. Since Social Security won't really be broke for thirty-four years, President Clinton faces a test of his leadership to see if he can fashion a solution to a problem this far from crisis.

To his credit, the President made this our nation's number one priority almost one year ago. Having done so, it's fair to ask the President what he intends to do now.

Will he submit a specific plan? If so, when? If not, why not?

Without a specific plan from the President, a very difficult job will become much, much harder. Some might say it will be impossible. If President Clinton believes he can get this done without his leadership or without a specific plan, he may be making the biggest miscalculation of his Presidency.

General principles won't get the job done. Broad outlines won't work. It will take Presidential leadership. It requires specifics. In short, *it takes a President.*

If President Clinton were here today, I would close with this message to him.

Mr. President, don't miss this opportunity. Just as only President Nixon could go to China, you alone can change the course of Social Security. When good Presidents lead, great nations follow. Lift up our nation, Mr. President. Put principles before politics and ideas before ambition. If you lead, we *can* be successful. Like no other issue, this one will test your Presidency. Are you willing to lead? Will you be specific? I commit to you that I will do everything necessary to strengthen and save Social Security. I look forward to working with you.

Chairman ARCHER. And now I am happy to yield to Mrs. Kennelly, representing the Minority, for any statement that she might like to make.

Mrs. KENNELLY. Thank you, Mr. Chairman, and as I look out at this audience this morning, each and every individual in this room understands that Social Security faces future financial challenges through the increasing life expectancies and the approaching retirement of the baby boom generation. I look out and see many faces that understand this problem, many people looking at this situation, getting ready to resolve this situation. And I say to you this morning, Democrats want a bipartisan, constructive approach to strengthening Social Security for the 21st century.

Criticism is so easy, but as a great Republican President, Theodore Roosevelt said, it is not the critic who counts, not the man who points out the strong man's stumbles or what the doer of deeds could have done better. The credit belongs to the man—and may I say the woman—who is actually in the arena. If both Members of Congress and the administration come together to work out a truly bipartisan plan, it will serve the American people much better than if we sit and wait for the other party to give something for us all to criticize.

I heard your remarks this morning, Mr. Chairman. I understand with your long history, with your knowledge of the Ways and Means Committee, with your former experience in Social Security, I know how sincere those remarks are. But may I say to you that the Minority welcomes Hon. David Wilcox. He is the point man for our President at this very moment concerning Social Security matters. You may be sure that Secretary Rubin will be with this group. I won't be here, but these Members will be here in this room, and the Secretary of the Treasury will be sitting right down there being part of finding a solution to the Social Security problem.

And may I say to you loud and clear, the President of the United States, William Clinton, will be very much involved in resolving this situation. If nothing else, we all learned when we tried to reform health care that only the administration and only the Members of Congress can carry out and find a solution. If we let the special interests in, if we let the special interests be the ones that are looking for the solution and calling the tune, we will not resolve this problem.

You say that this might be impossible. I know you, Chairman Archer. This is not impossible. You would not be Chairman of the Ways and Means Committee if you did not look at things that were terribly difficult and find solutions to them. No Member of the

Democratic team says this is impossible because we know the American people demand that we resolve this situation, that we make sure that the American people always have Social Security.

So we come this morning, and it is a gathering and an important gathering, but it is only a gathering of the 105th Congress. Next month or 2 months from now you will have the 106th Congress which will have as a number one priority—I heard Speaker Livingston talk about it yesterday, I know that Mr. Gephardt is talking about it, I know how clearly and how importantly the President of the United States feels that this has to be resolved.

So I wish I was going to be with you. I won't be. But I will be watching you, like all Americans will be watching. And this is one issue where we have to be bipartisan or we will all lose, but most importantly, the American people will lose. So I wish you well, Chairman Archer, I wish the Minority Members well, and I say to all of you: Resolve this situation. You can prove once again that the Congress of the United States is very important and they can work with the President of the United States.

[The opening statement follows:]

Opening Statement of Hon. Barbara B. Kennelly

Mr. Chairman, Social Security faces future financial challenges due to increasing life expectancies and the approaching retirement of the "baby boom" generation. The time has come for us to consider seriously ways to address these challenges while strengthening our system for current and future generations.

The Social Security Act of 1935 is perhaps the most successful program enacted in the twentieth century. The creation of the Social Security program has changed America's way of life by providing important financial benefits to our elderly, disabled, and survivors both old and young. Indeed, if it were not for Social Security, half of our nation's elderly would live in poverty. Social Security provides a solid, inflation-adjusted, guaranteed benefit that enables our seniors to live in dignity for as long as they live.

The Social Security program has some built in protections that benefit those who are most vulnerable. Women in particular benefit greatly from Social Security. Sixty percent of Social Security beneficiaries are women and Social Security is often the only source of retirement income for a majority of these women. Any proposals for strengthening our system must consider carefully the impact change would have on women.

Democrats want a bipartisan, constructive approach to strengthening Social Security for the 21st century. Criticism is easy. But, as the great Republican President Theodore Roosevelt said, "It is not the critic who counts, not the man who points out how the strong man stumbles or where the doer of deeds could have done them better. The credit belongs to the man (or I might add, the woman) who is actually in the arena..." If both members of Congress and the Administration come together to work out a truly bipartisan plan, it will serve the American people much better than if we sit and wait for the other party to give us something to criticize.

I am hopeful that this hearing represents a first step in a bipartisan effort, and I welcome our distinguished panel of witnesses.

Chairman ARCHER. Thank you Mrs. Kennelly.

Without objection, Members may insert written statements in the record at this point.

[The prepared statements follow:]

Statement of Hon. Robert T. Matsui, a Representative in Congress from the State of California

Thank you Mr. Chairman. I'd like to take a few moments to thank Barbara Kennelly for her contributions to this committee and to this institution. Her unwavering leadership on protecting women and families will be a strong legacy as we work toward Social Security reform measures next year. We will miss your guidance and your friendship. I look forward to working with you, Barbara, in other capacities in the future. Thank you.

Statement of Hon. Jerry Weller, a Representative in Congress from the State of Illinois

Mr. Chairman,

Thank you for calling us here today for this extremely important hearing. The 106th Congress is just around the corner and we certainly have our work cut out for us. By 2030, the number of elderly in America is expected to double more than 77 million due to the rapidly aging baby boom population. Fixing Social Security is certainly one way to address the future needs of these retirees. The future financial security of America's retirees is also distinctively liked with their health care needs. So, in addition, Congress must address the *comprehensive* needs of America's retirees, not only from an income perspective, but also from a health care perspective.

Over the past two years, the Social Security Subcommittee, under the leadership of Chairman Jim Bunning, has held a series of hearings to explore the various options for saving and strengthening Social Security. We have heard many different views, opinions and solutions. However, we have not heard the views, opinion, or solution from one very important person—the President of the United States. The President talks about saving Social Security; but the President has not shown any leadership. Chairman Archer asked the Clinton Administration to come to this hearing today and present a *plan*—to show some leadership on this issue. Unfortunately, the Administration is neglecting to step forward and take a stand—taking a back seat on one of the most important issues he will have the opportunity to work on.

As I said earlier, we in Congress have our work cut out for us. During the coming year, we will be making some tough choices—choices that are necessary to ensure the solvency of Social Security. I look forward to today's hearing and would like to wish Chairman Bunning well in his new role in the other body.

Chairman ARCHER. Now, Mr. Wilcox, we are happy to have you with us today. Again, I am sorry that your boss, Secretary Rubin, could not be with us, but we are more than pleased to have you here, and we would be pleased to hear whatever statement or presentation you would like to make to the Committee.

STATEMENT OF HON. DAVID W. WILCOX, ASSISTANT SECRETARY FOR ECONOMIC POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. WILCOX. Thank you very much Mr. Chairman, Members of the Committee. I am honored and pleased to have this opportunity to meet with you today.

Because this is my first appearance before this Committee, I thought I might begin by briefly sketching my professional background. I am the Assistant Secretary for Economic Policy at the Treasury Department, a post which I have held for exactly 1 year as of this week. Prior to that, I was on the staff at the Federal Reserve Board for 10 years; for the first 5 years with responsibility in the macroeconomic forecasting area and for the second 5 years more directly related to monetary policy.

I am pleased to be here today to discuss with you the vitally important issue of restoring Social Security to sound financial footing. I know that Secretary Rubin, Deputy Secretary Summers, and others in the administration look forward to working with you and the other Members of this Committee on this crucial issue.

As we begin this important undertaking, it is worth returning to fundamentals and reminding ourselves why it is so important that we move with dispatch toward achieving a bipartisan agreement. The case for rapid action rests on two key propositions. First, the sooner we move, the more we can take advantage of the economy's extraordinary performance achieved under President Clinton's economic strategy. Right now our economy is remarkably strong and the budget is the healthiest it has been in a generation. Unemployment has been at or below 5 percent for 19 months. Inflation is low and stable. Real incomes are rising again, breaking out of the pattern of stagnation that had persisted since the seventies. And for the first time since 1969, the Federal Government has posted a unified budget surplus.

But we may not always be in such a strong position, and we will likely never be in a stronger position to face the major challenge ahead of us associated with an aging society. One key fact illustrates the dramatic demographic elements that lie ahead. In 1960 the number of American workers for every Social Security beneficiary was 5.1 to 1. Today it is 3.3 to 1. In a little more than 30 years' time when there will be twice as many elderly as there are today, the ratio will be 2 to 1 and falling.

A second reason for moving expeditiously is that the sooner we place Social Security on a sound financial basis, the less we have to do to restore balance. The cost of waiting is that we would be confronted with a more painful set of choices down the road.

As you will recall, the President in his State of the Union speech last January called for 1 year of national dialog on Social Security. That year is now almost over. The President and Vice President have contributed an enormous amount of their personal time and energy toward this enterprise. The administration conducted three regional forums to discuss Social Security with the American people. Each forum involved Members of both parties, serving to broaden the range of ideas explored and giving concrete evidence of the administration's commitment to a bipartisan process.

These forums were jointly sponsored by the Concord Coalition and the American Association of Retired Persons in conjunction with Americans Discuss Social Security. In addition, many Members of Congress held forums in their own States. During this process, we have heard from the American people about their concerns, hopes, and fears about retirement and their views on Social Security.

What we have learned has been critical to the process and will help guide us from here. One of the many lessons from these national forums is that the American people, both young and old, are concerned about the health of the Social Security system, and are supportive of efforts to ensure that the system will provide benefits not only for them but for their children and grandchildren as well. These forums have laid the groundwork for the next stage of the reform process, including next month's White House Conference on Social Security.

This year of dialog has provided many opportunities for us to improve our understanding of the myriad issues involved. Through this process, three themes have been especially clear. First, the final reform package will no doubt assimilate a lot of good thinking from many quarters, and we should be receptive toward taking that thinking on board. The administration believes the many proposals put forward by the Members of Congress, think tanks, academics and interest groups have been constructive in fostering this year of bipartisan discussion.

Second, it makes little sense to judge specific policy options in isolation. They can only be adequately assessed in combination with all the elements that would be required to accomplish the full job.

Last, the administration believes that any plan should be consistent with the five principles that the President articulated at the regional forum held in Kansas City. I have spelled out these principles in some detail in my written testimony, but allow me just to list them for you.

First, reforms should strengthen and protect Social Security for the 21st century.

Second, reforms should maintain the universality and fairness of Social Security.

Third, Social Security must provide a benefit people can depend on.

Fourth, Social Security must continue to provide financial security for disabled and low income beneficiaries.

Finally, Social Security reform must maintain America's fiscal discipline.

Another step in the year of national dialog will be the White House Conference scheduled to take place on December 8 and 9. The administration views this conference as an outgrowth of the public discussions and the consultations that we have been having with Members of Congress from both sides of the aisle throughout the past year. In the time ahead, we intend to broaden and deepen both aspects of this communication.

We fully intend the conference to be bipartisan, to include Members of Congress, representatives of the public, and experts holding all views. The President has always believed that the only way to achieve Social Security reform will be on a bipartisan basis, and we intend for this conference to reflect that view.

Throughout the year, a number of observers have asked whether the administration might be putting forward a plan of its own for Social Security reform, and if so, when. The bottom line answer here is that the administration is committed to whatever course will be most conducive toward arriving at a bipartisan agreement that assures the American people of a stronger Social Security system.

It has been the President's judgment thus far that for us to put out a plan would not have been helpful and could have served to polarize the debate. He will continue to review on an ongoing basis whether proposing a specific plan would help move the process forward. We will obviously be consulting heavily with Members of Congress from both parties on this important issue.

Finally, with regard to engaging the Congress on our shared objective of achieving a bipartisan agreement, the President has consistently stated his intention to begin ongoing bipartisan discussions early next year. The administration recognizes the important role that the Ways and Means Committee will play on this crucial issue. Consultation with all the Members of Congress will be important, but consultation with this Committee will be especially so, and I fully expect the administration to pursue such consultation vigorously as we work toward our objective of forging a bipartisan solution to this challenge.

Mr. Chairman, today virtually every working man and woman in America is protected by Social Security. As we debate which policies will best strengthen of the Social Security Program, there should be no question of the importance of restoring financial balance to the system in a bipartisan manner as early as possible. The administration looks forward to working with the Members of this Committee and with others in Congress as we take on this critical challenge. Thank you, and now I would welcome your questions.

[The prepared statement follows:]

Statement of Hon. David W. Wilcox, Assistant Secretary for Economic Policy, U.S. Department of the Treasury

Mr. Chairman, Members of this Committee, I thank you for this opportunity to meet with you to discuss the vitally important issue of restoring Social Security to sound financial footing. I know that Secretary Rubin, Deputy Secretary Summers, and others in the Administration look forward to working with you and the other Members of the Committee on this issue.

During my remarks today, I would like to touch on four issues: first, the reasons why it is important to move expeditiously next year to secure a bipartisan agreement to preserve and strengthen Social Security; second, what we have learned during the national dialogue of the past year; third, the principles that the President has put forth to guide Social Security reform; fourth, how to best move forward to reach a bipartisan agreement that puts Social Security on solid financial ground for future generations.

THE IMPORTANCE OF SOCIAL SECURITY

As we begin this important undertaking, it is worth returning to fundamentals and reminding ourselves why it is so important that we move with dispatch toward achieving a bipartisan agreement. The case for rapid action rests on two key propositions.

First, the sooner we move, the more we can take advantage of the economy's extraordinary performance achieved under President Clinton's economic strategy. Right now our economy is remarkably strong and our budget is the healthiest it has been in a generation.

- Unemployment has been at or below 5 percent for 19 months.
- Inflation is low and stable.
- Real incomes are rising again, breaking out of the pattern of stagnation that had persisted since the 1970s.
- And for the first time since 1969, the Federal government has posted a unified budget surplus.

But we may not always be in such a strong position. And we will likely never be in a stronger position to face the major challenges ahead of us associated with an aging society. One key fact illustrates the dramatic demographic developments that lie ahead: In 1960, the number of American workers for every Social Security beneficiary was 5.1 to 1. Today it is 3.3 to 1. In a little more than 30 years' time, when there will be twice as many elderly as there are today, the ratio will be 2 to 1, and falling.

Second, the sooner we move to place Social Security on a sound financial basis, the less we have to do to restore balance. The cost of waiting will mean we will be confronted with a more painful set of choices down the road.

THE PRESIDENT'S NATIONAL DIALOGUE ON SOCIAL SECURITY

As you will recall, the President in his State of the Union speech last January called for a year of national dialogue on Social Security. That year is now almost over. The President and Vice-President have contributed an enormous amount of their personal time and energy in this enterprise. The Administration conducted three regional forums to discuss Social Security with the American people. Each forum involved Members of both parties, serving to broaden the range of ideas explored, and giving concrete evidence of the Administration's commitment to a bipartisan process. These forums were jointly sponsored by the Concord Coalition and the American Association of Retired Persons, in conjunction with Americans Discuss Social Security. In addition, many Members of Congress held forums in their own states.

During this process, we have heard from the American people about their concerns, hopes, and fears about retirement, and their views on Social Security. What we have learned has been critical to the process and will help guide us from here. One of the main lessons from these national forums is that the American people—both young and old—are concerned about the health of the Social Security system and are supportive of efforts to ensure that the system will provide benefits not only for them, but for their children and grandchildren as well. These forums have laid the groundwork for the next stage of the reform process, including next month's White House conference on Social Security.

In the remainder of my remarks, I would like to outline some of the Administration views and objectives for building on the national dialogue.

THE PRESIDENT'S PRINCIPLES

This year of dialogue has provided many opportunities for us to improve our understanding of the myriad issues involved. Through this process, three themes have been especially clear.

First, the final reform package will no doubt assimilate a lot of good thinking from many different quarters, and we should be receptive toward taking that thinking on board. The Administration believes the many proposals put forward by the Members of Congress, think tanks, academics, and interest groups have been constructive in fostering this year of bipartisan discussion.

Second, it makes little sense to judge specific policy options in isolation. They can only be adequately assessed in combination with all the elements that would be required to accomplish the full job.

Third, the Administration believes that any plan should be consistent with the five principles that the President articulated at the first Social Security forum in Kansas City.

- First, reform should strengthen and protect Social Security for the 21st Century. Proposals should not abandon the basic program that has been one of our nation's greatest successes. The importance of Social Security can hardly be overstated. Eighteen percent of our seniors—more than one in six—receive all of their income from Social Security. The bottom two-thirds of the aged population, in terms of income, receive half of their income from Social Security. Without Social Security, nearly 50 percent of aged Americans would be in poverty.
- Second, reform should maintain the universality and fairness of Social Security. For half a century, Social Security has been a progressive guarantee for citizens. It should be kept this way.
- Third, Social Security must provide a benefit people can depend on. Regardless of economic ups and downs, Social Security must provide a solid and dependable foundation of retirement security.
- Fourth, Social Security must continue to provide financial security for disabled and low-income beneficiaries. Unfavorable comparisons are often made between the returns on contributions offered by Social Security and the returns offered by the market, but Social Security is much more than just a retirement program. We must never forget that roughly one out of three Social Security recipients is not a retiree. Any reform must ensure that Social Security continues playing these other important roles in the future.
- Finally, Social Security reform must maintain America's fiscal discipline. Six years ago the deficit reached a record $290 billion. In the just-ended fiscal year we achieved a record surplus of $70 billion in the unified budget. In choosing the way forward on Social Security reform, we will need to continue that strong record.

MOVING FORWARD TOWARD A BIPARTISAN AGREEMENT

Another step in the year of national dialogue will be the White House Conference, scheduled to take place on December 8th and 9th. The Administration views this conference as an outgrowth of the public discussions and consultations that we have been having with Members of Congress from both sides of the aisle throughout the past year. In the time ahead, we intend to broaden and deepen both aspects of this communication.

We fully intend the conference to be bipartisan, to include representatives of the public, and to include experts holding all views. The President has always believed that the only way to achieve Social Security reform will be on a bipartisan basis, and we intend for this conference to reflect that view.

Throughout the year, a number of observers have asked whether the Administration might be putting forward a plan of its own for Social Security reform, and if so, when. The bottom-line answer here is that the Administration is committed to whatever course will be most conducive toward arriving at a bipartisan agreement that assures the American people of a stronger Social Security system. It has been the President's judgment thus far that for us to put out a plan would not have been helpful and could have served to polarize the debate. He will continue to review on an ongoing basis whether proposing a specific plan would help move the process forward. We will obviously be consulting heavily with Members of Congress from both parties on this important issue.

Finally, with regard to engaging with Congress on our shared objective of achieving a bipartisan agreement, the President has consistently stated his intention to begin ongoing bipartisan discussions early next year. The Administration recognizes the important role that the Ways and Means Committee will play on this crucial issue. Consultation with all the Members of Congress will be important, but consultation with this Committee will be especially so, and I fully expect the Administration to pursue such consultation vigorously as we work toward the objective of forging a bipartisan solution to this challenge.

Mr. Chairman, today virtually every working man and woman in America is protected by Social Security. As we debate which policies will best strengthen the Social Security program, there should be no question of the importance of restoring financial balance to the system in a bipartisan manner as early as possible. The Administration looks forward to working with the Members of this Committee and with others in Congress as we take on this critical challenge. Thank you, and I would now welcome your questions.

Chairman ARCHER. Thank you, Mr. Wilcox.

Any Member of the Committee wish to inquire?

Mr. Crane.

Mr. CRANE. I am pleased to hear your presentation and the acknowledgments from both sides of the aisle about the nonpartisan aspect of this, and to be sure, it is nonpartisan since it affects us all equally.

One of the things I am curious about is when did the administration get concerned about this pending bankruptcy of Social Security?

Mr. WILCOX. The long-term financial health of the Social Security system has been a concern of the President's for some long period of time.

Mr. CRANE. Like what time?

Mr. WILCOX. I am not familiar with his thinking on when he first began to focus on the importance of this, but this has been a concern of the President's for—on a consistent basis.

Mr. CRANE. Well, the reason I ask that, and I should yield here to the Chairman of our Health Subcommittee, that we only took up our awareness of the bankruptcy of Medicare like 1 year ago, wasn't it? Two years ago? And it was scheduled to go bankrupt in the year 2001, not 2032. I know that we addressed that, but that is only to buy life for another decade with respect to Medicare, and it has the same kind of problems confronting beneficiaries that Social Security does.

One of the things I find interesting at home in town meetings is the only folks paranoid about Social Security have white hair. And the ones who are going to lose any benefits, the younger kids, are the ones that are bored whenever you bring up the subject of Social Security. They would rather listen to more meaningful topics. Yet it is something that I think truly is a potential calamity if not addressed properly by Congress and the administration.

Let me ask you, since there have been many forums since the first of this year on Social Security, have you learned anything? Have you ruled anything in or ruled anything out in reforms?

Mr. WILCOX. Our view is that we have learned a great deal from the forums. We have heard from the American people about how important the Social Security system is to them. We have heard about how many different ways Social Security affects the lives of ordinary Americans. We have heard from people whose college educations have been funded by survivors' benefits from Social Security. We have heard from disabled individuals whose livelihood has been sustained by the DI, disability insurance program, of Social Security.

We have heard from, of course, from the large number of retirees who have counted on Social Security to provide them with a sound financial footing. And I think one of the most important messages that we have heard out of the forums is how supportive the American people will be of bipartisan efforts to place the program on a sound financial footing for the longterm.

Mr. CRANE. Are tax hikes an option for saving Social Security?

Mr. WILCOX. Sir, the President has indicated that he expects to be able to achieve a bipartisan agreement for Social Security without resorting to an increase in the payroll tax rate.

Mr. CRANE. So, you pushed aside the idea of any tax increase to try and resolve the problems?

Mr. WILCOX. The President has indicated that he expects to be able to do that without an increase in the payroll tax rate.

Mr. CRANE. What about benefit cuts?

Mr. WILCOX. The President, I think, quite consistently, has maintained a stance of attempting not to comment on specific proposals, but in order to allow full discussion so that all proposals and all avenues toward solving this problem can be explored, the President has tried to remain in an open-minded stance, in a belief that through a bipartisan and thorough discussion we can arrive at the best possible solution.

Mr. CRANE. So you are saying that benefit cuts could be a consideration?

Mr. WILCOX. None of the alternatives, sir, are attractive, and benefit adjustments are one of the approaches that might be part of an overall package.

Mr. CRANE. And how about retirement age?

Mr. WILCOX. Again, the administration has taken the view that as much as possible, what should be happening now is a full and open discussion of all possible avenues toward achieving sound financial footing for this system.

Mr. CRANE. So retirement age is then under consideration too.

Let me ask one final question. That has to do with the privatization programs in Chile, for example, and Australia. I have been told that there are disagreements on the part of some who have looked at the privatization approach to dealing with the pending bankruptcies of their own Social Security programs. Chile's I have been told is a very successful program. Over 90 percent of Chileans have opted to go that route. I am not conversant with Australia's program.

You have looked, I am sure, at other privatization programs that other countries have experimented with. What is your assessment?

Mr. WILCOX. Certainly, the international experience will be an extremely helpful laboratory for us to look to for lessons in how we proceed.

In a system of the type that Chile has adopted, England as well, there are a number of advantages and disadvantages. The control, for example, that individuals have over their own retirement financial destiny is an important advantage of a system of that type.

By the same token, a number of observers have expressed concern over the level of cost that is built into that system. By contrast with our current Social Security system, wherein more than 99 cents of every dollar taken in in payroll taxes is paid out in the form of benefits, in Chile—in both Chile and in England, 20 to 30 cents are absorbed in the form of administrative costs. So I think there is an important cautionary aspect from the experience of those countries, as well.

Mr. CRANE. Thank you.

Chairman ARCHER. Mr. Matsui.

Mr. MATSUI. Thank you very much, Mr. Chairman. Thank you for your testimony, Secretary Wilcox.

I just want to make a couple of observations. One, I think these regional forums are extremely important, not so much to come up with a specific plan but to show how important Social Security is to the life of an average family in America.

I think in one of the hearings—one of the forums—it came out that if we did not have Social Security, over 50 percent of the senior citizens in America today would live in poverty. And I think the public needs to know those kinds of facts.

In addition, I think your regional forums have brought out the fact that we need to fix the system; that over a period of time now, it has been pretty well established among average citizens that Social Security does have a 2 percent of payroll problem over the next 35 years or so, and in fact we have a big job ahead of us. And so I think those two points have been made by the administration.

I don't believe that the purpose of these forums is necessarily to come up with a specific fix. Obviously, you have got to demonstrate that there is a need for a fix first, and I think you have pretty much reached that point. Perhaps a little more work needs to be done.

It is my hope that over the next year or two, depending upon how long it takes before we actually come up with a solution, that all of us, both parties, work together in good faith. I think that is going to be extremely critical. Second, I think, as Representative Kennelly said, we should not be out to try to criticize. And, third, I think this is as important as anything else, that we shouldn't play the blame game, and I am afraid that has already started today and we need to really avoid that if we possibly can.

We all know the political dimensions of Social Security and how it could affect the parties, and it is my hope that we all try to do this with a good deal of openness, without immediately trying to find ways in which the other party is at fault.

Let me ask you, Mr. Wilcox, in terms of the issue of the surplus, the President has said that he wants to preserve that surplus, obviously for the purpose of dealing with the Social Security problem. Could you perhaps elaborate on why maintaining the surplus without using it for tax cuts or spending programs, big new spending programs, is important, and why it is important not to have tax cuts before we actually solve this problem?

Besides the fact—and I might just add this—that it will be important to show the senior population, if we have to make some tough decisions down the road, that we are acting in good faith in terms of their interests. So perhaps you could respond to that. There has been a lot of talk about enormous tax cuts, and we need to find out whether or not that is an important element.

Mr. WILCOX. Congressman, you asked why is it important to preserve the surplus. I think the simplest formulation I can give of that is that we have an extraordinarily favorable situation over the forecastable future. Whereas earlier we had deficits as far as the eye can see, today we are in the wonderful position of having surpluses as far as the eye can see. Those surpluses in the unified budget represent a very large financial asset.

We have in the Social Security system a very significant challenge ahead of us. The gist of the President's policy to reserve every penny of the unified budget surplus pending agreement on a bipartisan basis toward a Social Security solution, the gist is we should not dissipate that asset before we know the nature and form of the solution that we intend to use in terms of putting Social Security on a sound footing.

Mr. MATSUI. Is my understanding correct that we have a 2 percent of payroll problem over the next generation, the next 35 years or so, and by dipping into that surplus for new big spending programs or tax cuts, that this could make the 2 percent of payroll problem worse?

Mr. WILCOX. The gist of it is that we do not know exactly how much we are going to need, and therefore the policy is let's set aside every penny of that surplus until we know what course we choose to take.

Mr. MATSUI. Not knowing what the solution is, obviously we don't know the impact.

Mr. WILCOX. That is exactly right. Precisely right, sir.

Mr. MATSUI. Thank you.

Chairman ARCHER. Mr. Wilcox, I had planned not to do any questioning, but I think there are a couple of threads that need to be pulled together just to have a foundation on which this discussion continues. It sort of piggybacks on what my friend Bob Matsui was getting at.

When the payroll taxes come in, taken from the workers to go into the trust fund for Social Security benefits—and I must say I take some issue with my friend Phil Gramm's presentation today, and I think we need to set the record straight. Correct me if I am wrong. When those payroll taxes are collected, they come into the Treasury of the United States and they are immediately invested in government bonds paying market interest rates; is that correct?

Mr. WILCOX. That is correct, sir.

Chairman ARCHER. And when the need for Social Security benefit payments arises every month, the Social Security Trust Fund submits the amount of securities or reduction that are necessary to pay those benefits every month; is that correct?

Mr. WILCOX. That is correct, sir.

Chairman ARCHER. Can those securities be redeemed for any other spending purpose?

Mr. WILCOX. My understanding is that they cannot.

Chairman ARCHER. That is mine too. In fact, that is the law of the land. Now, it has often been said by both liberals, moderates, and conservatives that there is nothing in the fund, that the money has been spent. But the money has been borrowed by the Treasury to pay other operating bills, and the Social Security Trust Fund retains the Treasury securities to represent the moneys that will ultimately be paid in the redemption of those bonds. Now, challenge me if anything that I say is incorrect, because I think it is very important that the Members of this Committee and the people of the United States understand the fundamentals of Social Security.

Under those circumstances, how would it ever be possible to raid the Social Security Trust Fund, whether it be for other General Treasury spending or for General Treasury tax relief? Can you explain to this Committee how under any circumstances it would be possible to raid the Social Security Trust Fund when you give a tax relief out of the General Treasury?

Now, I am not talking about payroll tax relief. If you took payroll taxes and reduced them, you would be taking money out of the fund, money that would go into the fund. But inasmuch as all of those payroll taxes are immediately invested in Treasury securities—which are, by the way, the safest investment in the world and why interest rates are going down, because foreigners are now running to buy Treasury securities which are the safest investment in the world. And it is those securities that are held by the Social Security Trust Fund, backed by the full faith and credit of the United States of America.

Now, again, how would it be possible by either an appropriation spending bill or a general tax relief bill out of the General Treasury to raid the Social Security Trust Fund?

Mr. WILCOX. Sir, I am not sure I can answer that question without knowing the precise details of what you have in mind, but the conversation I was having——

Chairman ARCHER. Let me it more specific. Inasmuch as the trust fund is represented by Treasury securities that can be redeemed only to pay for Social Security benefits, which you said was correct, in what way does a general tax reduction or tax relief bill in any way attach to those securities? Are they going to be redeemed for the general tax reduction?

Mr. WILCOX. The gist of my conversation with Congressman Matsui was that the administration's position is specifically with respect to the disposition of the unified budget surplus.

Chairman ARCHER. I understand. That is not the question I am asking. I am asking you specifically whether those bonds that are in safekeeping in the trust fund and which represent all of the payroll taxes that have been paid in, whether they can be redeemed in any way or undermined in any way by a tax relief bill that does not involve the payroll taxes? It involves income tax relief. Can they in any way be undermined or used for that purpose?

Mr. WILCOX. As you observed, sir, my understanding is, as well, that the only purpose for which those securities may be redeemed is for purposes of payment of benefits.

Chairman ARCHER. All right. So the answer, then, is if the Congress elected to give tax relief on the income tax, that would in no way legally ever be able to raid the Social Security Trust Fund which is represented by bonds that are held in that trust fund; is that correct?

Mr. WILCOX. That would not compromise the validity of the securities held by the Social Security Trust Fund.

Chairman ARCHER. So under no circumstances could that be expressed in the terms of "raiding" the Social Security Trust Fund; correct?

Mr. WILCOX. I would hesitate to characterize what other observers might have in mind when they speak of raiding.

Chairman ARCHER. I am not asking about other observers. I am asking you and then I want you to tell me how it would raid the Social Security Trust Fund, inasmuch as all of those bonds are still intact.

Mr. WILCOX. I do not think I am prepared to characterize off the cuff whether that would constitute raiding——

Chairman ARCHER. Well, think about it a moment so it does not have to be off the cuff.

Mr. WILCOX. I, sir, have stated that I agree with you that the only purpose for which those bonds may be redeemed is for purposes of paying benefit obligations of the Social Security system, and I believe we are in full agreement on that point.

Chairman ARCHER. Thank you. Because I think that is very, very important, number one, to lay the predicate for the American people to understand.

Second, and where I disagree with my friend Phil Gramm, those bonds that are held by the Social Security Trust Fund have the same full faith and credit as a double A bond or any other Treasury securities that are bought by the general public. Is that not correct?

Mr. WILCOX. That is absolutely correct. They have the same legal standing, sir, as marketable Treasury securities.

Chairman ARCHER. So if those who say there is nothing in the trust fund believe that inasmuch as the money has been spent and there are only bonds held by the trust fund, would it not also be fair to say that those Americans who have bought double A bonds should go home and burn them because they are worthless, because the money has already been spent?

Mr. WILCOX. My understanding is that, unlike many of us who hold Treasury securities in an electronic form, there are literally, my understanding, physical certificates that are held in a vault in West Virginia, I believe.

Chairman ARCHER. That is good to know, too, but irrespective, it is a legal obligation of the United States of America, and it is the safest investment in the world, and the mere fact that the money that was given to buy the bonds has been spent does not in any way mean the bonds don't have a very real value, does it?

Mr. WILCOX. They are backed by the full faith and credit of the U.S. Treasury.

Chairman ARCHER. Absolutely. And many of my conservative friends do not understand that.

Mr. WILCOX. Well, together we can proselytize——

Chairman ARCHER. I apologize for the time taken today, but I think it is very, very important for people to understand exactly what is involved here. And now, what interest return do these bonds give to the Social Security Trust Fund today? There is the myth that there is no compounding of interest on these bonds that are held by the fund.

Mr. WILCOX. This is a complex topic. I will do the best I can to give you the broad outlines of it.

The securities pay a rate which is tied to the rate actually observed in the marketplace on coupon securities with 4 years and more to maturity. The securities are issued in a laddered set of maturities from 1 to 15 years, and all the securities of different maturity issued on the same date pay the same rate of return, which is that average on marketable coupons of 4 years and more. And if I have stated that incorrectly, I hope someone will correct me.

Chairman ARCHER. Well, the important thing is, I am told that currently the rate of return on the bonds to the Social Security Trust Fund is 7.5 percent APR.

Mr. WILCOX. I don't know that figure off the top of my head.

Chairman ARCHER. I would like for you to research that and confirm that, but it doesn't really matter. The important thing is that there is a significant compounding of interest into the fund today. And it is, for the safety of the securities that are held there, it is one of the highest returns that you can find anywhere in the world, for the very reason that you mentioned as to how the bonds are set up. So it is important for everyone to know as we go into this process that there is a compounding of return to the Social Security Trust Fund for the bonds that are held there.

[The information was subsequently received:]

The combined interest rate earned by the OASDI Trust Funds in calendar year 1997 was 7.5 percent; 7.6 percent for the OASI program and 7.0 percent for DI. The interest rate on the special issues purchased by the Trust Funds in June 1997 was 6.875 percent. (Source: 1998 Trustees Report)

Chairman ARCHER. These are all facts, and I hope the American people will learn more about it. Let me ask you one last question.

Inasmuch as the surplus, depending on how you define it, is generated by an unexpected increase in income tax revenues and a decline in spending that was not in the baseline that generate this so-called surplus, how would you use, in your plan to save Social Security, how will you use the General Treasury funds that are a part of this surplus to save Social Security? What would be options for the infusion of General Treasury funds, inasmuch as we have already established that the payroll taxes are going in, they are there, they stay there. That is not an issue of debate. The surplus now we are talking about is what do we do out of the General Treasury to save Social Security? What options would the administration consider for the use of these General Treasury funds to save Social Security?

Mr. WILCOX. First, Mr. Chairman, I should emphasize there is no administration plan, and therefore I can't speak as to how they would be used in an administration plan. The administration policy that does exist that is relevant to this, is the policy that we have been discussing of reserving the unified surplus pending bipartisan agreement on how to address this problem.

There have been a number of proposals put forward, and I expect that you will hear in your later panels from some witnesses who will discuss this, but there is a wide variety of proposals for how the unified surplus might be applied to the problem of solving the Social Security financial status.

Chairman ARCHER. Well, let me go back to the basics again. Whatever portion of the "unified surplus" is a result of the payroll taxes that are coming in, have they not already been reserved, inasmuch as they have gone into bonds and cannot be spent for anything else? Does the law not already preserve that in toto?

Mr. WILCOX. Again, I return to the basic observation that the unified surplus is an important asset that we must preserve.

Chairman ARCHER. I understand. But I am trying to be a little more specific because this gets confusing for the American people.

Mr. WILCOX. I appreciate that, sir.

Chairman ARCHER. And I am asking the specific question of, to whatever degree the unified surplus is a result of the payroll taxes going into the Social Security Trust Fund, which are represented immediately by government bonds, they cannot be used for any other purpose, is that not already protected under the law to be used only to save Social Security?

Mr. WILCOX. To the extent that payroll taxes exceed benefit obligations and administrative expenses, the balance in the Social Security Trust Fund rises by that amount.

Chairman ARCHER. Yes, and to the extent that that is a part of the unified surplus which you have referred to, that is already protected under law, is it not?

Mr. WILCOX. Well, I mean——

Chairman ARCHER. Why do we have to go back through this? You just said it cannot be spent for anything else, it must be protected.

Mr. WILCOX. It is protected in the trust fund. The reason why these issues are diffuse and difficult to get a hold of is that it is impossible to identify which dollar in the unified surplus came——

Chairman ARCHER. So it is not. You know exactly how much money is going into the Social Security Trust Fund from the payroll taxes in excess of the benefits that are paid out. You know exactly every year. It is not difficult. It is a very simple arithmetic formula. And to the degree that that amount of money is a part of the surplus, it is already protected, is it not? Why is it so hard for you to say yes to that when you said yes to all of the preliminary questions?

Mr. WILCOX. Sir, the thing that I am saying yes to is the President's determination to save the unified budget.

Chairman ARCHER. But that is a generality. I am trying to get basic information out so we can understand exactly where we are.

Let me ask you one more time. To the degree that the moneys coming into the Social Security fund each year are in excess of administrative costs and benefit outlays, to the degree that that is a part of the unified surplus, that is already protected under law, is it not?

Mr. WILCOX. To the degree that the payroll tax revenue exceeds benefit obligations and administrative costs, the trust fund is going up by that amount.

Chairman ARCHER. That is already protected for the purpose of saving Social Security because it cannot be spent for anything else.

Now, that is a part of the unified surplus which is already protected. Now, the issue then comes to the other part, which is the general operating Treasury and its role relative to the unified budget, and that is a different issue. Now, inasmuch as the part that is going into the Social Security fund and the payroll taxes is already protected to save Social Security under the concept in the mantra of "save Social Security first," we must only be talking about the operating Treasury moneys as their role in the surplus. And I am asking you the question, what options are there to take that General Treasury money to save Social Security?

Mr. WILCOX. And what I am attempting to state as clearly as possible, sir, is that there is at this point no administration position on how the unified budget surpluses might be applied toward the problem of addressing the Social Security problem. There have been a wide range of proposals put forward by others and we are interested in studying those proposals.

Chairman ARCHER. No, I understand that. But I am asking you for specific options that you would rule in and specific options that you would rule out relative to the use of the General Treasury surplus, whatever it might be, in the saving of Social Security. And I hate to repeat this again, but inasmuch as we have already established that the Social Security moneys that may be a part of the unified surplus are already committed to saving Social Security, now let's look at the other part, because you must be talking only about that when you say save Social Security first before you use any of it for tax reduction.

Mr. WILCOX. "Save Social Security" refers to the entirety of the unified budget surplus.

Chairman ARCHER. Well, I am obviously not going to get an answer to this question. But what I am trying to get at is that Social Security's sanctity over the years has always been that it is independent of General Treasury funds; that it is an insurance contract between the government and workers as a result of what they have sent to the fund under the payroll tax structure, and their benefits are directly related to what they paid in during their work life in the payroll structure.

Now, when you start talking about the unified budget surplus as a solution to Social Security, you must have some plan or some ideas about how General Treasury funds are going to be infused into the Social Security fund. And many, many people will come unglued when that happens because they will see the sacredness of the contract of Social Security undermined and the beginnings of it becoming a welfare system.

Mr. WILCOX. Perhaps, sir, I could give an illustration of one way that the unified surplus might be used, and this illustration has been put forward by a number of alternative observers.

Chairman ARCHER. Since the payroll taxes are already protected, let's talk about how you are going to use General Treasury funds out of the surplus to save Social Security. What options are available, in the way that you look at it?

Mr. WILCOX. One option that has been put forward by a number of advocates would be to take those special purpose bonds that are in the trust fund that we have been talking about and redeem those for the purpose of purchasing private sector securities. This option would have the effect of reducing the unified surplus.

In the first instance it would maintain the level of the Social Security Trust Fund exactly at its same level because it is a swap of equal value assets. Dollar for dollar, it would reduce the unified budget surplus, and so that would be a way of using the assets in the Social Security Trust Fund, reducing the unified budget surplus for the purpose of improving the financial status of the Social Security system.

Chairman ARCHER. OK. All right. I apologize for the length of my inquiry, but I wanted to set some sort of basic foundation for the balance of the discussion today.

And let me recognize Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman. I am already fairly heavily engaged in a bipartisan effort to save Medicare as the administrative Chair. One of the things we have tried to do, to not just maintain as a statement that we are in favor of a bipartisan solution, is that we have attempted to conduct ourselves in a bipartisan way.

Mr. Secretary, I read your statement very carefully, and notwithstanding in your second paragraph the statement how to best move forward to reach a bipartisan agreement, and then moving forward toward a bipartisan agreement, in your opening section on the importance of Social Security, what you outline is nothing more than a campaign statement on what has occurred over the last several years.

Now, perhaps you didn't intend that, but my recollection is that President Clinton was elected in 1992 and he had a Democratic majority in both the House and the Senate, and the American people in their wisdom decided to change that in 1994. And in three successive elections the Republican Party has controlled the House and the Senate, at which time the balanced budget was achieved.

And if your opening statement is going to be simply President Clinton's economic strategy, without any acknowledgment or willingness to admit that there has been a cooperative effort to reach the current economic state that we are in, what you have just made is a very partisan campaign statement, and that is your opening statement to this Committee that you want to be bipartisan. That kind of pitch has to stop. Saying you want to be bipartisan also has to be followed up by being bipartisan, both in word and in deed.

President Clinton is not going to run again. If he really wants a fundamental benefit legacy, it is not only Social Security, it will be Medicare reform, but time is running out.

And I listened carefully to some of the responses to my friend and colleague from Illinois about changes that are more often than not kind of boilerplate discussed, and in response to the change that was made in 1983 by the Congress, to an age change from 65 to 67, you have indicated that you did not contemplate any age change, and that, I think, is a very clear and easy answer. The problem is, the plan that was passed moved the retirement age from 65 to 67, not until 2027.

So is the administration in any way contemplating an adjustment within the current legal age limit requirement? That is, moving forward the achievement of the 67 age date prior to 2027?

Mr. WILCOX. Sir, let me begin by complimenting your leadership on the Medicare Commission——

Mr. THOMAS. I appreciate that, but I have got 5 minutes and that light is going to move really quickly.

Mr. WILCOX. The administration is studying a wide range of proposals, including those that deal with benefit adjustment, retirement age, revenues——

Mr. THOMAS. So nothing is off the table?

Mr. WILCOX. Nothing is off the table. As I said earlier, the President has indicated that he expects to be able to accomplish this without recourse to an increase in the payroll tax rate.

Mr. THOMAS. And you very carefully said that, and you repeated it very carefully again, and I will reference the discussion with the Chairman: No payroll tax rate increase. But fairly obviously there are a number of schemes that are available to utilize dollars that are, in fact, raised through taxes that are not rate increases. Is that what I understand your statement to be?

Mr. WILCOX. The administration has not taken a position on those, and we seek to leave an open and free——

Mr. THOMAS. So you haven't ruled that out.

Mr. WILCOX. That is correct, sir.

Mr. THOMAS. So tax increases are on the table. They have not been ruled out, but no payroll tax rate increase, and I understand that.

Now, let me urge you folks—and I understand, your concern—but, boy, you sound like you are bobbing and weaving, waiting for the next election. There is no next election for this President. He did invest a year going out, reaching out with the various hearings. He is going to have a bipartisan conference next month. That is 1998.

In 1999, can we expect the President to offer some specifics? Not principles. We spent a whole year searching, listening, wandering in the wilderness for principles. Can we get some specifics at the State of the Union? Yes or no?

Mr. WILCOX. Sir, the President will put forward a plan if and when he determines that it would be helpful to moving the debate ahead.

Mr. THOMAS. How about budget time, around April? Yes or no?

Mr. WILCOX. My answer would be the same.

Mr. THOMAS. How about fiscal year, around October?

Mr. WILCOX. My answer remains the same.

Mr. THOMAS. This guy is not going to run again. You are blowing a really wonderful opportunity by acting like he is going to run again. You cannot keep bobbing and weaving. It is tough and difficult, but just like we are doing on the Medicare Commission, we are grappling with specific provisions. Principles are fine, but you are going to have to start pulling them together.

If you are unwilling to commit by October 1, fiscal year, and you still may be mulling over the principles, you are in fact not stating that you are willing to join with us as a bipartisan way to solve Medicare. You have got to think just what you are going to be saying over the next couple of months, especially leading up to and after the State of the Union. I want a bipartisan solution, I believe you do, but this campaign rhetoric mode has got to end.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Secretary, I wonder if you could outline what classes of workers in the economy would be most at risk in a system where Social Security benefits, both disability and retirement, are not guaranteed to the workers?

Mr. WILCOX. I think in order to answer that, you would look to the classes of individuals for whom Social Security currently is most important. Social Security is extremely important for low-income workers. The replacement rates for low-income workers are considerably higher than for average- and high-income workers. So clearly a core element of our concern in the design of a plan should be to examine carefully the possible impact of a Social Security reform plan on low-income workers.

The second class of individuals for whom Social Security is extremely important is disabled individuals.

Mr. COYNE. What was that?

Mr. WILCOX. Disabled individuals. It is not commonly known that fully 10 percent of Social Security beneficiaries are disabled. This for a family of four, age 30, is roughly equivalent to a life insurance policy of about $300,000.

The third class of individuals for whom Social Security is extremely important is women. Women make up 60 percent of the total number of beneficiaries of the Social Security system, and there are a number of features of that system that make it especially important to them.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Shaw.

Mr. SHAW. Mr. Wilcox, I would like to follow up with your answer to Mr. Coyne regarding the importance of Social Security to your lower income people. Is the President thinking about means testing as far as the beneficiaries of the Social Security Program are concerned?

Mr. WILCOX. Sir, one of the principles that the President articulated in Kansas City was that Social Security should remain a universal system, although I could not speak to whether a proposal to means test the system would threaten that principle without seeing the precise details. Certainly, we would want to assess that proposal against the backdrop of the President's principle.

Mr. SHAW. Dr. Wilcox, you have a very distinguished academic background, and I can see you are visibly not very comfortable in the spot you are in right now. You brought us a message that you want to strengthen and protect Social Security. You want universality and fairness. You want to provide benefits that people can depend upon. You want to provide financial security and fiscal discipline. Well, I guess everybody wants to do that. But I must express the disappointment of this Committee that you were not allowed to bring us today some type of solution, and that we don't even have a timetable in which the President would bring us that type of solution.

As a matter of fact, I can find only one portion of your statement which I can take some encouragement from, and that is that the President will continue to review on an ongoing basis whether proposing a specific plan would help move the process forward. I think the Chairman has made it very, very clear that it would be extraordinarily helpful, and I think everybody on this Committee would agree that it would be helpful. And if there is anyone on the other side of the aisle who thinks this would not be helpful, that that would be destructive to the process, I would enjoy hearing that explanation.

The President was the one who made that famous statement of "Save Social Security first." Why is it that the President—who said that any tax cut would in some way invade the Social Security Trust Fund, which you made it clear that it would not raid the Social Security fund in the more political dialog, who insisted on more spending which did invade the surplus that we have, who has characterized himself as the defender of Social Security—why is it that he cannot come up with a plan that would assist us?

I can assure you that this Committee is extraordinarily anxious to work with this President on the Republican side and the Democrat side. We did it, we fought for a few years on welfare reform, but then we came together. On this particular issue, we are running out of time. We have a limited window of opportunity, and if it is not done during the term of this administration, it is going to be looked back on as one of the tragedies of this administration.

But if the President would sit down and all of us could talk just frankly, forget the rhetoric, and be open with each other, whether it be an open session or closed session, if we could do that I think we could come to some type of solution. I am looking forward to the White House Conference on Social Security. But from what you have told us today, I think that our expectations should be very small as to what is going to come out of that conference.

What do you think will actually come out of that conference? What do you think would be accomplished by even having the conference?

Mr. WILCOX. Oh, I think the conference will be a very important opportunity to summarize the events of the last year from the regional forums, to engage further in the consultation with Members of Congress, because I know the administration views that as an essential part of the process for moving forward.

Mr. SHAW. You think a solution will come out of the conference? You think the President might draw from the conference in order to draw a plan to send to us?

Mr. WILCOX. I don't think—I myself would not expect a 2-day conference to yield a solution to the Social Security question.

Mr. SHAW. So you do not think the President is going to develop a plan out of this conference. That certainly is disappointing.

I would hope the next time the President sends people down here, particularly people such as you, from your academic background, who have so much to offer, I would hope he would give them a longer leash so they could work with this Committee and try to get things done and get a solution to a tremendous problem.

The American people are tired of the politics, even though the politics of this seems to still be working. It is a tragedy. And representing the district that I represent, as one of the most elderly in the Nation, I can say that it is most disappointing that we are not moving forward and we are not moving the ball at all.

Thank you, Mr. Chairman.

Mr. CRANE [presiding]. Mr. Levin.

Mr. LEVIN. I am disappointed because essentially what the majority has said so far, lead by the Chairman, is that a bipartisan solution requires that the President should go first with his specific plan. That is essentially what you are saying. That is your definition of a bipartisan approach.

I think that sells this Congress short. I don't think we should be a junior partner. That wasn't the model that was used in 1982. That isn't the model that was proposed by the Chairman himself, that there be a commission. That isn't the model that is being used with Medicare.

Mr. SHAW. If the gentleman will yield, the President rejected the proposal by our Chairman.

Mr. LEVIN. I don't think it ever got out of the Senate, Mr. Shaw. There was a lot of objection to that in the Senate.

I think there is a different model we might use, and that is to try a bipartisan effort within this Committee. We did not do that in the last session on any major legislation, maybe with one exception. But the rest of the proposals were written within caucus and then essentially presented to us. So the effort to say bipartisanship won't work unless the President unveils a specific plan I think falls short in terms of what we as Members of Congress can do.

The other argument used by Chairman Archer is that the President should desensitize the issue politically, otherwise we cannot proceed, and the Nixon to China example is used, but I think that that isn't a good analogy. We are all deeply familiar with the Social Security issue, and I think our constituents are, and I don't think that we should say a prerequisite is a specific plan from the President.

I don't think the way to achieve a bipartisan result is to maneuver as to who goes first, and that is essentially what has been endeavored here. And I think, Mr. Wilcox, you have handled yourself with candor and confidence.

Let me just say one last word about the surplus. "Save Social Security first," as Mr. Wilcox has said, was a position that we should not spend the unified surplus until we save Social Security first. There would not be a surplus without the surplus in Social Security. That is what was said. And if we used moneys—and we can argue about the emergency funds, and they were increased in part because of an initiative from the Republican leadership in this House—the position of the President was that if we used the unified surplus before we save Social Security, it would make much more difficult or likely make more difficult saving Social Security for the long run.

We are going to hear from witnesses today, including those who propose overall privatization, whose plans, it would appear, would depend on some use of General Treasury funds, if not this decade or the next decade, the decade thereafter. So I think the position as explained by Secretary Wilcox and others is very clear, that we should not be spending the unified surplus until we make a mammoth effort to save Social Security for the long run.

I would urge that instead of trying to smoke out each other's positions, instead of a "them" and "us" approach, that we in this Committee set the example of starting to work on this on a bipartisan basis. We did not do that on key issues last session; we ought to do it this session.

Mr. CRANE. Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman, and let me apologize, because I have the scourge of what every Congressman fears, and that is losing one's voice. But I know for some of my adversaries their prayers have been answered in that regard, with my voice not here.

Mr. Wilcox, welcome. Thank you for coming for the first time to see us. And with all due respect to my friend from Michigan, I would just take it a step further. Let's set this not on a bipartisan plane but on a nonpartisan plane. And in that spirit, one of the basic fundamental tenets that every student learns in school, in elementary civics and government, is the notion that the President proposes, the Congress disposes.

And on something this important, free from partisan rancor, just simply the notion that the President proposes a plan rather than using the bully pulpit to simply articulate principles, I think as a notion is well deserved. And it is in that spirit, Secretary Wilcox, that I return to your statement, quoting now from what you testified to: "It has been the President's judgment thus far that for us to put out a plan would not have been helpful and could have served to polarize the debate."

Let me ask you, Secretary Wilcox, when was the last chance you had to brief the President on the different alternatives and options involved in saving Social Security?

Mr. WILCOX. I believe—time, if you will forgive me, time has run together a little bit here lately.

Mr. HAYWORTH. Understandable.

Mr. WILCOX. Either last week, I believe, sir, or the week before.

Mr. HAYWORTH. And, again, based on that time in the last 2 weeks, the President still feels no need to step forward with a plan?

Mr. WILCOX. The President is firmly committed toward achieving a bipartisan solution. I can tell you, based on my own personal observation, of the seriousness that the President attaches to this enterprise. The President is engaged on this issue and he is firmly committed toward seizing the opportunity of the current moment. He also has exhibited enormous leadership in bringing the process to this phase.

Mr. HAYWORTH. Mr. Secretary, we all agree that listening is a very important part of leadership. I think, again, that is a nonpartisan principle. It transcends political labels.

What I would like you to convey to the administration and my other friends who join you here from Treasury—and sadly, again, I must also say it is unfortunate that the Secretary, for whatever reason, could not join us here today—but let me humbly and respectfully request that, whether in the wake of this conference that takes place at the White House in a couple of weeks or in some other venue, that the President not hesitate to lead.

Constructive criticism is not always partisan, even in the wake, sadly, of the Medicare debacle of 1996. A plan is not there to always be attacked, and the President does enjoy the advantage of the bully pulpit. I would simply ask you to convey to the President our challenge: To step up and lead.

I thank you for your attendance. I have no further comments or questions.

Mr. CRANE. Mr. McDermott.

Mr. MCDERMOTT. Welcome, Mr. Wilcox. I don't remember your being up before the Committee, but you are being treated to what in the animal kingdom is probably analogous to porcupines making love. And given the way the last session ended, I think there is a certain amount of reluctance on the part of the majority to make love in this porcupine atmosphere.

The incoming Speaker has announced that his first bill will be H.R. 1, to take Social Security off budget. Now, I don't remember if it is two or three times we have already done that in the Congress. If I am wrong I want to be corrected. I want to know if you can conceive of any way that those payroll taxes can be put in such a place that they can never be reached by the Congress. Outside of what I think you already suggested, which was some kind of investment in the private sector, is there any other way that that can happen?

My understanding is, if the money is gone, then it cannot be used for any kind of tax cuts or anything else. My second question is, if we took all the surplus and put it in the private sector, out in Wall Street, and invested it, there would be no way it could be used to balance the budget and still give tax cuts; am I correct?

Mr. WILCOX. As you correctly observe, sir, there have been a number of proposals from Members of Congress and from think tanks, academics and so forth, that would involve using the resources of the Social Security Trust Fund to purchase private sector securities. And those proposals, that act of purchasing private sector securities would reduce the unified surplus.

Mr. MCDERMOTT. So the practice that was begun when Mr. Reagan was President and the Senate was in the hands of the Republicans, to use that surplus as a budget balancing mechanism, would be over; is that correct?

Mr. WILCOX. I think I would have to think through the analytics of exactly how that would work. I am not sure I can give you a blanket answer as to how it would work. There are different varieties of proposals.

Mr. CRANE. Mr. McDermott, would you yield just a second? Wasn't that Lyndon Johnson that folded it in so we could hide our annual spending deficits?

Mr. MCDERMOTT. I think Senator Gramm testified it was in 1983 when the proposal was made to make, the changes, that that is when they began using it as a part of the unified budget. Am I incorrect?

Mr. MCCRERY. No, that is not correct.

Mr. MCDERMOTT. Well, now, let the witness answer. It is my time.

Mr. WILCOX. I have just been informed that your earlier statement is a correct statement.

Mr. MCDERMOTT. Is correct?

Mr. WILCOX. Yes, sir.

Mr. CRANE. This did not happen in 1968?

Mr. WILCOX. What did not happen?

Mr. CRANE. Folding Social Security into the budget. The total budget.

Mr. WILCOX. I don't recall the chronology of the various times when Social Security has been brought in and taken off and so forth.

Mr. MCCRERY. If the gentleman will yield, I think if you will check, Social Security was made part of the unified budget under President Johnson.

Mr. MCDERMOTT. If I may reclaim my time, there was no surplus in Social Security until 1983, so that is when it began to be used. Lyndon Johnson may have considered it, but it was not possible because they were in deficit during the war.

Mr. WILCOX. Right. I think the unified budget as a conceptual framework was established in 1967. The emergence of substantial surpluses, for the purpose of partial prefunding of the system, was a consequence of the 1983 set of reforms.

Mr. MCDERMOTT. But my second point was, if it is somehow taken off budget, and really taken off budget—we have done this scam on the people two times at least, where we have said we have moved Social Security off budget but we haven't. We keep playing a game. If we really moved it off budget, there would be no way, without unbalancing the budget and borrowing more money, for us to give a tax reduction, would there?

Mr. WILCOX. I believe that is correct, sir. That is right. Your statement is correct.

Mr. MCDERMOTT. So the incoming Speaker is setting himself up in a box where he cannot deal with any kind of tax reductions, if I understand what you are saying.

Mr. WILCOX. I would like to consult with my budgetary expert here.

Yes, sir, your observations are correct.

Mr. MCDERMOTT. So his only choice would be further to reduce spending in order to give a tax break, if he was going to give a tax break.

Mr. WILCOX. I believe that would be correct, sir.

Mr. MCDERMOTT. Thank you, and I yield back the balance of my time.

Mr. CRANE. Let's see. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. I believe Mr. Wilcox has pretty well answered my question in Mr. McDermott's questioning, and that was, you referenced possibly using general funds to redeem the Treasury notes that are now held for the trust fund from that of government securities to private sector securities. Is that what I heard?

Mr. WILCOX. What I gave was one possible mechanism where a unified surplus could be used in a way that would strengthen the financial standing of the Social Security system. The particular mechanism, just to be clear, that I outlined was taking existing securities already in the trust fund, redeeming them and using the proceeds to purchase private sector securities. This is a proposal that a number of outside advocates have advanced as one possible approach.

Mr. COLLINS. But the reality of that would be that there would still be securities or IOUs in the trust fund.

Mr. WILCOX. Unless, I suppose, in the extreme one redeemed all of the special purpose treasury securities for the purpose of purchasing private sector securities.

Mr. COLLINS. No matter where you purchase securities, it is still an IOU to the trust fund, some type of security. There are still no funds in the trust fund as such, and there will always be an investment of those positive cash flows in those trust funds in some type of securities.

However, you earlier stated that the government security, as the Chairman stated, is the safest investment in the world, but yet you would entertain moving them from the safest investment on behalf of those who work and have those taxes reduced from their payrolls to another type of investment. It could possibly be even a less secure investment for the Social Security Program.

Mr. WILCOX. Right. I think you make——

Mr. COLLINS. Did I hear you say right?

Mr. WILCOX. I think you make two very important points with which I agree. First of all, inherent in a policy proposal of the nature that I gave would be a tradeoff between risk and return. This is a fundamental tenet of financial markets, that higher return is not available without assuming additional risk. So to move from special issue Treasury securities, backed by the full faith and credit of the U.S. Treasury, to equities of private sector U.S. corporations would be a move in advance, in the anticipation toward higher return, but also at the same time inherently involves assumption of additional risk.

Mr. COLLINS. In other words, if you move those funds from government securities to private securities, you are increasing the risk of those securities.

Mr. WILCOX. Absolutely.

Mr. COLLINS. Those funds that are deducted from every worker's payroll check.

Mr. WILCOX. Absolutely. That is an important consideration that has to be taken into account in assessing the advisability of a proposal of this nature.

Mr. COLLINS. Well, under that type of scenario, would the trust fund be the recipient of the return on the investment? Or do you have some type of idea or plan how that would be converted to an individual recipient as the form of investment?

Mr. WILCOX. I haven't seen anything fully "spec"-ed out in a way we could hand it to the managers of the trust fund and just say "Execute this." As it is commonly talked about, with sometimes the shorthand that the academics and other nonoperational folks have the luxury to use, what people envision is that simply in place of those special issue securities that the trust fund currently holds, that one might end up holding the common stock of a wide range of U.S. companies. The S&P 500 is prominently mentioned in these proposals as the type of thing, or even broader indexes of U.S. equities.

Mr. COLLINS. Would that not increase the possibility of politics entering into those type of investments based on contribution lists versus government securities?

Mr. WILCOX. Oh, I think one again would have to think very, very carefully before undertaking a step of this nature. In return, on the one side of the ledger, that increased prospective rate of return is very, very attractive. On the other side of the ledger one has to take account of very important factors such as the ones you are talking about.

Walling off these securities from political influence, the investment policy from political influence, would be of extreme importance if one were to undertake this. Proper appreciation of the additional risk being assumed by the Social Security Trust Fund, and a full analysis of the implications of that risk for the overall fiscal standing of the Federal Government, would have to be undertaken.

So there are a number of very important factors that would have to be taken into account.

Mr. COLLINS. The number one risk factor is the taxpayer that must be considered.

Mr. WILCOX. The taxpayer would be the ultimate bearer of the risk.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman. In the time that I have been here, I have seen many thousands of legislative proposals come before the House and the Senate. We introduce legislation all the time. We introduce scores of legislative proposals that are extremely important, of major national magnitude, and I am not aware of on each occasion the author of that legislation or the leadership in the House or the Senate first requesting the administration's input and the issuance of its own proposal before Members of Congress move forward to initiate that legislative proposal and work it through the process.

Certainly with Social Security, everyone is talking about a bipartisan process, but I know that you have been peppered with a number of questions about why the President hasn't come forward with his solution to the challenges facing Social Security. Let me ask you: Are you aware of whether or not Congress has forwarded to the President its solution to the problems facing Social Security?

Mr. WILCOX. I am not aware of that, sir.

Mr. BECERRA. The President has given us the principles he believes are most important in defining any solution for Social Security. Are you aware of whether or not Congress has forwarded its principles on what it believes should be most important in resolving the challenges facing Social Security?

Mr. WILCOX. I am not aware of any agreed upon set of principles that the Congress would use.

Mr. BECERRA. So at least at this stage it appears that while the President hasn't come forward with any solution, neither have those who are actually responsible for enacting legislation, Members of Congress, who must initiate the proposal, get it passed, before the President has any opportunity to sign any legislation into law, neither have those Members of Congress forwarded to the President what they believe would be the solution to resolve the challenges facing Social Security; is that correct?

Mr. WILCOX. That is correct, sir.

Mr. BECERRA. And you had an opportunity to engage in, I wouldn't call it a dialog, but an exchange of thoughts with the Chairman of the Committee on this whole issue of the trust fund and whether it would be raided if we took moneys and used it for other purposes. Let me try to play this out, because I know it gets very confusing, as the Chairman said.

You are the government; I am a worker. I pay to you a portion of my wages as a Social Security contribution, which ultimately will help me and others pay for a retirement benefit that I will get from the government. You get that money that I contribute, and you do not just hold it. What you do is you issue a Treasury certificate, a bond or whatever other government security you have, and you say "This certificate is now your proof that you will get that money that you have invested into the Social Security Trust Fund once you retire."

You then take the money that you take in lieu of the certificate that you have now told me is out there to secure my money, and you use that money for the operation of the government, for whatever purpose it might be. Is that correct?

Mr. WILCOX. Yes, sir.

Mr. BECERRA. Once you use that money, whether it is for cutting taxes for corporations or estates or individuals or for programs that the Federal Government operates, transportation programs, military programs, health programs, and so forth. Once you spend that money that you initially received through that employee's contributions, the money is gone; correct?

Mr. WILCOX. Correct.

Mr. BECERRA. At some point I get to reclaim the moneys that I contributed, that are now secured by that government security; correct?

Mr. WILCOX. And you are the Social Security Trust Fund?

Mr. BECERRA. No, I am an employee. At some point, when I decide to retire, I get to collect the moneys that I have contributed that have been secured through those government securities.

Mr. WILCOX. When you retire, the Federal Government pays out a benefit which is based on your earnings record. And your earnings record was also the basis for determining what your contributions were into the system.

Mr. BECERRA. And all along, the American worker is being told because the money is secured through government securities, the money is safe.

Mr. WILCOX. Those securities that the trust fund has invested in are on equal standing with the safest securities in the world.

Mr. BECERRA. At some point those securities will have to be paid out. Someone will have to be able to pay for that. The government somehow has to be able to pay for the security that it issued so it can spend the money now in its operating budget. No money is free. There is no program that is free here. There is cost involved, and it is a zero sum game. If I put in a dollar, ultimately I am going to be able to take it out at some point. And current workers, who are on the verge of retiring, whether today or in 30 years, who have been contributing, know that as well.

So whether or not you call this raiding the Social Security Trust Fund or not, somewhere, if you spend $1 dollar now, you are going to have to pay for it, whether today, tomorrow, or in 30 years. And if you have spent it in a way that you cannot have it in your pocket ready to pay out, you are going to have to find it from some other source, whether you have to cut education programs, whether you have to cut health programs, whether you have to cut military programs, because you have to ultimately pay those dollars that you said were secured by those government securities; is that correct?

Mr. WILCOX. I believe you have given a very succinct and nice summary of the underlying fundamental rationale, sir, for why the President's determination is so great for preserving the unified surpluses until a solution for Social Security can be found.

Mr. BECERRA. Mr. Chairman, I know my time has run, but I want to ask one last question.

So if you, as government, decide you want to give a tax cut or spend more on a government program with moneys collected through the Social Security contributions of American workers, ultimately that money will come due and you will have to be able to pay that worker his retirement benefits, and you have to find the money to pay for that somewhere because you spent the money he initially contributed on some other program once you got it.

Mr. WILCOX. I believe that would be correct, sir.

Mr. BECERRA. Thank you. Thank you, Mr. Chairman.

Mr. COYNE. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and thank you, Mr. Wilcox, for being here. I just want to thank my colleague for laying out the gravity of the situation we find ourselves in and the reason, among others, that we cannot move forward without Presidential leadership. Whether it is a specific legislative proposal or whether it is the answers to the dozens of questions that have been raised today, Congress, as a practical matter, is not able to do this alone and in the end, of course, would require Presidential signature in order to get it done.

I would ask some of my colleagues who think we need to do this as a Congress whether they support the Stenholm-Kolbe plan, whether they support the Stanford plan, whether they support the Gramm plan we basically heard today, or the Kerry plan? There are very few cosponsors on these pieces of legislation. And the reason is there is a great fear that you get out front on these issues without presidential support and leadership, at least on the basic questions that have to be answered, that you have the limb cut out from under you.

I don't know if Mr. Becerra is a cosponsor of any of those legislative priorities, but we have spent a year now in a concerted effort to gather the knowledge and wisdom of the American people, and it has been great. I have had a lot of hearings on it, both here and back home. We have had to exercise some hard choices in my district, and so on. It is time for leadership, and it is urgent.

I look at the testimony today, and we have something from Mr. Cogan where he says that delaying reform for 10 years is going to require a 25-percent benefit reduction. We have the 1994–96 Social Security Advisory Council report saying reform will be very costly, and said it will be necessary to reduce benefits by 15 percent even if legislation were enacted today. This is, I think, a crisis. And to say that it is an issue we can wait and resolve closer to the year 2034 I think is misleading to the American people.

I also note in Mr. Cogan's testimony he says every President from President Roosevelt has been actively engaged in this, and ensuring the solvency of the fund has been a priority and something the administrations have taken the lead on. Having been at the other side of Pennsylvania Avenue on this on other issues, I don't see how this one can be solved otherwise.

So I think we need to work together. It needs to be nonpartisan. I agree with my colleague from Arizona on that. I think it is how we did the IRS reforms and were successful on it. So I would urge you to take back the message, I know you have heard it loud and clear from everybody else, which is we need to see some answers to these questions, if not a specific proposal.

I would just briefly ask you a couple of things. One, does the administration support the Commission that passed the House?

Mr. WILCOX. I'm sorry?

Mr. PORTMAN. Does the administration support the legislation that Mr. Levin referred to earlier, which was for a Commission?

Mr. WILCOX. I'm not familiar with what specifically.

Mr. PORTMAN. I am not sure you were here several months ago when that proposal came before the House. Do you recall the proposal?

Mr. WILCOX. I'm not——

Mr. PORTMAN. It was reported out of this Committee and voted on in the House and it was not voted on in the Senate. Did the administration support that proposal? It is a yes or no answer.

The answer is no. Thank you, Linda.

Mr. WILCOX. I am advised the answer is no.

Mr. PORTMAN. It is, and that is just counter to what we heard earlier, just to set the record clear. I think because of that, frankly, you guys have taken on an additional responsibility, despite what we have heard earlier today. It is clearly the responsibility of this administration, if they do not want to have a bipartisan commission, to step up to the plate and give us some specific ideas.

I want to go through some of these ideas quickly. You said earlier, basically you will not rule out any options, which is fine, but then every time we raise an option, you raise five or six major concerns, and there are major concerns. This is all about tradeoffs. I guess, again, that would just underscore for me the need for some leadership.

I would ask you about payroll taxes again. Is it the rate of payroll taxes that is off the table?

Mr. WILCOX. Indeed.

Mr. PORTMAN. The tax rate?

Mr. WILCOX. The President has indicated he expects to be able to accomplish this without increasing the payroll tax rate.

Mr. PORTMAN. Does the President support or do we still have the idea of private accounts on the table, where we take some of the Social Security and put it into private accounts?

Mr. WILCOX. Clearly, individual accounts are on the table. The President will be inspecting those proposals for individual accounts very carefully for conformance with what he thinks is really a core principle, and that is the maintenance of a predictable and secure Social Security benefit.

Mr. PORTMAN. I would say again, there are specific proposals out there on that from Bob Kerry to Phil Gramm, and on our side, and I would love to know what the administration thinks about those proposals.

I would also say that is counter to what I have heard from Vice President Gore. Does he not represent the administration on that position?

Mr. WILCOX. With respect to individual accounts?

Mr. PORTMAN. With respect to private accounts.

Mr. WILCOX. Oh, I think what the administration has taken off the table—I am not familiar with what statement you may be referring to of Vice President Gore.

Mr. PORTMAN. At the Rhode Island conference the Vice President took a strong position against what he called privatization, which was described in that conference as individual accounts.

Mr. WILCOX. Right. I was there, and my recollection is that what he ruled out is what he called radical privatization.

Mr. PORTMAN. Radical. All right. None of us want to be radical, so that is OK.

I would just make one final point, and it is in the form of a question, really. Has the administration taken a hard look at the possibility, assuming individual accounts with some private investment is not off the table, of a nexus of reform of our pension system and expanding the availability and access to pensions with Social Security? In other words, having portability earlier, vesting higher limits on what you can invest into private pensions being part of Social Security reform.

Mr. WILCOX. I think we have just really begun to scratch the surface on that. The Secretary and the Deputy Secretary, as you know, feel extremely strongly about national saving measures to improve personal saving, and they view Social Security reform in a context as part of a fabric that will involve hard work, inspecting the pension system, and other measures to improve personal saving. We would like to work closely with you on proposals to advance those.

Mr. PORTMAN. I think it is something that holds tremendous promise. Time's a-wasting. We have had a good year, a lot of debate, and I would hope the administration could help us with regard to a leadership role on, again, being able to identify what options are not just on the table but are realistic, and then to help us create that nexus, which I think is a tremendous opportunity for the American worker to be able to put private savings together with a reformed and much more accessible and available pension system. And I thank you for your time today.

Mr. WILCOX. Thank you.

Mr. SHAW [presiding]. Mr. Nussle.

Mr. NUSSLE. Thank you, Mr. Chairman. My question is about the Social Security Trust Fund itself.

My understanding is that, aside from all the history we have heard today, that we have a separate Social Security Trust Fund; is that correct?

Mr. WILCOX. Yes, sir.

Mr. NUSSLE. And is that walled off from the general fund?

Mr. WILCOX. That is distinct from the general fund, yes, sir.

Mr. NUSSLE. And are there any other fire walls, by legislative enactment, that are necessary, in the opinion of the administration, in order for it to be any more off budget or any more secure or any more fire walled, or any more separation than what we currently have? Are you aware of anything that is necessary in order for us to have any more separation than we currently enjoy?

Mr. SHAW. I will not charge this time against the gentleman.

Mr. NUSSLE. This is going to be a good answer.

Mr. WILCOX. I think the answer is we would like to come back to you in written form and address this.

[The following was subsequently received:]

Question: And are there any other fire walls, by legislative enactment, that are necessary, in the opinion of the Administration, in order for it to be any more off budget or any more secure or any more fire walled, or any more separation than what we currently have? Are you aware of anything that is necessary in order for us to have any more separation than we currently enjoy?

Answer: The Congressional Budget Act already has firewalls and off-budget status for Social Security. The Budget Enforcement Act of 1990, which amended and added to the Congressional Budget Act which existed at that time, moved Social Security off-budget for all purposes of the Budget Act—including the annual Congressional Budget Resolution—for all purposes of the Budget Enforcement Act, and for purposes of the President's annual budget submission and mid-session review of the budget.

Of special note, the requirement for pay-go neutrality (which pertains to changes in revenues and mandatory spending programs) in the Budget Enforcement Act applies to the non-Social Security budget. The pay-go neutrality requirement is enforceable by an automatic sequester of some mandatory spending programs, including Medicare. This neutrality requirement prevents a surplus in the Social Security portion of the budget from being used as the justification for a deficit-increasing change in the non-Social Security budget.

Under current law, there are points of order in both the House and the Senate which prevent surpluses or Trust Fund balances of Social Security (in general) from being reduced by legislation. In the Senate, these points-of-order can only be waived with a supermajority of 60 votes.

The Administration is open to examining any new ideas on how best to run responsible fiscal policy today, so that we can help meet the challenges of aging of America. Of course, we are open to examining any new ideas and suggestions that Members of Congress may propose. In addition, as Social Security financing legislation moves forward, if we subsequently develop any new proposals of our own, we would want to discuss those proposals thoroughly with the Congress.

Mr. NUSSLE. Good answer. Let me ask you this. Let me tell you what my understanding is, and I would be interested in your reaction to this.

My understanding is that the reason we are even here today having this argument is because of the unified budget. It is walled off. My grandmother, her money she put in there is walled off; right? Can I please call my grandma up and tell her everything is fine with her money? Can you give her that assurance here today?

Mr. WILCOX. I think what you can call up your grandma and tell her is that the administration and the Congress——

Mr. NUSSLE. No, no, no, no, don't give me that, Mr. Clinton and his principles. You tell me, Mr. Wilcox, is her money safe today? That is what I want to know.

Mr. WILCOX. Her money is safe today, yes, sir.

Mr. NUSSLE. Thank you. That is what I want to know because I have heard a lot of stuff, and people are running around saying some people may not get their checks and all sorts of stuff like this. And that is a lot of nonsense, from what I understand. And if you think it is nonsense, I wish you would just tell me that so I can give her and other grandmothers across the country a little confidence tonight that their money is safe.

Mr. WILCOX. That is correct, sir. I think the other part of your message to your grandma might be that for the sake of her grandchildren and her grandchildren's grandchildren——

Mr. NUSSLE. Do I need to play any music behind this commercial? Let's get on with it, all right?

My understanding is the reason we are here today to discuss this whole issue of on budget, off budget surplus, and all this other stuff is because of this little word called "unified" budget. And because the CBO, Congressional Budget Office, and the OMB, Office of Management and Budget, report the budget surplus and/or deficit together on the same page—which they do by, I believe by law, if I am not mistaken—there is a reporting requirement that when they report the figures of the budget, that there is an on budget surplus and an off budget surplus. They are basically one line removed, and they are on the exact same page of their report. Is that correct, based on your budget guru, too?

Mr. WILCOX. Yes, sir, they are required by law to be on the same page.

Mr. NUSSLE. OK. If we separate that page, and we have an on budget surplus and a Social Security surplus or balance, however you want to put it, and put it on a separate page, how would that grab you?

Mr. WILCOX. I don't think it would change the fundamental analytics of fiscal responsibility.

Mr. NUSSLE. I understand that, but it would change whether or not the Wall Street Journal or the Washington Post or the President or the Congress or a Congressman or a Congresswoman or Senator would be able to say, "This year we ran a surplus." Because that is currently what is done.

And I guess my challenge to you is, since this is where we are coming down, I understand privatization and all that kind of stuff down the road is on the table for discussion, and we will have bipartisan all sorts of things for that, but I think the real challenge this year, if the President wants to show some leadership and wants to really demonstrate to the American people how seriously he wants to tackle this issue of the budget and budget surpluses and the Social Security surplus, is to join with us to change the law, separate the reporting mechanisms for these two different issues, which are different.

You are basically saying it is Social Security. It shouldn't be used for tax cuts. It shouldn't be used for general fund spending. We agree. I think we could probably have a vote on that today and we would have a huge majority vote for that.

There is only one problem. When the President submits his budget, it won't be in balance. And when the Republicans pass their budget, it won't be in balance unless a whole heck of a lot of work gets done on the spending side or on the increase of the revenue side, and that is the reason why we are having this problem.

So my challenge to you is, let the President know that we are willing to have this discussion, but let's separate, let's really separate the trust fund, and we will pass whatever law we need to do in order to make sure he can do a reporting requirement. But let's separate this on budget surplus from the off budget surplus. Let's separate Social Security, and let's let the President submit a budget without Social Security and without Social Security revenue included in that.

Would the administration go along with that?

He wants to give you something. I think it is the answer.

Mr. WILCOX. We will have to take that under advisement, sir.

Mr. NUSSLE. OK. You are going to let the President know that, though?

Mr. WILCOX. Yes, sir.

Mr. NUSSLE. OK, that would be great, because that is the bottom line here. It is the reporting of this that gets everybody mixed up. The Republicans want to be able to say they have balanced the budget, the President wants to be able to say he has balanced the budget. If Social Security is in it, you can't say that. You cannot hold Rose Garden ceremonies, you can't hold Capitol steps ceremonies. That is the reason this is going on.

I think for both sides, if they want to get serious about it, let's separate the reporting mechanisms for Social Security and let's separate the budget in the reporting fund mechanisms. Separate them at least by one page. I would even suggest let's separate them by days or weeks, so that we cannot say we have got a balanced budget with Social Security included.

When the President has the guts to do that, because I have already introduced legislation that is done in a bipartisan way, and I believe we are going to have a chance to move that in the next Congress, I believe we are going to have an opportunity to actually get past the first hurdle. And that first hurdle is, where is the money? Where is the money? That is what is scaring everybody right now.

Once we get past where is the money—show me the money—after we get past that part, then I think the rest of it, we can have an intellectual discussion. But up until that point we have all sorts of people running around the country trying to scare people that their money isn't there. And that is making it pretty darned difficult for my grandmother to allow me to join in this kind of discussion without her getting a little bit concerned about whether or not her check is coming, because she has got people scaring her, telling her that it isn't going to come if we have this discussion.

So I would hope the President would consider that as a possible first step reform, separating the reporting mechanism for Social Security in the budget so we can get on with the discussion and the debate.

Mr. SHAW. Mrs. Johnson.

Mrs. JOHNSON of Connecticut. Mr. Wilcox, I am sorry I missed your testimony, but I did look through it while I was elsewhere, and I do want to focus just very, very briefly on the conference that you scheduled on Social Security at the White House December 8 and 9.

First of all, it is my conclusion that minorities and women are particularly disadvantaged under our Social Security system for a lot of reasons. Would you agree?

Mr. WILCOX. Oh, on the contrary. I think the Social Security system is especially important to minorities and women.

Mrs. JOHNSON of Connecticut. It is especially important to them, but it is very hard for them to get a decent benefit under it.

Mr. WILCOX. No, I think there are a number of features of the Social Security system that are very constructive from the point of view of——

Mrs. JOHNSON of Connecticut. I do appreciate that the Social Security system better rewards lower earners than higher earners, but in general the pattern of women's work lives, who they work for and all those things, end up with women and minorities, on the whole, leaving them for the most part with a minimum benefit.

I am concerned about your conference on Social Security for the narrowness of its focus. I chair the Subcommittee on Oversight. We are going to be very heavily into pension reform this year. The administration and the Treasury is very aware that we did a lot of work on it last session and, frankly, I was very disappointed at the lack of vision from the Treasury in terms of pension reform.

Only 50 percent of Americans have any pension benefit program. Same percentage as many years ago. There are more employees, there is a bigger number, but it is the same percent. And the same people are disadvantaged under our pension laws as are disadvantaged under other health insurance laws. It is the same small employers who cannot afford to provide pension benefits to their employees.

And frankly, if we do not do something far more aggressive to simplify our pension laws, we won't possibly be able to help people develop the modest savings that they desperately need. Because living on a minimum Social Security benefit now is impossible, with Medicare not covering drugs, for one thing, but it is going to be even more difficult in the future because the minimum benefit is very, very low. And while it is accommodated for inflation, inflation doesn't well reflect the changes in cost of living in various areas, some areas where rentals are high above the norm, for example.

So it does worry me that the administration is approaching reforming Social Security without looking at the real issue, which is retirement security. And I consider Social Security a key element of retirement security, like I consider Medicare a key element of retirement security. But if we aren't as dead serious about pension reform and savings reform, people won't have retirement security.

So I would hope that you would plan the program, and I would be delighted to work on this with you and to participate, but if we do not lay out at that conference the public support, the dollars we spend through the tax system to support pension savings, and where that goes and who gets it, then we do not get a clear picture of how public resources do and do not support retirement security.

So I would urge you to broaden the focus of your conference on December 8 and 9 to include also pension reform and savings reform, with at least an eye to laying out the problems, as we did in our hearings earlier this session, somewhat earlier this year, to demonstrate truthfully the enormity of the problems of retirement security for our people. Social Security is only one problem that is not going to solve, as important as it is, the issue of retirement security. We have to look at how we manage our pension systems and how the law discourages employers from participating and discourages employees from participating.

So I urge you to think that through before you solidify the program for your White House Conference on December 8 and 9. Thank you.

Mr. SHAW. Dr. Wilcox, thank you. You have been sitting there for well over 2 hours, so you can take a much deserved rest. Thank you.

Mr. WILCOX. Thank you, sir.

Mr. SHAW. We next have a panel of witnesses. Hon. John F. Cogan is a senior fellow of the Hoover Institution, Stanford, California, former Assistant Secretary of the U.S. Department of Labor, and former Deputy Director of the Office of Management and Budget; Dr. Herbert Stein, senior fellow of the American Enterprise Institute for Public Policy Research; Hon. Robert D. Reischauer, senior fellow at the Brookings Institution; and Hon. Stanford G. Ross, Chair of the Social Security Advisory Board.

We welcome all of you. We have your full statements. You may care to summarize. We appreciate your being here.

I would say to all of you, I think it is very obvious from the former witness that there is great hesitation in politics on taking the first step on something that is this complicated, so perhaps you might be able to shed some light on it and help us find the way.

Mr. Cogan.

STATEMENT OF HON. JOHN F. COGAN, SENIOR FELLOW, HOOVER INSTITUTION, STANFORD, CALIFORNIA

Mr. COGAN. Thank you, Mr. Chairman, and thank the Committee for the opportunity to testify.

As the Committee begins its work, it might be helpful to consider in a historical context the enormity of the challenge that lies before you. I have prepared a chart which shows what will happen to Federal expenditures if we fail to address the Social Security financing problem. The chart places these consequences in a long historical perspective. The chart is in my testimony.

The bottom line of the chart, Mr. Chairman, is that financing the promised benefits with taxes will require a doubling of the Social Security and Medicare payroll tax by the year 2040. Financing promised benefits with debt will raise Federal spending to over 40 percent of gross domestic product as interest compounds upon interest. As the chart shows, this level of spending is unprecedented in our history, except for a single year at the peak of World War II. This level exceeds the largest annual expenditure during the War of 1812, the Civil War, World War I, Vietnam and Korea combined.

Regarding the process of reform, I would emphasize two points very briefly, since both of them have been touched on before. First and foremost, it is the case that substantial Presidential leadership and a creditable executive branch proposal are essential to achieving effective reform on a timely basis. This is a fact of life in Social Security's history.

Throughout this history, the process of enacting virtually every significant change in the program has begun with a well developed presidential proposal. President Roosevelt presented a very specific plan for creating the program. Presidents Truman and Eisenhower led the efforts to make the program universal. Social Security benefits were indexed to inflation only after President Nixon proposed to index them. President Carter's proposals to restore the solvency of the program were crucial in the 1977 amendments. President Reagan, undeterred by the pasting that his proposals received in 1981, worked through the Greenspan Commission to enact the 1983 reforms.

The history of Social Security legislation is clear: A well developed presidential proposal can greatly expedite the legislative process. An ill-formulated proposal will significantly delay the process. No presidential proposal usually means no legislative action.

A second point concerning the process that has also been made several times here today is that bipartisanship is essential. Now, Social Security legislation has not always been bipartisan, but given the highly charged atmosphere within which legislation occurs, this is not surprising. In the current context, however, I do believe that bipartisanship is very essential for the enactment of reform. There are over 40 million beneficiaries and nearly 150 million workers who pay taxes into the system. Acceptance of a significant reform package across such a wide segment of the American population requires that most of its elements be supported in Congress on a bipartisan basis.

Regarding the proper road to take to Social Security reform, I would like to emphasize two points: One is that an approach to avoid is one that attempts to build and maintain a large trust fund reserve. Social Security's legislative history offers a clear assessment of this approach. It won't work. From time to time, policy decisions, wartime economic conditions, and business cycle expansions have generated the buildup of a reserve or the prospect thereof. Each time the reserves have generated pressures for greater spending. Each time Congress has invariably responded by raising benefits or expanding eligibility. As a result, the projected reserves have never materialized.

Now, there are many that will argue that today's situation is different. The fact of the baby boom generation nearing retirement age might be argued to dissuade the Congress from spending the surplus in response to the political pressure that invariably comes with them. But I would say this: There is nothing in Congress' past history or recent history that suggests that they will be able to resist the pressures to spend surplus funds.

My other point is that I would recommend that the Committee be very cautious about following the legislative approaches of 1977 and 1983. The focus of each of these laws was primarily to fix the short-run financial problem that the program confronted. Fixing the long-run problem that was known at the time was a low priority.

Both laws relied primarily on raising revenues to finance the existing benefits. They solved the short-run problem but they did not solve the long-run problem. As my chart makes clear, the solution to Social Security is in reducing long-term liabilities, not in trying to finance the large obligations that we have promised current beneficiaries.

In closing, let me say that I applaud the Committee for holding these hearings. Looking at the process of reform is indeed the right place to start, and I would be happy to elaborate on any of my points or to answer any questions you might have.

Thank you, Mr. Chairman.

[The prepared statement follows:]

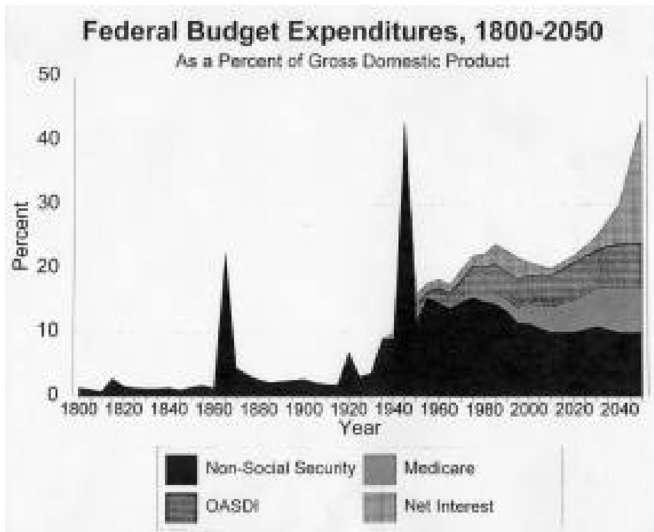
Statement of Hon. John F. Cogan, Senior Fellow, Hoover Institution, Stanford, California

Thank you for this opportunity to appear before your committee today to discuss the process of social security reform. There is no topic more deserving of the consideration of this committee than reform of the social security program.

Social security is financially insolvent. Although annual Social Security Trust Fund receipts currently exceed expenditures, this situation will be reversed when the baby-boomers begin retiring. In 2012, the fund will begin to draw upon its accounting reserves. By the year 2032, the program will have exhausted these reserves.

There are many ways to measure the enormity of the financial problem that social security creates for the federal government. One that I have found useful is to place the impact that social security will have on the federal budget in historical terms. Chart 1 shows actual federal outlays as a percentage of gross domestic product (GDP) from the year 1800 to the present and the projected outlays as a percentage of GDP for the next 50 years.

The chart illustrates the consequences of failing to address social security's and Medicare's financial problems. Without reform, federal spending on social security and Medicare will double as a percentage of GDP by 2040. Government borrowing to finance these higher expenditures alone will push federal spending upward to over 40 percent of GDP in 50 years. Financing this growth will require a doubling of the federal government's tax claim on private sector resources. This projected level of spending dwarfs any previous level our nation has experienced except, of course, the level temporarily reached at the peak of World War II. A solution to the social security problem must be found soon if we are to avoid imposing a crippling tax burden on future generations of workers. The first portion of my testimony presents my thoughts on the means of creating a proper legislative environment for reforming the program. The second part presents my views on what we might learn about the proper road to reform from the program's legislative history.



I. CREATING A PROPER LEGISLATIVE ENVIRONMENT FOR ACHIEVING REFORM

A. Substantive Presidential Leadership and a Credible Executive Branch Proposal are required.

When one reviews the long history of Social Security legislation, one cannot help but be impressed with the important role of the President and the Executive Branch in this process. The process of enacting the initial Social Security program and virtually all significant changes to the program, whether expansions or contractions, have begun with specific well-developed presidential proposals.

In 1935, President Roosevelt began the legislative process of creating social security by sending to Congress a fully developed plan for the program. All of the plan's chief architects; Edwin Witte, Labor Secretary Frances Perkins, and Treasury Secretary Henry Morgenthau, testified before this committee on the proposed plan. When short-comings of the proposal's financing became apparent, the President sent Henry Morgenthau back to this committee with a revised proposal. Over a seven-year period following World War II, 1948–54, Presidents Truman and Eisenhower submitted specific legislative initiatives proposing to increase benefits and expand coverage. As a result of their initiatives and legislative action by the Congress, social security coverage was nearly universal among private sector workers by the mid-1950s. The process of enacting the benefit hikes of the latter half of the 1960s and early 1970s all began with presidential proposals. Although proposals for an automatic cost-of-living-adjustment (COLA) for social security benefits had been put forward since the 1950s, legislation creating the COLAs was not enacted until President Nixon proposed them in 1971. In 1977 the program faced its first near-term financial crises. President Carter's package of legislative reforms, submitted less than five months after his inauguration, served as the starting point for the legislative reforms of that year. When it became clear in 1981 that the social security program was again in near-term financial crisis, President Reagan did not shy away from leadership. In May of that year, he proposed a set of initiatives designed to restore the program's near-term solvency. Although his initiatives met with a severe negative reaction, the president remained committed to reform. He proposed what has become known as the Greenspan Commission. The Commission was the vehicle by which the Executive and Legislative Branches would work together to develop a solvency package. This package was enacted virtually intact in early 1983.

In order for any other presidential proposal to be helpful in initiating a successful legislative process, it must not only be specific, it must be credible. A proposal that fails the credibility test will only delay the legislative process. Credibility is often in the eyes of the beholder. It is not easily measured nor known in advance of its being publicly released. President Carter's 1977 reform package was at the time judged as credible. It received serious review in Congress, served as an impetus for Congressional action, and large components of it were enacted into law. President

Reagan's 1981 package, in retrospect, was judged by Congress as less credible. Although most of the provisions of his package had been individually proposed earlier, they were viewed as "dead on arrival" when combined into a single package. These proposals not only failed to serve as an impetus for Congressional action, they actually contributed to delay Congressional deliberations over reform.

The history of social security makes clear that a specific and credible presidential proposal combined with the active involvement of senior executive branch officials can serve to expedite the process of enacting legislation. President Roosevelt submitted his proposal to create the social security program in January of 1935. With the help of his Committee on Economic Security, Congress enacted the new program in only seven months. The same number of months elapsed between the submission of President Carter's 1977 reform package and its final passage. In 1983, only two months elapsed between the issuance of the Greenspan Commission's recommendations and enactment of the 1983 Amendments.

In general, a minimum criterion for a plan to be credible is that it addresses the problem at hand. In the current context, the problem is not a near-term financial shortfall. The problem is that our society cannot afford to deliver currently promised social security benefits to persons retiring in twenty-five years. Thus, any credible plan must contain provisions for a reduction in future social security liabilities. A plan that proposes to maintain these liabilities and to finance them by raising taxes or asserting high returns on federal government investments of the social security trust fund will not pass the credibility test.

B. Strive for Bipartisanship

Bipartisanship with adherence to principles is a well-established recipe for developing and enacting successful social security reform. Attacks that serve short-term partisan ends generally produce failure.

Throughout its long history, the social security program has been subjected to an extraordinary amount of demagoguery. Early opponents attacked the program as "a scheme of hollowness and humbuggery," and "a solemn and cruel hoax." Recent reformers have been lambasted as "heartless" and "meanspirited." Given the highly charged atmosphere in which social security issues are usually debated, it is remarkable how often social security legislation has enjoyed widespread support from both sides of the political aisle. This has been true not only when the Congress has risen above partisanship to dip into the Treasury and raise benefits, as it did in 1972; it has also occurred when Congress moved to contract benefits, as it did in 1983.

In the current context, bipartisanship requires, above all else, political restraint. The temptation to attack the other party's proposal for short-term political advantage is ever-present. The temptation should be resisted. Inevitably, such attacks delay the enactment of reform. In 1981, the attacks on President Reagan's proposed social security reform package so permeated the atmosphere that enactment of needed reform legislation proved impossible for the remainder of the 97th Congress. Enactment of a reform plan had to wait until the Greenspan Commission made its recommendations and the 98th Congress convened.

In the current context, delay is costly. Each year's delay worsens the financial problem and deepens the magnitude of the required solution. As the *1994–96 Advisory Council on Social Security* noted in its report, a reduction of just over 15 percent in social security benefits would be required to make the program solvent if legislation were enacted today. If, however, legislation is delayed by ten years, the required reduction rises to 25 percent.

C. Use Prudent Economic, Demographic, and Behavioral Assumptions

At the outset of the committee's legislative deliberations, create a clear and firm set of rules about how the budgetary impact of proposed policy alternatives will be measured. These rules will guide the measurement of a budget baseline and your assessments of alternative reform proposals.

Often, as many economists know, the easiest route to solving a difficult problem is to assume it away. In the context of social security, this can be accomplished by adopting overly optimistic economic and demographic assumptions. Avoid this temptation and err on the side of using prudent assumptions. Keep "Rosie Scenario" locked in the attic. This will ensure that your policy solutions are real and not illusory. It will also enable you to avoid revisiting the same issues in a short period of time as the promised results fail to materialize.

At the same time, recognize that the economic and demographic assumptions you adopt are only forecasts of an uncertain future. The legislative impact of many of your provisions will occur twenty or thirty years from now. The ability of the best economists and demographers to forecast future trends and events occurring even a short time from now is severely limited. At the time of the 1977 Amendments were passed, the best forecast indicated that the trust fund would remain solvent until the year 2035. By the very next year, unforseen economic circumstances had shortened the forecasted period of solvency considerably.

One important dividend of proper social security reform is higher economic growth. Social security need not be a ''zero-sum'' game. Higher growth will raise the standard of living enjoyed by our children and all subsequent generations of American citizens. Higher growth increases the amount of resources that will be available to help finance future retirement obligations.

As economists who have previously appeared before the committee have testified, the current structure of social security induces young people to save less and induces others to work less, especially as they near retirement age. Each of these unintended consequences harms economic performance. When individuals reduce their savings and the federal government doesn't increase its savings by an offsetting amount, there is less money available to finance productive private sector investments. The cost of less investment is slower economic growth and, hence, a lower standard of living for future generations. When productive individuals choose to retire early because social security imposes a financial penalty on continued labor force participation, the economy operates at a permanently lower level and everyone loses. Although economists may differ about the precise magnitude of the current program's adverse impacts, there is general agreement about their direction. The current structure of the program is working against improvements in our standard of living. Proper reform can make the social security program work for our economy and an improved standard of living. The magnitude of the improvement will depend upon the particulars of the reform plan.

D. Try to Reach Agreement on a Set of Principles at the Start of the Process

Attempt to agree to a set of principles at the outset of your deliberations before proceeding to work out the legislative details. Finding agreement on broad principles is often easier than finding consensus on the specific means by which these principles can be achieved. Moreover, reaching agreement on principles often facilitates reaching agreement on specifics. A few areas in which the committee should attempt to reach agreement on principle are:

- the degree to which individuals would be permitted to invest their social security contributions in privately owned retirement accounts,
- the degree to which such investments should be regulated by the federal government,
- whether the federal government should be permitted to invest surplus social security funds in private securities, or whether such funds should continue to be exchanged for U.S. Treasury securities.
- the extent of a guaranteed minimum social security benefit and method of financing it,
- whether current retirees should be asked to bear any of the costs in terms of lower benefits

II. Lessons from the Past about the Proper Road to Reform

The history of social security legislation strongly suggests that certain approaches to solving the program's financial problem are not likely to work. The timely enactment of effective reform is enhanced by learning from this history, recognizing the pitfalls of these earlier approaches, and by avoiding these earlier mistakes.

A. Attempts to Build a Large Social Security Reserve Within the Federal Budget Will Fail

One approach to be avoided is to maintain the social security program's current structure and attempt to build and maintain a large reserve fund. Social security's legislative history offers a clear assessment of this approach: it won't work! From time to time throughout the program's history, policy decisions, wartime economic conditions, and business-cycle expansions have created large reserves or projections thereof. Those reserves have generated pressures for greater spending. Congress has invariably responded to this pressure by raising benefits or expanding eligibility.

During the development of the original Social Security program in 1934–35, there was widespread recognition that the program's future costs would be higher than its initial costs. The demographic projections at the time were much like those of today. The projected 30-year growth in the elderly population relative to the total population was, in fact, larger than it is today. The issue of how to finance these higher costs received paramount attention throughout the development of the initial program. The original Social Security Act of August 1935 adopted a financing plan under which payroll taxes would initially exceed benefit payments and a large reserve would be built. Interest earned on the reserve would be available to defray the program's future costs. This seemed at the time like an eminently sensible idea. However, within four years this reserve policy collapsed under an avalanche of criticism and rising pressure to expand benefits. The criticism and the pressure came from both sides of the political aisle. By 1939, the sizeable reserve that had seemed such a good idea four years earlier had become a political liability. That year, Congress enacted legislation to dissipate the reserve mainly by expanding eligibility and increasing benefits.

During the 1940s, the wartime economy generated a series of annual Social Security surpluses. By 1950, the trust fund balance had grown to a level large enough to finance benefit payments for the next decade. The large balance generated spending pressures. During the 1950s, Congress responded to this pressure every two years. In each election year from 1950 to 1960, Congress raised eligibility or expanded benefits. The benefit increases were large. The Social Security Amendments of 1950–54 more than doubled the typical recipient's benefits.

During the 1960s, the U.S. economy entered into a decade-long period of strong economic growth which fueled large increases in payroll tax revenue. Forecasts of the trust fund's near-term growth during 1965–73 were consistently the largest in the program's history. But, instead of holding the surplus, Congress expanded benefits. In the brief span of nine-years (1965–73), Congress enacted seven across-the-board increases that raised benefits by 83 percent, a third more than the amount required to compensate recipients for inflation. This period of extravagance ended with a 20 percent across-the-board benefit increase which first appeared in social security checks five weeks before the 1972 elections.

According to some observers, because the enormous future costs of financing the baby-boom generation's benefits are so widely recognized that Congress will be able this time to resist the inevitable political pressure to spend any surplus. However, social security's demographic problem is not new. Knowledge of large projected increases in the size of the beneficiary population have not previously deterred elected officials from spending surplus social security funds. As I noted earlier, in the 1930s, the projected 30-year growth in the elderly population relative to total population, was even larger than it is today. Yet, political pressures caused the federal government to spend the reserve by adding new categories of beneficiaries and increasing the level of benefits. In early 1950, the social security actuaries estimated that the number of beneficiaries per worker would rise by 270 percent in the ensuing 30 years, compared to today's 30-year estimate of only 70 percent. Yet, a few months later, the federal government granted a 77 percent increase in benefits for current and future retirees.

Observers also point to the absence of legislation expanding benefits during the late 1970s and 1980s as evidence to support their contention that Congress will be able to resist the pressures to spend that come with a large reserve. Persistently low trust fund balances during these years are the more likely reason for the lack of benefit expansion.

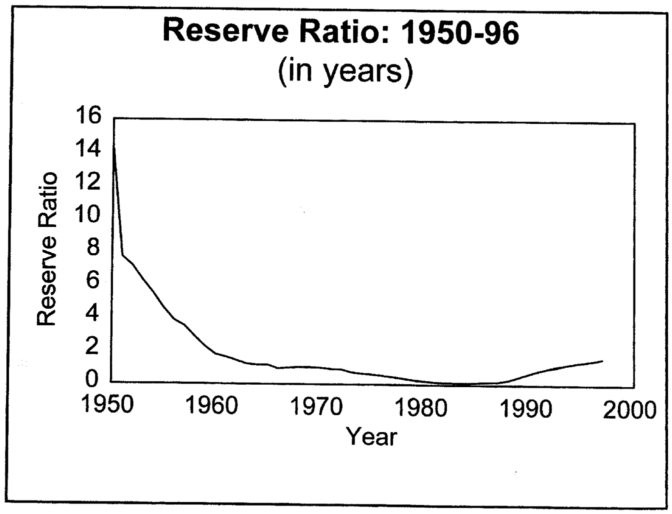
B. Past Approaches Are Unlikely to Succeed in Making the Program Solvent

Only twice in social security's history has Congress been confronted with the difficult task of addressing the prospect of financial insolvency: 1977 and 1983. In each instance, the trust fund faced a short-term financial crisis and a long-run financial problem. Projections made in early 1977 indicated that the trust fund's balance would fall to less than one month's worth of benefits by 1982. The long-term actuarial balance reached its lowest level in the program's history. In late 1982, the short-term problem was much more acute. The trust fund balance would be depleted in a matter of months. The long-term problem was less severe.

In each case, the primary means of restoring solvency was the same: rely primarily on higher revenues. In 1977, 90 percent of the projected short-term (3-year) solution and 70 percent of the improvement in the long-term actuarial balance was achieved by raising revenues. In 1983, the corresponding estimates were 63 percent for the short-run and 84 for the long-run.

Given the acute nature of the short-term financial crises in 1977 and 1983 and the extraordinary political difficulty of reducing near-term benefit payments below previously promised levels, the heavy reliance of enacted legislation on higher revenues in the short-run is not surprising.

Many observers claim that the 1983 Amendments began the process of building a reserve to finance future liabilities. Much of this acclamation is misplaced. First, as is shown in Chart 2, the actual growth in the beginning of year trust fund balance relative to that year's outgo is quite modest. Last year, the trust fund balance was still less than two years of trust fund outlays. Second, the principal focus of the 1983 Amendments was solving social security's short-term financial crisis. As part of this focus, the amendments were designed to build reserves sufficient only to protect the fund against economic downturns. Any growth in the balance above this level is due primarily to the strong economic growth since 1983.



Reserve Ratio is the beginning of year trust fund balance divided by that year's trust fund outlays.

The situation facing policymakers in 1999 is radically different from the short-run financial crises of the late 1970s and the early 1980s. There is no short-term crisis. Unless Congress can change its behavior from its 60-year norm of spending social security surpluses, adding revenues will not solve the problem. To the contrary, by attempting to add to the reserve will create political pressure to add to spending.

Mr. SHAW. Thank you, sir.
Dr. Stein.

STATEMENT OF HERBERT STEIN, SENIOR FELLOW, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH

Mr. STEIN. Thank you, Mr. Chairman. The last 3 hours have been very instructive to me. I would like to comment on the question that most of you seem to be concerned with, which is who should go first.

I think it is clear somebody has to go first, and I think the ball is in the President's court, just considering what time of year it is. But I think there is another reason why the President ought to take the leadership, other than any I have heard discussed, and that is because I think this question involves issues that are beyond any congressional Committee; that is, it is not just a question for the Ways and Means Committee, it is a question about the policy with respect to the budget, the long-run questions with respect to the budget, and it is also involves important questions with respect to planning for the future growth of the American economy.

So I think it is only the President who really can integrate all those concerns and who has the staff capacity for doing it. I think for that reason, among others, I would look forward to his coming ahead in the budget, in the economic report, in the State of the Union, and giving us some kickoff. And I think in that way he can raise the level of discussion to a higher point than it has commonly been raised in the political process.

With respect to the substance of the matter, as I understand the present situation, it has two parts. One is that the present reserves of the Social Security system, plus the future inflow of funds from the payroll tax, are estimated to become insufficient to pay the benefits provided by current law at some time in the next generation. The other is that with present taxes and expenditure programs, the unified Federal budget is in surplus and will remain so for some years to come. The question is what to do with the combination of conditions.

I believe we have a moral commitment not to disappoint the expectations of presently covered workers. I excuse myself from all that. I think I have been receiving these benefits for longer than anyone else in this room, and I am not sure that I expect to survive to receive them after you have completed your reform. But I think with respect to the workers who are now covered, and the younger ones who are already receiving benefits, their expectations should not be disappointed.

Some adjustment of benefits would be consistent with that to take account of unexpectedly long-life expectancy and an overstatement of the inflation rate in the official measurement, but I assume such adjustments will not bring the system into balance. If they would, then I think we do not have much of a problem.

The gap, the excess of expected benefits over the present resources of the system, will have to be made up by transfer of income from the rest of society, from the people who are earning incomes when the next generation is retired. And nothing you do about what is in the trust fund account, what is in some other account, will affect that. When people retire in the year 2040, their benefits will really have to be paid out of the income that is generated in that year.

The prospective surplus can help reduce the burden of this transfer on the rest of society. The budget surplus should be saved, that is not used to cut taxes or increase expenditures, but used to retire publicly held Treasury debt. That will give the present holders of the debt funds that they can invest in productive assets, which will raise the incomes of future generations and make it easier for them to pay the benefits expected by retired persons.

When I say they should not be used to cut taxes, They shouldn't be used very much. As I said in my prepared statement, I was around when Senator Dirksen said a billion here, a billion there adds up to money. Well, that is no longer true. A billion here, a billion there does not add up to money in this economy.

The strength of the commitment of future income earners to support the future of Social Security beneficiaries might be increased by depositing additional Treasury bonds in the Social Security account. That would be merely a symbolic gesture. For all that people have been saying here this morning about how your benefits are assured because money is in the account, if you were to decide tomorrow, I think—I think, maybe there are lawyers present—but I think if you were to decide tomorrow not to pay any benefits out of those accounts, I don't think anybody could sue you.

So nobody holds an insurance contract that he can sue you about if you don't pay the benefits. The payment of the benefits—relies on the moral sense of the American people and of the Congress and of course on their political awareness.

I think it might be easier to establish the commitment of future generations to pay these benefits to the large number of retired people if there were some securities in the account which you could point to and say "That is yours," and of course there is no necessary connection between the securities in that account and the surplus in any budget. The Treasury could just write 500 billion dollars' worth of debt and put it in the Social Security account—and it would be a claim. But I don't recommend that because people wouldn't understand it.

I do not believe that investing the Social Security funds collectively or individually in private assets would reduce the burden on the rest of society of supporting the beneficiaries. The Social Security funds would earn higher yields. But if the Social Security funds hold more private assets they will hold less government securities, and private investors as a whole will have to hold more government securities. To induce them to do that will require an increase in the interest rate on the government securities, on all government securities. The rest of the society, the taxpayers will indirectly pay for the higher earnings of the Social Security accounts by paying higher interest on the publicly held debt.

The critical question is whether privatizing the system in the sense of turning over to private ownership some of the funds collected by the system would increase private saving beyond the amount of funds so transferred. This is a question on which economists are divided. And this Committee did have a report from the CBO which was very relevant to the subject, a report on Martin Feldstein's proposal.

I think that unless the system were so changed as to reduce the amount of benefits covered workers expect, there would be no increase in private savings except for the amount of funds transferred to the private accounts. The amount of government savings, the government surplus, would be reduced by the same amount. In that case there would be no increase in total national savings, no increase in the rate of economic growth, and no additional source out of which to pay benefits.

As I see it, privatization in the form of converting some of the Social Security accounts into privately owned accounts would have one advantage. It would get some money out of the budget surplus and so reduce the temptation to cut taxes or raise expenditures. I am open minded about whether we need that kind of self-deception. Thank you.

[The prepared statement follows:]

Statement of Herbert Stein, Senior Fellow, American Enterprise Institute for Public Policy Research

I explained to your staff director that I am not an expert on Social Security. But since he persisted in inviting me despite that, I will offer some thoughts on the subject.

As I see it, our present situation is that we have a problem and an opportunity. The problem is that by common estimates the reserves in the Social Security trust fund plus the inflow of payroll tax receipts dedicated to the fund will, at some future date, be insufficient to pay the benefits provided by existing law. The opportunity is that by common estimates the Federal budget—the unified budget including the trust accounts—will be in substantial surplus for the next several years, if present tax rates and expenditure programs are continued. I emphasize the words. "by common estimates." I recognize the uncertainty of all these estimates, but I am unable to make such estimates by myself, and I only proceed on the assumption that the estimates are correct.

So, we have two questions. What should we do about the deficit in the Social Security accounts, which will become evident some time in the future if nothing is done? What should we do about the surplus in the unified budget that is now present?

I shall start with the Social Security question.

One course would be to cut the benefits that are provided in existing law. The government has no legal obligation to pay the existing benefits. No one can sue you if you decide to change the law. But I believe that there is a moral obligation not to disappoint the expectations on which generations of workers have counted, and I think that most people would agree with that.

There are some changes of benefits that could be defended as not denying previous expectations. People on the average live longer than they used to live, and will receive benefits for a longer period than was contemplated even a few years ago. Some adjustment was made for that in 1983 by an increase in the retirement age. A further increase could probably be justified. Also, when social security benefits were first indexed to the cost of living, in 1972, we did not realize by how much the official measurement might overstate the increase in the cost of living. Some adjustment for that might be justified .

Whether adjustments of this kind would be sufficient to bring the Social Security accounts into long-run balance I don't know. I shall be assuming that they are not sufficient, and a significant deficit remains.

Before I proceed further I want to make clear that my adherence to the present benefit schedule is entirely based on the fact that it has become expected. If we could start over, I would prefer a different system, that would be smaller and cheaper, providing a low-level equal retirement benefit for everyone. In fact, it might be a good idea to start developing a system that would apply to everyone born after the year 2000, who could not claim that his or her expectations had been denied. But that is a subject for another day.

So, suppose we start with the proposition that even after the benefit scale has been adjusted the reserves and future receipts of the system will be unequal to the planned benefits. What will be the source of the additional funds that will be needed?

The additional funds will have to come out of the income of the rest of the society—the part that is not drawing the benefits. There are two questions here. One is how to make the transfer of income from the rest of the society to the beneficiaries as painless as possible. The other is how to make the commitment of the rest of the society to support the beneficiaries as strong as possible.

The surplus now in prospect can provide an answer to both questions. The best way to facilitate the support of the next generation for the social security beneficiaries of that time is to make the national income of the next generation higher—that is, to raise the rate of economic growth over the next generation. And the most reliable thing the government can do to raise the income of the next generation out of which benefits will be paid is to save the budget surpluses now in prospect. By saving them I mean refraining from cutting taxes or enlarging expenditure programs but using the surpluses to reduce the outstanding Federal debt to the public. If we do that the savers who would otherwise be holding Federal debt will have funds available to invest in private productive assets, and that will raise the income of future generations.

I am not a fanatic about the surpluses. There may be tax cuts or expenditure increases of small size and large benefits that should be made. Contrary to what Senator Dirksen said about 50 years ago, a billion here and a billion there no longer adds up to money. But I am talking about saving most of the surplus.

Even if we have done what we can to raise the income of the next generation, how can we make sure that the active earners of the next generation will make the payments needed for the benefits of retirees? The literal answer is that we cannot. We cannot now commit the voters and Congress of the year 2040 to pay those benefits. But we can do some things that will add assurance. If we do not cut taxes now or embark on additional expenditure expenditures now it will be less necessary in the future to raise taxes or cut expenditures, which is always difficult.

Beyond that, we of this generation could make a contribution to the Social Security reserves. That would be an act of only symbolic significance, without immediate fiscal or economic consequences. The Secretary of the Treasury could write a check for any amount, say $100 billion, and deposit it in the Social Security trust fund, where it would be used to buy Treasury bonds. That would not change the unified budget surplus, it would not change the debt held by the public, it would not change national savings and would not change the rate of economic growth. But the symbolism might be important, because the enlarged reserve of the trust fund might seem to make more concrete the obligation of the next generation to pay the promised benefits.

There is no necessary connection between the size of this contribution to the social security reserves and the size of the unified budget surplus. Nevertheless, the idea might be easier for people to understand and accept if the policy were seen as contributing a surplus to the reserves. The surplus in the social security accounts is automatically contributed to the reserves. By present calculations in about five years the surplus in the unified budget will begin to exceed the surplus in the social security accounts, That is, the rest of the budget, excluding the social security accounts, will begin to run surpluses. One possible policy would be to contribute these surpluses, in addition to those in the social security accounts, to the social security reserves. That might continue until the reserves were sufficient, along with future payroll tax revenues, to pay the promised benefits for some long period into the future.

Up to this point I have not mentioned the magic word "Privatization." Privatization has two meanings. The first is that the funds of the system should be invested, in whole or in part, in private assets, instead of in Treasury securities, as they now are. The second meaning is that the funds should be owned, in whole or in part, privately by individual covered workers or beneficiaries.

These two meanings are not necessarily connected. One can imagine a system in which each covered worker receives each year a Treasury non-negotiable bond with his name on it, equal to some fraction of his contribution for that year, and redeemable for cash when he begins to draw his benefits. This bond would be his private property, and the system could be called privatization. It would have one advantage. It would reduce the apparent budget surplus and so reduce the temptation for the government to spend the surplus. Otherwise this nominal form of privatization would make no difference.

The great interest in privatization is connected with the first meaning, to invest some of the funds in private assets, rather than in Federal securities. The attraction of this idea is the observation that on the average private investments yield more return than Treasury securities yield. Investment of the social security funds in private assets would increase the earnings of the system and so enable the system to pay the planned benefits. This spread, the excess of the yield of private assets over the yield of government securities, would seem capable of bringing the system into balance without—and this is the critical point—without having to take anything away from anyone.

I believe that on this critical point the argument for privatization is wrong unless privatization adds to total saving. If it does not add to total saving it will not add to total national income, and if it does not add to total national income the increased earnings of the social security accounts will be balanced by less earnings of the rest of the society. Privatization would then be an indirect way of abstracting money from the rest of the society and transferring it to Social Security beneficiaries.

I have this schematic view of the way the transfer would occur.. There are two kinds of assets in the country—private assets and Treasury securities. The private assets yield more return than the Treasury securities. There are two portfolios in the country—the Social Security accounts and the sum of private portfolios. At present the Social Security accounts are entirely invested in Treasury securities and they earn a lower rate of return than the private portfolios. Suppose we now decide to invest some of the Social Security accounts in private assets, and therefore invest less in government securities. Then more government securities have to be held in private portfolios. But the private people whose portfolios those are cannot be forced to hold more Treasury securities. They have to be induced to do so. And what will induce them is a rise in the yield on the Treasury securities, narrowing the spread between the yield on Treasury securities and the yield on private assets. So taxpayers will have to pay more interest on the Federal debt, and that is the form in which they will transfer income to the Social Security accounts. It seems to me that either private investors will earn less on their total assets or taxpayers will pay more in interest on the publicly-held debt. The increase in the income of the Social Security accounts will not be costless for the rest of the society.

The picture might be different if privatization resulted in an increase in total saving. Then one could see an increase in the total national income and an increase in the total earnings of assets, so that the Social Security accounts could earn more without anyone earning less. But this seems to me an entirely unlikely development. This is probably clearest if the privatization takes the form of changing the assets held in a collective pool in the Social Security accounts. Nothing has happened to the surplus or deficit in the Federal unified budget. And nothing has happened to make private people want to save more. The rate of return on Treasury securities will be higher than it was and the rate of return on private assets will be lower, because the Social Security accounts will now be in the market buying some of those assets.

But the situation is not really different if some of the Social Security funds are returned to covered workers and they are allowed to invest them as they choose. The amount that would be returned to them would have been saved in the Social Security accounts anyway. They will have no different incentive to save any other income than they already have.

I understand that his is a complicated subject and that there are people whose opinion I respect who disagree with me about the consequences of privatization for total saving. But this is where I come out. Setting up private retirement accounts out of money that would otherwise have gone into the Social Security accounts is a way of getting that money out of the apparent surplus and so reducing the temptation of the government to spend it. But that would happen whatever the private retirement accounts were invested in.

In conclusion:

1. Except for possible adjustments relating to the retirement age and the indexing formula we should meet the benefit schedules that are in current law for all workers now covered.
2. We should preserve most of the forthcoming surplus in the unified budget—that is, not use it for tax cuts or expenditure increases but use it to retire some of the publicly-held debt.
3. We should contribute the publicly-held debt we are retiring to the Social Security accounts as a symbol of our intention to provide the benefits that presently-covered workers expect under current law.

Herbert Stein is a Senior Fellow of the American Enterprise Institute. The views expressed are his own.

Mr. SHAW. Mr. Reischauer.

STATEMENT OF ROBERT D. REISCHAUER, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. REISCHAUER. Mr. Chairman, Members of the Committee, I appreciate this opportunity, which I will need to touch on several points that are made in my prepared statement.

The first of these is that it is terribly important that we all realize how unusually favorable and yet how fragile the current policy environment is for dealing with the Social Security issue. I say that notwithstanding the sparring that took place with Secretary Wilcox over the previous 2 hours. Representative democracies with 2-year election cycles rarely address problems before action is absolutely unavoidable.

Nevertheless, we have a situation now in which both political leaders and the public seem willing to take up the long-run problem of Social Security several decades before it will become a full blown crisis. This favorable policy environment has a number of elements.

First, Members of Congress have a broad understanding about the problem and the need for a solution. Second, the public accepts the reality that something will have to be done sooner or later to sustain the system. Third, many Members of Congress have exhibited courage by fashioning specific proposals, some of which are quite radical. Fourth, the President has been willing to provide leadership and to organize the reform effort. And, finally, the budget and economic conditions that Secretary Wilcox talked about are very favorable.

In short, the planets are aligned about as well as one could hope for, but these conditions could deteriorate very rapidly and the window of opportunity that we now have could close abruptly, not to reopen for several decades. If that happened, your successors will find the options available to them severely constrained. Ideas that are considered now will be summarily ruled off the table, and there is a high likelihood that increased payroll taxes will constitute a very large portion of whatever solution is adopted.

The second point I would like to touch on is that there are lessons that we can learn from past efforts to deal with Social Security's long-term fiscal problem. These lessons are obvious but they are worth repeating.

First, change has to be bipartisan. A party that goes forward on its own does so at considerable peril. Neither Republicans nor Democrats should look ahead and hope that at some point in the future they may control both houses of Congress and the White House and, therefore will be able to adopt their favorite restructuring of Social Security. I think divided government is, in fact, the appropriate environment in which to reform a program as important as Social Security.

Second, significant change should be done only with long lead times, lead times that allow affected individuals and interests sufficient time to adjust to the new regime.

And, third, many small steps are more viable than a few giant leaps, even when both take you to the same end position.

Let me now turn to a third topic and say a few words about the relative desirability of the two broad approaches that exist to solve Social Security's long-run problem, namely establishing individual accounts that would be used to supplement a sharply scaled back defined benefit program; and, second, strengthening the finances of the existing defined benefit system by shaving future benefits and increasing the program's income in ways that preserve the underlying principles of this important program.

When evaluating these two broad approaches for reform, I urge to you keep the fundamental purpose of the Nation's mandatory pension system clearly in focus. That purpose is to provide workers with a secure and predictable basic retirement pension, one that lasts as long as the worker and the worker's spouse are alive and one that provides benefits whose purchasing powers is not eroded by inflation.

As you begin to deliberate, I also urge to you lay out explicit criteria for evaluating specific plans. My colleague Henry Aaron and I have spelled out four such criteria in a book that will be released on December 1 when you will all receive copies.

They are, first, the adequacy and equity of the benefits provided by the proposed system; second, the degree to which the proposed system protects participants against risks which they are ill-equipped to bear; third, the system's administrative costs and complexity; and, fourth, the impact of the new system on national saving.

Taking into consideration both the fundamental purpose of a mandatory retirement system and the four criteria I have just listed, I have concluded that it would be best to work to strengthen the long-term fiscal position of the existing defined benefit program. There are many ways in which that might be accomplished. The specific measures endorsed in our book are laid out in Table 1 of my prepared statement. Together they are more than sufficient to close the program's long-term deficit.

Most of the specific changes included in our reform package are familiar to those of you who have been around this debate for the last few years. However, the largest of our proposed program changes is not. It involves investing a portion of the trust fund's balances in private bonds and equities. While shifting trust fund investments from government to private securities would not have a direct or immediate affect on national saving, investment, the capital stock, or production, the trust fund would earn higher returns because it would hold assets other than relatively low-yielding government securities.

This would reduce the size of the benefit cuts and payroll tax increases needed to close the program's long-run deficit. While this is attractive, the concern that investing the trust fund reserves in private securities might lead to an inappropriate government influence over the private sector is valid, and if institutional safeguards were not available to reduce the risk of political interference to a de minimis level, I would strongly oppose such investments. I think, however, that such safeguards can be established, and they are laid out in some detail in our book and, in a shorter form, in my prepared statement.

While privatizing Social Security has attractive elements, I think that individual accounts should not be part of the Nation's mandatory pension system for several reasons. First, such accounts introduce added risk and unpredictability into retirees' basic pensions. Second, it is difficult to maintain adequate social insurance in a system in which individual accounts play an important role. Such assistance has made Social Security the Nation's most important and least controversial antipoverty program. Third and finally, individual accounts unavoidably will increase the complexity and administrative costs of the Nation's basic pension system.

Let me conclude by noting that whether we decide to strengthen the existing defined benefit program or restructure that program and supplement it with a system of individual accounts, the reform is going to involve some sacrifice by taxpayers, beneficiaries, or, most likely, both. In recent months some analysts have suggested that this need not be the case, that there exist ways to save Social Security that are painless. Some even go so far as to promise future beneficiaries all of the benefits called for by current law with no increase in payroll taxes.

By and large, these plans utilize the projected unified budget surpluses to fulfill their promises of a free lunch. These surpluses are very uncertain and if they materialize, there are other worthwhile uses to which they could be put. This Committee should carefully consider those other uses. Moreover, it is important to realize that for the next 5 years or so there are no surpluses other than those that are being created by the Social Security Program itself.

Thank you.

[The prepared statement follows:]

Statement of Robert D. Reischauer, Senior Fellow, Brookings Institution

Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss the future of the Social Security program with you. My statement deals with three issues:

- The surprisingly fortuitous environment that exists today for reforming or restructuring the nation's mandatory pension system,
- The lessons that can be drawn from past efforts to reform Social Security, and
- The broad options available to strengthen or restructure the program.

THE POLICY AND POLITICAL ENVIRONMENT

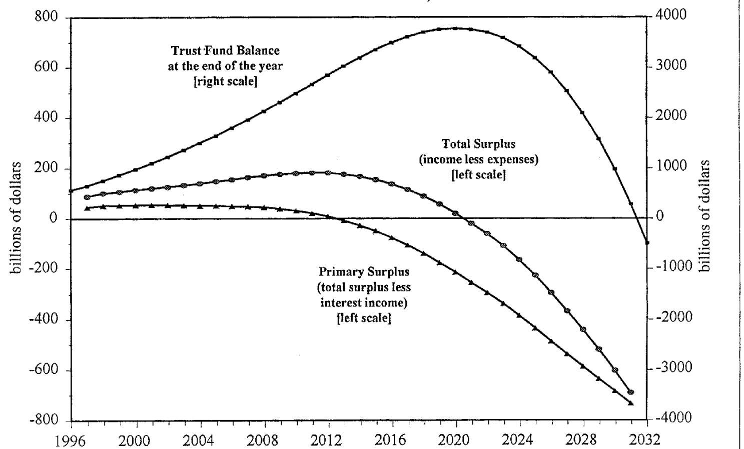
Restructuring the largest and most popular federal program, one which touches the lives of virtually all Americans, is a monumental challenge. Such an effort can only hope to succeed if policy makers and the public understand the nature of the problem and the need for change, if Republicans and Democrats are willing to forgo short-run political advantage and agree to cooperate for the long-run national good, if the economy remains strong and the budget in surplus, and if there is strong leadership. On all of these dimensions, conditions are unusually favorable as the nation approaches the new millennium.

Every member of Congress understands the nature of the problem. Each knows that while Social Security currently is recording substantial surpluses which add to the Trust Funds' reserves, those surpluses will turn into deficits around 2021, and by 2032 reserves will be depleted (see Figure 1). When the Trust Funds are exhausted, substantial benefit reductions or increases in payroll taxes will be needed to sustain the program. The widespread appreciation by lawmakers of the problem has generated a broad bipartisan commitment, at least at the rhetorical level, to address the problem sooner rather than later.

The public is also well aware of the long-run difficulties that face Social Security. For at least a decade, the media, pundits, and politicians have bombarded Americans with the consequences of the retirement of the baby boom generation for Social Security and Medicare. Polls indicate that most people realize that the program, as currently structured, is not sustainable. Polls also show that the public would like its political leaders to address the problem. Because the economy is strong, incomes are rising, and inflation is low, the majority puts "fixing Social Security" high on the list of public sector priorities—higher than expanding various social programs or cutting taxes.

For over a decade, the unified budget deficit problem has cast a pall over virtually all policy initiatives. With the focus on deficit reduction, any initiative to strengthen Social Security's financial position could have been characterized as an attempt to balance the unified budget on the backs of Social Security beneficiaries or taxpayers. Three multi-year deficit reduction packages, enlightened monetary policy, a strong economy, and a hefty dollop of good luck have combined to banish the deficit scourge, at least for the next few years. According to CBO's baseline projections, the unified budget should be in surplus until around the middle of the second decade of the next century. If policies are not changed, aggregate surpluses over the next decade will amount to roughly $1.5 trillion; if these surpluses are used to pay down the national debt, the ratio of debt to GDP by 2015 will be lower than at any time since before the Great Depression. Of course, over the next few years, Social Security will account for all of the projected unified budget surpluses; non-Social Security taxes are expected to fall short of covering the costs of the government's non-Social Security activities until after 2004 (see Figure 2). Nevertheless, the projected unified budget surpluses should provide a bit of fiscal flexibility that policy makers may use to ease the transition to a reformed Social Security system.

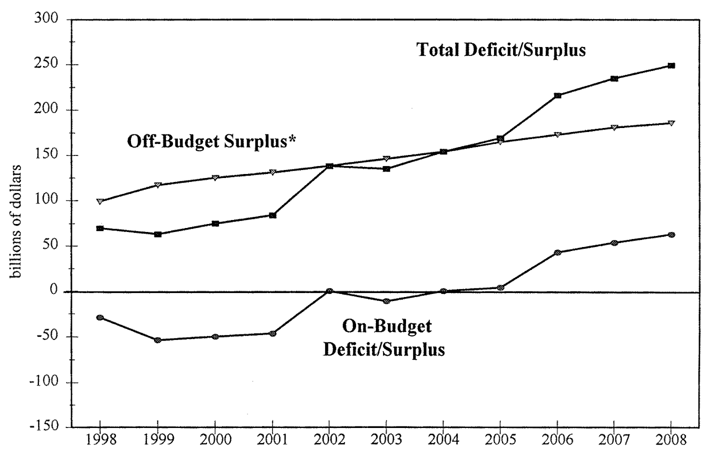
FIGURE 1
OASDI Surplus and Trust Fund Balance at the End of the Year, 1996-2032



Source: OASDI Trustees Report, 1998.

Robert D. Reischauer: November 1998.

FIGURE 2
Budget Deficit / Surplus, 1998-2008



*Postal Service and Social Security.
Note: Author's calculations based on CBO November 1998 figures.

In the past, few politicians have been eager to lead Social Security reform efforts because such undertakings are fraught with political risks. Over the course of the 1990s, however, many Members of Congress have put forward proposals that would fundamentally restructure Social Security in an effort to strengthen the program for the long term. Their courage has stimulated a lively debate and reduced the political risks of a frank discussion of this issue. Constructive as this has been, someone of national stature must provide leadership, structure the debate, communicate with the public, and push the effort forward when, as it inevitably will, movement stalls. Realistically speaking, this role can only be filled by a president. Barring an immediate crisis as there existed in the early 1980s, however, few presidents will volunteer for this assignment. President Clinton, a president with a keen sense of history, a desire to leave a significant legacy, and the freedom that comes with a second term, has stepped forward to provide such leadership. It may be some time before another chief executive is willing to fill that role.

As we inch closer to beginning a national dialogue and debate on how best to ensure that future generations have adequate incomes in retirement, both policy makers and the public should understand that a very unusual confluence of circumstances has created the current environment in which it is possible to consider addressing Social Security's long-run fiscal problems before they reach crisis proportions. But this environment is as fragile as it is rare. It far from guarantees that the effort will succeed or even get off the launching pad without exploding. Rather, it means that reform has become a long shot rather than an impossibility.

Some will argue that there is no need to act preemptively. They will point out that, under current projections, the Trust Funds will not be depleted until 2032 and that long-run projections are fraught with uncertainty. Small increases in trend economic growth, the fertility rate, immigration, or real interest rates could push the date of insolvency off for a decade or more. The effect that small changes in current economic conditions and those assumed for the future can have on the long-run outlook was illustrated dramatically when the 1998 Trustees report estimated that the date at which the Trust Funds would be depleted was 2032, not 2029 as estimated in the 1997 report. Some analysts expect the 1999 Trustees report to contain another small reprieve.

The fact that current projections do not point to an immediate crisis should not be used as an excuse to put off action. Uncertainty is a two edged sword. Current projections of the Trust Funds' balances could prove to be too optimistic if medical advances and improved personal health add more to average life expectancy than the actuaries have assumed or if economic growth falls short of expectations. Moreover, Social Security will begin to put pressure on the budget long before the Trusts Funds are exhausted. The position of the unified budget is improved by Social Security only as long as the program's primary surplus—its non-interest income less its expenditures—grows.[1] This primary surplus, which was about $52 billion in fiscal 1998, will begin to decline by a few billion dollars a year after 2003 (see Figure 1). When this occurs, the unified budget's position will begin to deteriorate if taxes are not raised or spending is not cut. If the unified budget is in surplus, this deterioration may be viewed as acceptable because it will be attributable to the shrinking primary surplus of Social Security. The situation will become more severe around 2021, however, when Social Security's income, including interest receipts, falls short of covering benefit payments and administrative expenses, forcing the program to redeem some of the Treasury securities held by the Trust Funds. Unless the on-budget accounts are in substantial surplus at that time, the nation will be faced with the unpleasant choice of increasing borrowing from the public, hiking taxes, or slashing expenditures.

While there may be no fiscal imperative to act this year to reform Social Security, the sooner we begin to strengthen the fiscal position of the nation's mandatory pension system the easier decisions will be, the more gradual the process can be, the less wrenching the adjustments need be, and the more options policy makers will be able to consider.

Retirees and those approaching retirement often have little or no ability to compensate for or adjust to benefit reductions or tax increases. Both political reality and considerations of equity, therefore, require that whatever shape reforms take they not change significantly the rules of the game for such individuals. This judgement is reflected in the proposals that would partially privatize Social Security, virtually all of which leave those age 55 and older under the existing system. This means that if decisions concerning how best to reform Social Security are postponed until action is unavoidable two decades from now, the bulk of the large babyboom generation will not contribute to solving the problem and the burden on younger generations will be all the larger. Even a decade from now the politics of reform will be much tougher than they are now. Starting in 2002, the fraction of the adult population age 55 and over will begin to rise more rapidly than it has during the demographic holiday the nation has enjoyed over the past decade (see Figure 3). By 2021, when Social Security's surpluses are projected to turn into deficits, 39 percent of the adult population will be age 55 or older, up from 29 percent this year. The growth in the importance of retirees and near retirees among likely voters is even more dramatic because older citizens tend to vote at higher rates than do younger Americans. While less than one third of voters in the 1996 presidential election were age 55 and over, 45 percent of voters in the elections of 2020 will be in this age group

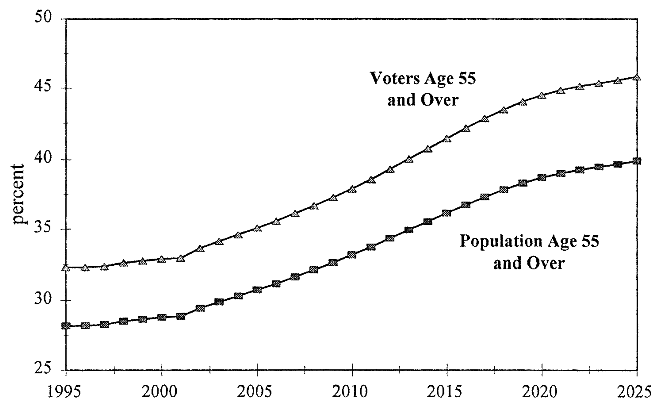
[1] From the unified budget's perspective, interest is a wash because it is an on-budget expenditure and an off-budget receipt of equal size.

if current age specific voting patterns persist. In such an environment, increased taxation of benefits and delays or reductions in COLAs will probably be ruled out. The longer decisions about reform are put off, the greater the role payroll tax hikes are likely to play in the solution. Because delay constrains the policy options that realistically can be considered to strengthen the system, it would be wise to act now even if the program changes agreed to are not phased in for a decade or two.

Favorable economic, budget and political conditions have opened a window of opportunity for reform. This window may close abruptly and not reopen before today's problem has been transformed into a full blown crisis which demands precipitous action, as was the case in 1983.

FIGURE 3

Percent* of Population and Likely Voters Age 55 and Over



Source: Census Bureau and author's calculations.
* Of those age 18 and over.

Robert D. Reischauer, November 1998.

Lessons from Past Efforts

Policy makers have addressed Social Security's long-run fiscal problems a number of times over the course of the last quarter century. The two most substantial initiatives—those of 1977 and 1983—were prompted by the impending exhaustion of Trust Fund reserves. Unlike the current situation, some immediate corrective legislation was unavoidable. Despite this key difference, the experiences of the past offer some simple and obvious lessons for the current situation.

The first of these is that policy makers should refrain from portraying the reforms they are proposing as the solution to the problems of the nation's mandatory pension system for all times. Undoubtedly, economic, demographic, and social developments over the next half century will not follow the paths that seem most likely today. Further adjustments may be required quite soon after any major reforms are adopted, as was the case after the 1977 legislation was enacted.

A second obvious lesson is that significant changes are more acceptable if the workers and taxpayers are given a considerable amount of time in which to prepare. For example, the increase in the age at which unreduced benefits are available that was enacted in 1983 will first affect those turning age 62 in 2000. The seventeen year delay between enactment and implementation has given those affected fair warning and an opportunity to change their personal saving behavior and work effort to compensate for the reduction in benefits that this change represents.

A third lesson that can be garnered from the experiences of the past is that successful reform efforts usually involve gradual, rather than abrupt, change. A giant leap is often unacceptable whereas a series of small steps that end in the same place is viable. For example, the two year increase—from age 65 to 67—in the age at which unreduced benefits will be paid will take place two annual month steps stretched over a 23 year period. Similarly, the bite imposed by subjecting a portion of benefits to the income tax will grow gradually each year because the income thresholds above which this policy applies are not indexed.

Finally, the experience of the past suggests that bipartisan cooperation is indispensable if the reform effort is to succeed. Debates over Social Security offer unlimited opportunities to engage in demagoguery for political advantage. The issues are complex, the consequences of some reform proposals are unknown, many people do not understand how the program now works, and the program's benefits are vitally important to the well being of most older Americans. Such conditions create a highly combustible environment in which to hold a national debate about restructuring. It will take immense self restraint and rhetorical moderation on the part of lawmakers, policy experts, and interest groups to move forward without touching off a conflagration that could scar the political landscape so badly that few would risk raising the issue again until the problem has become a full blown crisis. Divided government—Republican majorities in Congress and Democratic control of the White House—may improve the outlook because the responsibility for governing the nation and for policy development is shared by both political parties.

EVALUATING THE BROAD OPTIONS FOR REFORM

The debate over how best to provide basic income for future retirees has been about two broad options. Advocates of the first of these, which goes under the generic label of "privatization," believe that the nation's interests would best be served if Social Security were scaled back and a defined-contribution pension plan consisting of individual accounts were established to supplement Social Security. Proponents of the other approach believe that it is important that the nation's mandatory pension system remain exclusively a defined-benefit plan. They therefore seek ways to strengthen the long-run financial position of the current system through measures that would increase the program's income and reduce its expenditures while preserving Social Security's underlying principles. Each broad approach has advantages and disadvantages. In addition, as is so often the case, the details of each specific proposal make a great deal of difference.

When evaluating the broad options for reform, it is important to keep the fundamental purpose of the nation's mandatory pension system clearly in focus. That purpose is to provide workers with a secure and predictable basic retirement pension, one that will last as long as the worker and the worker's spouse are alive and one whose purchasing power will not be eroded by inflation. This pension should be viewed as the foundation upon which other sources of retirement income are built.

It is also useful to lay out explicit criteria for comparing the broad options and specific plans. My colleague Henry J. Aaron and I have spelled out four such dimensions in a book (Countdown to Reform: The Great Social Security Debate) that will be released by The Century Foundation Press on December 1. They are the adequacy and equity of the benefits provided by the system, the degree to which the system protects participants against risks which they are ill equipped to bear, the system's administrative costs and complexity, and its impact on national saving.

Taking into consideration both the fundamental purpose of the mandatory retirement system and the four criteria enumerated above, I have concluded that it would be best to work to strengthen the long-run fiscal position of the existing defined-benefit program. There are many ways in which this might be accomplished. The specific measures Henry Aaron and I have endorsed in our book are laid out in Table 1. Together, they are more than sufficient to close the program's long-term deficit. This means that some recommended program changes could be phased in more gradually than we have proposed or even dropped from the package of reforms without compromising the objective of closing the long-term deficit.

Table 1.—Closing the Projected Long-term Social Security Deficit

	Deficit or Change in Deficit As Percent of Payroll	Proportion of Adjusted Long-term Deficit Closed
Projected long-term deficit—1998 Trustees Report	2.19	n.a.
Effects of correcting the Consumer Price Index	−.45	n.a.
Adjusted long-term deficit	1.74	n.a.
Program Changes		
1. Gradually reduce spouse's benefits from one-half to one-third of the worker's benefits and raise benefits for surviving spouses to three-quarters of the couple's combined benefit.	+.15	−9
2. Cut benefits by increasing the unreduced benefit age—raise the age to 67 by 2011 rather than by 2022 and thereafter raise the age at which unreduced benefits are paid to keep the fraction of adult life spent in retirement constant.	−.49	28
3. Increase the initial age of eligibility from 62 to 64 by 2011 and thereafter raise the age of initial eligibility at the same pace as the unreduced benefit age.	−.23	13
4. Increase the period over which earnings are averaged from 35 to 38 years.	−.25	14
5. Cover all newly hired state and local employees.	−.21	12
6. Tax Social Security benefits the same as private pension income.	−.36	21
7. Gradually invest the trust fund's balances that exceed 150 percent of yearly benefits in common stocks and corporate bonds.	−1.20	69
Total Program Changes	−2.59	148

Source: Estimates from the Office of the Actuary, Social Security Administration.

The particular changes included in our reform package were chosen not simply to close the deficit. They were also intended to modernize Social Security in ways that reflect the economic and societal developments that have occurred over the last half century. Most of these changes are familiar to those who have followed the Social Security discussion during the past few years. However, the largest of the proposed program changes—investing a portion of the Trust Fund balances in private equities—is not and, therefore, needs some further explanation.

Shifting Trust Fund investments from government to private securities would not have a direct or immediate effect on national saving, investment, the capital stock, or production. The Trust Funds, however, would earn higher returns because they would hold assets other than relatively low-yielding government bonds. This would reduce the size of the benefit cuts and payroll tax increases needed to close the program's long-run deficit. While this is attractive, the question which has troubled many since the inception of Social Security concerns the possibility that Trust Fund investments in private securities might lead to inappropriate government influence over private companies. For example, Social Security trustees might be subject to political pressures that would force them to sell shares in companies that produce products some people regard as noxious (for example, cigarettes or napalm) or that pursue business practices some people regard as objectionable (such as hiring children or paying very low wages in other countries, polluting, or not providing health insurance for their workers) or to use their stockholder voting power to try to exercise control over private companies.

If institutional safeguards were not available to reduce the risk of such interference to a de minimis level, I would oppose such investments. But such safeguards can be established. The core of this protection would be provided by a new institution, the Social Security Reserve Board (SSRB), which would be modeled after the Federal Reserve Board. The governors of this independent entity would be appointed by the president and confirmed by the Senate for staggered fourteen year terms. They could not be removed for political reasons. The SSRB would be empowered only to select on the basis of competitive bids a number of fund managers. The fund managers would be authorized only to make passive investments in securities—bonds or stocks—of companies chosen to represent the broadest of market indexes. These investments would have to be merged with funds managed on behalf of private account holders. To prevent the SSRB from exercising any voice in the management of private companies, the fund managers could be required to vote the Trust Funds' shares solely in the economic interest of future beneficiaries.

Such a system would triply insulate fund management from political control by elected officials. Long-term appointments and security of tenure would protect the SSRB from political interference. Limitation of investments to passively managed funds and pooling with private accounts would prevent the SSRB from exercising power by selecting shares. The diffusion of voting rights among independent fund mangers would prevent the SSRB from using voting power to influence company management and would protect voting rights of private shareholders from dilution. Congress and the president would have no effective way to influence private companies through the Trust Fund unless they revamped the SSRB structure. While nothing, other than a constitutional amendment, can prevent Congress from repealing a previously enacted law, the political costs of doing so would be high.

While "privatization" proposals are attractive on some dimensions, I think that individual accounts should not be part of the nation's mandatory pension system. Such accounts introduce added risk and unpredictability into retirees' basic pensions. With individual accounts, benefits will vary depending on when during their lives individuals worked and contributed to their accounts, what assets they invested their account balances in, and market values when workers retire. Unless retirees are required to convert their individual account balances into inflation-protected annuities upon retirement, there would be no guarantee that they would have adequate income through their final years.

Furthermore, it is difficult to maintain adequate social assistance in a system in which individual accounts play an important role. The social assistance provided through Social Security has helped workers with low lifetime earnings, spouses with limited or no participation in the workforce, survivors, and divorcees. It has made Social Security the nation's most important and least controversial anti-poverty program.

In addition, individual accounts, unavoidably, will increase the complexity and administrative costs of the nation's basic pension system. Added burdens will be imposed on employers, workers, and the government. Under some privatization plans, the administrative load could be sufficiently onerous as to make the proposed system unworkable. Under other privatization plans, the impact of added administrative costs would largely be felt through reduced returns on individual account balances. Even this effect could be significant. A one percent annual charge—which is close to the average mutual fund fee—imposed over a forty year career would reduce the size of a retiree's pension by about 20 percent.

CONCLUSION

Strengthening the long-run fiscal position of the existing defined-benefit Social Security program or restructuring that program and supplementing it with a system of individual accounts is going to involve some sacrifice by taxpayers, beneficiaries, or, most likely, both. In recent months, some analysts have suggested that this need not be the case—that there exist ways to "save Social Security" that are painless. Some even go so far as to promise that "current law" benefits need not be reduced nor payroll taxes raised. By and large, these plans utilize the projected unified budget surpluses to fulfill their promise of a free lunch.

I would like to conclude with several cautions about these tempting mirages.

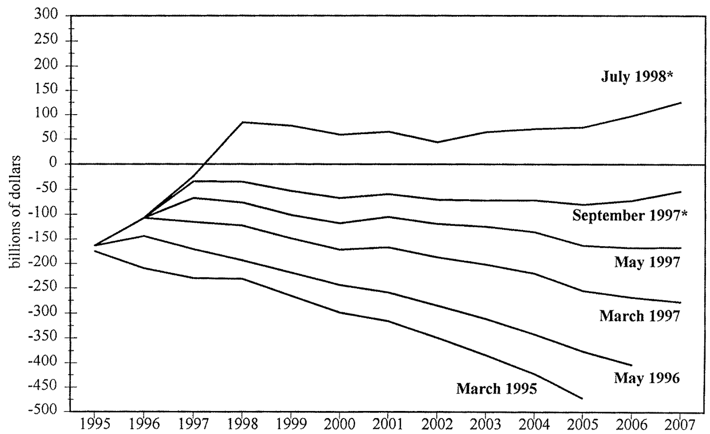
- First, the projected unified budget surpluses are not manna from heaven that have no other uses. If they are used to seed individual accounts in a privatized system rather than to pay down the national debt, debt service costs will loom larger in the baseline budget projections and national saving may be reduced. Furthermore, if the surpluses are devoted to "saving Social Security," they will not be available to sustain Medicare, fund tax relief measures, or support expanded spending on defense, medical research, education, or other areas that many members of both parties regard as high priorities.
- Second, as the experience of the past few years amply demonstrates, projections of the unified budget deficit/surplus are very uncertain. Congress and the president can enact policies that reduce surpluses, as was the case in October. But even abstracting from policy changes, estimates of the future position of the budget jump around from year to year because economic assumptions and technical factors change. Figure 4 provides my estimates of CBO's ten-year baseline budget projections excluding the effects of policy changes. Between the projection released in March 1995 and that issued in July of 1998, the projected fiscal 2005 budget situation improved by about $500 billion. While the budget projections over the last few years have shown a steadily improving bottom line, the experience of the late 1980s and early 1990s serves as a warning that the budget outlook can deteriorate just as rapidly and as significantly as it can improve. Given this situation, there is a risk to linking the future of the nation's mandatory pension system to surpluses

that may or may not materialize. If the expected surpluses are not realized, a contentious debate could develop over whether the federal government should incur deficits and borrow more money from the public so that workers can deposit these funds in their personal retirement accounts.

FIGURE 4

Projections of Baseline Deficit / Surplus Excluding Policy Changes

(March 1995 to July 1998 Baselines)



*Excluding the effects of the 1997 Reconciliation Acts.
Source: Author's estimates based on CBO figures.

• Finally, proposals that promise future beneficiaries all of the benefits called for by current law with no increase in payroll taxes are distributionally inequitable and represent a misdirection of scarce resources. One such plan would establish a refundable 2 percent income tax credit for deposits workers make into personal retirement accounts. The cost of this tax credit—some $3.4 trillion over the next 25 years—would be financed largely out of the projected unified budget surpluses. Upon retirement, the account holder's Social Security benefit would be reduced by 75 cents for every dollar of pension provided by the personal retirement account. In other words, no one would be worse off and all those who had a positive account balance would be better off.

Benefits under this approach would rise proportionately more for high earners than for low earners. The contribution to individual accounts and, hence, the size of account balances would be a constant fraction of income. Social Security benefits are proportionately larger for low earners than for high earners. Since the plan would reduce Social Security benefits by three-quarters of any benefits derived from individual accounts, pensions for high earners would rise proportionately more than would pensions of low earners as the following simple numerical example illustrates.

Monthly Amounts

	Average Earnings	Social Security	Individual Account	Total Pension	Change in Pension
Low Earner	$1,000	$560	$240	$620	+11%
High Earner	$5,600	$1,375	$1,340	$1,720	+25%

Considering that high earners are more likely than low earners to be covered by employer sponsored pension plans and are more likely to have significant personal savings that they can use in retirement, one may question the equity of a proposal that would use budget surpluses to boost pensions disproportionately for those who are well off. One may also question whether the best way to "save" the nation's mandatory pension system is to increase benefits for all future retirees. It may be that the public sector is forced to increase, above currently promised levels, the resources it devotes to future retirees. But certainly the most likely area for that pressure to manifest itself is in medical care which may absorb amounts much larger than the surpluses projected for the next decade and a half.

The views expressed in this statement are those of the author and should not be attributed to the staff, officers, or trustees of the Brookings Institution.

Mr. SHAW. Thank you, sir.
Mr. Ross.

STATEMENT OF STANFORD G. ROSS, CHAIR, SOCIAL SECURITY ADVISORY BOARD

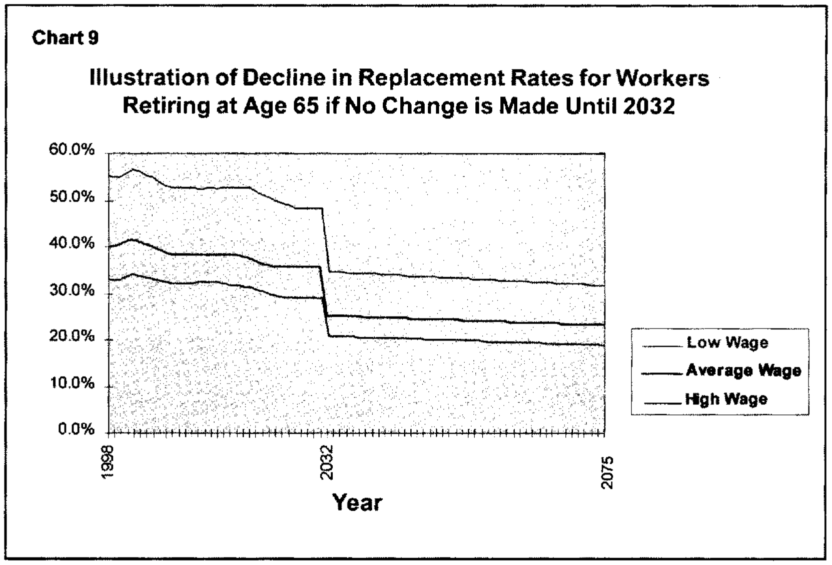
Mr. ROSS. Thank you, Mr. Chairman and Members of the Committee. I appreciate the invitation to testify today. The Committee on Ways and Means bears a large share of the responsibility for securing the future of the Social Security Program. I commend you for moving promptly to address this issue.

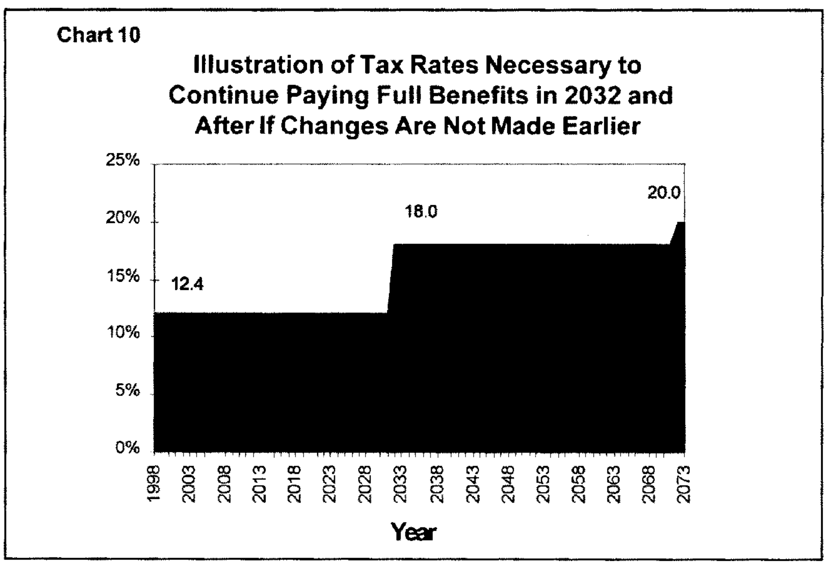
As Chair of the Social Security Advisory Board, I welcome the opportunity to report to you on the work the Board is doing to help with the Social Security financing debate and to address other issues that are important to the future of Social Security. I will also be making some remarks in my individual capacity.

We have devoted a great deal of effort to the financing issue, and this summer we issued a report entitled ''Social Security, Why Action Should Be Taken Soon.'' It is a bipartisan report, since we are a bipartisan Board, and it was based on professional nonpartisan analysis. We hoped that in laying out some basic facts about the problem, we would encourage others to find common ground in order to develop the changes that are going to be needed to preserve the Social Security system over the long term.

In particular, I recommend that you look at two charts of the report. They graphically show why it is important to take action now and not to wait until the so-called crisis date of roughly 2032. Chart 9 shows that if you wait until that date and have to reduce benefits to level of the revenues that will be available, it produces almost unthinkable results for beneficiaries. Similarly, if you wait until 2032 and have to address the problem by raising payroll taxes, you will need about a 6-percentage point increase in payroll taxes, from 12 to 18 percent. This would be an unprecedented tax increase that would have almost unthinkable economic repercussions.

[The charts follow. The full report, ''Why Action Should Be Taken Soon,'' is being retained in the Committee files.]





The point of our report is to provide a great deal of detail in order to make people understand that when we say action should be taken soon, that there are real reasons for that. It is not just a platitude, and if it is not done, the Nation will have even more severe problems later from things that are already built into the system.

Second, we are holding a series of forums on the impact of raising the retirement age. We held one just a few weeks ago in the

Capitol. Polling data show that only one in five Americans are aware that the retirement age is already scheduled to move from age 65 to age 67 beginning in the year 2000. And a large majority of the public, more than 70 percent, opposes an increase in the retirement age when presented with that option in isolation from any other reforms.

However, because an increase in the retirement age beyond the increase that has already been legislated is part of many reform proposals, and could make up a significant portion of the financing shortfall, it is important to understand the implications. We are bringing together some of the Nation's outstanding analysts to talk about this subject and will make our findings available to this Committee and the entire Congress.

Social Security is also facing a number of other serious challenges. One is the disability program, about which we recently issued a report. This is now about a $75 billion a year program providing benefits to over 10 million people. Changes in the retirement age will impact the disability program. And, indeed, as you go about your work in trying to maintain solvency in the old age program, it is important to recognize that you may have to deal explicitly with the disability program. One of the problems will be establishing appropriate criteria for determining disability in older persons as part of further consideration of the retirement age issue.

We have also issued reports on increasing public understanding of Social Security and on policy and research issues. We are now undertaking work to assess SSA's service to the public and expect to issue a report on this topic early next year.

I would now like to point out one problem which I think has not received sufficient attention, and that relates to the administrative issues that are raised by proposals to make individual investment accounts a part of Social Security. Many people feel that if a plan is adopted, the administrative issues will be solved in due course.

This is one bridge we should not jump off without knowing how and where we will land. Too much is at stake. I cannot think of anything more likely to further undermine confidence in government and in the wisdom of policymakers than taking money from nearly all of America's workers to invest in the markets and not accomplishing the task well and in a timely way.

I have great doubts about the proposals to have the Federal Government create and administer private accounts. In my view there is a serious question about the capacity of the IRS and SSA computer systems to set up the millions of accounts that would be required in a cost-effective manner within a reasonable timeframe.

Finally, in closing, I would make two quick points. I agree very much with those who have noted that Medicare reform is on the table at this time. These two programs affect the same people and depend in large part on the same payroll tax base. Even though you can only deal with one at a time as a practical matter, I believe that you should have an integrated strategy for addressing both programs so that you do not exacerbate the difficulty of solving whichever problem comes second.

Similarly, I agree with Congresswoman Johnson and others who have noted that all parts of the retirement income system are in need of review. Social Security reform alone will not get the job done. It must be combined with a strengthening of all parts of the retirement income system. Considering Social Security reform within this larger context is a vital aspect of the reform process.

The task before this Committee is difficult, yet I am confident that, as has been done in the past, the Members of this Committee and others in Congress will find a way to come together. The Congress has amended the Social Security law many times since it was enacted in 1935. It has never allowed the program to reach the point where promised benefits could not be paid, and it is unthinkable that it would ever do so in the future. As you undertake your work, I assure you that the Social Security Advisory Board, and I myself as an individual, stand ready to assist you in any way we can.

Thank you.

[The prepared statement follows:]

Statement of Stanford G. Ross, Chair, Social Security Advisory Board

Mr. Chairman, Mr. Rangel, and Members of the Committee, I want to thank you for inviting me to testify today on the important subject of Saving Social Security. As the Committee of jurisdiction in the House of Representatives, the Committee on Ways and Means bears a large share of the responsibility for securing the future of the Social Security program. I commend you for moving promptly to address this issue.

As Chair of the Social Security Advisory Board, I welcome the opportunity to report to you on the work the Board is doing to help with the Social Security financing debate and to address other issues that are also important to the future of Social Security. I will also be making some remarks in my individual capacity.

Creation of an independent bipartisan Advisory Board was an integral part of the 1994 legislation that established the Social Security Administration as an independent agency. By providing for a standing Board, the Congress recognized the value of having a permanent institution to which the Congress, the President, and the Commissioner can turn for bipartisan advice and assistance.

THE MANDATE OF THE BOARD

The 1994 legislation gives the Board a challenging mandate. It directs the Board to make recommendations with respect to the quality of service that the Social Security Administration provides to the public; the policies and regulations of the Old-Age, Survivors and Disability Insurance (OASDI) and Supplemental Security Income (SSI) programs; a long-range research and program evaluation plan for SSA; and policies that will ensure the solvency of the OASDI programs. Among its other responsibilities, the Board is also directed to increase public understanding of Social Security and make recommendations relating to the coordination of the OASDI and SSI programs with the Medicare and Medicaid programs.

This is a tall order for a part-time Board that by statute is directed to meet not less than 4 times a year, and has experienced several vacancies since it began its work in the spring of 1996, including two vacancies at the present time. Nonetheless the Board has undertaken an ambitious program of work, and has generally been meeting monthly. We have issued seven reports that respond to the mandate that you have given us and have plans to issue more in the coming months.

Last week the Board sent to each Member of Congress its first annual report for the fiscal year 1998. The report describes the work the Board has completed and the work that is under way. We will be issuing similar reports in future years because we believe it is important that we be fully accountable to the public.

THE BOARD'S WORK TO DATE

A point that our report makes clear, and that I would like to underscore today, is that Social Security is facing a number of serious challenges in addition to the issue of program solvency. Since it began, the Board has been working on a bipartisan basis to address these challenges, and we hope that our work will encourage others to examine them as well in a professional, nonpartisan way.

I would like to describe briefly the work that we have been doing.

ASSURING RETIREMENT SECURITY FOR FUTURE GENERATIONS

The subject of today's hearing—assuring retirement security for future generations of American workers and their families—has been a major focus of our efforts.

Many organizations and individuals have proposed plans to reform the Social Security system. The Social Security Advisory Board has chosen not to add to the abundance of specific proposals. Instead, we are working to contribute to the debate in ways that we hope will help in finding common ground on at least some important issues. In addition to our joint efforts as a Board, each of us individually is actively participating in the discussion about the future of Social Security.

This summer we issued a report entitled "Social Security: Why Action Should Be Taken Soon." Our purpose was to provide policy makers and the public with a source of reliable information on the dimensions of the changes that are required if the Social Security system is to maintain solvency beyond 2032, and the advantages of taking action sooner rather than later. Our report also describes various options to address the long-range solvency problem and their impact on the deficit. It is a bipartisan report. Our hope is it will help others come together to develop the changes that need to be made to preserve the Social Security system over the long term.

The Board also recently sponsored the first of what will be a series of forums on the impact of raising the Social Security retirement age. This is one of the most sensitive public policy issues that you have before you. Polling data show that only 1 in 5 Americans is aware that the retirement age is already scheduled to move up from age 65 to age 67, beginning in the year 2000. And a large majority of the public—more than 70 percent—opposes an increase in the retirement age when presented with that option in isolation from any other reforms.

Nonetheless, because a further increase in the retirement age is part of many reform proposals and could make up a significant portion of the financing shortfall, it is important to understand the many implications that such a change would have for both employees and employers. We will be bringing together some of the Nation's outstanding analysts on this subject to share their research findings and their experience in order to promote better understanding of the issues that are involved.

In addition to the solvency issue, the Board has been working on other matters that are important to the future of Social Security. I would like to mention several of them.

The Disability Programs

In fiscal year 1998, the Social Security Administration paid about $73 billion in Disability Insurance and SSI disability benefit payments to some 10.3 million individuals. These numbers have grown rapidly in the last decade and are expected to continue to grow, although at a reduced rate. Apart from the Social Security Administration, only the Defense, Health and Human Services, and Treasury Departments have budgets as large as the disability programs. As recently as 1994 the Congress had to take action to reallocate resources from the Old-Age and Survivors Insurance program to the Disability Insurance program in order to maintain solvency, thereby increasing the financial shortfall of the Old-Age and Survivors program.

I would also note that the increases in the retirement age that have already been enacted, quite apart from any additional increases, could have the effect of further increasing the number of disability beneficiaries. This would be particularly so if the age for early retirement (age 62) is raised, as some have proposed, in order to keep the period between the normal retirement age and the early retirement age at three years. Indeed, the problem of appropriate criteria for determining disability in older persons may need to be addressed explicitly by the Congress as part of further consideration of the retirement age issue. As the normal retirement age increases, older workers will have a major incentive to apply for disability benefits as a way to gain access to health care (Medicare for Disability Insurance beneficiaries and Medicaid for SSI disability beneficiaries). Thus, the issues of the disability programs are an important aspect of the future financial solvency of the Old-Age and Survivors Insurance program.

Recognizing the importance of the disability programs to policy makers and the public, the Board has made them one of its highest priorities for review. Today, as in the past, there are serious concerns about the lack of consistency in decision making; unexplained changes in application and allowance rates; the complexity, slowness and cost of the application and appeals process; the lack of confidence in the system; and the fact that few beneficiaries are successfully rehabilitated so that they can become part of the economic mainstream.

The Board has issued an initial report with recommendations that address these concerns in the context of the existing system. Our work on disability will be ongoing, because we recognize that the complex nature of the programs requires continuing scrutiny and improvements, and at some point may involve proposals for structural change.

Service to the Public

At the present time the Board is studying the Social Security Administration's service to the public and we have held two public hearings on this subject. Over recent months we have met with hundreds of Social Security employees at all levels of the agency. We have heard widespread concern about the agency's ability in the future to provide high quality service and insure program integrity.

In particular, the demographics of the SSA workforce are troubling in that a large number of employees are in the latter stages of their careers. Indeed, the expectation is that an increasing portion of the staff will retire in the next few years. Yet at the same time, because hiring was relatively limited in the 1980s and 1990s as the agency underwent a major downsizing of its staff, adequate numbers of experienced replacements may be lacking. High levels of retirements will coincide with an anticipated increase in the agency's workload, as the baby boom generation enters the age of retirement and experiences increased incidence of disability.

The Board is concerned that public confidence in the program will be further eroded if the issues related to maintaining a high quality of service are not addressed in timely and effective ways, and we expect to issue a report with recommendations for action early next year.

Increasing Public Understanding

Opinion polls show that few Americans understand how Social Security financing operates or how it relates to the overall Federal budget. The lack of understanding of Social Security's principles, benefits, and costs increases the difficulty of building the consensus that is needed to resolve important policy issues. In September of last year the Board issued a report that called upon the Social Security Administration to take a far more active role in informing the public about the Social Security program and how Social Security, combined with pensions and savings, will fit into an individual worker's long-term financial planning.

Research and Policy Development

When the Social Security Administration became an independent agency in March 1995, it took on new responsibility for Social Security research and policy development, a responsibility that it formerly shared with the Department of Health and Human Services. This was a responsibility that the agency was ill prepared to bear. Its policy and research staffs had been disproportionately affected by downsizing over the last couple of decades, which critically weakened its capacity to provide the information and analysis that policy makers and the public need to make sound policy decisions.

The Board has issued two reports with recommendations on the steps that SSA needs to take to rebuild the agency's capabilities in these areas, and we are pleased that this rebuilding process has begun. However, it will require the continued commitment of the Commissioner, the Office of Management and Budget, and the Congress to complete the job of providing the Social Security administration with the capacity to engage in the quality and quantity of research and policy analysis that the program needs to be adjusted soundly to changing circumstances.

Administrative Issues Raised by Individual Investment Accounts

Let me turn now to what is one of the most sensitive and complex proposals before this Committee and the Congress, and that is the proposal to make individual investment accounts a part of the Social Security system.

Although I cannot speak for the Board on this matter, I would like to express my personal view that before making decisions, the Congress and the Administration need to conduct a careful study of the administrative issues that are raised by this proposal. How these accounts would be constructed and operated is a matter of critical importance to this country, and the stakes are enormous.

I have yet to see a plan presented in sufficient detail to enable us to be confident that it can be administered in an efficient and effective way. Creating and maintaining individual investment accounts for the 147 million workers who are now covered by Social Security would be one of the most complex administrative challenges ever undertaken by either government or the financial services industry.

The complexity is compounded by the fact that about a third of all workers paying Social Security payroll taxes in 1994 had covered earnings of $8400 or less. For them, a contribution of 2 percent of payroll would provide an account equal to $168 or less. As a benchmark, maintaining an account in a well-run mutual fund often costs $30 to $35 annually, although no-frills accounts may reduce the cost. If small accounts such as these are to be administered by the private sector, the issues of relatively high costs for small contributors and potentially heavy administrative burdens on employers must be addressed.

As an alternative to administration by the private sector, some have suggested that the Federal government could administer individual investment accounts, the suggestion being that this could both lower costs and distribute the costs more appropriately. In my view there is a serious question about the capacity of the IRS and SSA computer systems to set up the millions of accounts that would be required in a cost-effective manner or within a reasonable time frame. Very likely the government would need to outsource a great deal of the development of the necessary systems and information technology to establish these accounts. The appropriate roles of government and of the private sector in providing the infrastructure that would be required to administer individual accounts is a major issue that must be addressed.

I cannot think of anything more likely to further undermine confidence in government and in the wisdom of policy makers than taking money from nearly all of America's workers to invest in the markets and not accomplishing the task well and in a timely way.

Based on my experience in the government and the private sector, I urge you to look at administrative issues carefully. They are critical regardless of how you view the merits of making investment in individual accounts a part of the Social Security system.

In my opinion there has been too much wishful thinking that the many problems involved will somehow be solved in due course once a plan is enacted. This is one bridge we should not jump off without knowing how and where we will land. Too much is at stake.

In closing, I would like to make two additional points.

ROLE OF MEDICARE

Because Social Security and Medicare serve many of the same individuals, and both are financed largely from payroll taxes, they share the challenge of paying for benefits for an increasing number of older persons at the same time that growth in the workforce is slowing. In many ways, Social Security reform is the easier of the two reforms to make. The shortfall in Medicare is much greater, and it will occur much sooner—within 10 years, according to the actuaries at the Health Care Financing Administration. It will be important to consider the impact that changes in one program may have on your ability to assure the long-range solvency of the other. Ideally, an integrated strategy for fixing both would be the prudent way to proceed, even though realistically you will be addressing them one at a time.

NEED TO REVIEW ALL PARTS OF THE RETIREMENT INCOME SYSTEM

Finally, it should be emphasized that all parts of the retirement income system are in need of review. Americans as a whole are not making adequate provision for their retirement. Social Security reform should be combined with a strengthening of the other parts of the retirement income system, including employer pensions, individual retirement accounts, 401(k) plans, and other savings mechanisms. Considering Social Security reform within this larger context is a vital aspect of the reform process.

Similarly, the entire health care system presents a myriad of problems that need addressing. Considering Medicare reform within this larger context is important so that any changes preserve, or at least do not diminish, your ability to address non-Medicare health care system issues. Again, an integrated strategy for resolving clearly related issues would be the prudent way to proceed, even if only one issue is being addressed at a particular time.

ASSURING SOCIAL SECURITY FOR THE FUTURE

Again, I commend this Committee for its attention to this important issue. Your task is difficult, yet I am confident that, as has been done in the past, the Members of this Committee and others in the Congress will find a way to come together to assure that Social Security will be preserved for future generations. The Congress has amended the Social Security law many times since it was enacted in 1935. It has never allowed the program to reach the point where promised benefits could not be paid, and it is unthinkable that it would ever do so in the future.

As you undertake your work, I assure you that the Social Security Advisory Board stands ready to assist you in any way we can.

Mr. SHAW. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. I would like to thank all four of the panelists for their testimony. It was all very enlightening and I appreciate it.

I would like to ask Dr. Ross, Chairman Ross, a question if I may. You talked about the potential administrative costs in terms of private accounts, should we move in that direction. You didn't state a possible number. I have heard that figures of up to 30 percent could be administrative costs, either the Federal Government maintaining these costs or perhaps in some other fashion.

Perhaps you can answer this first. Do you have an idea of what the overall administrative costs might be? And perhaps others could respond very quickly, because I have one or two more questions.

Mr. ROSS. I will take a first crack at it. The costs depend a great deal on how you structure the accounts, who is going to create them, and how they are going to be maintained. As a benchmark, an account in a well-run mutual fund runs about $30 to $35 a year.

One of the things that compounds the problem is that about a third of all workers paying Social Security taxes in 1994 had covered earnings of $8,400 or less. For them, a contribution of 2 percent of payroll would provide an account equal to $186 or less. That is a long-winded way of saying there is a real problem because of the number and magnitude of these small accounts. I think until you see a really specific plan, it is going to be very difficult to get a cost number that is reliable. But it is a major problem.

Mr. MATSUI. Thank you, I perhaps will not ask the other ones that, because I think you perhaps elaborated enough, but I thank you very much.

Bob, we have been having this discussion about the unified budget versus the not unified budget. If in fact we either have a big spending program that pretty much eats up the surplus or half the surplus, or perhaps a big tax cut that eats up the surplus or half the surplus, even though we have a guarantee that Social Security will be paid out if we do not change the program substantially, if we do not have the money it means we cut other social or defense programs or we increase taxes or we have a budget deficit, a huge budget deficit.

Is that what our choices are if we make the decision of spending programs or tax cuts before we solve the Social Security problem?

Mr. REISCHAUER. Not quite. The formulation that you presented was if we take half the projected surpluses and devoted them to say a tax cut, what would happen. We would pay down the national debt more slowly, interest costs would be higher and debt relative to gross domestic product, GDP, in 2015 would be higher than it would otherwise be. At that point when Social Security begins to run an annual deficit, it has to begin turning in its IOUs and collecting money from the balance of the government. We would have to cut spending more, raise taxes more, or borrow more from the public than we otherwise would.

The debt would be higher than it otherwise would be. Probably the economy would grow a bit slower than otherwise would be the case. And, as Dr. Stein pointed out, the pie available to support both working people's needs and retiree's needs would be smaller.

Mr. MATSUI. Thank you.

Dr. Stein, you talked from a macroeconomic perspective in terms of these private accounts, and I was impressed with your comments. If the government, or individuals, but the government is involved in these private accounts or individuals are, that means somebody will still have to buy government bonds. And the government bonds go up in terms of the interest that the Federal Government has to pay or else, I guess, if they just go unpurchased there is another problem to it.

What does this do in terms of the overall deficit? This is not a freebie then, is it? Because overall we are just shifting the costs from the Social Security system to some other function of government; is that correct?

Mr. STEIN. I think that is right. That is, I think we only change the form of the obligation of the taxpayer. In one case he has an obligation to the Social Security accounts, if its own funds are inadequate. In the other case in which the Social Security accounts have bought the private assets, the taxpayer has to pay more interest, a higher rate of interest on the Federal debt that is now held by the public in larger quantity.

I think if you go back to what Bob Reischauer says, he doesn't think that the privatization will add to saving, will not add to the national income, will not add to the economic growth, then those additional earnings by the Social Security account have to come out of somebody else's earnings. Or another way to look at it is say, well, there is a certain amount of capital income in this country. If more of that capital income is going to be earned by the Social Security accounts, less of it is going to be earned by somebody else. Either the taxpayer will become liable for more interest payment, or the owners of private accounts, private assets, are going to earn less.

So the spread between the yield on government securities and the yield of private assets will decline if the Social Security accounts are no longer a captive buyer of Treasury securities.

Mr. MATSUI. Thank you. I want to thank all of you very much. Dr. Cogan, I didn't ask you a question but that is just because I ran out of time. Thank you, thank you all.

Chairman ARCHER [presiding]. If I may, let the Chair jump in. I apologize that I had another meeting that I could not get out of, so I was not here to welcome all of you when you took the witness chairs.

But is it not true that the amount of money that we have to borrow governmentally is determined by what happens within the General Treasury rather than Social Security? In other words, if we run an operating deficit in the General Treasury, is that not the basis on which we have to borrow money?

Mr. STEIN. The amount that you have to borrow from the general public——

Chairman ARCHER. No, no, I'm talking about the total debt. Whether the debt is held by Social Security or whether it is held by the public, it is scored against the debt ceiling. And the total debt that the Federal Government has must, as a result, be determined by what we do within the operating budget, within the General Treasury of the United States.

And we will, in effect, either borrow the money from the Social Security Trust Fund or we will borrow it from the public, but the debt will be the same in the aggregate. Whether or not we run a Social Security surplus or not, irrespective of the amount of the Social Security surplus within the trust fund, that is the amount over and above what is paid out in benefits and administrative costs each year.

I think we need to be clear on that. The debt that is owed to the trust fund has the same full faith and credit and pays market interest rates as the debt that is held by the public—or the private sector.

Now, somehow as you begin to go through your analysis, it gets confusing. But let's get back to the basics, and that debt must ultimately be paid off out of General Treasury funds, not out of the payroll tax funds.

Mr. STEIN. I think you and I disagree about what are the basics.

Chairman ARCHER. I don't know how there could be any disagreement about that. I would be happy to have an explanation as to why that is not accurate.

Mr. STEIN. Because I think what is basic is the rate of national saving, and that the Federal Government's effect on the rate of national saving is the result of its unified budget surplus or deficit. So that it is that borrowing, it is that borrowing that is abstracting funds from the flow of private savings and preventing it from being invested in private productive assets. There is a certain special quality to the borrowing that the Federal Government does from the general public that is different from the borrowing it does from the Social Security account.

Chairman ARCHER. But in the end, if you reduce the debt that is held by the Social Security Trust Fund, you then increase the debt that is held by the private sector.

Mr. STEIN. Right.

Chairman ARCHER. At any one period of time, but the aggregate debt remains the same.

Mr. STEIN. Right.

Chairman ARCHER. OK. I just want that to be clear, because I think that got a little confused in some of the responses to my friend Bob Matsui. And so when people say, well, we are really more concerned about the debt that is in the trust fund or we are less concerned about the debt that is in the trust fund, whether it is going to be paid off or not, and in the end you are going to have to either cut spending or raise taxes to pay it off, the same thing would apply if you had that debt held by the public or private sector. You still are going to have the same debt, you are still going to have to raise taxes or cut spending in order to accommodate it. It is still going to be a part of the debt ceiling.

Mr. STEIN. Oh, yes.

Chairman ARCHER. This is in the First Reader, and I think the——

Mr. REISCHAUER. It is still part of the debt ceiling, but it doesn't have the same impact on national saving or economic growth.

Chairman ARCHER. It may or may not.

Mr. REISCHAUER. That is important from the standpoint of Social Security, because our ability to provide benefits to future retirees will depend on the future strength of the economy, not the number of IOU's that are floating around in one account or another account.

Chairman ARCHER. Well, Bob, to some degree I agree with that. But it has to be a combination of both, really, and it seems to me that we get into some of these more macro concepts of economics and a lot of that we need to think about. But if you are taxing people to put it in the Social Security Trust Fund, you are taxing potential savings. If you are borrowing from the public and private sector, you are taxing potential—you are taking away potential savings.

Mr. REISCHAUER. You are mostly taking away potential consumption. We are a society that——

Chairman ARCHER. I don't agree with that, Bob, because for right now in my own personal financial situation, I have decided to take assets that are invested in equities which are savings and convert them into Treasury securities. No consumption is involved in that.

Mr. REISCHAUER. But there is somebody else who is buying your other assets.

Chairman ARCHER. Well, perhaps. They may be buying them at a lower price as a result of my selling, which means there is no net increase in savings. This gets very complicated and we are not going to solve all of it right here, but it is not as simple as sometimes it is presented to be.

But in the end, it seems to me that when we talk about whether we are going to save Social Security with the unified budget surplus, I get lost because when somebody tells me that, they have to also tell me how are you going to take the General Treasury dollars and infuse them into the Social Security Trust Fund to save it. Because as I went through the fundamental analysis with Mr. Wilcox earlier this morning, the payroll taxes are already saved. They are in there. They cannot be spent for anything else.

So when you say we are going to save Social Security first before we give income tax relief, you have got to be assuming that you are going to take moneys out of the General Treasury that are part of the unified surplus and some way infuse them into the Social Security Program in order to save it, and I wonder how you do that.

Mr. REISCHAUER. Well, if we had $100 billion surplus in our non-Social Security accounts, the Treasury could go out and buy, on the open market, securities that were held by individuals and give them to the Social Security Trust Fund. But you don't have to face that issue because we are a long way from having a surplus in our non-Social Security accounts.

Chairman ARCHER. I think I understand what you are saying but I would present it differently, because the Treasury has no power to give anything to the Social Security Trust Fund.

Mr. REISCHAUER. It would only do that if you passed legislation instructing the Treasury to do that.

Chairman ARCHER. OK. So that analysis then would presume that the Congress would change the law and permit a direct infusion of General Treasury funds raised out of the income tax revenues, and put that in the Social Security fund to stabilize it. And I would suggest to you that——

Mr. REISCHAUER. I am not advocating that.

Chairman ARCHER. I understand, but it is fair though to think about what are potential analyses, and—because I want to hear what are the options, because I think there is an irrefutable opposition to every one of them, probably from AARP. And so we need to clarify what we really mean when we say "save Social Security first" before we can give an income tax reduction.

And also, it is very interesting to note that this issue popped up this year in January for the first time. Where was it last year when we did not have a projected surplus but had projected deficits, and still gave tax relief? Wouldn't that be an even greater undermining of Social Security?

Mr. REISCHAUER. It was——

Chairman ARCHER. It disappeared then because everybody said "We are all for this and we can do this," and nobody said anything about Social Security in a worse economic environment than we have now. And now we are told because we have a better economic environment, we cannot give a tax reduction until we save Social Security.

Mr. REISCHAUER. But you combine that tax cut with even larger cuts in spending, so the net effect was deficit reduction over a 5- and 10-year period, not over the 1-year period.

Chairman ARCHER. But, Bob, that does not matter. It does not matter because the aggregate economic situation even with the spending cuts was not as good as what the aggregate economic conditions are today. And we still did not see the argument that we are in some way jeopardizing Social Security. Is that not accurate? You are nodding, so I assume it is.

Mr. Cogan would you like to comment?

Mr. COGAN. I would offer another observation. If without a tax cut the government spends more money, as I think they did with this recent budget agreement, then the alternatives are not between a tax cut and reducing the national debt. They are between higher government spending and a tax cut.

And Bob said something that is worth elaborating on in that regard. Bob said that the strength of the economy is critical for preserving Social Security's solvency. He is absolutely right. One benefit of a tax cut—whether it is a benefit over and above debt reduction I will not get into a discussion on, I don't think there is a very good answer, although I don't think that debt reduction is the alternative—one thing about the tax cut is that it will be good for Social Security because it will stimulate the economy. It will provide for higher economic growth, and that higher economic growth will ultimately benefit to some extent Social Security.

So I think that if the two alternatives are spending part of the surplus as was done in the recent budget agreement, and cutting taxes, I think you can make a compelling case on economic grounds that it may be preferable for the Social Security Program to have a tax cut.

Chairman ARCHER. Thank you for that comment.

Mr. REISCHAUER. Let me just say that I fundamentally disagree with what John just said. We will duke it out in the hall.

Chairman ARCHER. I understand that there is a division between the economic ranks out there as to that issue. But Bob, let me ask you this, because I have great respect for you and I have great respect for the job you did here with CBO.

If we are to give an income tax cut this year, can there be in any way the allegation that we have raided the Social Security Trust Fund? And that is a simple yes or no answer. You don't have to go into a long explanation.

Mr. REISCHAUER. You know analysts never have yes or no answers. But in the accounting sense you are dead right.

Chairman ARCHER. OK. Now because if you had said it could, then I would say to you we raided it double last year, then, and it had the support of all of my Democrat friends and the President of the United States. If in fact a tax cut, an income tax cut is raiding the Social Security Trust Fund at this present juncture in time, we did it in spades in 1997 with the total approval of my Democrat colleagues and the President of the United States.

I have more than exhausted my time, and I recognize Mr. Levin.

Mr. LEVIN. I would love to carry on the discussion.

Chairman ARCHER. I suspected you might be tempted.

Mr. LEVIN. I think it really underlines the utility of our having these discussions within our own ranks. While you were gone, I commented on the notion that the President should go first. I really think what we need to do is to have a bipartisan discussion within the Congress.

Bob, I also wanted to say to the Chairman, I applaud you for the composition of this panel. You know, on a lot of issues, the majority—and we did it the same way—picks most of the witnesses and then the minority picks its witness, and I am not sure exactly who picked which witness. I have a hunch on some of you, but I do not on the others. I don't know who picked Dr. Stein, whose testimony I think has been very helpful, or you, Chairman Ross.

I think, Mr. Chairman, the answer to your question is that when we talked about saving Social Security first, what we meant was that none of the unified surplus should be spent until we put Social Security on a sound basis for the long term. And a number of the proposals, especially of the privatization proposals, indeed would seem to be utilizing the unified surplus in the longer run if not in the shorter run, because there is no other way in some cases, it would appear, to make them work unless you drew upon the general operating moneys.

And why was it not the same issue in 1997? In part it was because we paid for the tax provisions. And I know that the terminology that was used by some in the campaign maybe sticks in the craw of you and others. I think now is the time, though, to go on and talk about how we resolve the problem before us.

So let me just ask a quick question to Bob Reischauer. There was reference in your testimony about the impact of Social Security on the social safety net. I don't think it is well understood, and it relates to women, I think, and the disabled especially. Briefly describe what the meaning is. You could call it the progressivity and related provisions in Social Security.

Mr. REISCHAUER. The term that we have used in our book is "social assistance." The Social Security Program provides a lot of social assistance that could not be provided in a purely privatized system. That social assistance comes in various forms. It comes through providing workers with low average lifetime earnings a higher payback on their payroll tax contributions than workers who have had high earnings throughout their lifetimes.

It comes through providing benefits to spouses who have not participated in the paid labor force for sufficient time over their life to get a worker's benefit. It comes in the form of survivors benefits. When a spouse dies, the survivor gets 100 percent of the primary worker's benefit. It comes in the form of benefits for divorcees based on their previous spouse's earnings record. If you are an individual who has been married for 10 or more years to a worker and you have not been remarried when you reach retirement age, you get either a worker's, a spouse's, or survivor's benefit based on the work history of your spouse. And in a society where about half of marriages end in divorce, this is a terribly important benefit.

There are many forms which social assistance comes. Together they make Social Security the program that removes the most people from poverty that we have in our arsenal of public policies. It is one that has done this job without much controversy. And so we should think very carefully about any kind of reforms that might jeopardize that great achievement.

Mr. LEVIN. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you Mr. Levin.

Which one of you wants to go first? Ladies first. Mrs. Johnson.

Mrs. JOHNSON of Connecticut. Thank you, I would like to, if we have time, Bob, hear you talk a little bit more about why you think a tax cut funded by a surplus does not drive more economic growth than spending from surplus. Because I think those are—at least that is what I heard behind your discussion. But I do have a larger issue. Let me put the larger issue on the table.

Mr. REISCHAUER. I would make no distinction between a tax cut or an increase in spending.

Mrs. JOHNSON of Connecticut. Well, really the debate, what happened in the last session was we took $20 billion of the surplus for spending. Some of us wanted to take a little of the surplus for tax cuts, and it seems if you take surplus and you spend it for tax cuts, you drive the economy more effectively than if you take the surplus and spend it for spending.

Mr. REISCHAUER. That gets into the debate that I have with John, which is which policy would produce more economic growth? And the answer is in the detail. What kind of tax cut are you talking about? What kind of spending increases are you talking about? By and large, I think most of the tax cuts and spending increases that the Congress has been considering and that the administration has been proposing have very little to do with economic growth and a whole lot to do with increased consumption.

Mrs. JOHNSON of Connecticut. OK. The issue I want to put on the table, though, goes sort of beyond that. There has been a lot of discussion about generational equity. And those who want to spend every dollar of the surplus to solve the problems in Social Security are really taking the position that the current generation, which sets aside 15 percent of its own income to support retirees, must set aside 20 percent possibly of its income to support retirees. I don't see that as any different than outright raising Social Security taxes.

Mr. Ross' material shows that if you solve the Social Security problem entirely by raising taxes, you go from 12 percent to 18 percent and eventually up higher. When you add Medicare to that, you are basically looking at currently 15 percent up to 20 percent.

Frankly, I think that is just outright unaffordable, unaffordable to the younger generation. They won't be able to buy houses and educate their children and have the quality of lifelong education they need for their careers and so on and so forth.

So I think a 20-percent tax burden simply with the retirement population is generationally unfair. But if you dedicate every dollar of this surplus to that generational purpose, you probably will effectively increase taxes just as much. It will just be a different tax.

Now, I would like you to comment, because you have done a lot of thinking about this, on this issue of generational equity. What is our obligation to use some of this surplus for other purposes, and to find a solution for Social Security that does not take every dollar of the next 10 years of surpluses so that one generation can support another generation?

Mr. REISCHAUER. In a very real sense this is water over the dam, because for the first 40 or so years we ran a pay-as-you-go Social Security system in which beneficiaries got a tremendous payback. And we can argue about whether that was fair or not. Many of us think, given the wealth of the country, it was the appropriate thing to do.

Since 1977, and then reaffirmed in 1983, we have tried to partially fund the Social Security system. Most of the reform proposals that are being debated now suggest that we should more fully or fully fund Social Security's obligations for the future. I am in favor of doing that.

But if you decide to do fund the system, there is no way around the fact that some generations are going to have to pay twice, because $3 out of every $4 that everybody in this room is sending into the Social Security system right now goes right out the door to pay our parents or grandparents, our uncles and so on, and very little is left over for us.

If we want to fully fund our retirement benefits, it is going to cost us more as long as we decide not to cut back on the benefits of current beneficiaries. And so this is a value judgment for society. Should we fund the program more fully, or is it more important to devote resources to education or to reduce taxes? That is why we hire you.

Mrs. JOHNSON of Connecticut. That is why it makes it so very important to look at the issue of how do we fully fund those benefits. Do we fully fund those benefits for the current generation and the coming generations through tax increases or from one source or another, or do we fund them in part through stimulating the investment of new capital into that system, which is what the private investment and the compounding of a higher return would do?

Mr. REISCHAUER. Or as Dr. Stein as pointed out——

Mrs. JOHNSON of Connecticut. One last statement. I don't know whether in your book you look at whether or not the option of doing this through—even through the pension system, so that people who had pension plans subsidized by the government would be affected by Social Security a little differently.

Mr. REISCHAUER. We do not look at that in the book, although I would like to reiterate what you and others have said which is that all retirement policy should be looked at as a whole. That is really is a terribly important point. And I agree with it completely.

Mrs. JOHNSON of Connecticut. Thank you. My time has expired.

Mr. SHAW [presiding]. Mr. Collins.

Mr. COLLINS. No.

Mr. SHAW. I have a couple of questions. I haven't heard anybody really touch on something that I think we should be thinking about. Some of these graphs that have been supplied to the Committee show very clearly that we are going to reach a point where the trust fund is going to have meltdown, whether it has private securities in it or public securities in it. What effect is that going to have—or has anyone done any research on the effect that you would guess that that would have on the marketplace, when we start putting all of these things into the marketplace and cashing them in in order to take care of the benefits? I would throw that out to anybody who might be able to shed some light on that.

Mr. COGAN. Well, the issuance of large amounts of debt—and believe me, financing the currently promised Social Security and Medicare benefits would involve issuing an extraordinary amount of debt—cannot help but slow the growth of our economy.

The issuance of debt acts as a double tax on future generations. One tax comes from the fact that the debt has to be serviced and the second comes from the fact that the standard of living will rise more slowly as the higher debt retards economic growth.

Mr. REISCHAUER. Let me add a footnote to John's answer. If the surpluses projected by the Congressional Budget Office or by the Treasury really materialize, and are not spent, and the assumptions are correct, by 2015, 2020, we would have very little debt. By 2015 the debt-to-GDP ratio would be lower than it has been since before 1920. This would mean that when you tried to resolve the Social Security problem, you could go out and borrow from the public without getting to a position anywhere near where we are today for a few years.

But as John's tables show very clearly, that is not the long-run solution. It buys you maybe 5 or 10 years of time to adopt a solution, but at that point the politics of the solution would just be, I think, impossibly difficult.

Mr. SHAW. Do any of you all care to comment on what was just said? The point that I am trying to make, and I am probably not making my question quite as clear as I should, is when you start cashing in these securities, whether they be stock, personal savings accounts, or all of these things, what effect is that going to have on the market, whether we are talking about Treasury bills, corporate bonds, or corporate stock? Has anyone done any studies on the effect on markets?

Mr. REISCHAUER. Some of John's colleagues at Stanford have done estimates. The real issue here is what is national and world saving at that time. While the baby boomers might be selling their assets, their stocks, there will be others who are younger, who are richer than we ever hope to be, who will be buying stocks. Those individuals might be people in Peoria or they might be people in Singapore, now that we have an integrated world market. You really do not know what is going to happen to financial asset values as a result of the disinvestment by baby boomers, if they had substantial individual accounts with these assets in them.

Mr. SHAW. So you don't think it would have a marked effect on the market?

Mr. STEIN. But it is negative as compared to not having to sell all of those.

Mr. COGAN. There is only the question of magnitude.

Mr. REISCHAUER. Is it a small effect or large effect? My seat-of-the-pants estimate would be a small effect. But I would defer to others who have studied this.

Mr. COGAN. We have never had to issue as much debt in peacetime as we would. We have never had to sell off as many equities as we would to finance the baby boom claims. So it is very much outside of our experience. Hence, the calculations that economists have made are very, very imprecise. As Herb and Bob said, the direction is clear but the magnitude is quite unclear.

Mr. REISCHAUER. The more interesting area, of course, is housing values, because markets for financial securities are worldwide and demand is insatiable. People do not own two primary residences and people in Florida do not want to buy a house in Elmira, New York. And so you could see, I would imagine, much more substantial effects on real estate prices in some parts of the country.

Mr. MATSUI. Mr. Chairman, may I just ask Dr. Stein, he was—Chairman Archer and Mr. Reischauer were talking and Dr. Stein, I think you wanted to say something. Would you mind stating what you were going to say?

Mr. STEIN. I wanted to say something to Chairman Archer, but he is gone so it doesn't really matter.

Mr. MATSUI. Perhaps for the record, because I was following the debate and I wanted to get your point of view.

Mr. STEIN. I guess basically what I am trying to say is that you need to get this analysis out of the framework of puts and takes within the budget, between one budget and another part of the budget. You need to put it in the system of national accounts and see what it does to savings and investment and consumption and to the rate of economic growth.

So I think one consequence of all of this discussion is maybe to raise the stage a little bit to a more general world, because these puts and takes between the two kinds of budgets really don't matter. What matters in the end, if you are going to pay these benefits, is you want to have a richer economy out of which to pay them, and how do you do that?

And doing something about the surplus is one way, and maybe doing something about the taxes and maybe doing something about education, and of course it may be that we are on the brink of a new technological revolution in which the economic growth will be

3 or 4 percent per annum and not 2½ percent. That will make a big difference in all of these things.

I think you have got to put these issues in a much broader perspective, and that is one reason why I originally said I thought we ought to get some overall view from the President, not just about Social Security but about what is our policy with respect to budget surpluses. We have—even without respect to Social Security—we have no policy in this country about budget surpluses. We only know deficits are a bad thing. We don't know anything about surpluses and we don't know what we think about economic growth, and that is all very relevant to Social Security discussions.

Mr. SHAW. It has been a very interesting panel. We very much appreciate you taking your time to be with us today. And I think we all learned quite a bit from you. But you may be called back because we might find ourselves in a deeper hole in a couple of months. Who knows? Thank you very much.

[Whereupon, at 3:03 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Hon. Rosa DeLauro, a Representative in Congress from the State of Connecticut

On November 3rd, the American people sent Congress an unmistakable and indisputable message: work together in a bipartisan manner to forge a consensus on "kitchen table" issues important to their families, such as Social Security reform. Social Security is one of our nation's greatest success stories, especially for women. This financial safety net has kept millions of seniors out of poverty, and is an essential source of income for retired women. Although women make up roughly half of America's population, they account for sixty percent of Social Security beneficiaries. Three-quarters of unmarried and widowed elderly women rely on Social Security for over half of their income.

The aging baby boomer generation has precipitated a national debate about how to best protect retirement security in the future. As America's baby boomers reach their golden years, there are fewer taxpayers to cover the cost of their retirement. In 1950, there were 16.5 taxpayers for every Social Security recipient. By 1997, this ratio had dropped to 3.3 taxpayers to every recipient, and it is expected to fall even further.

The time for reform is now. As Congress considers the various Social Security reform proposals that will be presented over the coming months, it must consider the unique potential effects these proposals may have on women.

Women spend less time in the workforce, because they take an average of 11.5 years out of their careers to care for their families. As a result, fewer women than men have private pensions through their work: 40 percent of women, compared to 44 percent of men. These pensions tend to be worth less than those received by men. According to the National Economic Council's Interagency Working Group on Social Security, among 1993–1994 new private sector pensions annuity recipients, the median annual benefit for women was $4,800. This is only half the median benefit received by men. Furthermore, during their years in the workforce, women earn an average of 70 cents for every dollar men earn. In fact, the average female college graduate earns little more than the average male high school graduate. Thus, women receive lower Social Security benefits in old age.

Any changes must be thoroughly researched and carefully considered to maintain Social Security's successful underlying foundation—a guarantee of financial stability in old age. Women, and all Americans who work hard and play by the rules, must be assured that their years of hard work will be rewarded, not punished with risk and insecurity.

In August, I joined many of my female colleagues in the House at a press conference to raise awareness of this important issue in Congress. Social Security reform will top the agenda of next year's Congress and women, now and in the future, have a great deal at stake in the future structure of the Social Security system. It is essential that Congress be committed to ensuring that the financial security of women be protected in their old age. I look forward to working with my colleagues to meet this challenge in the coming months.

Statement of Ric Edelman, Chairman, Edelman Financial Services, Inc.

Mr. Chairman, I am honored to submit this statement to the Committee on the future of the Social Security System and what new, innovative ideas I might be able to bring to this debate. I am also pleased that in seeking information on this issue, the Congress has sought input from someone like me who has spent the last 15 years of his life giving families sound financial planning advice and guiding them towards financial security.

My perspective comes from my activities both as a provider of financial services and as one of the nation's leading educators in the field of personal finance. By way of background, I am the author of two New York Times bestsellers, The New Rules of Moneyand The Truth About Money, with a revised edition of the latter due in bookstores later this month. My award-winning radio program, ''The Ric Edelman Show,'' is heard on WMAL in Washington, D.C. and WLS in Chicago. I also host the national television show ''Money University'' on America's Voice cable network, write a syndicated column, publish a newsletter, and run a major advice area for America Online. I am on the faculty of Georgetown University, and my company, Edelman Financial Services Inc., manages almost $1 billion in client assets, establishing my firm as one of the largest financial planning companies in the nation.

When I last came before this Committee's Subcommittee on Social Security in June, I testified that giving Americans unrestrained opportunity to privately invest their Social Security assets in the equities markets was a mistake. In point of fact, out of the nine panelists that testified, I was the only one who did not believe that Social Security should be completely privatized. I still do not.

Why? Because the majority of Americans do not understand the basic principles of investing. Consequently, I think most people would be exposed to fraud and abuse if left on their own to invest for retirement.

Because of my background, you might assume that I would have been strongly in favor of privatization, and the incredible amount of money which would have flowed into the stock market and into the money management and financial planning industries.

But in the end, in my estimation, the risks do outweigh the rewards. The majority of Americans do not know the proper way to invest, nor do they know how to hire and work with a financial advisor. Although I and my colleagues are trying to make Americans more educated about investing and becoming more involved in their own financial future, many still do not understand such fundamental investment basics as the power of compounding or diversification. Complicating matters would be the contradictory advice emanating from the financial community as each organization strives to capture the assets of American workers. Furthermore, experience shows that most Americans tend to emphasize risk over performance when it comes to investing and left to their own discretion, far too many Americans would invest their assets in the wrong asset classes, defeating the goal of improved performance that this privatization issue seeks to achieve.

This could lead to great, sudden stock market outflows of Social Security assets by consumers, acting emotionally with their investments, and having a disastrous effect on the stock market. Today, too many consumers believe that stock prices only rise. What will be the sentiment when stocks fall, as they did recently when the Dow fell to about 7,000 and nervous investors wondered whether to flee the market? As I rhetorically asked in June, what happens when—not if—the nation enters a true bear market—something that hasn't happened for nearly 30 years?

Unfortunately, there is still some critical discussion going on in some circles that urges investing Social Security assets in the private sector. If the Congress still sees this as a possible viable alternative to securing the System's future, I would like to briefly reiterate my proposals on this issue:

Prior and existing Trust Fund assets should not be invested into equities.

A portion of new contributions to the Trust Fund should be directed toward equities, limited by Congress to no more than 25% of future contributions.

Each American worker should declare annually on their W–9 form what portion of their current Social Security contributions they wish to be invested into stocks, up to 25%.

Each annual election must be irrevocable, meaning that workers will not be able to rescind their previous W–9 declaration, and such designated monies must not be withdrawn from the stock market until the assets are needed to make payments to Social Security beneficiaries. Withdrawals or redemptions for any reason—and especially because of concerns over current market conditions—must be strictly prohibited.

The equity portion of the Trust Fund would be invested into a broadly-based equalization (unweighted) index comprised of at least 2,500 U.S. stocks. A capitalization-weighted index must not be used. As explained in my book, The New Rules of Money, index funds that mimic the S&P 500 Stock Index are poor investments, for the following reasons:

In a capitalization-weighted index, like the S&P 500, the biggest companies have the biggest effect on the index, instead of each stock having an equal effect. For example, a 10% gain by the #1 company would have a much bigger impact on the index than a 10% gain by the smallest company. It also means that the index would buy more of the biggest stocks than the smallest stocks. And the higher a company's stock price gets, the more the index fund would buy it. It sounds bizarre, but it's true: Index funds buy more of a given stock merely because the stock has already risen in value.

Because index funds tend to hold disproportionate amounts of stock—holding much more stock of big companies than it holds of little ones—it's impossible to maintain a balanced portfolio. If a stock grew in price, a typical money manager might want to sell some of it. But in a capitalization index fund, you can't. Instead, the fund will buy even more—at the new higher prices. This explains why S&P Index funds have as much money invested in the 50 biggest stocks as in the other 450 combined. The result is that such index funds make money only if the biggest stocks make money, because big gains in little stocks don't make much difference. Thus, index investors were lucky in 1996: Six of the S&P 500's biggest stocks collectively produced 26% of the index's total gain. Put another way, just 1.2% of the holdings produced 26% of the profits, while the other 494 stocks in the index earned the rest. The Congress must not create an investment whose results are so dependent on such lopsided performance.

The format I propose here is similar to that currently used by the Federal Election Commission:

Previously-received federal revenue is not used for federal matching contributions.

Congress determines the maximum annual allowable contribution by each taxpayer; currently set at $3.

Each taxpayer chooses whether or not to make this contribution.

Once the election is made, taxpayers cannot change their mind.

The Government determines how the assets are to be "invested," or distributed, among the candidates. The individual consumer plays no role in this decision.

The Campaign Contribution program is very efficient and effective, and a similar program can be created as easily by the Social Security Trust Fund.

Now I would like to turn the Committee's attention to the underlying question I often ask my clients: "Do you think Social Security will exist when you retire?" When I ask that question in my financial seminars, those over age 45 say "yes" and those under 45 say "no." As a planner, I personally believe and tell my clients that Social Security will continue in some form, but I make no predictions about what the benefit levels will be or how old you'll have to be to receive them.

However, dire predictions of the demise or diminution of Social Security benefits has made many of my clients concerned that Social Security may not exist as they know it by the time they are ready to retire, let alone be there for their children or grandchildren.

That is why I am taking this opportunity to bring to this Committee's attention the revolutionary new retirement planning tool from Edelman Business Services Inc., known as the Retirement InCome—for Everyone Trust™. In just the past few months alone, hundreds of Americans have invested well over $1.25 million in the RIC–E Trust™ as a first step towards ensuring the financial security of the kids and grandkids they love and as an adjunct to the current Social Security System.

Let me briefly explain the history of the RIC–E Trust™, what it is, how it works and why I consider it a viable and complimentary addition to the present Social Security System.

More than a year ago, I took a call on my Saturday morning radio show from a listener who wanted to save for his son's retirement. I thought it was a crazy notion, but it got me thinking: Imagine if you could set aside money for a child, for 50 or 60 years. The potential compounded growth, for example, could be this: $5,000 invested for 65 years, assuming the 10% annual return which the stock market has produced since 1926, would grow to $2,451,854.[1]

[1] Results based on $5,000 earning 10% per year, compounded annually. Calculation does not reflect any charges or fees that might be applicable; such charges or fees would reduce the return. This figure is for illustrative purposes only and does not reflect the actual performance of any particular investment. Investment results fluctuate and can decrease as well as increase.

Continued

Most people only think about saving for a child's college. That's great, and certainly worthwhile. And if you start early enough, you won't have to struggle as much to pay for college when the bills come. But what's the real purpose of going to college?

For many, it's so the child can get an education and get a good job. Then, with a good job, he or she can earn a decent wage so they can save for their own retirement and hopefully live comfortably. Well, why not cut-to-the-chase and put some extra money away for the child's retirement in the beginning?

You see, the biggest factor in a child's favor is time. That's because time gives money the chance to grow, through compounding. Given enough time, a tiny sum can grow into a fortune.

Although this concept seems simple enough, making it a reality is not. There were three major issues to creating the RIC–E Trust™: taxes, the law, and the ability to deliver it economically. First, investment profits are typically subject to taxes, and when a trust is used as in the RIC–E Trust™, the taxes are at the *highest* rate. These taxes would be so costly, in fact, that it would be virtually pointless to even create such a trust.

Second, if a Uniform Gift to Minors Account (UGMA) or Uniform Transfer to Minors Account (UTMA) is used, the child—by law—takes possession when he or she turns 18 or 21. Clearly, a person that young is not thinking about retirement. Therefore, it would be in the child's best interest to set aside this money beyond their reach, so it'll be there for their retirement.

Finally, the typical costs to hire a lawyer, trustee and investment advisor would erode much of the economic gains that the trust might enjoy.

After employing two accounting firms and 11 teams of lawyers, the three obstacles facing the RIC–E Trust™ have been solved. Now every parent and grandparent who opens a RIC–E Trust™, can be assured that their contributions will be preserved for one sole purpose: helping to secure their child's retirement.

As the creator of the RIC–E Trust™, I made enrolling as easy as possible. First, an interested consumer fills out and returns the enrollment form and one-time setup fee of $300. The consumer then receives a confirmation letter, an attorney directory and a $150 certificate towards the payment of that attorney's fee.

Since a trust is a legal document, an attorney is required to prepare the RIC–E Trust™. That's why investors will receive an attorney directory, which lists the names of attorneys in their area who can prepare the trust for them.

After an investor obtains the RIC–E Trust™ Specimen Trust Agreement from their attorney, I or an associate of my financial planning investment advisory firm, Edelman Financial Services Inc., (or another individual financial advisor selected by the client) will establish an investment account in the Trust's name. Resources Trust Company, one of the largest and most reputable trust companies in existence, has agreed to serve as Trustee, and to do so for free for the entire life of the Trust, provided that the investor uses the pre-approved Specimen Trust Agreement. Resources Trust manages more than 200,000 accounts holding nearly $14 billion in assets. An investor can select a different trust company if they wish, but they will need a Trustee who is able to serve for the entire life of the child, and it is highly unlikely that they will find another trust company willing to serve at no cost.

When the child reaches retirement age (which is any age the investor chooses, but no younger than 59) the Trustee will distribute the assets to the child. I've included more information about this and Resources Trust with my statement.

Once the Specimen Trust Agreement is in place, the investor funds the Trust with their contribution ($5,000 minimum). The Trustee will have this money invested in the proposed tax-deferred investment, with the assistance of the financial advisor the client selects. Using a tax-deferred investment is important, because avoiding annual income taxes allows the investor's contribution to grow and compound over the child's lifetime, without paying taxes on the potential growth until his or her retirement (more specific information on tax deferral, and on selecting a financial advisor, is also enclosed).

After the child grows up and reaches the "age of distribution" (again a minimum of age 59½), he or she receives the assets from the Trust. When the child receives the money in retirement, he or she will pay taxes at that time. In the event the child dies before reaching the distribution age, the money reverts to their estate, and is distributed to his or her heirs.

One important point about the RIC–E Trust™ is that each Trust is only established for one child. So, if an investor wants to provide a RIC–E Trust™ for more

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Figures do not take into consideration time value of money or any fluctuation in principal. Your tax liability may vary depending on your particular circumstances. Please consult your tax advisor.

than one child, he needs to create separate RIC–E Trusts™. Each child can have an unlimited number of RIC–E Trusts™ and an investor can create as many RIC–E Trusts™ for as many children as they like.

One of my key goals as the creator of the RIC–E Trust™ was to make this revolutionary planning tool affordable to the general public. In order to accomplish that goal, it was important that the Trust's potential earnings not be "chiseled" away with fees. That's why it's so important that Resources Trust Company has agreed to serve as Trustee for free (provided that the Specimen Trust Agreement is used). And, if I or another associate advisor of my investment advisory firm, Edelman Financial Services, serves as Financial Advisor, the applicable investment advisory fees will be waived as well, for every RIC–E Trust™ created. The Financial Advisor will receive compensation on the ultimate sale of the investment used to fund the Trust. And in order for the client to enjoy those free benefits, they must have the RIC–E Trust™ prepared by an attorney who's a member of the RIC–E Trust™ Attorney Network, because many of these attorneys tell us that they often accept the $150 Certificate as full payment for their services.

What do ordinary, hard-working Americans have to say about this new concept? Here's what three Northern Virginia families think. Walt Szczpinski, an information technology executive and former naval officer, said he has arranged this new Trust for his three grandchildren, so they can have a secure financial future long after he is gone. Renee Culbertson, a marketing manager and widow, said she worries that Social Security may not exist when her young daughter needs it. So Renee has put money aside in the new Trust, assuring that money will be there for her child's "golden years." Financial planners John and Mary Davis felt that by investing in this unique, planning tool, their two young girls will have a great headstart on their retirement savings, and can focus on other financial challenges the kids will face as they grow into adulthood.

In summary, Mr. Chairman, I want to commend you and the Committee for convening this hearing and having the political courage to air out all of the new ideas aimed at saving -or as in the case of the RIC–E Trust—complementing, the current Social Security System. For many years, Social Security Reform was the "third rail" of politics, and change was shunned by both ends of Pennsylvania Avenue. It is healthy for this Committee to discuss changes that were unthinkable just a few years ago—cutting benefits across the board, raising the payroll tax, raising the age at which retirees become eligible, and yes, even letting workers contribute to their own security accounts that the government or the workers would manage.

But as this debate moves forward, I want to point out to this Committee and the Administration that some of the American people are not sitting idly wondering if Social Security will be there for future generations.

Instead, many investors, as evidenced by our own clients, are taking the idea of "privatizing" the Social Security of their own sons and daughters and grandkids into their own hands, by investing in retirement tools such as my own RIC–E Trust, as a form of "safety net" to the current Social Security System.

The Winchester Star — Tuesday, November 3, 1998

Saving for Your Kid's Retirement?

New Fund Could Help Youngsters Prepare for Loss of Social Security, Northern Va. Businessman Says

By DALE HOPPER
Associated Press Writer

SPRINGFIELD — While politicians bob and weave over the future of Social Security, Ric Edelman has packaged a way to give today's children a retirement income no matter what happens to the national retirement fund.

The chairman of The Edelman Financial Center Inc. in Fairfax got the idea after a call to his financial radio show from someone who wanted to know how to save for the retirement of his newborn child.

"I thought it was the wackiest thing I ever heard," said Edelman, 40. "But the more I thought about it the more sense it made because of the power of compound interest."

Doing some quick calculations, Edelman figured a one-time $5,000 contribution at 10 percent per year for 65 years would grow to $2.4 million, possibly creating an annual income worth about $40,000 in today's dollars.

If that same $5,000 went toward a college fund that was withdrawn in 18 years at the same annual interest rate it would amount to only $27,000, he said.

The new fund, called The Retirement Income for Everyone Trust, is a one-size-only package that uses a tax-deferred annuity and a flat-rate structure.

For a minimum $5,000, 1.52 percent in fees each year and $300 to set it up, a parent, grandparent or other adult can establish a fund that can't be tapped until the recipient is at least 59½, Edelman said.

The money must be invested in a Polaris annuity, but investors can use their own attorneys and financial planners.

A more traditional trust fund would cost more to set up and then accountant fees and taxes are added on top of annual fees, said Robert Tull, a certified financial planner in Chesapeake.

The smallest trust fund he's put together had assets of $25,000.

Other tax-deferred ways of holding money for children turn over control as early as age 18 or upon the death of the adult who set up the fund, he said.

"There's nothing new here," Tull said. "It's just packaging it so it's simple for the average consumer."

Ed Slott, an accountant in Rockville Centre, N.Y., who edits a monthly newsletter on retirement accounts, said the fund could be part of a mix that would satisfy a lot of grandparents who fear a child may be spoiled by getting too much inheritance too soon.

"They're always afraid it'll be squandered," Slott said. "I don't see any big downside risk other than loss of flexibility. But the people who set this up, like the grandparents, want that."

Walt Szczypinski, 62, bought three of the new funds for his grandchildren. He welcomed the opportunity to keep it out of their reach until retirement "so they're not squandering it."

The executive vice president at Techmatics Inc. in Fairfax is also helping with his grandchildren's education.

"My initial priority is to help my children raise their family," Szczypinski said. "Whether they have Social Security or not, this is certainly something that would supplement whatever retirement savings or plans they may have."

Associated Press

Ric Edelman, chairman of Edelman Financial Services, sits in his Fairfax office on Monday. His firm is offering a trust fund for a child's retirement that for a minimum investment of $5,000 could return more than $1 million when the child retires.

The chairman of The Edelman Financial Center Inc. in Fairfax got the idea after a call to his financial radio show from someone who wanted to know how to save for the retirement of his newborn child.

[Enclosures are being retained in the Committee files.]

Statement of Edwin E. Forsman, Futura Magazine, Phoenix, Arizona

My name is Ed Forsman, I am an artist living in Phoenix, Arizona, where I publish a magazine on the Internet as part of my work. I am a private citizen representing my wife, my two children, and my two parents. I am making a copy of this testimony available on the Internet, to encourage other citizens to step forward and add their voices in the debate over Social Security Reform.[1]

[1] URL: http://www.geocities.com/~futura__zine

Thank you for this opportunity to file a written statement for consideration by the committee. I, too, feel that the reform of Social Security is of the utmost importance, particularly in light of the evidence that in just fourteen years, Social Security will, by all accounts, be paying out more than it will be taking in.

Any discussion of meaningful, bipartisan, democratically instituted reform of the Social Security System, must include an honest, straightforward discussion of what reforms are needed in Congress itself. All of today's testimony before this Committee is in basic agreement on that point; it is the actions of Congress itself that have brought about the need for reforming the system.

This committee does not have to be reminded that a majority in Congress have been crying out for campaign finance reform for 30 years, yet have remained paralyzed by the very thing that is in need of reform: money. This is directly related to any meaningful discussions involving how our nation deals in a truly democratic fashion, with its elderly, its sick, or with raising the standards of living for all of its citizens.

In considering the statistics cited at this Hearing in the statement of the Chairperson of the Social Security Advisory Board, only 20% of Americans are even aware that they will be laboring an additional two years before they are allowed to rest, and 70% of our Nation's citizens would oppose the raising of the retirement age if they had a say in it; yet, Congress has already passed this increase in the retirement age into law. Given the historical significance of this day, it is difficult to interpret these statistics in any other meaningful way, other than to raise the question as to why Congress is doing a far better job of informing voters about the details of a President's sex life, than it is of informing them about what Congress is doing in their lives.

The question as it relates to meaningful Social Security reform is not only a recognition that Congress has brought about this need for reform, but what can be done to reform Congress?

If we are to honestly consider meaningful reform of the Social Security system, we must unabashedly examine the nature of our system of transferring wealth from one segment of society to another, coupled with the apparent paralysis of a Congress in carrying out meaningful, democratically instituted reforms.

The recent DNA evidence regarding one of our most cherished national and historic figures, Thomas Jefferson, confirms that the majority of our nation's founders were, if not comfortable with, at least inextricably locked into a flawed system of economics that could not function without taking advantage of another's labor.

Historically, rising standards of living have never been permanently arrived at by tinkering with one fund for the benefit of another, nor by the printing of money, nor by investing in speculation. Rising standards of living have always been caused by broadening the base of political power, and increasing democratic participation in the institutions of power. How then do we do that now? And can our technology assist us in this task?

Africans living in America did not attain a better standard of living because slavery was reformed; they attained it because slavery was abolished. Americans who happened to be white and laboring under indentured servitude did not profit from that system until they were freed from it.

The economic system adopted by our founding fathers was something they were not strong enough to invent, like the Declaration of Independence. It was an economic system from which they were helpless to extricate themselves. It took less than a decade in a new nation functioning under that flawed economic system before an even larger revolution took place. History records that General Washington had to muster a larger army than he had used to throw the British out, in order to subdue that second, American revolution; and a National Constitution had to be formed as a result of it.[2]

The revolution we ought to be reexamining in our national dialog has never been the one about throwing the British out. That revolution of 1776 with its Declaration of Independence was a revolution concerning British subjects, rising against a British Crown.

The revolution we ought to be debating in our national discussion about Social Security is the revolution that reached its climax in 1787. That was the first revolution of American citizens, free from external rule, who were raising a revolution against American lawyers, bankers, and speculators who ran legislatures that controlled the printing of money.

Those same, systemic problems which gave rise to that revolution ought to be the focus of our attention in any debate about Social Security reform.

[2] See Shay's Rebellion, circa 1787

The first genuinely American revolution was against an economic system which allows those with money who produce only "services," to take advantage of those who produce something tangible, but require the services of others in order to increase their productivity. It is this revolution that forced the drafting of a national Constitution, the Bill of Rights, and the birth of our Nation.

In order to survive its infancy, our nation had to compromise with seriously flawed, but very powerful economic institutions that have never yielded their power willingly. It was our infant nation's weakness that reached unwanted compromises and allowed an outdated world financial system to stay where the British had been forced to leave. Those compromises and that weakness quickly led to the Civil War, followed by a series of national and world wide depressions which catapulted the world into World Wars, the Russian Revolution, and ultimately the total waste of a 50 year cold war. This list of human suffering will continue to expand as long as systems are in place that allow power to take advantage of the labor of those without power, and allows money to exert more influence than humanity.

Had machines been available that could keep track of 400 million transactions per second in 1787, the arguments of Hamilton, Jefferson, Washington, and the New York banking interests would probably have been quite different. i.e., "If I use my ATM card, why is there a bank between me and the Treasury where we print my money, keep track of its debits and credits for the proper measure of my production or consumption, and control its manufacture through a democratic process?" Or: "If I can attend Congress through my modem, participate in its debates on issues that concern me, cast my vote and have it tallied at the speed of light; what real role should a Representative be assigned; and is there any part at all to be played by paid lobbyists in such a democratic system, even if they come in the guise of 'think tanks'?"

These are the questions that need to be addressed here and now, because what is conspicuously absent at these, as in most Congressional Hearings, is the average person who will be most affected: the citizen who actually produces something consumable with his labor, and therefore should be most interested in changes proposed to the Social Security System.

What could be done to make the will of the people more audible in Hearings such as these? For the price of a used video camera and a donated computer, this committee could make itself available to citizens who, by right, ought to be present here and at each and every one of Congress' meetings.

Let the Committee begin here and now. Let the American people into these Congressional committees now, then begin to listen to their advice.

To seriously consider the continual raising of the retirement age of working citizens, or schemes to recalculate the rate of inflation, or an establishment of undemocratic institutions that funnel the funds of workers into companies that produce the likes of cigarettes, napalm and other machines of destruction; then allow "fund managers" familiar to Wall Street and Congress to skim a percentage off the top, is not only marching backwards in time to drums turned upside down, it is in direct opposition to the will of the people, corrupting of everything democratic and, in light of the statistics as they have been laid before this committee today, deserving of a general rebellion such as Shay's, if enacted.

Today happens to be a meaningful day in history. But it is as ironic as it is symbolic, in that as a private citizen among the vast majority of citizens residing outside of Washington, D.C., I found myself having the Impeachment Hearings being thrust upon me by commercial interests using public airways, against my will; whereas when I voluntarily tried to attend these Hearings on Social Security, and attend to the questions and answers surrounding my retirement; using a publicly financed Internet, for non-commercial reasons; I was unable to attend despite my fervent wish to do so.

This day ought to be a historic one for other reasons: for not only is it a day when Impeachment Hearings were opened for only the third time in our Nation's history, it may be the first time in American history that our Nation's citizens began to reclaim their rightful place in Congress by way of a computer revolution.

As one of our Nation's poets once admonished, "Come Senators, Congressmen, please heed the call, don't stand in the doorway, don't block up the hall." [3]

Respectfully submitted this 19th day of November, 1998.

EDWIN E. FORSMAN
Publisher, Futura Magazine

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[3] Bob Dylan, circa 1963

Statement of the Generation X Committee on Social Security, Tax Reform and Economic Justice

The Generation X Committee on Social Security, Tax Reform and Economic Justice welcomes this opportunity to submit comments for the record to the House Ways and Means Committee on the process for considering legislation to save Social Security. We believe the question of process will, in large part, define both the debate and the mix of possible solutions considered.

First, we are concerned that a process which starts with a proposal from the Administration will confine the debate to options which the White House will find politically acceptable. Such a proposal would constitute the opening salvo in the 2000 presidential elections, including limited privatization to reach out to moderate Republicans and measures to shore up the current system to please the Democratic base. The response to these proposals will be predictable, with the Vice President's likely Democratic opponents challenging any privatization. The likely Republican response of many Republican members and candidates will then be attacks on the White House plan, repeating the style of debate used to oppose the President's health care reform proposals in 1993 and 1994. Such a limited debate will result in much heat and very little light.

Secondly, we believe that a piecemeal debate on Social Security reform alone, tax reform alone, Medicaid alone and Medicare alone will result in solutions which will neither work nor pass. Currently, there are separate discussions of each of these issues. However, to reform one you must reform all. To make progress on these issues, they must be considered together.

Only a global approach will result in the comprehensive reform needed to assure the baby boom generation of a sound retirement without breaking the bank and the backs of the succeeding generations, especially Generation X and those at the tail end of the Baby Boom. Such comprehensive reform should also make real gains in creating a more just society, both at home and globally, taking into account the needs of the poor, the unborn and those who come to this country as immigrants (both legally and illegally). While we are skeptical of the ability of the current establishment to undertake such visionary leadership, we continue to hope that such things are possible and will offer such a comprehensive solution.

We urge the Committee, in concert with the Senate Finance Committee and the Administration, to initiate an open and joint process which examines the full range of available solutions to each of the areas mentioned above and how each area impacts the other. However, before such a comprehensive solution is outlined, some ground rules are necessary.

1. Any comprehensive reform must result in the retirement of the debt held by the public by the year 2030, if not before.

2. Any privatization or partial privatization of Social Security must duplicate the redistributional effects of the current system, i.e., individuals who are subsidized in retirement must be subsidized at the investment stage. Social Security works because it operates under the myth that benefit payments are not welfare. Initiating a needs based subsidy for some retirees adds the stigma of welfare, which will lessen program participation and throw some seniors into poverty.

3. Any privatization of Social Security must be economical, with low administrative costs. Additionally, if possible, employee stock ownership and voting control must be a component of the system.

4. Any comprehensive health care solution must address the problem of the uninsured and must eliminate waste from the system, without compromising the quality of care. Any further Medicare and Medicaid reform must include measures which spread cost savings to the general population, as it is markedly unfair to taxpayers with surviving parents to bear the risk of Medicare and Medicaid system failure while taxpayers whose parents have passed pay nothing.

5. Any tax reform must simplify or eliminate compliance for individual middle class taxpayers and must retain some form of progressivity, with the top wage earners in the current 36% and 39.6% brackets continuing to pay a higher rate than the general population.

6. Any general budgetary reform must eliminate incentives for wasteful spending and tax breaks targeted at industries favored by narrow interests at the expense of the rest of the nation. However, certain tax benefits must still be maintained and strengthened, including tax advantages for child rearing, home ownership, health insurance and education/training of the young. Such tax advantages are necessary for the preservation of the family. If high enough tax benefit levels are set, abortion

can be eliminated through economic incentives, rather than punitive measures against women and doctors which some still desire to attempt.

Adoption of these ground rules will result in reform which benefits all segments of society and will lift up the poor and the young, rather than favoring solely the connected and the powerful in hope that benefits will then trickle down.

The Committee's proposed solution will now be described. The following summary table will be followed by a description of each of the plan elements.

Current Revenue Source	Future Revenue Source	Items funded
Personal Income Tax revenue taxed at the 15%, 28% and 31% tax rates.	Business Income Tax with a single rate, credits for family size (payable to the employee), and deductions for material costs, home mortgage interest, health insurance and education/training (including stipends).	Discretionary spending, Non-pension Entitlement spending
Payroll Taxes for Health Insurance, Disability Insurance and Survivors Insurance (for individuals under retirement age).	Business Income Tax with a single rate, etc.	Unemployment Insurance, Disability Insurance, Medicare Insurance, Senior Medicaid, Survivors Insurance Trust Funds
Corporate Profits Taxes	Business Income Tax with a single rate, etc.	Discretionary spending, Non-pension Entitlement spending
Payroll Taxes for Old Age Insurance and Survivors Insurance (for individuals over retirement age).	Individually managed investment accounts for employee share (with administrative costs paid by the employer rather than from dividends), ESOP accounts with equal contribution levels for each worker for employer share. Phased in over 40 years..	Individual pensions
Personal Income Tax revenue taxed at the 36% and 39.6% rates.	Personal Income Tax on all individual income from wages and investments over $130,000 (except income from municipal or federal bonds).	Interest on the debt and debt retirement
Self-funded prescription costs to Medicare patients. Health care costs born by the uninsured and hospitals (which are then transferred to the system).	Repayments to medical lines of credit and medical savings accounts financed by Business Income Taxes.	Prescription and optional spending

Business Income Taxes

The Business Income Tax combines the proposals to enact a National Sales Tax/ Value Added Tax with the most popular provisions of the personal income tax. All business income would be taxed, both individual and corporate, over $10,000.

The tax payment will be based on gross sales, less material costs (similar to a VAT), with a tax credit for family size and tax deductions for health insurance purchases, employee mortgage interest (either paid to employees or financed through the employer's financial institution) and education/training costs for low and moderate income employees.

The tax rate should cover all Defense, Medicare, Social Welfare and General Government Expenses, less revenue earned from excise and gasoline taxes. Collection and enforcement of this tax will be accomplished by the states. Collection and audit functions of the Internal Revenue Service will be abolished.

The employee family size credit would be paid directly to employees with dependents at an equal amount per dependent-regardless of income. The credit must be high enough to cover all expenses and be indexed to inflation. It will be paid directly to the employee, regardless of income. This would, in effect, be a pro-life credit, as it would eliminate any economic incentive for abortion for workers, wives and daughters.

Note that all industries would be required to pay taxes, as this tax is more a replacement for individual income taxes than a national sales tax. There should be no exemption for food, as both farmers, food processors and grocers pay income taxes on employee wages.

NON-PENSION PAYROLL TAXES

Employer and Employee contributions for Unemployment Taxes, Disability Insurance Taxes, Health Insurance Taxes and Survivors Insurance for individuals under 62 would be shifted to the Business Income Tax. OASI(62+) would be privatized in phases—with an employee contribution based on income and an equal payment from the employer to each worker—which would duplicate the leveling effect of the current Pension system (see below).

The Health Insurance portion of FICA will be merged with Business Income Taxes. Business Income Taxes will include provisions for Health Insurance cost deductibility and family income equity, so that all workers and employers will be able to afford health insurance.

CORPORATE INCOME (PROFIT) TAXES

This tax would be abolished as a separate tax, as this income would be taxed under the business income tax. The many industry specific tax breaks must be ended. The importance of this cannot be emphasized enough, as compliance will be assured if everyone feels the pain.

PENSION INVESTMENTS

Most proposals privatizing Social Security ignore the central strength (and conservative criticism) of the program, it's leveling effect. This effect is caused by the pooling of payments by all beneficiaries, who receive a guaranteed minimum payment, provided they work the minimum number of quarters. The current systems subsidizes poor workers at the expense of the more well off, hence the criticism of the program and the desire to tie benefits solely to income by the privitizers. Yet, without the leveling effect, no privatization will survive the legislative process and will fail in implementation. If passed without leveling, privatization will throw millions of our generation into certain poverty upon retirement and widen the gap between rich and poor.

We propose that Old Age Insurance and Survivors Insurance for those over 62 be privatized. The employee share will continue to be based on individual income. However, the employer contribution will be equal for all employees, maintaining the current system of redistribution.

The employee share would be invested in an individual investment account or a company sponsored fund, with the employee having the option of investing these funds in employer voting stock. To hold administrative costs down and preserve funds for retirees, the employer would be required to pay administrative costs up front, rather than have them come out of plan investment gains. This adds an immediate cost cutting incentive. Currently, employees contribute 5.35% of their income to OASI. Excluding survivors of non-retirees will reduce this base figure somewhat. However, transition to a non-government program will lessen the resistance to an increased contribution. We recommend that by 2040, the contribution level should be increased to 10% (an increase of roughly 1% of income every ten years). See the phase in schedule below.

The employer contribution would be equal for each employee, at the national average FICA OASI contribution. This is currently 5.35% of the average national wage (which in 1997 was $1,442). This figure should also be increased to 10% of national average eligible earnings, in increments of 1% every decade. Corporations would invest these funds in their own voting stock, with dividend reinvestment and the employees or their representatives having control over how these shares are voted. This proposal will provide increased funds for each firm, which will reduce resistance to the increasing size of the contribution. The contribution for employees of privately held companies would go to the individually managed accounts funded by the employee share. For small, low wage, firm, a tax credit on the Business Income Tax will be provided if the average company wage is below that national average. See the following table for the phase-in schedule.

Year	Employee OASI	Employee Invested	Employer OASI	Employer Invested
2000	4% indiv. income	2% indiv. income	4% avg. income	2% avg. income
2010	3% indiv. income	4% indiv. income	3% avg. income	4% avg. income
2020	2% indiv. income	6% indiv. income	2% avg. income	6% avg. income
2030	1% indiv. income	8% indiv. income	1% avg. income	8% avg. income
2040	none	10% indiv. income ..	none	10% avg. income

During the transition, funds would be slowly shifted from FICA to individual management. At the end of the transition period, any remaining federal beneficiaries would be capitalized with government bonds for the amount they would have received had they participated in the plan from the start, less withdrawals to date. Individuals over 55 at the enactment of the plan will continue to be covered entirely under the federal system. Individuals under 30 at the enactment of the plan will wholly covered by the new system. Individuals between these ages will receive mixed coverage. Federal employees would chose from a menu similar to the current thrift savings plan, with the same phase-in period percentages and the same level of equality in employer contributions.

This phase-in assumes that 1% of both employer and employee contributions will be transferred from the current Social Security surplus. If the current surplus does not allow this, the schedule can be altered, with a slower start and a more rapid conversion. Additionally, this plan requires fiscal discipline. Business income tax revenues and federal spending (less interest on the debt) must always match, or be in surplus to cover all retiree pension costs beyond FICA revenues.

Note that higher income individuals will receive more of their retirement income from their own contributions, while lower income individuals will receive more income from employer contributions. The employer contribution provides a floor for retirement income.

PROGRESSIVE INCOME TAXATION

Personal Income Taxes over $130,000 would remain at a lower rate (at least the current rate less the Business Income Tax rate) and would be dedicated to the payment of Net Interest on the Debt and its retirement. Rates could be set higher to facilitate earlier debt retirement. After debt retirement has begun, additional debt may only be incurred in time of war, and then only for defense, and to capitalize the remaining Social Security beneficiaries in 2040.

Progressive income taxation must be preserved. The main reason for retaining such a tax is practical. Without such a provision, no tax reform will pass. Any tax reform will be dead on arrival unless the wealthy continue to pay their fair share. This proposal, unlike the others, does that.

There are also several economic reasons to maintain progressive elements. The first is the need to encourage consumption. Without progressive taxation, the savings sector increases at the expense of the consumption sector—leading to a need for risky investments of the sort taken in real estate and junk bonds which led to the Savings and Loan Crisis and the current Asian financial crisis. Currently, both the consumption and savings sectors are strong, leading to healthy corporate profits and a strong stock market. This came about partly through an increase in the tax rate on the wealth sector from 31% to 36% and 39.6%.

This proposition can be tested empirically by comparing growth (in percentage terms) with the financial margin, which equals the net of net interest and the deficit or surplus expressed as a percentage of GDP. The financial margin is multiplied by −1 during Republican administrations to account for tax policy (Republican presidents cut taxes on the wealthy—requiring deficits to growth the economy, while Democrats raise taxes on the wealthy—so that lower deficits lead to higher growth). The slope multiplier for the financial margin can be independently verified by examining data for each administration without multiplying the financial margin by −1.

A final reason for progressive taxation comes from business investment strategy: to wit, before a penny is spent on plant and equipment there must be an available customer base with the ability to consume. No corporate investment manager will hold his job for any length of time if he recommends investment because capital costs are low in the absence of such a customer base. This is why, when consumption is high, companies invest and growth continues.

HEALTH INSURANCE

We propose dividing Medicaid into two funds

- Support for poor individuals and families (including those with HIV/AIDS), which will be transferred to a business income tax deduction or a TANF credit. Medicaid for the non-elderly poor can be replaced by a Catastrophic/MSA/MLC plan, as described below.
- Medicare Part C for the elderly poor. Medicare parts A, B and C should be managed as one program

Medicare trust funds can be shorn up with increased use of Medical Savings Accounts, Medical Lines of Credit and Long Term Care Credit Lines (along the lines of a negative mortgage). Medical Savings Accounts (MSA) are becoming increasingly popular. These can be augmented by Medical Lines of Credit (MLC), which would cover expenses not covered by MSAs (such as chiropractic and massage therapy), any gaps between MSAs and Catastrophic Insurance coverage and for insurance for new employees.

Business Income Taxes must be set high enough so that some part of the burden for the increased cost senior health is shifted to taxpayers, ending the subsidy to those whose parents have already passed.

The Committee thanks you for the opportunity to address these issues. A copy of this statement will be provided to the Administration. We welcome the opportunity to testify in the future before the Committee on Ways and Means, the Senate Finance Committee and any joint task force or committee established to examine these issues. We are also available for any questions or comments from Committee members, members of the House, the Senate, the Administration or the general public. Please address all such inquiries to our Chair, Michael Bindner.

NATIONAL CONFERENCE OF STATE LEGISLATURES
November 19, 1998

The Honorable William Archer, Chairman
Committee on Ways and Means
U.S. House of Representatives

Dear Chairman Archer:

The National Conference of State Legislatures (NCSL) commends you and the Committee on Ways and Means for beginning the arduous task of considering the alternatives available to reform Social Security and the process by which the House will undertake this task. The nation's state legislators feel very strongly about one aspect of Social Security reform, that of the extension of mandatory Social Security coverage to all or new state and local government employees. NCSL vigorously opposes any efforts to extend mandatory coverage to additional groups of state and local government employees in any package to restore solvency and integrity to Social Security.

As you are aware, the Social Security Act of 1935 specifically prohibited state and local government employees from coverage in part, because state and local government retirement plans effectively provided retirement benefits to many state and local government employees. Most recently, the Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) required mandatory coverage of state and local employees not covered by a public pension plan. Further, OBRA 1990 ordered that these plans maintain minimum contribution and benefit level standards equivalent to Social Security in order to avoid mandatory coverage.

Numerous proposals intended to extend the life of Social Security offered since the 1980s have included a menu of options for bringing solvency to the nation's largest retirement insurance system. Many of these proposals have included plans to extend mandatory Social Security coverage to state and local employees under the guise of simplifying program administration and broadening participation in an important national program. While we agree that Social Security is a valuable program that provides benefits to the vast majority of Americans, state and local government retirement systems provide comparable and in many cases superior benefits to those provided by Social Security as well as flexibility to specific classifications of employees who are ill-suited to participate in Social Security.

State and local government retirement systems effectively provide retirement and supplemental benefits, such as health care, to state and local employees and their families. These systems effectively manage retirement funds on behalf of public employees and are models for effective private retirement savings that should be studied for best practices, not raided as a short term fix to extend social security for a limited number of years.

State and local employees earned these funds, contributed to these plans and in many cases bargained successfully for the range of retirement benefits offered by state and local government retirement systems. State and local employees with a proven commitment to personal savings should not be punished for their planning and initiative. Many of those critical of state and local government retirement plans have stipulated that mandatory coverage is "only fair." We disagree. It is not fair to resolve the Social Security solvency problem at the expense of public employees who have saved and planned for their retirement in good faith and in partnership with their employers, state and local government.

Mandatory coverage is not a sound policy. Mandatory coverage would devastate the retirement savings of state and local employees, without any guarantee that their Social Security benefit would be equal to their benefit under their current savings plan. The General Accounting Office (GAO) argues in an August 1998 report that by extending mandatory Social Security coverage to all newly hired state and local government employees Social Security's long-term actuarial deficit would fall about 10 percent and the program would remain solvent for an additional two years. GAO maintains that the "effect on public employers, employees, and pension plans would depend on how state and local governments with noncovered employees respond to the additional costs and benefits associated with Social Security coverage." State and local governments, as employers, would be faced with the untenable choice of decreasing or discontinuing benefits, raising the costs to participate in the program, or being forced to supplement these plans with additional funds from state revenues at the expense of other valuable state and local programs. While states are currently experiencing a lift in the economy, state and local governments might be forced to increase borrowing, reduce spending, or raise revenues to honor our commitments to public employees and to state retirement systems if we were unable to reduce benefits or impose additional costs on plan participants.

Similarly, the Congressional Budget Office (CBO) routinely suggests as a means to provide funds for federal priorities or budgeting balancing purposes that the federal government mandate coverage of state and local employees. In March of 1997, CBO estimated that the extension of mandatory Social Security to all State and Local workers would generate $6.9 billion dollars to the federal government over five years. Yet, these reports fail to examine adequately the long-term consequences of these proposals. In the out years, as these employees receive Social Security benefits the federal systems is again at risk of becoming insolvent.

We understand the immediate fiscal appeal of extending mandatory coverage, but maintain that it would totally uproot state and local government retirement systems supported by employee contributions. Further, reduced contributions to state and local government plans would have a dramatic effect on the long term financing of state and local plans, shifting the solvency problem to state and local retirement plans that to date have performed auspiciously on behalf of employees.

An extension of mandatory coverage would impose a tremendous cost shift to states, which we are certain would constitute an unwieldy unfunded mandate. While seven states—California, Colorado, Illinois, Louisiana, Massachusetts, Ohio and Texas—account for 75 percent of the employees who participate in government sponsored retirement plans, the extension of mandatory coverage affects all states. (See attached table).

State and local government retirement plans must be fully preserved and allowed to operate without additional intrusive and administratively cumbersome federal regulation. We urge you to consider our concerns and resist quick fix efforts such as extending mandatory coverage that leave so many worse off.

We appreciate your consideration of the views of the National Conference of State Legislatures on this issue. If our staff can be of any assistance to you, please do not hesitate to contact Gerri Madrid at (202) 624–8670 or Sheri Steisel at (202) 624–8693.

Sincerely,

REPRESENTATIVE NORMA ANDERSON,
Co-Chair, NCSL Taskforce on Social Security Reform, Colorado House of Representatives

DELEGATE JOHN HURSON,
Co-Chair, NCSL Taskforce on Social Security Reform, Maryland House of Delegates

Estimated Social Security Coverage of Workers with State or Local Government Employment, 1992[1]				
Sorted by the Number of Uncovered Workers				
[based on 1-percent sample; numbers in thousands]				
State [2]	*All workers*	*Covered Workers*	*Number of Uncovered Workers*	*Percent Covered*
California	2,198	1,069	1,129	49%
Ohio	800	61	739	8%
Texas	1,355	793	562	59%
Illinois	985	515	470	52%
Louisiana	396	114	282	29%
Massachusetts	325	46	279	14%
Colorado	330	122	208	37%
New York	1,673	1,553	120	93%
Georgia	580	461	119	79%
Michigan	790	674	116	85%
Kentucky	325	241	84	74%
Connecticut	255	174	81	68%
Florida	1,003	927	76	92%
Missouri	385	313	72	81%
Wisconsin	464	399	65	86%
Washington	437	374	63	86%
Nevada	93	32	61	34%
Maine	110	51	59	46%
Indiana	436	378	58	87%
Tennessee	409	353	56	86%
Pennsylvania	740	690	50	93%
Alaska	82	34	48	41%
North Carolina	579	532	47	92%
Virginia	518	471	47	91%
Maryland	396	357	39	90%
Alabama	360	324	36	90%
New Jersey	591	556	35	94%
New Mexico	175	145	30	83%
South Carolina	310	280	30	90%
Iowa	270	242	28	90%
Kansas	257	233	24	91%
Mississippi	222	202	20	91%
Arkansas	191	172	19	90%
Hawaii	107	88	19	82%
Oregon	264	246	18	93%
Utah	165	147	18	89%
Oklahoma	267	250	17	94%
Arizona	340	324	16	95%
Montana	93	77	16	83%
New Hampshire	88	74	14	84%
Nebraska	165	152	13	92%
Rode Island	74	61	13	82%
Wyoming	66	56	10	85%
North Dakota	70	61	9	87%
West Virginia	154	145	9	94%
Delaware	65	60	5	92%
Idaho	113	108	5	96%
South Dakota	75	72	3	96%
Vermont	52	50	2	96%
Minnesota	422	658	-236	156%
Total for All States	20,620	15,518	5,104	75%

Source: 1998 Green Book (from the Office of Research and Statistics, Social Security Administration)

[1]Includes seasonal and part-time workers for whom State and local government employment was not their major job.

[2]Information not available for the District of Columbia, Puerto Rico and the U.S. Territories.

Prepared by the National Conference of State Legislatures.

Statement of Hon. Jim Ramstad, a Representative in Congress from the State of Minnesota

Mr. Chairman, thank you for calling today's hearing to discuss how to preserve and protect Social Security—a program of vital importance to seniors and individuals with disabilities across the nation.

As we all know, Congress faces a daunting task in working to preserve Social Security. As the demographics of our nation change, and more and more seniors draw benefits, the program faces its biggest challenge.

The "easy" solutions of increasing taxes and cutting benefits are *not* acceptable. Thus we must pursue more complex resolutions to the financial problems facing this program. In town meetings and other forums, my constituents have expressed interest in directing payroll taxes into some special, voluntary Personal Retirement Accounts, to take advantage of the power of compound interest.

Mr. Chairman, as the demands on the Social Security system grow, the country benefits by addressing this issue before it is an overwhelming crisis. By acting now, we will have the time and flexibility to make changes that will actually protect and preserve the program for generations to come.

Like all of my colleagues, I am anxiously awaiting the specific proposals the Administration will send to Congress to begin this important debate. Presidential leadership will be crucial to any potential reform program. Neither Republicans nor Democrats can solve this problem. We must work together in Congress and with the administration to provide a safe and secure future for everyone.

Thank you again, Mr. Chairman, for calling this hearing. I look forward to hearing from today's witnesses about their thoughts for saving this crucial program.

Statement of Cynthia Wilson, President, Retired Public Employees Association, Inc.

As the President of the Retired Public Employees Association, an organization of more than 78,500 of New York State and local government retirees and their spouses, I am writing to urge that the Committee use in-depth analyses to test reform proposals before legislation is enacted. Adequate testing should be a significant prerequisite for development of a "solid and fair plan to save Social Security for all Americans."

1. We recommend a study of the effects of various reform proposals on the economic status of separate demographic and income-level groups. This would include:

- identifying those adversely affected;
- proposing means of reducing or eliminating the negative effects; and
- estimating the cost of such interventions.

Examples of topics that would merit this type of additional study are:

- the proposal to increase from 62 to 65 the earliest age at which the old age pension could be collected; and
- the proposal to subject the small personal investment accounts of low-wage workers to regular administrative costs.

2. We recommend a detailed investigation into the administrative issues and costs surrounding the creation and maintenance of 147 million individual investment accounts. We support Stanford Ross, Francis Cavanaugh and Dallas Salisbury, experts who have already expressed concerns about this issue.

3. We recommend an explicit description of how reform proposals will affect disability and survivors benefits.

4. We support John Cogan's recommendation for creation of "a clear and firm set of rules" for measuring budgetary impacts of proposed policy alternatives. In view of the dynamic activity of the U. S. economy in the past few years, we are convinced that it would be appropriate to recalculate, at the *start* of deliberations, the size of the deficit to be made up.

5. We recommend that estimates of the financial effects of individual proposals reflect interactions, where possible.

6. We support Herbert Stein's suggestion of a study to evaluate the effects of reform proposals on total national savings.

7. We also support Stanford Ross' request to review all parts of the retirement income system.

8. Finally, we support recommendations made by the Technical Panel on Assumptions and Methods to the 1994–1996 Advisory Council. This group recommended that the evaluation of the long-range financial status should put less emphasis on the "75-year actuarial balance" and the "test of long-range actuarial balance" and more emphasis on the projected date the Trust Fund Ratio would fall below 100 percent. They also recommend that "when definitive legislative revisions are adopted, subsequent long-range evaluation should compare up-dated projections with the intended results of legislation."

In requesting these involved calculations, we urge that the computer power and expertise as well as the available data of those in the private and academic sectors be called on to supplement what is currently available to the Social Security Actuary and to the Committee.

Since the results of these deliberations will affect millions of Americans, both young and old, and over many years, the greatest care and thoroughness should be taken during the process.

Statement of Hon. Bernie Sanders, a Representative in Congress from the State of Vermont

Mr. Chairman, I am pleased to have the opportunity to address the committee today on Social Security -a program that affects us all. Social Security is the nation's most successful anti-poverty program, serving over 40 million Americans, including retirees, disabled individuals, widows, and orphans.

While some would like for us to believe this vital program faces a "crisis," the reality is that the Trust Fund can continue to pay out full benefits for the next 34 years, until 2032. I would not call this a crisis and neither would the 87.9 percent of American surveyed by International Communications Research for the Institute for America's Future who prefer that the Congress and the President take the time to better explain the Social Security reform options before going forward with changes. However, given the fact that our population is aging and fewer workers will be supporting older Americans in the future, it is imperative to take a harder look at how we can preserve this important program for our children and grandchildren.

I am concerned that many Social Security reform proposals are advocating reducing benefits, raising the retirement age, and worst of all, privatizing all or part of the program. We need to take much less drastic steps to maintain the Social Security system.

One area that has received little discussion in the Social Security debate is raising or eliminating the earnings cap, which will rise from the current $68,400 to $72,600 next year. Currently, workers and their employers each pay a 6.2 percent Social Security tax on earnings up to the maximum amount.

This is one of the most regressive approaches to taxation since millionaires and billionaires stop paying all of their Social Security taxes for the year on January 1 while everyday working men and women pay these same taxes all 365 days a year.

Contrast the limits on the Social Security tax with the Medicare Hospital Insurance tax (1.45 percent or 2.9 percent for the self-employed). There is no maximum limit on the Medicare tax and I think one option this committee and the Congress as a whole should explore is eliminating or at least raising the Social Security earnings cap. This would ensure that all Americans would be paying the same tax on their earnings. In addition to being an issue ofsimple fairness, I believe this plan could raise enough revenue to bring needed Social Security tax relief to low-income Americans and/or the self-employed.

Self-employed individuals pay the full 12.4 percent Social Security tax themselves. Often, paying the requisite 15.30 percent (including Medicare Hospital Insurance taxes) is a major hardship for those Americans running their own businesses. For example, the average farmer in Vermont earning $30,000 a year pays $4590 a year in Social Security and Medicare Hospital Insurance taxes alone before income taxes are factored in.

The plan to raise the earnings cap is supported by a two-to-one ratio, according to a recent poll by the nonpartisan group, Americans Discuss Social Security. I find it interesting that despite widespread support for raising the earnings cap, no one seems to talk about this plan.

Eliminating the cap completely and increasing benefits accordingly would make up 1.3 percent of the 2.19 percent actuarial gap. That takes us more than halfway there. Factoring in a tax break for low-income Americans and the self-employed would cut into the 1.3 percent, but if done in a reasonable manner, we could provide this tax relief and still make up part of the actuarial gap. I am not contending that this will completely take us to where we need to go, but it is a partial solution that I believe is both fair and economically feasible.

Turning from these plausible, acceptable options, a number of other options that have been raised as "solutions" to the Social Security "crisis" are simply unacceptable. Cutting the Consumer Price Index, or CPI, which determines Social Security cost of living adjustments (COLAs), would be an outrageous attempt to balance the budget on the backs of the elderly. Cutting the CPI or reducing seniors' COLAs would be a disaster for senior citizens, half of whom live on less than $15,000 a year. In 1996, 12 percent of Vermont seniors lived below the poverty level. In 1999, the Social Security COLA will only be 1.3 percent and cutting this small increase would be disastrous to elderly Americans. We should not make our seniors choose between paying for their prescriptions, heating bill, or groceries in order to "save Social Security."

In addition, the majority of Americans oppose raising the retirement age even further. Workers age 40 and younger today will already have to wait until they are 67 to receive their normal Social Security retirement benefit. Increasing this to age 70 is an absurd idea. Many hardworking Americans simply cannot labor into their 70s and cannot afford to retire early and receive reduced benefits. I urge this committee and Congress to stand with our constituents and reject this plan.

Finally, I am deeply concerned about efforts to privatize all or part of the Social Security system. If Members could guarantee that the market would never again crash or we could educate every working American how to play the market without risk and make a fortune off of it, it might be worth a shot. But we know that is impossible. Arthur Levitt, the Chairman of the Securities and Exchange Commission, has stated that "the gap between financial knowledge and financial responsibilities is unacceptably wide. For example, more than half of all Americans do not know the difference between a stock and a bond; only 12 percent know the difference between a load and a no-load mutual fund; only 16 percent say they have a clear understanding of what an Individual Retirement Account is; and only 8 percent say they completely understand the expenses that their mutual funds charge." What this means is that less than 20 percent of the population has a grasp on some of the most basic investment information. Forcing them to invest their retirement money in the stock market instead of keeping it in Social Security would be disastrous for a huge majority of our constituents. We do not know what will happen to the stock market in the future. What will happen if our workers make poor investments and lose the money in their retirement fund? How then do we take care of them when they retire? This is a risk that our nation cannot afford. Privatization is a misguided route.

I am thankful for this opportunity to address the committee with my thoughts on a fair, rational way to reform Social Security. Over forty million Americans depend on this vital program and we need to ensure that it is there for them and for generations to come.

Statement of Laurence S. Seidman, Professor of Economics at the University of Delaware

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Statement of Hon. Nick Smith, a Representative in Congress from the State of Michigan

We all have loved ones whose lives are better because of Social Security. Over forty million elderly and disabled Americans receive benefits. This is why we must aggressively respond when Social Security's actuaries tell us that the system's unfunded liability exceeds $9 trillion. The pubic is ready for decisive action. In this year's election, they repudiated negative campaign attacks that distorted positions on Social Security. They voted for reform advocates like Charlie Stenholm (D–TX) and myself, giving us victories with comfortable margins.

Some have suggested that Social Security is financially secure until 2032. That would be true if there was a real trust fund. In fact, there is no real trust fund. All Social Security taxes being paid in are immediately spent for Social Security benefits or other government programs. For government to pay back the unsecured borrowing from Social Security, it must do one of three things: increase taxes, reduce other spending, or borrow more. These are the exact three alternatives that would have to take place if there were no trust fund even in name.

While we are in a deep hole, there is an escape ladder. We can allow workers to put aside an increasing amount of their payroll taxes into personally owned retirement accounts while we simultaneously and gradually reduce the size of future retirees' publicly financed monthly benefits. Because workers' "nest eggs" will grow rapidly, their total retirement income, coming from two sources instead of one, will be higher than under current law—even as federal spending on public Social Security benefits is trimmed to levels that avoids payroll tax increases.

My own bill, the Social Security Solvency Act of 1997, shows how making just incremental changes over long periods of time can free up enough Social Security taxes to provide funds for prudent investments that turn workers of average means into wealthy retirees. The Social Security Administration has officially informed me that this can be done. Reforming Social Security to include supplemental retirement accounts is a popular idea. In surveys, over 60% of respondents support it.

Many opponents of personal accounts agree that investing Social Security surpluses in the private capital markets will reduce the amount of tax increases or benefit cuts needed to restore the program's financial integrity. However, they suggest that the federal government should do the investing. This strategy has two fatal flaws.

First, the size of the government's equity investment will eventually grow to an imposing amount that practically guarantees unparalleled corruption. Imagine the potential for insider trading when a few officials meet in secret to buy or sell billions of publicly traded securities. Consider the consequences if public officials have the ability, through stock price manipulation, to blackmail or bribe CEOs into making campaign contributions. In the 1930's, the architects of Social Security, FDR and Democratic Congresses, rejected this dangerous plan. Those who support it today must explain why the designers of the system were wrong.

Second, government investment in the capital markets cannot accomplish the retirement security that its advocates seek. Under the existing generational transfer system, there is no legal relationship whatsoever between the revenues that Social Security takes in during the years that a worker contributes to Social Security and the future benefits a worker will receive. This is not subject to debate. The Supreme Court has confirmed this in two important cases, Flemming v. Nestor (1960), and Richardson v. Belcher (1971):

- "It is apparent that the noncontractual interest of an employee covered by the Act cannot be soundly analogized to that of the holder of an annuity. . . To engraft upon the Social Security system a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands."
- "The fact that social security benefits are financed in part by taxes on an employee's wages does not in itself limit the power of Congress to fix the levels of benefits under the Act or the conditions upon which they may be paid. Nor does an expectation interest in public benefits confer a contractual right to receive the expected amounts."

Even the Social Security Administration has made the point that paying Social Security taxes does not "buy" anyone the right to a retirement income paid by the federal government: "There has been a temptation throughout the program's history for some people to suppose that their FICA payroll taxes entitle them to a benefit in a legal, contractual sense. That is to say, if a person makes FICA contributions over a number of years, Congress cannot, according to this reasoning, change the rules in such a way that deprives a contributor of a promised future benefit. Under this reasoning, benefits under Social Security could probably only be increased, never decreased, if the Act could be amended at all. Congress clearly had no such limitation in mind when crafting the law . . ."

The point is clear. With no legal link between tax payments and retirement benefits, there is no guarantee that future retirees would reap the benefits of any investment gains the federal government might earn. The funds could go for any purpose, from buying battleships to paying for abortions. Workers still would have no legal right to a specified publicly funded retirement income, and they would remain at risk.

Recent history shows this risk is not trivial. The 1977 reforms created "Notch Babies" who have received benefits significantly less than those granted to friends just a few years, or even weeks, older. In 1983, Congress passed legislation that taxed up to half of a beneficiary's Social Security income. This new tax, coupled with a six-month delay in cost of living increases, cut benefits to some retirees by 27%. As part of the 1993 Budget Act, some seniors suffered benefit cuts of 14% when Congress decreed that up to 85% of these payments were taxable. The millions who were hurt by such benefit cuts have no recourse. The only way to lock in gains for workers' retirement is to give them ownership of their accounts.

Opponents of personal accounts point out that investing can be risky. Over the short run, this is true. However, there is no twelve-year or longer period in U.S. history when investors have lost money. Long-run investing isn't risky, but betting on the government to keep its word decades from now surely is.

Eight Senators and six House members from both parties have introduced reform plans that allow workers to accumulate personal retirement savings. President Clinton has said he will support personal accounts as part of overall reform. With both ends of Pennsylvania Avenue committed to finding a solution, we have the architects and the blueprints to enact meaningful reform. It's time to act.

Statement of Society for Human Resource Management

Chairman Archer and Members of the Ways and Means Committee:

Thank you for holding a hearing on saving social security and for the opportunity to express the views of the Society for Human Resource Management. The Society for Human Resource Management (SHRM) is the leading voice of the human resource profession. SHRM, which celebrates its 50th anniversary in 1998, provides education and information services, conferences and seminars, government and media representation, online services and publications to more than 100,000 professional and student members through out the world. The Society, the world's largest human resource management association, is a founding member of the North American Human Resource Management Association and a founding member and Secretariat of the World Federation of Personnel Management Associations (WFPMA).

SHRM is currently in the process of developing social security reform policy and principles, which we will be releasing in early 1999.

The ability of current and future retirees in the United States to financially sustain themselves can either be facilitated or eroded by legislative initiatives, influenced by the short and long-term need for tax revenue. Individuals rely on three main sources to finance their retirement: (1) Income from private sources (e.g. employer-sponsored retirement and health care plans); (2) Their own personal savings; and (3) Social Security and Medicare. A critical foundation of retirement is the affordability and access to adequate health care. Economic, demographic, social, accounting and regulatory trends, as well as the demand for current income indicate that in the long-term an increasingly large proportion of retirees may not have sufficient income and medical coverage from each of the three sources when they retire.

To provide a sound foundation for retirement planning, and minimize the number of retirees on welfare, a national retirement policy is essential to guide the various governmental entities, businesses and individuals in their fiscal and health care planning. Such a policy should recognize significant trends and enable policy makers to institute and/or revise income, taxation and retiree health care funding systems to effectively meet longer-term challenges.

BACKGROUND:

Today most individuals are able to retire comfortably. From 1971 to 1991, the elderly poverty rate fell from 22 percent to 12 percent. On average, workers retire earlier and live longer than in the past. However, a number of trends in the economy and workplace suggest that it may be more difficult for American workers to retire with a reasonable standard of living in the future. These trends are highlighted below.

Aging Population Increases the Need for Adequate Retirement Income and Health Care Coverage:

As the U.S. population ages rapidly and the elderly live longer, an increasing proportion of the population will depend on retirement income and retiree health care. Without re-enforcing the traditional retirement support systems, the declining ratio of workers to retirees will place a huge burden on Social Security, Medicare and Medicaid. In 1990, 13% of the population was aged 65 or older, compared to 10% in 1970. The Department of Labor projects that by 2050, 22% of the population will be aged 65 or older.

Mobility Causes Inadequate Retirement Income:

Employees are likely to change jobs several times over their careers. Those frequently changing jobs, not always voluntarily, may be less likely to have adequate retirement income and employer sponsored retiree health care upon retiring since many traditional retirement programs (income and health care) provide benefits based on length of service, and vested benefits for shorter service terminations are frequently paid out in cash and not saved for retirement.

Firms Without Retirement Income and Retiree Health Care Plans:

The self-employed and employees of small firms, which create most new jobs, are less likely to have employer-provided retirement programs than employees in larger firms. According to the Employee Benefit Research Institute, in 1991, 19% of workers in firms with fewer than 25 workers were covered by an employer-sponsored retirement plan compared to 78% of employees in companies with 1,000 or more employees. Similarly, 18% of smaller employers provide employer sponsored retiree medical coverage, while 44% of large employers provide medical coverage to retirees.

Conservative Defined Contribution Plan Investments Reduce Retirement Income:

According to the Pension and Welfare Benefits Administration (DOL), from 1975 to 1990 most of the growth in employer-sponsored plans can be attributed to an increase in the number of defined contribution plans from 207,700 to 599,200. The shift to defined contribution plans may affect retirement savings as a result of participant's conservative investment choices, which may lead to lower than expected retirement standards of living. Several studies have found that participants in defined contribution plans, which generally allow participants more discretion in investment allocation, often choose low-risk, low-return investments.

Erosion of Pre-Retirement Fund Distributions:

Based on Employee Benefit Research Institute (EBRI) data, most employees choose not to roll over their lump sum distributions, particularly small distributions, into another retirement account when they leave a job. According to EBRI's study, only 22% of lump sum distributions are rolled-over into other qualified plans, while most are used to fund current consumption or other expenses. Withholding regulations implemented in 1993 may be reducing this practice somewhat, leading to more funds being rolled-over into other qualified plans.

Complex Regulations Deter Employer-Sponsored Plans

The complexity of existing retirement plan regulations and the substantial administrative cost of complying with them discourage employers from establishing and maintaining retirement plans. A 1991 survey conducted by the American Academy of Actuaries found that among those actuaries whose had been involved in a plan termination in the previous year, the largest single reason (30%) cited was government regulations (including complex rules, the increasing cost of compliance, and frequent changes in the retirement plan law) as the key reason employers terminate their defined benefit retirement plans.

Accounting Standards Changes and Medical Inflation Deter Employer Sponsored Retiree Health Care:

The advent of requiring corporations to establish financial statement liabilities for retiree medical programs caused businesses to focus on this major expense. As a result, many businesses have reduced or eliminated their post-retirement medical coverage. At the end of 1994, according to a recent EBRI study, fewer than 34% of retired employees are covered by employer sponsored medical plans.

Retirement Plans Are Not Significantly Under-Funded:

According to a recent report by the Pension Benefit Guaranty Corporation (PBGC), which insures most private sector defined-benefit plans, pension underfunding fell to $31 billion in 1994 from $71 billion in 1993, and most pension plans today are adequately funded. This represents only 1% of the $3.2 trillion held in trust to pay current and future benefits and in spite of cutbacks in the limits on contributions that were repeatedly enacted since 1982. Much of the under-funding may partly be due to the highly conservative assumptions used by the PBGC. Further, the Retirement Protection Act, which Congress passed in 1993, may help prevent future pension plan failures by increasing the incentives for funding underfunded plans.

Social Security and Medicare Are Not Sufficiently Funded:

The Social Security and Medicare trust funds have been viewed as sources of government program funding, causing them to be unreliable sources of retirement support. Since the Social Security system is currently generating more revenue than it pays in benefits, the government borrows the surplus revenue to fund other government programs. On the other hand, Medicare benefits already exceed the taxation revenue, causing the trust to decrease each year. However, as the population continues to age, more workers will rely on Social Security and Medicare benefits and proportionately fewer workers will be funding the benefit. The Board of Trustees for the Social Security Trust Fund advised in their 1995 Report that the Federal Old Age and Survivors Insurance (OASDI) Trust Fund will be able to pay benefits for about 36 years. Of more urgency is the funding of the Medicare Trust, which its trustees report will be depleted within 7 years.

A Source of Government Revenue:

Policy makers look to retirement funds for potential revenue, to reduce the national deficit. The Treasury Department estimated the government would have gained $64.9 billion in FY 1995 revenue if employers (including federal, state, local and private) were taxed on the value of contributions to retirement plan funds. According to EBRI, this tax revenue loss is overstated. More than half of this is attributable to public sector retirement plans. In addition, tax expenditure discussions focus on current revenue impact rather than the future value of taxes when retirement income would be paid out in future years.

Lower Income Individuals Depend Heavily on Social Security and Employer-Sponsored Plans:

Fifty one percent of all persons employed by private businesses with pension plans earned less than $25,000 and 89% earned less than $50,000. According to EBRI, because most workers earn under $50,000, retirement programs primarily benefit workers with income below this level. Individuals with fewer than 50,000 will depend most heavily in their retirement years on Social Security qualified retirement plans and Medicare, as they are least likely to have personal savings or private medical insurance.

Impact of the Growth in the Service Sector and the Contingent Workforce:

Traditionally, employer-sponsored retirement income and retiree medical plans have been more prevalent in the manufacturing than the service sector, where the proportion of employment has continued to increase. Economic and demographic shifts have also contributed to a rise in the number of seasonal, part-time, and contingent workers. These individuals may comprise as much as one-third of the workforce and are less likely to participate in employer-sponsored retirement income and retiree medical plans. The above trends and current regulatory burdens have created the need to reexamine the employer, individual and federally funded retirement systems and implement a uniform and consistent national retirement policy. Below is a framework of principles and specific recommendations to guide the formulation of such a national policy.

General Principles

SHRM believes that government shares responsibility with American workers to achieve adequate retirement income and have access to adequate medical care. Moreover, to enable employers to help support retired employees; public policy should encourage the voluntary establishment of retirement programs. To facilitate sound retirement planning, we have established the following three fundamental principles:

1. Primary Individual Responsibility for Retirement Financing: Individuals should have primary responsibility to provide for their own adequate retirement income and health maintenance funding. Individuals should be responsible for planning and building their own retirement resources, including anticipating their retirement expenses and the sources of funding to meet their needs. To this end, the government should encourage or otherwise facilitate retirement (financial) needs planning of the American worker and families, including voluntary employer education programs. Importantly, the government should encourage individuals to provide for their own retirement income and health maintenance, by making available tax-favored savings vehicles.

2. Government Responsibility for Retirement Income and Medical Coverage: Through its mandated Social Security and Medicare programs, as public policy the government shares with the American worker the responsibility for providing some reliable basic retirement income and health care for all individuals. Through taxation of, and an implied promise to, all American workers, these programs have become fundamental components of our country's retirement system. The government should also facilitate the continuation and growth of employer sponsored programs and provides consistent tax incentives and simplified regulations to encourage employers to provide retirement benefits that otherwise would be sought from the government at greater cost to society. In addition, to enable American workers to have an adequate and secure retirement, it is incumbent on the government to maintain a fiscal policy that ensures low inflation over the long term.

3. Employer's Role in Providing Retirement Benefits: Employers may find themselves voluntarily able to help workers achieve adequate retirement incomes and maintain their health during retirement, reducing pressure on government funding for retirees. Employers play key roles in providing retirement income and medical coverage through payments into the Social Security and Medicare systems and voluntarily to employer sponsored retirement income and medical plans.

Upon these principles, we propose the following framework for a national retirement policy:

Specific Framework Recommendations:

Individual Responsibility for Retirement Financing

1. Regulation by Individual: To avoid retirement income inequities caused by multiple retirement plans, variability in generosity or finances of employers, dual family incomes, and complex retirement plan regulations, contributions set aside for retirement income and retiree health care should be regulated, if at all, only on an individual basis in aggregate rather than on an employer, family or retirement plan basis. Any necessary regulations should be understandable to the general public, and consistent with the long-term objective of individual financial stability.

2. Limitation on Retirement Plan Contributions: To obviate the need for non-qualified retirement plans, overly complex regulations, and excessive plan administration costs, all arbitrarily established limits on the dollar amounts which may be deferred for retirement income should be eliminated. If there are concerns that a few senior employees would inordinately benefit from tax qualified plans; limits should only be applied to a tightly defined group of policy making executives. In that all distributions would be taxed when received, this change would not affect the amount of taxes paid, but only the timing of tax revenues.

3. Regulations and Access to Retirement Plan Funds: The same regulations on administration and investment of, and restrictions on access to, funds set aside for retirement should apply equally to individual retirement plans and employer sponsored plans. Access to any plan funds for retirement income or medical expenses prior to retirement should be limited to significant life events, including purchase of a primary residence, funding of the taxpayer's higher education, demonstrable severe hardship, and other similar reasons acceptable to the plans administrators. All funds distributed prior to retirement should require a scheduled payback into the retirement plans within a reasonable time frame.

4. Facilitating Retiree Mobility: Recent federal legislation was enacted which prevents states from taxing retirement benefits based on the location earned rather

than where received. To perpetuate this legislation ERISA pre-emption also should be applied to state tax laws to base taxation of retirement income on receipt rather than where income liability was incurred. This will more fairly align state tax revenues with the services required by retirees, will be more equitable between states, and will reduce the administrative cost of retirement plans.

5. Qualified Individual Retirement Plans: Due to increased employee mobility, the number of employees working for multiple employers and/or working for employers which don't sponsor retirement plans, and the need to facilitate employee retirement savings for years when an employee will not earn a vested retirement benefit, regulations and tax laws should be revised to:

a. Streamline the establishment of individual savings accounts for both retirement income and medical expenses during retirement.

b. Encourage self-employed individuals and small to medium size employers to provide retirement income savings and retiree medical plans,

c. Encourage personal saving for retirement, and

d. Permit retroactive contributions to individual retirement plans to make-up contributions subsequently permitted by regulatory change or plan operation (e.g. loss of vesting).

SHRM Board Approved Position, March 1991: SHRM supports efforts to permit retroactive contributions to IRA's for years for which a participant loses retirement plan vesting (e.g., short-term employment). To provide equity with married employees, who each earn retirement benefits from separate employers, IRA contribution eligibility should not be precluded by a spouse's qualified retirement plan coverage.

Federal Government Provided Basic Retirement Income and Medical Care

1. Mandatory Coverage. Coverage for every employee in a federal government retirement program (such as the current Social Security and Medicare programs) should be mandatory. Current parallel plans (e.g. Federal & State Government, & Railroad Retirement and religious body plans) should be consolidated with Social Security into one successor program to produce a single consistent approach toward a floor of retirement income.

2. Maintenance of Benefit Levels: It is important to avoid further erosion of currently accrued (hence earned) Social Security and Medicare benefits. This is essential to ensure workers at every level receive the total retirement income and medical protection on which they have based their financial planning, believing Social Security and Medicare benefits were promised by the government throughout their careers. Maintaining these benefits will also facilitate the affordability of employer-sponsored retirement plans, many of which assume retirees also receive federally sponsored retirement income benefits.

3. Funding. In order that current workers and work force entrants will be assured of some minimal retirement income and retiree health care, the Social Security and Medicare trust funds, and/or their successors, must be maintained on a financially sound basis, in line with the funding required of individual and employer sponsored plans. However, this should be 10 accomplished without shifting the funding burden substantially to employers through increased taxes.

Employer-Sponsored Retirement Programs

1. Individual Retirement Savings Accounts: To encourage small employers to provide retirement programs, and to facilitate transfers of retirement funds between employers of all sizes when employees change employers, regulations should be simplified to permit and/or facilitate employers to place current retirement income and retiree health care contributions into an employees qualified individual retirement plan (savings) rather than necessarily establishing separate participant accounts within those employers plans, regardless of employer size.

2. Funding Restrictions: Reform of accounting rules (i.e. FASB) and retirement plan insurance (i.e. PBGC) should encourage faster funding of unfunded obligations and under-funded plans for retirement income and retiree health protection. For example, increasing maximum annual contributions, and using realistic or actual interest and pay assumptions would expedite funding. Public and nonprofit organizations should have identical access to plan alternatives and be subject to the same regulations as other employers. Government policy and regulations affecting retirement plans should be consistent and hence coordinated throughout all government agencies.

3. Investment Education: For retirement plans in which the employee bears the risk of investment return, employers should provide employees cost-effective diversified alternatives to direct the investment of those funds. In such plans, employers and plan administrators should be protected from unnecessary fiduciary liability to

facilitate educating employees on the financial impact the investment choices they make could have on their retirement income.

Either voluntarily or involuntarily, employers should be permitted to transfer (to other qualified plans or accounts) vested benefits following termination of employment. Similarly, employers should be permitted to distribute (to other qualified plans or accounts) all vested proceeds for any pre-retirement termination, regardless of the amount involved. Receiving plans should be indemnified against any disqualified funds so received. Regulations should continue to permit service based vesting schedules, permitting employers to optimize contributions for the benefit of employees who remain employed for more than a few years.

SHRM Board Approved Position, March 1991: SHRM recognizes that the lack of a comprehensive retirement plan portability policy could adversely affect the future retirement security of this nations workers and therefore supports efforts aimed at enabling participants to easily transfer funds between pension plans and retirement vehicles such as IRAs. However, portability and preservation solutions should not interfere with the voluntary nature of the current retirement plan benefit system by imposing burdensome and unnecessary obligations upon plan sponsors.