PRESERVING AND STRENGTHENING SOCIAL SECURITY

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

JANUARY 21, 1999

Serial 106–4

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

55–995 CC WASHINGTON : 1999

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PRESERVING AND STRENGTHENING SOCIAL SECURITY

THURSDAY, JANUARY 21, 1999

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

The Committee met, pursuant to call, at 10:10 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (Chairman of the Committee) presiding.

[The advisories announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
January 12, 1999
No. FC–2

Archer Announces Hearing on Preserving and Strengthening 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 preserving and strengthening Social Security. The hearing will take place on Thursday, January 21, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:00 a.m.

Oral testimony at this hearing will be from invited witnesses only. Witnesses will include former Committee Member and Social Security Subcommittee Ranking Democrat Barbara B. Kennelly. Appearing together will be former Member of Congress, former Secretary of the Department of Housing and Urban Development, and Vice Presidential nominee Jack Kemp, and the Reverend Jesse L. Jackson, Sr., President and Chief Executive Officer of the Rainbow/PUSH Coalition, Inc. 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:

America's Social Security program has had great success in alleviating poverty and boosting the incomes of millions of workers and families affected by retirement, death, and disability. In the years ahead, the program faces a funding shortfall due to long-term demographic changes. The 1998 Social Security Trustees' report notes that spending will exceed tax revenues in the year 2013; by year 2032, the Trust Funds will be exhausted and the program will be able to meet less than 75 percent of its obligations.

In anticipation of these challenges, several reform proposals have been introduced in Congress. Beginning with the 1998 State of the Union Address, the President stressed his intention to save any budget surpluses to secure a stronger future for Social Security. The President has since hosted a number of regional forums and convened a White House Conference on Social Security on December 8–9, 1998, at which he called for bipartisan cooperation to achieve needed reforms.

In announcing the hearing, Chairman Archer stated: "As the 106th Congress convenes, we must work together with the President to preserve and strengthen our Social Security system for all Americans. I look forward to hearing from Jesse Jackson, Jack Kemp, and Barbara Kennelly. Their extensive experience and thoughtful perspectives will immeasurably aid the Committee in our deliberations over the future of Social Security."

FOCUS OF THE HEARING:

The hearing will focus on major issues raised by Social Security reform proposals, including: whether change is needed and the prospect of continuing the current Social Security program without fundamental reform, whether workers should be permitted to establish personal savings accounts, and whether the Federal Government should invest a portion of the Trust Funds in private stocks and bonds.

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, February 4, 1999, 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.

***** NOTICE—CHANGE IN TIME & WITNESS *****

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE — CONTACT: (202) 225–1721
January 15, 1999
No. FC–2-Revised

Time and Witness Change for Full Committee Hearing on Thursday, January 21, 1999, on Preserving and Strengthening Social Security

Congressman Bill Archer (R–TX), Chairman of the Committee on Ways and Means, today announced that the full Committee hearing on preserving and strengthening Social Security, previously scheduled for Thursday, January 21, 1999, at 9:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building, will begin instead at 10:00 a.m. The Honorable Barbara B. Kennelly will not be appearing as a witness. Alicia Munnell, Peter F. Drucker Chair in Management Sciences, Boston College, will be an additional witness.

All other details for the hearing remain the same. (See full Committee press release No. FC–2, dated January 12, 1999.)

Chairman ARCHER. The hearing will come to order. The Chair would invite guests and staff to please take seats so that we can commence.

Yesterday we found that we were not able to recognize all of the junior Members, and I hope that we can get through the hearing today by accommodating them, as well as the senior Members.

Mr. RANGEL. Mr. Chairman.

Chairman ARCHER. Mr. Rangel.

Mr. RANGEL. We might allow the Members that did not have the opportunity to question to have priority and just set aside the seniority system in this one instance to give them an opportunity to question first.

Chairman ARCHER. I thank the gentleman for his comments because the Chair would like to do exactly that. Without unanimous consent, however, the rules do not permit it, so the Chair would ask unanimous consent that Members who were unable to question yesterday be the first to be recognized today.

Without objection, so ordered.

Good morning and welcome. I have called today's hearing because I believe in the power of ideas. I especially believe in the power of ideas that transcend generations and partisanship.

To save Social Security, our Nation must take into account the security and well-being of our grandchildren as well as our grandparents, including my own 95-year-old mother who still lives by herself and drives her own car and is a great blessing to her son.

Thanks to Social Security, poverty among seniors has become rare, but now we face new challenges. To assure that Social Security is there for tomorrow's seniors, we need to take the best Republican ideas, the best Democratic ideas, the best Independent ideas, the best ideas of the entire Nation and put them together and build a lasting solution to Social Security's problems.

In doing so, we face a question. When it comes to Social Security, is the role of government simply to redistribute existing wealth or to foster conditions that enable everyone to make more wealth? Should the government solve problems and protect people from adversity or should the government help people equip themselves to solve their own problems?

I personally want hardworking Americans to be able to enjoy the fruits and the benefits of their labor. I want to create a growing circle of winners in America. I want women who live longer than men to know that their retirement needs will be addressed and protected.

By focusing on opportunity instead of redistribution, we can fully protect today's seniors while giving a boost to baby boomers, generation Xers and women so they too can retire in comfort and security. We must carry out our work in an inclusive manner, remembering that we are all in this together.

There is an income gap in America, and it should be reduced. But what is the most effective way to do it? Do we narrow the gap by taking away from those who have, denying the fruits of the labor to those who work harder, or do we create opportunity so others can have more? I personally say lift people up, let's not tear people down.

A nationwide bipartisan survey of adults conducted by the Luntz Research and Siegel & Associates for Oppenheimer Funds will be released later today and the results are sobering. Two-thirds of all Americans under 50 believe it is more likely that a pro wrestler will be elected President than believe they will collect all the Social Security money that they are entitled to. Half of all Americans believe a thousand dollar bet on the upcoming Super Bowl will give them a better return on their money than the taxes they pay into the Social Security system.

Before I close, let me tell you about Regina Jennings who for 15 years mopped floors and dusted classrooms at West Virginia University in Morgantown, West Virginia. Regina earned only $10,000 a year as a custodian and yet she drives a GMC Jimmy. She also just donated $93,000 to the university's law school, $93,000. How did she do that? Well, for 23 years she rented a piece of property that she had inherited and she invested her rental income along with her salary. She said I didn't make a lot of money but what I did make I kept. I paid myself first; I saved before I paid others in spending my money.

That is what happens when you combine the power of ideas with the creation of opportunity. I believe that left to their own devices with low taxes, less government interference and more freedom, there is nothing that the American people cannot do.

[The opening statement follows:]

Opening Statement of Hon. Bill Archer, a Representative in Congress from the State of Texas

Good morning.

I have called today's hearing for a simple reason. I believe in the power of ideas.

I especially believe in the power of ideas that transcend generations *and* partisanship. To save Social Security, our nation must take into account the security and well-being of our grandchildren, as well as our grandparents, including my 95-year old mother who lives in Houston and still drives her car.

Social Security was founded by visionaries like Franklin Roosevelt who vowed to protect seniors from spending their last years in poverty. It worked.

Thanks to Social Security, poverty among seniors has become rare. But now we face new challenges.

To assure that Social Security is there for tomorrow's seniors, we need to take the best Republican ideas, the best Democrat ideas, and everyone else's good ideas, put them together and build a lasting solution to Social Security's problems.

In doing so, we will face a question.

When it comes to Social Security, is the role of government simply to redistribute existing wealth, or to foster conditions that enable everyone to make more wealth? Should the government solve problems and protect people from adversity, or should the government help people equip themselves to solve their own problems?

I want hardworking Americans to be able to enjoy the fruits, the benefits of their labor. I want to create a growing circle of winners in America. I want women who live longer than men to know their retirement needs will be protected. By focusing on opportunity instead of redistribution, we can fully protect today's seniors while giving a boost to baby boomers, generation Xers, and women so they too can retire in comfort and security.

We must carry out our work in an inclusive manner, remembering we are all in this together. There *is* an income gap in America and it should be reduced. But what's the most effective way to do it? Do we narrow the gap by taking away from those who have, or do we create opportunity so others can have more? I say lift people up. Let's not tear people down.

A nationwide, bipartisan survey of adults conducted by Luntz Research and Siegel & Associates for Oppenheimer Funds will be released later today, and the results are sobering.

Two-thirds of all Americans under age 50 actually believe it's more likely that a pro-wrestler will be elected President than believe they will collect all the Social Security money they're entitled to.

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She also just donated $93,000 to the university's law school. *$93,000!* How did she do it?

Well, for the last 23 years she rented a piece of property she had inherited. She invested her rental income along with her salary.

"I didn't make a lot of money," she said, "but what I did make, I kept."

That is what happens when you combine the power of ideas with the creation of opportunity.

I believe that left to their own devices, with low taxes, less government interference, and more freedom, there is nothing the American people cannot do.

With that, let me welcome our two guests: Jesse Jackson and Jack Kemp. You both believe in the power of ideas. While you may offer differing views on how to save Social Security, I believe you agree with me that we can solve this problem if we work together to put principles before politics and ideas before ambition.

With that, let me welcome our two guests, Jesse Jackson and Jack Kemp. Both of you believe in the power of ideas. While you may have differing ideas, you both want to save Social Security, and I believe that you agree with me that we can solve this problem if we work together to put principles before politics and ideas before ambition. And I yield for any statement that he might like to make to the Ranking Minority Member, Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. I have to take a deep breath because I am so moved by your initiative to bring about a bipartisan flavor to our study of what we must do with Social Security.

I am glad we have Jack Kemp here. Nobody has put a more compassionate face on the Republican Party than my dear friend and former colleague, Jack Kemp. The people that find themselves in public housing have never received more support than when you served as the Secretary of HUD and found the time to go into every county and every community to give hope to the people. There is no question in my mind that preserving Social Security and having health care for our senior citizens is a top priority for you.

Reverend Jackson, you have given so much not only to fulfilling the dream of your dear friend, the late Martin Luther King, but to make that dream a reality for us and generations and generations to come.

Your concept was treating inner cities and rural areas with the same priority that we do developing countries. It was moving to hear our President share that vision with you. You have worked so hard to give to Americans the same opportunities we give to other people, to encourage investment, to educate the people, to give them disposable income and let them also be consumers and our trading partners.

Both of you have so much in common that the only question that remains is how we can really break down the polarization that unfortunately remains in Congress and how this Committee can get on with the people's work to shore up Social Security.

We have been asking the President, for God's sake, don't just talk about Social Security; give us a plan, give us a framework, give us something to work with. Well, the President has done just that. He says, Let us take the surplus, reduce our national debt, and repair Social Security.

The best time to repair a leaking roof is when the sun is shining. We have the surplus. Let's get on with it.

The President has said, Let's take a small part of Social Security investments and have the government invest in the private market. Some say shame . . . Everyone believes that will be terrible and so does Greenspan.

So, put it aside. Let's not dwell on that. Let us talk about the something we agree with, and that is saving Social Security, saving the Medicare Trust Fund. And let's talk about a tax cut. After all, it is not our money; it is the people's money. But if we all agree that Social Security should be preserved first, let's concentrate on those positive things.

Reverend Jackson, you have done a great service for the President of the United States in providing counsel to him and his family during a time of need. Do the same thing for Chairman Archer and me. Do it for the Republican Party and the Democrats, because come the year 2000, the voters won't care whether it is Republican or Democrats. They want to know, what did the Congress do. Let us be able to say we have saved Social Security. We saved Medicare. We fought on how to give an equitable tax cut, but we did the best we could.

Thank you, Mr. Chairman.

Chairman ARCHER. Without objection, all Members will be able to include written statements in the record at this time.

Mr. RANGEL. I would like to include Congressman Stark's statement in the record.

[The opening statement of Mr. Stark follows:]

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

Mr. Chairman, I agree with those who claim we need a Social Security system that suits the needs of workers in the 21st century. However, the current system has provided quality retirement, disability and spousal benefits for over sixty years. The change in demographics prompts us to address long-term solvency issues but the underlying system shouldn't be scrapped.

Social Security is a social insurance program. It provides a guaranteed retirement benefit for seniors as well as protecting those who encounter unforeseen tragedies such as the untimely death or disability of the primary wage earner from a life of poverty. Plans to privatize Social Security will hurt minorities, low-income workers, women and the disabled. Privatization will dismantle the social insurance program Americans have come to rely on. American workers will be forced from the protection of collective responsibility to the uncharted waters of individual risk.

Privatization would gouge Social Security's Trust Fund, diverting needed payroll taxes and creating large cuts in Social Security's guaranteed benefits. The lofty idea posed by those who wish to privatize Social Security is that individual accounts will replace the retirement benefits part of Social Security for some individuals, depending on how the stock market performs and how savvy the risk-taker. SEC Commissioner, Arthur Levitt tells us that less than 50 percent of all Americans know the difference between a stock and a bond. Yet, some members of Congress are willing to throw America's retirement funds into the hands of uneducated investors. You can bet that the Wall Street investor will come out ahead in that equation.

The part that privatizing proponents do not tell us is that individual accounts cannot make up for the loss of Social Security disability or survivor benefits. Workers who become disabled well before retirement age, or spouses and dependents of workers who die well before retirement age will be left out in the cold. Individual accounts will not be able to subsidize the reduction in disability and survivor benefits when the GOP neglects to shore-up the current Social Security system in favor of a privatization scheme.

Social Security has a highly progressive benefit formula. Workers with relatively low earnings receive a much higher proportion of their wages as a retirement benefit than high-wage earners do. As a result, low-wage workers get back their payroll tax contributions in substantially fewer years than high-wage earners do. If retirement pensions were proportional to earnings or payroll tax payments, benefits for low earners would fall by over 25 percent. Poverty among the elderly, disabled, and survivors would increase. Welfare expenditures would rise. And many young and middle-aged workers would have to support parents, siblings, and other relatives who now manage independently because of the Social Security income benefits they receive.

This is of particular importance to minorities. Since African Americans and Hispanic Americans make up a disproportionately large share of low-wage workers (and a disproportionately small share of highly paid workers), the Social Security benefits they receive tend to return their payroll tax contribution in fewer years than is true, on average, for non-minorities.

Nine percent of all couples age 65 and older rely on Social Security for their entire income. Twenty-three percent of Hispanic couples do. In addition, Hispanics live an average of 3 years longer than the average American does. Those with a longer life span receive more monthly benefit checks, adjusted for inflation, from Social Security. Since Hispanics have a longer life expectancy, have lower wages and fewer covered years of employment, they benefit greatly from the Social Security system.

In contrast, the individual account plan imperils them to a greater risk for retirement. Hispanics could face a greater-than-average risk both of having their accounts run out of funds before they die and of losing a substantial amount of the purchasing power of the funds in their accounts to inflation as the years pass.

The current benefit rules of the Social Security system favor not only low earners but also survivors, spouses, and divorcees who have no or limited earnings.

Women's Social Security benefits are lower than men's benefits, due to their lower earning levels. Women earn only 70 cents to every dollar men earn for similar work. Women tend to be out of the workforce more often, and to hold part-time jobs, particularly during childbearing years. This results in lower Social Security benefits for women than men. Privatization only exacerbates the pension disparity.

More men (56.5%) than women (48%) have pensions. On average, men's pension funds are twice the size of women's pension funds. Women also make more conservative investments when they invest their retirement savings themselves. Women, ages 51 to 61, invest a lower percentage of their total assets in stocks, mutual funds, and investment trusts than men had. These assets are riskier, but have higher yields than others, such as certificates of deposits, savings accounts, or government bonds. On average, the ratio of riskier assets to total assets held by men was 8 percentage points higher than the same ratio for women. With very conservative investments, the investment return may not be adequate to see many women through their retirement years.

A completely privatized system cannot offer these additional forms of protection needed by minorities, women and the disabled. It would have to be supplemented with a separate government program that provided extra benefits to vulnerable groups. The Social Security program integrates retirement pensions and social assistance. By placing the social assistance program in a separate program, you remove one of the essential elements attributed for its success. The social assistance program could come to be regarded as welfare; a category of government spending that has had little sustained political support in the United States.

This is a formula for disaster. Individual accounts and privatization are the tools for destroying the Social Security system. The American worker has come to expect the peace of mind that Social Security provides. Congress must not allow privatization advocates to dismantle the cornerstone of Americans' retirement.

Chairman ARCHER. Without objection, any written statement by any Member will be included in the record at this point.

[The opening statement of Mr. Coyne follows:]

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

As we evaluate the various proposals to change Social Security and work to guarantee its long-term solvency, our first priority should be to keep the promises that we have made to millions of American workers and retirees. 96 percent of American workers participate in the Social Security system. Social Security provides retirement security, but it also protects workers and their families from poverty if they die or are disabled before retirement.

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 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.

Therefore, our first priority must be to maintain the solvency of the Social Security Trust Fund so we can pay all the benefits we promised to workers. Before we consider any other use for the surplus, we must be confident that the Trust Fund and its cash reserves are sufficient. Therefore, I support the President's proposal to shore up Social Security's reserves first, before using the budget surplus for anything else.

During the 106th Congress, our Committee will consider a number of ideas to improve retirement income for senior citizens. I strongly support this important goal, but I also believe we should be careful not to make new promises that we cannot keep. The surpluses are temporary, and any changes or additions we make will become permanent obligations.

I applaud the President for wanting to reduce poverty among elderly women, particularly widows. During last year's Oversight Subcommittee hearings on pensions, representatives of the Heinz Foundation told us that elderly women are much more likely to depend on Social Security for all of their income, and much less likely to have private pensions. I hope to be able to work with the Administration and Members of both parties to enact meaningful pension reforms that will give women, minorities, and low-wage workers greater long-term retirement security.

I look forward to hearing from today's witnesses and to moving ahead on a range of retirement security issues on a bipartisan basis. But I hope that the members of this Committee will move cautiously, doing nothing to undermine Social Security's successes and not making any promises we cannot keep.

Chairman ARCHER. The Chair welcomes both Jack Kemp and Reverend Jackson to the meeting this morning. We are honored and pleased to have you here and we welcome your ideas. And so for the moment, we will be happy to listen to you, and I am sure that the Members will want to inquire in turn after you have completed your statements.

Reverend Jackson, would you be kind enough to lead off.

Reverend JACKSON. Jack is older than I am. He has more seniority.

Mr. KEMP. I would be happy to lead off if you want.

Chairman ARCHER. The Chair has no preference between the two of you, so——

Mr. KEMP. Well, I hope the Chair leans a little to the right.

STATEMENT OF HON. JACK KEMP, CODIRECTOR, EMPOWER AMERICA; FORMER SECRETARY, HOUSING AND URBAN DEVELOPMENT; AND FORMER MEMBER OF CONGRESS

Mr. KEMP. I want to thank you, Mr. Chairman, and all your colleagues on this prestigious committee for having Jack Kemp and Jesse Jackson side by side talking about what you alluded to in your opening comments, and that Charlie Rangel, my friend and distinguished Ranking Minority Member, alluded to as well: Saving Social Security and Medicare, cutting taxes, making the economy grow.

But, Charlie, you left out one other commonality between Jackson and Kemp. We were both quarterbacks. I was a quarterback at Occidental College when he was a quarterback at North Carolina A&T along with several of my Buffalo Bills and San Diego Charger teammates. As quarterbacks, both of us have a vision of America that is audacious.

I was pleased and privileged to be with Charlie and Jesse at the Wall Street Project last Friday, the 70th birthday of Rev. Martin Luther King. I quoted Dr. King, who more than 30 years ago said that he had an abiding faith in America and an audacious faith in mankind.

I think we all share Dr. King's abiding faith in America here on the eve of a new century, a new millennium; and we have an audacious, hopefully, faith in mankind that we can come up with solutions that reach across the aisle, that reach across generations—as you talked about, Bill, Mr. Chairman. It is tough to call you Mr. Chairman after serving 18 years with you in the Minority.

Mr. RANGEL. I know the feeling.

Mr. KEMP. Don't eat into my time, Rangel.

You mentioned—Bill, you mentioned a woman in Morgantown, West Virginia, at West Virginia University. Regina. I didn't catch her last name. I would briefly tell the story of Annie Shriver, a woman according to the New York Times who passed away not long ago and left $22 million to Yeshiva University. Yeshiva is a great university. I have nothing against leaving your estate to Yeshiva or Notre Dame or Occidental, where I went, but her story is fascinating.

In 1946 she was a waitress according to the New York Times, and she had $4,000 after taxes because you can't do anything until you pay your taxes. And she lived in New York City, Charlie. She invested in three stocks, circa 1946, Merck, Coca-Cola, and IBM. The $4,000 grew to $22 million.

The power of compounded rates of return is the most powerful force on Earth to create wealth, to give people access to capital, to establish a shareholders' society, and I want to make sure that you know why she's my woman of the year. She is my woman of the year because she said to the New York Times when they asked her, "Why didn't you sell Merck, Coca-Cola, and IBM over the generations that you held onto it?" And she said, "Capital gains taxes were too high."

In other words, the tax system was biased toward holding onto the asset, using the asset as collateral, leveraging it against a loan, writing off interest on the debt on your taxes, but keeping the capital locked up. So a young black, Hispanic, Anglo male or female never got his or her access to capital, and I suggest that is the single biggest problem in the country with poor folks. I don't care whether it is Black Enterprise magazine, Kweisi Mfume or Jesse Jackson talking about building bridges to rural America, building bridges to urban America—how can we do it with a Tax Code that punishes the sale of an asset and rewards consumption and debt?

So my testimony is for the record, Mr. Chairman, we need to personalize Social Security. The President should be congratulated for touching the third rail, as are you. This debate is long overdue. Ideas, when their time has come, can rule the world, and the time has come to allow a working man or woman to take advantage of a compounded rate of return, to put initially 2, 3, 4 percentage points into a Roth IRA, an individual personal account.

The President said the government should do it. I agree with Chairman Greenspan. I don't want the government investing for me. I have got nothing against the government doing things it ought to be doing, but I am totally opposed as I hope this Committee will be to having the government making decisions between Microsoft and Netscape, between big tobacco and big gaming interests. It won't work. It is not a high enough rate of return.

Why don't we take the moment and suggest that every worker in America should end up like Regina or Annie Shriver and take advantage of the fact that since Franklin Roosevelt started Social Security—what, 1937—the rate of return on Social Security is 1.4, 1.5 percent. The rate of return on the S&P 500 has been 7.9, 8.5 percent. Every worker in America, in the AFL–CIO from Buffalo, New York, would be a billionaire by the time they are in their late forties.

Let's take this moment, Mr. Chairman, and allow the American people to be empowered instead of empowering the government. Let's enrich the workers, not enrich the government. Let's make sure we have a rate of growth that can sustain Medicare and Social

Security. A 1-percent higher rate of growth over 40 years does more to save Social Security than all the fixes that I have seen and all the legislative proposals to give tax credits there and development banks there.

We don't need tax credits in the Code. There are too many of them. Reduce the rates. Let's go back to a 28-percent rate. Let's get rid of the capital gains tax. Let's expand Roth IRAs. You want to increase savings: Lift the lid on Roth IRAs. They are flowing for middle America and low-income America and working America. In fact, it has fueled this Dow Jones at 9200, 9300 and this NASDAQ at all-time records.

I disagree with Chairman Greenspan. The stock market is not irrational. People want the rate of return that Regina got and Annie Shriver got, and I look forward to working with this Committee on behalf of empowering the working men and women and the poor of America, whether they live in Harlem or South Central Los Angeles.

Thank you very much, Mr. Chairman.

[The prepared statement follows:]

Statement of Hon. Jack Kemp, Codirector, Empower America; Former Secretary, Housing and Urban Development; and Former Member of Congress

Chairman Archer, Congressman Rangel, and members of the Committee, thank you for inviting me to testify today as we commence this important debate on the structure and role of Social Security in the 21st century.

Imagine an America early in the next century where every working man and woman is empowered with an ownership stake in the economy. An America where the ladder of opportunity reaches not only the boundless heights but also extends all the way down to the bottom so that families who begin with nothing can get a leg up onto the rungs of the ladder and eventually climb all the way to the top. In other words, imagine America not just as a constitutional republic, but as a vibrant shareholder democracy where everyone not only has a vote but also owns property.

This past Friday, it was a pleasure to be with Jesse Jackson at a conference sponsored by the Wall Street Project discussing how to make capitalism work for everyone. Jesse made the point that we have many bridges to move capital overseas—the Export-Import Bank, OPIC, and so forth—but no bridges to get capital into our own inner cities and rural areas. With all due respect, we don't need an OPIC for our urban and rural areas; we need tax rate reductions, tax reform, and personal retirement accounts. We have an incredible opportunity to put Social Security to work transforming the labor of every man and woman in America into capital.

Instead of forcing workers to put 12.4 percent of their wages and salaries into a government-run, pay-as-you-go retirement plan, which leaves them dependent on government for their retirement, why not give them the opportunity to divert most of their payroll tax payments into their own personal retirement accounts? Why not seize this opportunity to create an America where capital is abundant and each and every one of our citizens has a shot at the American Dream?

The American Dream is not confined to one class or one color or even one nation. It is the most powerful force for economic growth, wealth creation, and emancipation in human history. I believe that with the right policies, we can look forward to the promise that poverty as a permanent condition can be overcome not in the distant future but during our lifetime.

So, how do we save and strengthen Social Security? How do we encourage not just retirement security but retirement prosperity? How do we create this new shareholder democracy?

Let me be clear about something right at the outset. Economic growth is the key to the long-term health of Social Security and Medicare. And economic growth is essential for us to make the transition to the new shareholder democracy I have mentioned.

It's simple. Without higher economic growth than is currently projected, we cannot save Social Security and Medicare, and we cannot transform our nation's retirement system into one of opportunity and wealth accumulation.

That is why, above all else, we need a bold growth agenda—not a laundry list of legislative proposals, tax credits, and development banks.

We need tax reform, and we need to empower people to save and accumulate wealth.

Unfortunately, what we are seeing in Washington right now is a failure of both the left and the right. When I think of ambitious leadership for America, I think of big ideas, not big government. I think of policies that empower people to get rich, not enrich the government.

It appears in many ways that the era of big government is back. I say this with sadness. I was heartbroken that President Clinton, in his State of the Union address Tuesday night, failed to call the American people or the Congress to action. He failed to lay out an agenda that could capitalize on all the opportunities that lie before our nation. Instead he offered a laundry list of tax credits and new spending proposals.

But today we are discussing Social Security, and there was plenty in the president's State of the Union on which to comment.

What makes President Clinton's proposals on Social Security so frustrating is that it is clear he understands, and even acknowledged, two of the fundamentals of this debate:

(1) private markets have proven over 200 years to offer much higher real rates of return than government "markets;" and

(2) incentives drive decision making.

But what is so frustrating is that the president misapplies his insights. He would rely more on private markets to enrich government, not individuals, and he would use the power of incentives to perversely shape people's behavior to his liking, instead of giving them more choices.

The president's plan rests on two central tenets—debt reduction and government investment—both of which will actually harm Social Security. And his ill-conceived plan to subsidize worker saving through what he calls USA accounts misses the point entirely. We don't need to subsidize saving. We already found out with Roth IRAs that if you give workers a chance, and an opportunity, they are more than anxious to save on their own without any inducement from the federal government. Further, these USA accounts appear to be highly targeted and restrictive, only allowing certain Americans who fall into the right category to participate. We need equal tax treatment for everyone, not more class warfare.

While most of the president's ideas are relatively small when measured against the greatness of America, all the president's ideas mean bigger spending, artificially high taxes, and a perpetuation of a nanny state that micromanages our lives. And none of them go to the core objective I am here to talk about here today: economic growth as a means to distribute capital and expand opportunity.

The one "big idea" the president did offer—an absolutely terrible idea—must be shot down immediately. With his suggestion that the government invest the wages of hard-working American men and women, the president has proposed something antithetical to everything we believe in. This proposal also belies what is happening all over the world as country after country moves away from state ownership. The president has instead proposed a leveraged buyout of corporate America.

I know this committee can do much better than debt reduction, nationalization of the Trust Fund, and highly restrictive and targeted USA accounts.

Entrepreneurs of Ideas

The Ways and Means Committee has a difficult job ahead of it. A debate over the future of the single largest federal program—a program that affects virtually every American—will surely be challenging. But as we have seen throughout American history, humble men and women who are committed to doing great things for their country and their countrymen find ways to achieve the progress that is the hallmark of our nation. And I would venture to say that you and your colleagues in the full House and in the Senate will do the same.

Here are the ideas that I hope members will consider as we begin this debate:

A Good Start for the 106th

I understand that Majority Leader Armey has reserved H.R. 1 for President Clinton's legislative plan to reform Social Security. The Majority Leader's offer is significant because it shows the American people how important this issue is to the Members of this House, and it gives the president and the Congress a real opportunity to begin work on this issue in an environment of good will. Congress shouldn't wait, however, to lay out its own optimistic plan for the American people.

A Guarantee to Seniors

In my opinion, Congress should use H.R. 2 to take immediate action. In my mind, H.R. 2 should guarantee every penny of the Social Security benefits promised to every current retiree and to every person currently receiving Social Security disability payments. This legislation would pass overwhelmingly, and it would advance the debate in a number of ways.

First, guaranteeing benefits to current retirees is the right thing to do. It would immunize retirees from suffering any harm during the reform process.

Millions of Americans have planned their retirements assuming full Social Security benefits. Others are dependent on the program because they are disabled. They have put their trust in you. Yet, the United States Supreme Court ruled in Flemming v. Nestor (363 U.S. 603) that senior citizens have no legal right to their Social Security benefits. Congress may reduce benefits, or even take them away completely any time it desires. Listen to what the Court said:

> "The noncontractual interest of an employee covered by the Act cannot be soundly analogized to that of the holder of an annuity, whose rights to benefits are based on his contractual premium payments."
>
> "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 and which Congress probably had in mind when it expressly reserved the right to alter, amend or repeal any provision of the Act."
>
> "Termination of Appellee's benefits . . . does not amount to punishing him without a trial. . ."

Is it any wonder that many senior citizens view Social Security "reform" as a euphemism for "cutting benefits," and look forward to Congress's taking up this issue with a sense of dread?

Before embarking on a process to restructure Social Security for the 21st Century, I believe it is imperative that Congress give some peace of mind to retirees here in the 20th Century. In my opinion, Congress should protect seniors' Social Security benefits by converting the moral, but legally unenforceable, promise into an ironclad legal contract. A simple congressional resolution—even if signed by the president—stating Congress's intent to hold current retirees harmless under any reform plan will not suffice. Even though such a resolution might make it more difficult politically for the current Congress to reduce benefits, it would have no greater legal effect than the law already on the books.

The easiest and most straightforward way to convert today's Social Security promise into a legally binding Social Security contract would be to replace that promise with a tax-free, inflation-adjusted, annuity backed by the full faith and credit of the United States government, just like the bonds Uncle Sam sells to private investors, or the pension benefits the federal government provides to federal employees. These non-taxable annuities should give Social Security beneficiaries inviolate property rights to their annuity benefits and all promised cost-of-living increases, which could be defended in the courts if necessary. Such a bill would guarantee current retirees that they would receive every penny of the benefits they have been promised and that no one could take those benefits away.

Second, giving current retirees a legal guarantee against their benefits being cut would also make it much more likely that real reform could begin this year. Not only would this guarantee eliminate senior citizens' opposition to designing a new Social Security for younger workers, it would transform a large share of them into outright proponents of reform for the sake of their children and grandchildren.

A guarantee to seniors would eliminate much of the politics and demagoguery that we otherwise can expect to arise during congressional deliberations on how to fix Social Security. Indeed, the demagoguery already has begun. Just two weeks ago, I heard one distinguished Member of the House minority on C-Span's Washington Journal accuse a member of the majority of wanting to abolish Social Security. In the next breath he told tens of millions of viewers across America that he was going to make sure that Democrats protected seniors against any Republican attempt to dismantle Social Security. Scare tactics have no place in this debate. I call on Members of the minority to stop scaring America's old people before they poison the well on Social Security the way they did on Medicare in 1995. Instead, enact H.R. 2 as I have laid it out here, and let's get on with the business of designing a new Social Security retirement system for the 21st Century.

ECONOMIC GROWTH IS THE KEY TO "FIXING" SOCIAL SECURITY

The medium-term and long-term actuarial outlook for Social Security is bleak. The Committee is familiar with the details. The Social Security actuaries project that in 2013, Social Security payroll tax revenue will be insufficient to cover all benefits. By mid-21st-Century, the actuaries project that the combined employer/employee payroll tax rate of 12.4 percent (6.2 percent each) will cover only about 71 percent of promised benefits and would have to rise to about 17.5 percent in order to pay all promised benefits. By 2075, the actuaries project that the combined payroll tax rate would have to rise to about 18.5 percent to cover promised benefits.

The Demographic Problem.

The Committee also is familiar with one of the primary reasons for this situation. Demographics are turning against Social Security's unfunded, pay-as-you-go, tax-and-transfer scheme in which today's workers pay for the retirement of yesterday's labor force and must rely on the tax payments of future workers to support their own retirement when the time comes.

At the beginning of the Social Security program in 1937, there were 42 workers paying 2 percent of their first $3,000 of wages in taxes to fund the Social Security benefits of one retiree. Today, the are only 3.3 workers paying taxes to support each retiree, and Congress has increased Social Security benefits to the point that those 3.3 workers must pay 12.4 percent of their first $68,400 of wages to support one retiree. By 2030, according to the actuaries' intermediate economic assumptions, there will be only two workers per retiree, and they will have to pay 16.6 percent on the first $276,500 of wages and salaries in order to fund Social Security benefits.

Clearly, one key to fixing Social Security for the long run is getting to the point where workers fully fund as much of their own retirement as possible during their working years so that the only portion of retirement income paid by government on a pay-as-you-go basis is whatever safety-net Congress determines is necessary. In this regard, the major challenge facing the country in moving from a pay-as-you-go system to a fully funded system is how to allow workers to contribute sufficiently to their own retirement while they continue to pay taxes sufficient to fund the Social Security benefits of those retirees who were unable to fund their own retirement during their working years because every penny of their Social Security payroll taxes was required to support the pay-as-you-go system. This constitutes the so-called "transition problem" about which I will have more to say below.

The Slow-Growth Problem.

Beyond demographics, the even more important reason for Social Security's bleak outlook is the fact that the economy is not expected to continue performing as well as it has to date since the end of World War II. Since Social Security is funded by a payroll tax, only robust economic growth—specifically high employment levels and rising real wages—can ensure that revenues keep flowing into the program.

We have enjoyed almost uninterrupted economic growth for about 16 years now thanks to the turn around in tax and economic policy ushered in by Ronald Reagan. And while the 1990s will be known for general prosperity, we must remember that a bipartisan tax hike and credit crunch in 1990 followed on by another tax increase in 1993 have worked to hold economic growth below potential during this decade. In spite of stronger economic performance during the past several years, overall, we remain in the midst of the slowest economic recovery and expansion since the Great Depression, and official economic forecasts do not show any significant turn-around.

We still place too many burdens on our economy that prevent it from reaching its potential. Thankfully, Alan Greenspan's inspired effort at the Federal Reserve to eliminate inflation, and the contributions of America's high-tech revolutionaries in the marketplace to boost productivity, have combined to make it possible for the economy to overcome the continued drag placed on it by the tax system and unnecessary government regulations.

The actuaries project that the long-run growth potential of the American economy will decline by about one-third from its performance level throughout the post-war era. Since the end of World War II, gross domestic product (GDP) has risen 3.2 percent a year on average after taking inflation into account. The actuaries assume that during the next decade, the economy will not grow faster than 2.0 percent on an inflation-adjusted basis and that thereafter annual real economic growth will not rise above 1.5 percent for the next 65 years.

Surely, we can do better—we must. The retirement security of the baby boom generation and of their children depends on it.

I asked Empower America's chief economist, Dr. Lawrence Hunter, to estimate what portion of Social Security's financial problems derive from this projected decline in economic growth. The results of his analysis are noteworthy. Dr. Hunter found that a return to the same level of economic performance experienced between the end of World War II and 1990 would generate growth of real wages in covered employment roughly one percentage point a year above the rates assumed by the actuaries in their intermediate Alternative II scenario, which would put real wage growth at roughly 2.0 percent a year. Under these assumptions, the long-term payroll tax revenue shortfall would be reduced by almost two-thirds—from an anticipated 5.5 percent of taxable payroll in 2070 to 1.9 percent.

Any solution to the Social Security problem, therefore, simply must start with raising long-run real economic growth at least back up to it post-war norm of 3.2 percent a year in order to raise payroll tax revenue without raising payroll tax rates or increasing the wage base.

The Tax Code Problem.

Much of the Social Security debate has and will continue to revolve around the relationship between Social Security and taxes. These two issues are indeed intertwined, but not in the way that most Americans have been led to believe.

It is a paradoxical truth that the current tax code, which the president and his party—and all too often members of my own party—seek to perpetuate in the name of "saving Social Security," is actually one of the primary factors undermining Social Security.

The president's slogan last year—"reserve every penny of the surplus for Social Security"—regrettably premised the entire budget debate of 1998 on a false assumption, i.e., on the supposed competition between cutting tax rates and "saving Social Security." Americans were told that cutting tax rates would reduce the surplus, and that reducing the surplus would hurt Social Security. Nothing could be further from the truth. This untruth, unfortunately, has been repeated so often that people have come to believe it unthinkingly.

The notion that we can't afford to cut taxes because it would weaken Social Security has achieved the status of conventional wisdom among many even in my own party. It is simply wrong, and it is hurting the economy. Far from strengthening Social Security, the hoarding of surpluses in Washington is stimulating more federal spending. Although the president's slogan scared Republicans out of cutting taxes last year, he and Members of both parties in Congress eagerly joined in spending about a quarter of the surplus last year.

As a general rule, surpluses always should be returned to the taxpayers: they are simply one representation of artificially high taxes, an overcharge to taxpayers who have already fulfilled their obligation to fund essential government operations. If we ever needed proof that government cannot be trusted with surpluses, last year's experience demonstrated beyond a shadow of a doubt that unless Congress returns surpluses to taxpayers, they will be spent.

If the surplus is not returned to taxpayers, it can only be spent on government programs or used to reduce the total government debt. Surpluses can't be used to help Social Security in any way, shape or fashion.

Last year, Congress made the fatal mistake of giving the public the impression that it thought cutting tax rates and saving Social Security were incompatible, or at least in significant competition with one another, requiring major tradeoffs. In my opinion, Republicans compounded this false perception by pretending along with Bill Clinton that hoarding budget surpluses in Washington and using them to retire federal debt somehow strengthened Social Security.

Far from being in competition with Social Security reform, tax rate reductions and the eventual overhaul of the entire tax code are vitally important to the financial health of our Social Security system. You can't do one without the other. The current tax code is burdensome and inefficient. The economic damage done by its high tax rates and multiple taxation of capital income more than offset any possible economic benefit derived from running budget surpluses and retiring debt. A reasonable estimate of the inefficiency of the current tax code is that for each additional dollar in revenue raised through the tax code, the burden of extracting the higher revenue from the private economy retards the growth of output by about $1.50. Running budget surpluses to retire federal debt with the hope of strengthening Social Security is like taking two steps forward and three steps back. The longer such a policy persists, the further behind Social Security will fall.

John Maynard Keynes said that during peacetime, tax rates should not exceed 25 percent. Today, many working class people face marginal tax rates of more than 30 percent and too many middle class people confront marginal tax rates above 50 percent. Last year, federal taxes took more than 20 percent of GDP, an all-time peacetime high, exceeded only during the height of World War II. We punish wealth accumulation with the strangest tax on the books: the capital gains tax. And we still hold back many inner-city Americans with schools that are grossly inadequate and with Soviet-style regulations that discourage new enterprises.

Don't forget, the ultimate source of improved productivity—and, therefore, economic growth—is always human ingenuity, not balanced budgets or government "investment," but human ingenuity. And when we tax people, we tax their ingenuity. We tax their incentive to work hard and to invent and to save and to succeed.

We all want a dynamic and growing economy. But many in Washington seem to have forgotten exactly how the federal government keeps a thumb on the scales against long-term prosperity with ill-conceived policies. They seem to have forgotten the lesson of the 1920s, 1960s, and 1980s: The best thing the government can do to foster economic growth is to remove its thumb from the scales. That was Ronald Reagan's economic model. It is the American people who do the work and who grow the economy, and the best thing Washington can do to assist them is to simply get high tax rates and excessive regulations out of their way.

Ronald Reagan's key insight was that there is a complimentary, dynamic relationship between expanding the economic pie and raising more revenues for government. As long as we persist in the fictions of static analysis, we will remain paralyzed, unable either to cut tax rates or use part of the surpluses to create private investment accounts to save Social Security for today's workers. That is why I strenuously oppose any plan to phase in tax rate reductions over 10 years—a ridiculously long time—contingent upon the emergence of a so-called "on-budget" surplus. The distinction between "Social Security surpluses" and "on-budget (non Social Security) surpluses" is nothing but a budgetary artifice. It has been concocted to pretend that surplus revenues cannot be returned to taxpayers because they are required to pay fictitious interest into a fictitious trust fund. Instead of pretending that the fictitious Social Security Trust Fund precludes tax rate reductions, I propose that we convert the Trust Fund into real assets and distribute them back to the people who have been paying the Social Security overcharge since 1983. I will discuss this idea in greater depth below.

Only robust, long-term economic growth can generate sufficient revenues to guarantee promised benefits to retirees, maintain the federal safety net, and facilitate a transition to a new, fully funded, market-based system. And bold tax rate reductions, and eventually a complete overhaul of the tax code, will be required to generate robust growth over the long haul.

That is why I propose a major, across-the-board tax rate reduction on capital and labor income as a fundamental component of any Social Security reform.

That is why in 1999, as its first step to "save" Social Security, Congress should cut tax rates deeply, across the board, for every taxpayer. Specifically:

• The top marginal income tax rate should be brought back down to at most 28 percent, where it was when Ronald Reagan left office, and the 15 percent bracket should be cut by one third to 10 percent.

• The capital gains tax rate also should be cut in half, to 10 percent, if not eliminated altogether.

• Also, eliminate the income restrictions and remove the contribution limits that apply to Roth IRAs. Why on earth should Congress restrict any worker from contributing as much as he or she wants to their Roth IRAs when the so-called "revenue loss" is minimal even under the static revenue estimating methods used at the Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO)?

• Repeal the Social Security earnings test that drives senior citizens that want to work out of the labor force; and at least repeal the 1993 increase in the tax on Social Security benefits. I would go further and urge you to fundamentally overhaul the tax treatment of Social Security benefits to eliminate the severe marginal tax rate penalties imposed by the current method.

• Finally, eliminate the death tax altogether. It actually loses revenue and is completely at odds with the kind of retirement security system we seek to build for the 21st Century.

Beyond these actions, I believe we should set the ambitious goal of overhauling the entire tax code within the next few years. It must be simpler. It must be fairer. And it can no longer be used as a tool to punish. It must instead be transformed from a bureaucratic tool of social engineering into a fountainhead of opportunity and growth.

We must not shrink from bold action when bold action is called for. Remember John F. Kennedy's words?

> "It is a paradoxical truth that tax rates are too high today and tax revenues are too low, and the soundest way to raise the revenues in the long run is to cut the rates now. . . The purpose of cutting taxes now is not to

incur a budget deficit, but to achieve the more prosperous, expanding economy which can bring a budget surplus."

CREATING A SHAREHOLDER DEMOCRACY

While stronger economic growth could realistically solve about two-thirds of the Social Security problem, growth alone is not enough. The demographic problem is so great that even a restoration of post-war growth rates would only delay for a decade—until 2022 or thereabouts—the time when Social Security payroll tax revenues cease to cover all benefits. But that decade's worth of breathing room is vital. That's why in order to make up for the rest of the projected shortfall in Social Security we also need to begin this year to allow workers to direct a substantial portion of their payroll taxes into personal investment accounts similar to Roth IRAs.

There is a second reason why we must begin the transition to investment-based private funding for retirement. Even if it were possible to maintain the pay-as-you-go, tax-and-transfer New Deal structure of Social Security, why would workers want to? Certainly, the pay-as-you-go tax-and-transfer system is not required for the government to maintain an adequate retirement safety net for all Americans.

Even if we could solve all of Social Security's financial problems without dramatically changing its structure, we would still be left with a system that pays benefits too small to justify the high FICA tax rate. That is, even if we right the program's financials, Social Security still fails on the rate-of-return question. The fundamental truth is that not even higher economic growth will make Social Security an acceptable deal in terms of the rate of return to the taxpayer.

Because of its high-tax/low-rate-of-return structure, the current system denies many citizens, especially lower-income Americans, the opportunity to invest, accumulate real wealth, and achieve not just retirement security but retirement prosperity.

Moving towards a privately controlled investment-based system could go a long way towards erasing the class divisions that still divide us in these otherwise prosperous times.

Middle-aged taxpayers send 12.4 percent of their wages to Washington in exchange for Social Security benefits equaling a 1 or 2 percent real rate of return. Today's young workers do even worse, with some actually paying more into the system than what the government promises to pay back during their senior years. This means that for certain demographics—like young, single black males—the government mandates an investment with a negative real rate of return.

Consider the following facts reported in a recent Heritage Foundation report:

- Currently, Social Security's inflation-adjusted rate of return is only 1.23 percent for an average household (assumes two, 30-year-old earners with children in which each parent made just under $26,000 in 1966). Such a couple would pay (including employer share of tax) a total of about $320,000 in Social Security taxes over their lifetime. They can expect to receive benefits of about $450,000 in 1997 dollars before applicable taxes when they retire at age 67.
- Had this couple placed that same amount into a conservative tax-deferred IRA investment such as a mutual fund invested half in Treasury-bills and half in equities, they could expect a real, inflation-adjusted rate of return equal to 5 percent. Their total pay-out would be $975,000.
- The rate of return for minorities is actually negative because of lower life expectancy. For example, single black males born after 1959 will get back only about 88 cents for every dollar paid in payroll taxes.

That's not just bad economics, it's immoral. It points out the real reason to privatize Social Security: Today, Social Security usurps individual freedom and initiative, fosters dependence on government, provides unnecessarily small retirement benefits (although more than the program can afford) and yields workers an unacceptably and unnecessarily low rate of return.

Personal accounts have an added advantage in that they comprise real assets that can be passed on, in tact, to spouses and eventually to other loved ones—unlike the current system in which a widowed spouse under 60 receives a one-time death-benefit payment of $255 and a reduced monthly benefit. This feature is just one more positive factor in building a system that is good for families, not just good for the economy.

A new, fully funded system would also eliminate the possibility of future actuarial imbalances brought about by demographic aberrations, like the baby boom, that are inherent in any tax-and-transfer program. When every American owns real assets, demographics become irrelevant.

As an aside, there is another important point to be made. Personal retirement accounts, contrary to the statements of some privatization backers, will only have a positive, dynamic impact on economic growth if we couple this reform with the other prerequisites for strong growth: a simple, low-rate tax code, a regulatory structure more friendly to entrepreneurial activity, and of course sound money. One need only look to Japan—where the saving rate is incredibly high but investment opportunities with attractive after-tax rates of return are scarce—to understand why. There must be opportunities to put this newfound capital to good use in a marketplace free from unneeded restraints. Otherwise, the newly available flow of capital will simply bid down the rate of return it can fetch in the market. That's why restructuring Social Security, cutting tax rates and eventually overhauling the federal tax code are so inextricably connected.

As significant as increasing retirement income and stabilizing Social Security's financials are, we cannot fail to appreciate how dramatically personal retirement accounts will change America's cultural and socioeconomic landscapes.

I can't think of a better way to directly move capital from Wall Street to Main Street, and from the government to the people, than to allow each worker to become a saver, an owner, and indeed, a capitalist—with personal retirement accounts.

If we don't change Social Security, we are locking many of our urban and minority citizens in an economic cage. The FICA tax, which for many is more oppressive than the income tax, prevents them from breaking free. If we insist on the status quo, we are telling them that our highest goal is to promise them a pitifully small return because we don't want to subject them to the risks of the American economy. All the while, these urban and minority citizens are watching from the sidelines as their fellow Americans get rich.

It is estimated that almost half of all Americans, about 125 million, now own stock in publicly traded corporations, either directly or through pension funds. These investors have greatly benefited during the stock market's extended bull run. But what about those for whom the payroll tax is an effective prohibition on saving and investing? What about those who have not been able to participate in our nation's broader prosperity?

The Great Emancipator Abraham Lincoln said:

> "I take it that it is best for all to leave each man free to acquire property as fast as he can. Some will get wealthy. I don't believe in a law to prevent a man from getting rich; it would do more harm than good. So while we do not propose any war upon capital, we do wish to allow the humblest man an equal chance to get rich with everybody else. When one starts poor, as most do in the race of life, free society is such that he knows he can better his condition; he knows that there is no fixed condition of labor for his whole life. I am not ashamed to confess that twenty-five years ago I was a hired laborer, mauling rails, at work on a flatboat—just what might happen to any poor man's son. I want every man to have a chance."

Unfortunately, today's Social Security system locks capital away from lower-income men and women. Today's system keeps them from getting rich. We should adopt Lincoln's philosophy and emancipate people from poverty by freeing up capital.

Remember, benefits build dependence; assets build hope.

When I was HUD Secretary, I always talked about how important ownership is. When people own their homes, as opposed to renting subsidized public housing units, they take care of their investment. And they take better care of the neighborhood, too.

In the same manner, if every American owned stock, if they had a stake in the broader American economy, each of them would demand policies from their government that encourage opportunity and growth. This is the virtuous cycle at work.

We may decide to start small by allowing workers to dedicate just a few percentage points of the payroll tax to these personal accounts. But I envision a day in the not too distant future where individuals may voluntarily dedicate every dollar of his or her payroll-tax contribution to their personal retirement account, and to private life and disability insurance policies.

Reason should calm any fears we might have about making some of these changes that, admittedly, are substantial. No one is suggesting, certainly not I, that we dismantle the Social Security safety net for those who truly need it. We would still provide a basic federal retirement benefit to the neediest Americans, but we would do so without mandating that every other citizen receive benefits in the same inefficient manner. We would still provide every worker a basic retirement-income guarantee. The wealth generated by these and other growth-oriented policies, along with the new federal guarantee I mentioned, will allow us to take care of the truly dependent and indigent, and anyone else who for one reason or another is unable to save enough during their working years to provide themselves an adequate retirement income.

Principles for Reform

During the past few years, there has been an outpouring of research on how to go about privatizing Social Security. Each plan offers some insight on what to do and what to avoid. I don't come today armed with a specific plan right down to time tables and benefit schedules. Instead, I would like to offer some general observations and suggest some guiding principles by which to design a process of reform and to evaluate the various plans that will come before you.

Beware of Grand Schemes.

First, I would say beware of grand schemes. Given recent political history, I am wary of grandiose national plans that purport to sweep away all our problems with one large, swift brush of the broom.

We shouldn't pretend that we know, or can figure out, how to plan each and every American's retirement. Nor should we labor under the delusion that it is possible to correct the serious problems of a program that makes up a quarter of the federal budget with one master blueprint. We should not pretend that we can ensure the books will balance over the next 75 years with a single piece of legislation. And we shouldn't try. What we need to do is make the correct directional choices that point us along the right path and that give millions of working Americans the incentive and opportunity to build wealth for themselves.

Once Americans understand the journey on which we have embarked, they will approve, applaud, and vote for more.

I believe that Social Security plans that propose detailed, 50-year, "down-to-the-dollar" programs for revolutionizing our retirement system may suffer from some of the same deficiencies and meet the same fate as the national health plan idea. Especially troubling is the proclivity of some plans to require people to make huge, life-altering decisions about their retirement future based on inadequate information. For a reform plan to be successful, it must allow for people to make many small incremental choices throughout their working careers, giving them the ability to adjust their course frequently and even to change directions dramatically as their circumstances change. We must avoid locking individuals into a straight-jacket in order to make the plan's 75-year financials add up on paper. Anyone who has ever written a business plan knows exactly what I am talking about.

Make the Social Security Trust Fund Real and Privatize It.

Second, Congress must break out of the prison created by the fictitious Social Security Trust Fund. It is not real. There are no real assets in the Trust Fund and the annual "interest" accrued in the Trust Fund is not real either. Both are nothing more than accounting conventions that allow the federal government to keep track of how much of future Social Security benefits Congress has pledged to pay for out of the general fund of the United States. The fact that the Trust Fund "goes broke" in 2032 simply means that Congress has not pledged enough general revenues to cover all benefits promised. We could wipe the Trust Fund from the books tomorrow and absolutely nothing real would change.

Not only does the fictitious Trust Fund confuse and mislead people, it is being used to thwart privatization and across-the-board tax cuts by those who would keep tax rates high and "fix" Social Security by raising taxes and cutting benefits.

Therefore, I propose that Congress:

- transform the "special issue" federal bonds held in the Trust Fund (i.e., the general fund's IOUs) into real assets by converting them into marketable, long-term, federal zero-coupon bonds with maturity dates beyond 2013; and then
- privatize the Trust Fund assets by distributing the bonds into the private retirement accounts of the taxpayers and retirees who paid in the excess Social Security payroll taxes since 1983; requiring that
- any withdrawals of proceeds from their sale or redemption reduce the individual's Social Security benefits dollar for dollar.

Do Not Raise Taxes or Tamper with Social Security's Benefit Guarantee to Pay Transition Costs.

Finally, the proposal to transform the Social Security IOUs into real assets and distribute them to overcharged taxpayers illustrates a very important principle that I believe Congress should observe in dealing with the so-called transition problem. Under no circumstances raise taxes or reduce the amount of retirement income currently promised by Social Security to pay for these costs.

The reason not to worry about transition costs is simple and doesn't require complex calculations and mathematical simulations to justify. We believe Social Security should be privatized because in the long run everyone can get a better rate of return on their retirement contributions in private accounts. In other words, all else equal, future retirement benefits will be higher under a privatized system than under the current tax-and-transfer program. This higher income will lessen the burden on Social Security while enabling the federal government to maintain a retirement income guarantee. Also, I have already suggested that we commit ourselves to pay every penny of benefits promised to current retirees. Therefore, we should not shrink from guaranteeing every current worker a retirement income no less than they would be entitled to under the current program.

There is no need to reduce the retirement-income guarantee that workers are currently promised by Social Security. In a nutshell, we should plan explicitly to cover "transition costs" out of the general fund of the U.S. Treasury. To the maximum extent possible we should rely on the higher revenues generated by faster economic growth, controlling the growth of spending, and borrowing the remainder. I can think of no more justified purpose for federal borrowing than to cover the cost of transition from the current tax-and-transfer Social Security system to a new privately controlled investment-based system for the 21st Century.

Misinformation and Counterproductive Proposals

As I indicated earlier, it is widely reported that the only possible solution to Social Security's problems involves some combination of tax increases and benefit cuts—a version I might add of an earlier misconception about the federal budget deficit, which also was proven wrong by events. Remember when it was widely held that the overall federal budget deficit was so large that it would require huge tax increases and spending cuts to eliminate it?

Instead, Congress cut taxes and spending continued to rise. The budget was balanced and surpluses emerged because the economy grew faster and Congress simply stopped increasing spending faster than the economy was growing.

The situation with Social Security is similar. I have described two strategies above—cutting tax rates to increase long-term economic growth and allowing workers to begin investing in personal retirement accounts—that eliminate the need for these painful "remedies."

Both of the generally accepted fixes, in fact, will only exacerbate the key problems with the current system.

We should resist any efforts to increase the Social Security payroll tax rate, the taxable earnings level for workers, or the taxable benefits level for retirees. The problem with today's Social Security system is that the government asks too much from workers and gives back too little in return. In other words, given the near-zero real rate of return today's young adults can expect from Social Security's current structure, payroll taxes are already much too high. Tax increases would reduce these already paltry returns, while doing little to shore up the system.

For example, eliminating the earnings cap for workers as some have suggested would increase the top federal marginal tax rate from 41 percent to 47.2 percent, and over 53 percent if the employer's contribution is taken into account. This isn't tinkering with the system—this is a tax increase of monstrous proportions, sure to hurt the overall economy and Social Security in the process.

We should also resist additional payroll tax rate hikes whether they are proposed as a way to bring more revenues into a cash-strapped, tax-and-transfer system or as some sort of new mandatory savings requirement. And increasing taxes on current retirees' Social Security benefits is quite simply a cruel hoax.

Payroll taxes are already too high, and retirement benefits are already too low. Let's not do anything to make these problems worse.

Finally, the primary reason the actuaries project abysmally low economic growth is the projected decline in labor force growth. One way to mitigate this expected decline is to allow senior citizens that desire to work to remain in the labor force longer. As Americans live longer and healthier, as America's population ages and the proportion of people in the 16 to 65 age groups declines, and as high technology continues to revolutionize work, the demand for older, more experienced workers will rise. In fact, successful mobilization of older workers will be essential to maintaining an adequate workforce that will keep the economy performing at its peak capacity. Congress should do everything possible to remove artificial barriers, such as the Earnings Test and taxes on Social Security benefits to allow senior citizens to continue working as long as they desire. We should also continue traditional American immigration policies that encourage talented and motivated people from all over the world to come to our shores and contribute to the building of our nation.

Reject Federal Government Investment in Private Debt and Equity Markets.

As I mentioned at the outset, the president wants to let the federal government invest part of payroll tax revenues in private debt and equity markets. This is an absolutely terrible idea. Giving greater control over people's lives and U.S. firms to the federal government by making Washington a part owner in numerous publicly traded companies would be dangerous and entirely counterproductive. We should empower people to get rich, not the federal government. Government investing of the Trust Fund in private markets is a big-government power-grab, and the idea should be shot down before it ever leaves the ground. If you have any doubt that this is a pernicious idea, simply reflect back on the Clinton administration's earlier proposals to mobilize private pension funds for social investment, so-called Economically Targeted Investments (ETIs). I shudder to think what this administration would do if it ever got its hands on companies' stock directly.

CONCLUSION

As we approach the new millennium, let us not "propose any war upon capital." Instead let us "allow the humblest man and equal chance to get rich with everybody else."

I, like Lincoln, want every man—and every woman—to have a chance.

To this end, therefore, I urge Congress to:

- adopt policies that encourage sustained economic growth, including broad-based across-the-board tax rate reductions and eventually a complete overhaul of the federal tax code;
- guarantee the Social Security benefits of current retirees with a tax-free, inflation-adjusted annuity backed by the full faith and credit of the United States government;
- immediately allow young and middle-aged workers to begin dedicating a significant share (at least 3 percentage points) of their FICA contribution into personal retirement accounts, and increase that percentage as quickly as possible;
- convert the Social Security Trust Fund IOUs into real assets (marketable federal bonds) and distribute them back to overcharged taxpayers; and
- reject counterproductive tax increases, benefit cuts and schemes to get the federal government into the investment business.

These are the types of directional choices we should make at the outset that will get us off to a flying start yet still allow us the flexibility to make mid-course corrections in the coming years.

Thank you, Mr. Chairman. I would be pleased to take questions from the Committee.

Chairman ARCHER. Thank you. Thank you, Congressman Kemp, Secretary Kemp, my friend Jack.

Mr. KEMP. Former.

Chairman ARCHER. Reverend Jackson, we are pleased to have you before the Committee today. We will be very happy to hear your ideas.

STATEMENT OF REV. JESSE L. JACKSON, SR., FOUNDER AND PRESIDENT, RAINBOW/PUSH COALITION

Reverend JACKSON. Thank you, sir. Chairman Archer, Congressman Rangel, distinguished representatives, ex-quarterback evangelist Jack Kemp, let me express my appreciation for the opportunity to speak with you today about the fundamental issue of Social Security. I am here not as an actuary or an accountant, but as an American concerned about defending Social Security, which is so vital to working and poor families.

I do not provide a partisan policy prescription from the left or the right, but offer the common concerns of the moral center.

Let me speak briefly about three major topics: The importance of Social Security, what it means to save Social Security, and a perspective on the President's reform proposals outlined Tuesday evening.

Social Security is vital to American families. Legislators, the affluent, those with unions enjoy pensions for retirement, but many Americans do not. For them, Social Security is the difference between decency and despair. Two-thirds of all old Americans rely on Social Security for half or more of their income. Thirty percent of the elderly get virtually all of their income, which accounts for 90 percent or more, from Social Security.

Social Security is America's most successful poverty program. Without it, more than half of all those over 65 would live in poverty.

Social Security is America's most vital workers' benefit. With it, working people can enjoy retirement without terror. This guarantee grows more important as pensions grow more rare. It grows more important as the stagnating wages witnessed over the last 2 decades make it harder and harder for families to save.

Social Security is America's most vigorous family program. With it, families are protected not just in retirement, but in tragedy, sudden death, disability or disaster. Its benefits go to workers, to spouses, to children.

The contrasts with all the recommendations for private accounts are stark and clear. Social Security provides family based benefits for spouses and children, literally widows and orphans. Private accounts offer no such guarantee. Social Security provides support for the families of those who are disabled through no fault of their own. Private accounts offer no such guarantee.

Those who stand for family values should join us in the fight to save Social Security. There is no more important program for families, for traditional families in which one parent stays home with the children, for families in which both parents work, for families struck by sudden tragedy. Every program to privatize or partially privatize Social Security, by definition, turns the program away from supporting families and toward individual risk.

Having challenged Conservatives to join us, I was gratified to see that Gary Bauer, former head of the Family Research Council and now potential Republican presidential aspirant, has issued a ringing defense of Social Security and critique of the "perils of privatization." As he states, The very structure of Social Security upholds intact marriage, a father's responsibilities and a mother's sacrifice. As a Conservative, he warns against those who appear to "treasure change more than stability by gambling away the solid past on an economic future based on abstract economic theories." This is not about left or right, but the moral center, about right and wrong, safe and high risk.

Social Security is particularly important to people of color and women. Three of four older African-American and Latino households rely on Social Security for half or more of their retirement income. People of color are less likely to have savings income or receive a pension, and they are more likely to need Social Security's survivors and disability benefits. Every major proposal to privatize Social Security would also make deep cuts in guaranteed benefits, raise the retirement age, and slash disability benefits; all of these would be hardest on those who rely most on Social Security, especially people of color.

Similarly, Social Security provides women—particularly the divorced, widows or those never married—with the bulk of their retirement income. Women are also less likely to have decent pensions or adequate savings. And they benefit from Social Security's progressive payout for low-income workers, its family protections against disability or death. Since women tend to live longer, they benefit even more from Social Security's guarantee of a benefit, protected against inflation that lasts until you die.

What does save mean? As political leaders, you know how popular Social Security is. That is, virtually every candidate for Congress in the last election pledged to save Social Security. In Washington, of course, common words sometimes have uncommon meanings. What do we mean by save?

Last month I joined with leaders from all corners of our society—women's and civil rights groups, churches, unions, small businesses, young people—in the New Century Alliance for Social Security. The alliance came together over a set of principles about what save means. I append them to my testimony and recommend them to you as a guide for your work.

[The following was subsequently received:]

A Statement of Principles for a New Century Alliance for Social Security

Social Security is vital to millions of Americans. For over sixty years Social Security's retirement, disability and survivors benefits have kept generations of people out of poverty and provided a secure base for middle class retirement. Most Americans will depend upon its portable, progressive and guaranteed retirement benefits and its social insurance protections to provide at least half of their income. We must all work to ensure that Americans of all ages will continue to be protected by Social Security from serious loss of income because of old age, disability or the death of a family's wage earner.

Congress and the President should work to strengthen the finances of Social Security for future generations. "Privatization" proposals to shift a portion of Social Security taxes to private investment accounts would inevitably require large cuts in Social Security's defined benefits and make retirement income overly dependent on the risks of the stock and bond markets.

We join together to insist that Social Security's central role in family income protection must not be compromised, and we endorse the following principles for Social Security reform:

- Social Security's benefit structure should remain universal and portable, guaranteeing monthly benefits that provide a decent income and are adjusted to keep up with inflation for as long as you live.
- Social Security must continue to provide risk-free disability insurance protection for workers and their dependents. It must also continue to provide survivors insurance for spouses and children of deceased workers, as well as continuing to provide benefits for those adults with severe disabilities who are dependents or survivors of their parents. These crucial insurance functions must continue without harmful benefit reductions.
- Beneficiaries who earned higher wages during their worklife should continue to receive benefits related to their earnings history, and Social Security should continue to replace a larger share of low-income workers' past earnings as a protection against poverty.
- We must take care that the impact of changes in the Social Security system not fall disproportionately on lower income groups, or on those whose worklife has been physically demanding. Any changes should not make the financing of Social Security any less progressive.
- Many privatization proposals finance the cost of private accounts partly by increasing the retirement age. Raising the age at which people can collect benefits is the equivalent of a benefit cut, with especially onerous impacts on those in physically challenging jobs or on groups with lower life expectancy.

• Basic benefit protections for women -who have lower lifetime earnings and more workforce absences because of care giving for children, parents or spouses -should be preserved and strengthened.

• While Social Security should continue as the foundation of our social insurance and retirement system, we also need new policies to encourage employers to provide good pensions and to spur private savings. But this should be done in addition to, rather than at the expense of, the existing Social Security benefit structure.

• Private accounts should not be substituted for Social Security's current defined benefits. Diversion of Social Security tax revenues to pay for private investment accounts makes the projected long term Social Security financing problems more severe, forcing deep benefit cuts, such as large increases in the retirement age, and weakens the system's ability to follow the principles above. Social Security benefits should not be subject to market fluctuations.

• We should save Social Security first, instead of using budget surpluses to pay for tax cuts.

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Reverend JACKSON. The principles are clear. Social Security should remain a program of shared security, not one of individual risk. Its benefits should remain universal and portable with the guarantee of a decent income, protected against inflation for as long as you live. It must continue to provide disability insurance protection to workers and survivors insurance for widows and orphans. Its financing and its payout should not put more burdens upon those who earn less. We reject raising the retirement age.

We recommend saving Social Security first, rather than using budget surpluses for tax cuts. Saving Social Security would prohibit substituting private risk accounts for Social Security's defined benefits.

In this day of polling and positioning, there are those who believe that you can fool most people most of the time. But those of us who joined the Alliance for Social Security want to put all on notice. Americans have a very clear idea of what Social Security is and what it means to save it. We respectfully suggest those who trample the idea may find themselves more personally involved with Social Security than ever due to their early retirement.

Last, the President's proposals. The President's proposals provide a sound basis for reform. As he said, the best way to keep Social Security solid is not to make drastic cuts in benefits, not to raise payroll taxes, and not to drain resources from Social Security in the name of saving it. He would save Social Security first, using the bulk of hoped-for budget surpluses to bolster the current Social Security system. He would keep the system of shared security intact, not tampering with the retirement age or its benefits structure. If any money is left after Social Security and Medicare are saved, he would create separate private accounts, offering middle- and low-income workers a matching incentive for the money they save.

While the details of the USA accounts remain to be seen, as long as they remain an additional program to spur saving, not a rakeoff of Social Security, they do no violence.

Last, the President will also invest some of the Social Security Trust Fund into stocks in a manner protected from political influence. I personally question much of the exaggerated expectations of increased return from investing stocks over time. I agree with Secretary Rubin and Federal Chair Greenspan that whatever returns may end up awash with the declining demand for bonds, but government investment of a small portion of the trust fund, essentially what every State does now, is not that much of a risk.

A final word on the coming debate, one thing you should know: America will participate in the debate over Social Security, the groups associated with the New Century Alliance are already scheduling townhall meetings across the country. AFL–CIO President John Sweeney has promised to launch the largest mobilization our churches and our Nation has ever seen.

The things you can do to help: First, make certain that all voices are heard, for example, the one-third of Social Security is for people with disabilities. This Committee should ensure that the GAO or Congressional Research Service examines publicly how each reform proposal will impact upon those with disabilities. Their representatives should be given star billing. The same is true for widows or for the 4 million children who usually are not counted.

Second, since the impact on workers and retirees is the most important measure of reform, I recommend that a beneficiary impact statement be prepared for every reform proposal by the Social Security Administration. The document should examine the hypothetical benefits and costs to workers, children, and survivors. People should have an opportunity to review it; the stakes are far too high for a back-room, last-minute deal.

You have a historic covenant to fulfill. The promises of Social Security should not be abandoned. The promise to Social Security should not be violated. Its future must be secured not by radical experimentation or dismantling, but by sensible steps and sound judgment.

I look forward to working with you in this effort, Mr. Chairman. Thank you very much.

Chairman ARCHER. Thank you, Reverend Jackson.

We are today beginning the process of listening to diverse views.

Reverend JACKSON. Thank you.

[The prepared statement follows:]

Statement of Rev. Jesse L. Jackson, Sr., Founder and President, Rainbow/PUSH Coalition

Chairman Archer, minority leader Rangel, distinguished representatives, colleagues.

Let me express my appreciation for the opportunity to speak with you today about the fundamental issue of Social Security.

I am here not as an actuary or an accountant, but as an American concerned about defending Social Security which is so vital to working and poor American families. I do not provide a partisan policy prescription from the left or the right, but offer the common concerns of the moral center. Let me speak briefly about three major topics—the importance of Social Security, what it means to Save Social Security, and a perspective on the president's reform proposals outlined last night.

I. THE PROMISE OF SOCIAL SECURITY

Social Security is vital to American families. Legislators, the affluent, those with unions enjoy pensions for retirement, but many Americans do not. For them, Social Security is the difference between decency and despair. Two-thirds of all older Americans rely on Social Security for half or more of their income. Some 30% get virtually all of their income—90% or more—from Social Security.

Social Security is America's most successful poverty program. Without it, more than half of all those over 65 would live in poverty. Instead, our parents are now more protected against destitution than our children are.

Social Security is America's most vital workers' benefit. With it, working people can enjoy retirement without terror. This guarantee grows more important as pensions grow more rare. It grows more important as the stagnating wages witnessed over the last two decades make it harder and harder for families to save.

Social Security is America's most vigorous family program. With it, families are protected not just in retirement, but in tragedy—sudden death, disability or disaster. Its benefits go to workers, to spouses, to children.

The contrast with all recommendations for private accounts are stark and clear. Social Security provides family based benefits for spouses and children, literally widows and orphans. Private accounts offer no such guarantee. It provides support for the families of those who are disabled through no fault of their own. Private accounts offer no such guarantee.

Those who stand for family values should join us in the fight to save Social Security. There is no more important program for families—for traditional families in which one parent stays home with the children, for families in which both parents work, for families struck by sudden tragedy. Every program to privatize or partially privatize Social Security by definition turns the program away from supporting families and towards individual risk.

Having challenged conservatives to join us, I was gratified to see that Gary Bauer, former head of the Family Research Council and now potential Republican presidential aspirant, has issued a ringing defense of Social Security and critique of the "perils of privatization." As he states, "the very structure of Social Security upholds intact marriage, a father's responsibilities and a mother's sacrifice." As a conservative, he warns against those who appear to "treasure change more than stability by gambling away the solid past on an economic future based on abstract economic theories." This is not about left or right, but about the moral center.

Social Security is particularly important to people of color and women. Three of four older African American and Latino households rely on Social Security for half or more of their retirement income. People of color are less likely to have savings income or receive a pension, and they are more likely to need Social Security's survivor and disability benefits. Every major proposals to privatize Social Security would also make deep cuts in guaranteed benefits, raise the retirement age and slash disability benefits—all of these would be hardest on those who rely most on Social Security, especially people of color.

Similarly Social Security provides women—particularly the divorced, widowed or never married—with the bulk of their retirement income. Women are also less likely to have decent pensions or adequate savings. And they benefit from Social Security" progressive pay out for lower income workers, its family protections against disability or death. Since women tend to live longer, they benefit even more from Social Security's guarantee of a benefit, protected against inflation that lasts until you die.

II. WHAT DOES "SAVE" MEAN?

As political leaders, you know how popular Social Security is. That is virtually every candidate for congress in the last election pledged to "save Social Security." In Washington, of course, common words sometimes have can have uncommon meanings so the question is what does "save" mean?

Last month, I joined with leaders from all corners of our society—from women's and civil rights groups, churches, unions, small businesses, young people—in the National Alliance to Save Social Security. The Alliance came together over a set of principles about what "save" means. I append them to my testimony, and recommend them to you as a guide to your work.

The principles are clear. Social Security should remain a program of shared security, not one of individual risk. Its benefits should remain universal and portable, with a guarantee of a decent income, protected against inflation for as long as you live. It must continue to provide disability insurance protection to workers, and survivors insurance for widows and orphans. Its financing and its pay out should not put more burdens upon those who earn less.

We reject raising the retirement age. We recommend saving Social Security first, rather than using budget surpluses for tax cuts. Saving Social Security would prohibit substituting private risk accounts for Social Security's defined benefits.

In this day of polling and positioning, there are those who believe that you can fool most people most of the time. But those of us who joined the National Alliance to Save Social Security want to put all on notice.

Americans have a very clear idea of what Social Security is. And of what it means to save it. We respectfully suggest that those who trample that idea may find themselves more personally involved with Social Security than ever, due to their early retirement.

III. THE PRESIDENT'S PROPOSALS

The President's proposals provide a sound basis for reform. He would save Social Security first, using the bulk of hoped for budget surpluses to bolster the current Social Security system. He would keep the system of shared security intact—not tampering with the retirement age, or its benefits structure. If any money is left after Social Security and Medicare are saved, he would create separate private, offering middle and low income workers a matching incentive for the money they saved. While the details of the USA accounts remain to be seen, as long as they remain an additional program to spur saving, not a rake off of Social Security, they do no violence to the program.

The president would also invest some of the Social Security trust fund into stocks in a manner protected from political influence. I personally question the much exaggerated expectations of increased return from investing in stocks over time. I agree with Treasury Secretary Bob Rubin and Fed Chair Alan Greenspan that whatever returns may end up a wash with the declining demand for bonds. But government investment of a small portion of the trust fund—essentially what every state now does with public pension funds—retains the structure of shared security. It does not turn the program into one of individual risk.

So I am happy to lend my support to the thrust of the president's plan, while waiting to see the details.

In all of this, a central concern must be economic growth and increasing wages. Sustaining a full employment economy is the largest, best, most sensible basis upon which to save Social Security. Already recent growth in jobs, wages and the economy has made a dramatic difference in bolstering Social Security's strength.

IV. A FINAL WORD ON THE COMING DEBATE

One thing you should know. Americans will participate in the debate over Social Security. The groups associated with the National Alliance are already scheduling town meetings across the country. AFL–CIO President John Sweeney has promised to launch the largest mobilization in AFL–CIO history. Rainbow/PUSH is working to insure that churches, community groups and the media follow this reform effort. What you choose to do will receive significant scrutiny.

There are things you could do to help. First, make certain that all voices are heard. For example, one third of Social Security is for people with disabilities. This committee should insure that the GAO or Congressional Research Service examines publicly how each reform proposal will impact people with disabilities. Their representatives should be given star billing. The same is true for widows or for the four million children who usually are not counted.

Second, since the impact on workers and retirees is the most important measure of reform, I strongly recommend that a Beneficiary Impact Statement be prepared for every reform proposal by the Social Security Administration. The document should examine the hypothetical benefits and costs to workers, children, and survivors. People should have an opportunity to review it. The stakes are far too high for a back room, last minute deal.

You have an historic covenant to fulfill. The promises of Social Security should not be abandoned; the promise to Social Security should not be violated. Its future must be secured, not by radical experimentation or dismantling, but by sensible steps and sound judgment. I look forward to working with you in this effort.

Chairman ARCHER. And we welcome the views of all Americans as we work through one of the most important issues that face all of us.

At the outset, I believe I can speak for the Republican Majority in saying that we will accept the President's offer and commit to reserve 62 percent of the surplus until we have saved Social Security and work together within that framework.

Reverend JACKSON. Mr. Chairman, is that Social Security and Medicare both, combined?

Chairman ARCHER. Sixty-two percent was the President's figure for Social Security alone.

Reverend JACKSON. Do you add the additional 13 percent or so to Medicare?

Chairman ARCHER. We are only dealing today with Social Security. We are awaiting the Medicare Commission's recommendations, which will be on a bipartisan basis before us in a short period of time. But today we are going to focus on Social Security, and if we can, I would like to limit the discussion today because that is a broad enough topic in itself.

Reverend JACKSON. Yes, sir.

Chairman ARCHER. Also, the Chair believes, and I hope that the rest of the Americans agree on both sides that we do not intend, while we are talking about Social Security, to undertake any changes in disability, but that we will be reviewing the Disability Program as a separate item to be certain that the people who are disabled are protected, as you have said in your statement, Reverend Jackson. So we are in agreement that that is a No. 1 priority for us to be sure that those on disability—those who are disabled are protected.

Now, having said that, if I may, let me—Reverend Jackson, ask a question or two of you.

You have supported the President's proposal to invest Social Security Trust Fund moneys in the private marketplace.

Reverend JACKSON. A limited amount.

Chairman ARCHER. I understand.

Reverend JACKSON. But that is important to state.

Chairman ARCHER. I understand. The President's proposal is to, I believe, put about $700 billion out of the Social Security Trust Fund into the private marketplace. As one of the President's counselors, as Congressman Rangel mentioned earlier, would you advise President Clinton that any government investment decisions be influenced in part or in any way by so-called corporate responsibilities, or should investment decisions be based solely on how to get the highest return?

Reverend JACKSON. Well, we run—always run a high risk. We separate morality from our money interests. We made the right decision. We took the risk, even of lives to protect our integrity from Nazi Germany. It was the right thing to do.

We did the right thing when we chose to disinvest from apartheid South Africa because its values devalue our moral authority as its partner. But thanks be to God, Nazi Germany and apartheid are behind now. Those two critical glaring issues are behind us now, so there is always in the American promise some sense of morality and money and security interest coming together.

We could never divorce our money interests from our moral interests and our commitment to human rights. Without that, we lose our moral authority in the world.

Chairman ARCHER. I appreciate your answer. Correct me if I am wrong, but my understanding is that you would advise the President to consider corporate responsibilities as a factor in determining which corporations would receive the government investment.

Reverend JACKSON. Because that is the law. Corp's that receive government support, whether it is through tax break or contracts, have an obligation to honor the law, the law of inclusion of all Americans; and inclusion leads to growth. It is both the law, morally right, and an economic stimulus, so why should we ever invest in an arrangement that does not honor the standard of law which is inclusion of all Americans? And any company that receives our tax benefits or our stimulus that does not honor that law, it by definition is in conflict with our government's policy.

Chairman ARCHER. Would you favor having government investment decisions be influenced in part or in any way on a company's hiring practices or spending practices?

Reverend JACKSON. Repeat that again. I am sorry.

Chairman ARCHER. I said, would you favor having the government's investment decisions of the Social Security Trust Fund moneys be influenced in part or in any way by the hiring practices of the corporation to receive the investment or the spending policies of the corporation?

Reverend JACKSON. We should always invest in companies that honor the law less we be illegal. And if the company does not have an American hiring policy which is inclusive of all Americans, that company is illegal. It should not get investments—not stimulus, not tax breaks, not contracts—because it is un-American and it is illegal. So why should we be complicitous with an illegal arrangement?

Chairman ARCHER. What about areas that are not illegal technically under the law?

Let me give you an example. Would you advise the President one way or another as to investing in tobacco companies? Tobacco is a legal product. Would you advise the President whether or not to invest in tobacco companies?

Reverend JACKSON. I certainly would, but again, that is my personal opinion. In the end, that type of situation would be influenced by the Secretary of the Treasury, I would suppose, and his Council of Economic Advisers. But he is there in this tension between a company whose product is illegal, but whose unintended consequence is to run up our medical bills and to be a stimulus to funeral directors.

Chairman ARCHER. So you think that should be a consideration as to the investment policies?

Reverend JACKSON. I cannot imagine America ever again, our government ever again making the decision in foreign policy that includes human rights or domestic—one that excludes domestic rights. It is a matter of corporations honoring the American standard of law.

Now, the law is inclusion, by the way, which leads to growth. It is both doing well and doing good at the same time.

Mr. KEMP. Mr. Chairman, could I just make a comment about this debate?

Chairman ARCHER. Please.

Mr. KEMP. That is the problem with the President's proposal. It is that reason that Chairman Greenspan suggested yesterday that this is a dangerous path down which he doesn't believe we would want to go or should go.

I went to the Web site of the U.S. Justice Department Antitrust Division yesterday. There are 340 cases on their Web site of so-called "alleged antitrust violation" from companies as wide-ranged as Cisco to Microsoft to Visa Card. Are you going to, a priori, rule out the investment in any company under attack by the U.S. Government?

You mentioned tobacco. I mentioned gaming. You could mention apartheid, and many in this room supported the disinvestment in the apartheid regime. But there are issues of great complexity that some people will think are moral, others immoral. So I would say, Mr. Chairman, you are exactly right in raising these questions, and we should not go down that path. It should be personalized.

That is the beauty of a free choice for the American worker. The risk will be taken out of it because we can guarantee the benefits of each and every retiree. On average, over the last 70 years, the rate of return has been three, four, five times higher in basic conservative equities and bonds. We can still give young working men and women an opportunity to get this rate of return by investing rather than putting it into a government system. This system is antithetical to what we have learned in Eastern Europe and the Third World.

Reverend JACKSON. There is the assumption that all American companies aren't willing to comply with the law. And the law of inclusion of all Americans, excluding none, that includes all of our talents, all of our productive energy, all of our capacity to be hired by end consumers, those laws lead to economic growth. When there is a growth, everybody is a winner.

No one wins when we have exclusive practices in corporations that limit market, limit money, limit growth, and I must say to you that baseball was a great game before Jackie Robinson. When they extended the tent, it got better, it grew. Basketball was a great game before Bill Russell and Michael Jordan. It got better.

The NBA was—we put lots in basketball. WNBA comes out of title IX because you cannot give all the money now to men's athletics. You have to give half to women so young girls can get scholarships, and then they go to college, and women's coaches, women's gymnasium, WNBA, women in commercials. Now you have to buy your son and your daughter a basketball.

That didn't hurt NBA. We see that the value of the law, and often companies would rather remain exclusive and limited than to grow.

I think the government has no higher double duty than to make laws and to enforce them. When the laws of inclusion are enforced, they will always lead to economic growth. So who's against growth?

Chairman ARCHER. Reverend Jackson, let me ask you about companies that are within the law.

Would you advise the President not to invest or to invest in gun manufacturers?

Reverend JACKSON. I would. Again, that is my personal choice. That is not the judgment he will ultimately make, of course. I think he should not invest in the—in gun manufacturers and shouldn't address—shouldn't invest in liquor companies and shouldn't invest in tobacco companies, but those are my own moral values. Those are my own views, because I see the consequences of those corporations.

But that would be my recommendation. Again, do not exaggerate my influence on him when he makes the final judgment of that latitude.

Chairman ARCHER. I am aware of that.

Finally, I assume from what you said that if the Federal Government is either suing a company, as they are, for example, Microsoft, although it has not been proved that the government is correct, should the government then deny an investment in any company that is being sued by the government?

Reverend JACKSON. I would think that a suit is not a conviction. That is a matter of judgment and timing. We should not be so flighty that we assume that you choose a newsroom over a courtroom and that we suspend due process and deliberations. I would think that most of the major companies would want government investment or securities or implied securities would tend to honor the law. It could very well be a stimulus to meet government standards because you stand to gain more by being on good terms with our government than not being. And so I would see that the—the challenge, the access to more capital would be a stimulus for companies as opposed to a deterrent.

Chairman ARCHER. I thank both of you for your comments, and I appreciate the responses; and I yield to Mr.—I recognize Mr. Rangel for inquiry.

Mr. RANGEL. Thank you, Mr. Chairman. Let's take advantage of what we have agreed on. You said that you can speak for the majority of Republicans and say that we will dedicate approximately 62 percent of the surplus and repairing and shoring up Social Security—and I am not going to hold you to the percentages; the President has recommended that—but I certainly speak for the Democrats in saying that is one heck of a great beginning. Now we find ourselves with some dispute as to——

Chairman ARCHER. Will the gentleman yield?

I said we would be pleased to reserve 62 percent of the surplus until Social Security has been saved.

Mr. RANGEL. You reserve it, and we want to work with you to make certain that that is reserved for Social Security. This disagreement as to whether some percentage should be invested by the government in securities, we can put that aside. That is something in serious dispute; I don't think it is going to be resolved. But the American people want the Social Security system to be shored up.

Other governments, State governments, they invest more. If you object to Federal Government investments in equities, OK. Let's see what we can work out, whether we can work it out.

You also suggested that this is not the day to deal with Medicare. OK. But that implies you want to deal with it. If you suggest that that is going to be important, let me then join with you and say, let's put tax cuts on the table, too. So maybe down the line, without the cameras, we can save Social Security, Medicare, tax cuts; and let's get there somehow.

Reverend Jackson, you testified under a terrible disadvantage because this—since we lost the Majority—as relates to the Tax Code, this Committee has gone colorblind. The questions of morality and fairness involving minorities that historically have been denied opportunities, especially in the FCC, cannot be addressed. We cannot make those determinations because as soon as I became Ranking, the Committee lost its ability to distinguish between colors. But we will deal with that.

Jack Kemp——

Mr. KEMP. I would like to answer that question for you.

Mr. RANGEL. No, no, no.

Mr. KEMP. Why not?

Mr. RANGEL. You are not the Chairman. Hey, I have to live with the rules out of here. And not only that, the Chairman is not only philosophically colorblind, but he has difficulty distinguishing colors physically. So I can't challenge any of these things.

Let's move on. I accept it, at least for now.

Of the 12.4 percent that beneficiaries donate to Social Security——

Mr. THOMAS. That's outrageous.

Mr. RANGEL. I apologize if I have offended anybody. Who's speaking?

Mr. THOMAS. I just tell the gentleman we have two very distinguished individuals in front of us who look at the economy slightly differently, and I would really be interested in exploring their views although I know your views are important in terms of how you believe the Chairman or the Majority operates. But that is going to be a 2-year process and we won't have these gentlemen for 2 years.

Mr. RANGEL. If you were mumbling something that implied that I said something that embarrassed the Chairman, I apologize to him. But if you think that you have to lecture me on how I inquire of witnesses, then you have to wait to be able to do that.

Mr. THOMAS. I agree with the gentleman on the former, and I did not intend the latter.

Mr. RANGEL. Let me say this. You would like for the individual beneficiary to be able to exercise his or her own judgment with regard to direct investment and take advantage of the higher yield in the market; is that correct?

Mr. KEMP. Yes, sir.

Mr. RANGEL. You do recognize that most studies would clearly indicate that if you withdraw that money from the pool of benefits, that you dramatically reduce—and they say by up to one-third—the benefits to the beneficiary. Of course, you would say, yes. Look at the greater return they would get if we would invest even larger amounts in the private market.

I have just two questions: One, what guarantees would you give the beneficiary that she or he would have the same benefits as the investors in IBM and Coca-Cola and Merck, since only now are we expecting tremendous returns in the market? Sometimes we don't do that well. And second, who gives guidance to the individual beneficiary in terms of which stocks he or she should invest in?

Mr. KEMP. I think I understand the question, Mr. Rangel. Unfortunately, given the brevity of our appearance, I wasn't able to go through the whole testimony. But I did suggest that before we even talk about personalized retirement accounts or distributing the trust fund assets to individuals, I suggested that Congress take the immediate action to guarantee every penny of Social Security benefits promised to every current retiree and to every person currently receiving disability under Social Security. The legislation, I think, would pass overwhelmingly.

The easiest way to do this is to make the Social Security promise into a legally binding Social Security contract with the American people, to replace that promise with a tax-free inflation-adjusted annuity, backed by the full faith and credit of the U.S. Government, just like the government does when it sells bonds to private investors. That would be first.

Mr. RANGEL. Who manages this for the individual?

Mr. KEMP. That is a guarantee. That is just like a government bond. But you asked me about taking the risk out of the current retirees. That would take the risk out.

Mr. RANGEL. I didn't say current. I am talking about future retirees.

Mr. KEMP. Well, you cannot, and this is a point I tried to make, albeit briefly, you cannot save Social Security or Medicare; you just can't, without a growing, expanding economy.

So the first order of business is to think, at large, how do we reform our Tax Code? How do we bring down the high rates of taxation that are preventing the economy from growing fast enough to give us the revenue in the next century that we are getting currently? We are looking at a surplus of $1 trillion. Without a growing economy, there would be no surplus.

Mr. RANGEL. God bless the ever-growing economy. I am talking about the beneficiary's return on that private investment. That is not guaranteed. The market can't guarantee a yield.

Mr. KEMP. Charlie, if the risk of investing over 20, 30, 40, 50 years, is better in government bonds, as opposed to what municipalities are doing, such as in the California State Teachers Union; 80 percent of which is invested in equities and bonds. I am sure we could design a system that would give the working men and women of America a distinctly higher rate of return on their payroll taxes and the revenues from these hardworking taxes.

Mr. RANGEL. OK, you work on that so that I can yield to what you are talking about, because if California hasn't decided to do it that way, and the States haven't decided, we will take a look at that.

Mr. KEMP. Well, every municipality and every pension plan is invested in equity and bonds. Why can't we do it at the Federal level?

Mr. RANGEL. We will do it. Who gives guidance to the beneficiaries in terms of how to undertake these investments?

Mr. KEMP. The same way you do it at the municipal level and the State level.

Mr. RANGEL. We don't do it.

Mr. KEMP. I don't have to be the architect of the new system, I just have to give you a vision of how much better we could do. I noticed Mr. Greenspan said yesterday that there was a poll suggesting that young people have lost faith in Social Security. This is not just because of what the Chairman has stated, but primarily because they see a higher rate of return from investing and personalizing Social Security than by leaving it in government T-bills.

Mr. RANGEL. Let me thank both of you. I think you have done what the President has done, and that is to give us a framework. Now we have the responsibility to come together as Republicans and Democrats to come up with something that saves the Social Security system.

Chairman ARCHER. The gentleman's time has expired. Under the unanimous consent agreement, the Chair recognizes Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman, and to members of the panel, I welcome you and we are honored you are here.

Mr. Chairman, it is a great honor to be a junior Member on this side of the aisle. I believe in the power of ideas, I really do. I think that the ingenuity, the innovation, the free enterprise, releasing people's abilities has been the American way and we have to continue to leave that freedom there.

I also believe strongly in the power of compound interest. Like a lot of parents, I know my son sometimes gets in the rut of spending, spending, spending. Maybe sometimes the government is that way, too. I kept looking for ways to get my son motivated about saving, saving, saving. I would leave little articles out around his room. I left one on the power of compounding interest that totally turned his attitude around about trying to make sure he puts some back into savings. There is no question today he realizes that he will have retirement because of his savings.

Last week, the Chairman and some of us were in Chile. In reviewing the Chilean program I was very impressed with what I call the personalized security account—I think maybe you could call it a personal savings account. A personalized security account where over 90-some odd percent of the people that are in it; they have a choice, they can stay in the system they are in if they are in it already, or they have a chance to move in that direction of where they can start investing in a personalized way, not a government, but in a personalized way. After having been a person who has gone through a couple of IPOs, I realize the shareholders become the owners. You have to consider shareholders all the time.

The question I wanted to ask is this: Have you studied the program that has been in effect in Chile? And give me your thoughts on that. I was impressed with what they are doing.

Mr. KEMP. Well, may I say to my friend from Oklahoma, I have looked fairly carefully at the Chilean personalized savings accounts, or personalized retirement accounts. According to José Piñera of the Cato Institute, every working man and woman carries around in his or her pocket a little personal card with the rate of return that they are getting on investments in the Chilean stock market.

There is a risk, as there always is under any system. If we don't devote our attention to making this economy as expansive and prosperous in the next century as we have tried to do, in my opinion, since Ronald Reagan became President, and now with this President who has had a very good run, it seems to me we are going to miss the greatest opportunity to create the conditions where this discussion can go forward.

But with the Chilean experiment, they are doing it in Great Britain, they are doing it in the Scandinavian countries, they are doing it in several Third World countries. It seems to me the greatest democracy in the world can figure out a way to create a stakeholder society where all people, of color or not of color, have a stake in the American dream and a shot to that ladder of opportunity that we all want to make more equal.

I just want to say to my friend Charlie Rangel, there is no one in this Congress who has spent more time thinking about how to get capital into urban and rural America more than me. I think if you look at the experiment that Mr. Lincoln started and was prevented from doing, he wanted to create ownership opportunities, giving every man, every woman, every family, a chance to own a piece of land, from Oklahoma to Illinois under the Homestead Act.

We should be thinking of that in urban and rural America, whether it is Appalachia, as Jesse and I talked about last Friday, or urban Harlem. So, in my opinion, we can look at Chile, we can look at some of these other experiments, and I believe we can do it better.

Reverend JACKSON. Mr. Congressman, I suppose on this matter that I am more conservative than Jack Kemp. He wants to deal with the risk for the people at risk; I want to guarantee security for those at risk, and protect Social Security first. If it ain't broke, don't fix it; expand it. That is why save Social Security first is a priority in my mind.

The second concern I have, you are always fighting to save the poor, but I am concerned about how to keep poor people from remaining permanently poor. There is a way to break that cycle too. But often you hear the word "minority" and you immediately think of racial minority. The minority are those that have high concentrations of wealth. That is the minority. For the wealthy minority, there is no roof.

For the middle class, there is a sinking downsizing, outsourcing, anxious feeling. For the poor, there is no floor, except Social Security. So there is the tension, and it is vertical more than it is horizontal and class more than it is race.

Therefore, the recommendation we made which the President addressed the other night was the idea of looking at the underserved markets in America, with underutilized talent and untapped capital. There is no Third World market, no Eastern European market, no Asian market, with as much money as, as close as, as secure as, with as much potential as underserved American markets.

So, why can't we see building a bridge from Wall Street to Appalachia; not just Wall Street to Washington; Wall Street to Appalachia, Wall Street to rural Oklahoma, Wall Street to rural Texas, as we stimulate more growth by including more Americans?

Just last, here is an idea about OPIC, the Overseas Private Investment Corporation. Please hear this. I think the more we grow, the more options all of us have. Some years ago when Mr. Rostenkowski sat where Chairman Archer sits now, he went to Poland and came back, Congressman Archer. He tried to call back to Washington about 7 hours. He couldn't get through because the infrastructure was down, the lines were fractured and broken, the ports were broken. He put together something for Poland, $240 million, 40-year loans, three-quarters of 1 percent, first payment due in 10 years; for Hungary, $40 million.

We used incentives for investment, a combination of tax cuts, long-term low-interest loans, OPIC, Export-Import Bank and development bank. It was good for Poland because they could begin to develop goods for us and we could expand to a developing market. Everybody was a winner.

We have for Indonesia and Southeast Asia such incentives on the front side, and IMF, the International Monetary Fund, as a hedge against risk on the back side. We don't have that for Appalachia, we don't have it for Oklahoma, we don't have it for the Ozarks.

So part of my question about growth is how to deal with those areas of America where there is brokenness and infrastructural crisis, to provide incentives, whether they are a tax break, investment, or different terms. Let us include all of America in the big tent of America's growth and prosperity, that which we would not only save Social Security for the seniors, we would in fact give them more practical options.

Chairman ARCHER. The gentleman's time has expired. I am not sure that the Chair asked unanimous consent that the full written statements of both witnesses be included in the record, but I do so now, without objection.

The Chair would encourage the witnesses, if possible, to try to limit their responses to how we solve Social Security, because we have a lot of Members here. We are not going to be able to get around to letting all of them inquire unless we do try to limit it to the Social Security issue.

Mr. Hayworth.

Mr. HAYWORTH. Mr. Chairman, I thank you for the time. Mr. Secretary Kemp, Reverend Jackson, thank you very much, it is a privilege to have dueling quarterbacks here. For purposes of full disclosure, and as the attorneys might say, there is a preponderance of physical evidence to indicate that at one time I was an offensive lineman, although in my college days it should also be noted I was recruited as right tackle, but ended up left out.

Mr. Chairman, I would also rise to a point of personal privilege, because I am just so pleased that joining us in the audience today is a young man who attends Desert Mountain High School in Scottsdale, Arizona, Michael Lacorey. Given the time difference, his classmates are now in first period, so he is getting a very different type of field trip today.

Michael, would you stand, please? I would like everybody to welcome you today. Michael, thank you very much for being here. He is a student leader and very active in Teenage Republicans. He is nice enough to reciprocate a visit, as I was visiting his school a couple of weeks ago, and he now joins us here this morning.

One of the questions that came up in our minitownhall at Desert Mountain High School a few weeks ago had to do with Social Security. As has been relayed by Members on both sides of the aisle on this panel, the fear not only among baby boomers, but those that follow, is that what they pay in will not be there.

Because the individual accounts as proposed by the President don't begin until after Social Security is, "saved," depending on how long this takes, baby boomers and even those of Michael's generation would possibly get no significant benefit from controlling their own funds. Would you agree with that assessment?

Mr. KEMP. I really agree. The young man that you just introduced, or one of my 12 grandchildren, is going to get a lower rate of return. Given the demographics of the country, 80 million people turn 51 in the next 15 years. In the next 15 years, 79 to 80 million people will be turning into their fifties. So the demographics are working against us, at least if you look at it statistically.

Second, the actuaries of Social Security have pointed out that the growth of the economy is going to slip from the 3 to 4 percent range to the 1 to 2 percent range by the time Mr. Lacorey is retired. If we don't have an economy that is back to the post-World War II average of 3.3 or 3.5 percent, I would say to the gentleman from Arizona, either you have to raise payroll taxes or raise the age for retirement.

I don't favor either. That is why as Johnny-one-note here, I continue talking about how important growth is to finding solutions, both to the issue of civility as well as to the issue that we care so much about. In my opinion, just debating Social Security without debating the size of the pie is going to be a serious mistake, because it is going to put us into a zero sum discussion.

I just want to quote from my statement. The actuaries right now are suggesting that the real rate of economic growth for the next 65 years, how they know, I don't know, but it is down to 1.5 percent. If it is 1.5 percent, that young man who just was introduced is going to either face much higher payroll taxes to the length of his lifetime, or they are going to raise the retirement age, neither of which I would support nor would you, J.D.

Reverend JACKSON. Mr. Hayworth, I submit that Jack Kemp, my friend, is a super insurance salesman. I am not. I do not keep an actuarial chart.

Mr. KEMP. That is praise from Caesar.

Reverend JACKSON. It is that. But I submit this to you; that if we include this young man in America's growth and prosperity, by choosing for him incentives for school on the front side and not jails on the back side, that is fundamental to our growth. We cannot keep growing with 2 million Americans in jail, most of them under age 30. That is a big piece of our future too.

Most of our States, Congressman, every city I visit, there are at least two new buildings; a new ballpark and a new jail, first-class jails and second-class schools. They will impact upon our ability to handle Social Security.

So I guess my real point simply is this: That now that we have a surplus, let's prioritize using the portion that Chairman Archer seems to agree upon. Let's save Social Security first, then deal with these more exotic, more risky ideas.

Mr. HAYWORTH. I see the time has expired, Mr. Chairman. Accordingly, I would yield my time and thank the Chair and thank the gentlemen.

Mr. ARCHER. The gentleman has no more time to yield.

Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman. Thank you for both of you distinguished gentlemen being here today. We certainly can say this has been an exciting game here today.

Mr. Kemp, in reading the testimony that you didn't get a chance to go all the way through, you do make some observations and some definitions, one of which has already been talked about, but I would like some clarification on it, because you talk about guaranteed benefits to current and near-term retirees. I am not sure how far that goes out.

In the second place, which I am not sure that I understand this, on point 3 you mention that you could take these 3 percentage points of their FICA contribution and increase the maximum percentage workers can voluntarily invest as quickly as possible until all retirement benefits as well as survivors and disability benefits can be funded out of personal accounts, if the worker so chooses. I don't know what happens if he or she does not choose that.

But third, I think there is an issue here that some of us have seen in poll after poll. Not-for-profits, government entities, have all suggested that any kind of privatizing individual accounts really does hurt women, in particular, because of their workplace habits. For one, they probably work 11 years less, they generally stay at one job for about 4.7 years, so they never have the opportunity to invest in any kind of program at that point; they receive 74 percent on a dollar compared to their male counterpart; and they live longer.

So in your personal accounts, what suggestions or what conclusions have you come to that would in fact make up for those differences for women in the workplace? How do we address this, because those will be and have been the people in poverty.

Mr. KEMP. Yes. That is a terrific question, and one that many men and women of good will are wrestling with today.

I would make the generic point, the general point at least, that women would get a higher rate of return on their money than they get from working. Sixty-five percent of all of the American women with children are in the work force. We want them to have higher real wages. I would suggest that the tax on them is a burden. It is a burden on everybody. I don't favor little tax credits, with all due respect. We have too many in the Code right now. The Tax Code has become too confusing. Give families a chance to take $2,000 after taxes in a tax-free account for the life of their investments. I think that is the best thing you guys have done, is transform the Roth IRA. If you expanded Roth IRAs now and allowed women to do the same thing, the possibilities would be insurmountable.

Mrs. THURMAN. Mr. Secretary, if I could interrupt for a second to engage in this, there is also shown, because women do have, for example, the Roth IRAs, they would be the first ones to have to pull that out in case of emergency for families, for education. So while you may expand that, you still have not addressed the idea that that would not be available for the woman when she retires, because that might have been used earlier on for that.

Mr. KEMP. The problem you talk about though, with all due respect to the gentlewoman's question, is a problem across the board. That is a problem right now in Social Security. There is no guarantee of anything along those lines. Under Social Security she can't pull it out immediately for any problem.

Mrs. THURMAN. But she has the safety net.

Mr. KEMP. That is the point that I made. She could take the money out of her Roth IRA tax free. Name a better deal for a working woman than to be able to put $2,000 away, circa 1998 or 1999, and then for some emergency or some reason later on, be able to pull it out without any tax consequence.

Mrs. THURMAN. But we are not talking about in their working years. We are talking about when they retire. We are talking about their safety net when they retire.

Mr. KEMP. If they choose to take a safety net over the possibility of that compounded rate of return that Regina in West Virginia or Annie Schriver in New York City received, I would suggest people should be allowed the freedom of choice. They should be empowered, not government. My problem with having the government invest money, is that it would not invest in Mr. Lacorey, it would enrich the U.S. Government.

We don't need a bigger government, with all due respect. We need bigger people, bigger opportunities, a bigger ladder that reaches down into the levels of poverty that you talked about and gives them access to capital. Without capital, you can't get rich.

Reverend JACKSON. I think that some of this antigovernment rhetoric from credible people undercuts the government's authority and discounts its valuable role.

Most people, if you just ask "the people," they would chose a Lotto over Social Security. They don't know any better. The poorest county in Georgia has the highest amount of Lotto investment.

So the fact they are choosing Lotto, the people, over the market, makes them big, but not wise. The fact that they would use credit cards as a substitute for money is a choice, but it is stupid.

So we have got to make sense. We are leaders, and all this kind of antigovernment has a way of discounting, to me, what the government does. It is the foundation upon which other options, which other options emanate. The government has a role in providing basics. I tell you, GM would not make cars if they did not make roads. There is a dynamic interplay, and don't downplay government's role in protecting and preserving that which is basic and common to all of us.

Mr. KEMP. I will do that, if you don't downplay the intelligence of low-income people who want a better life for themselves and their families. It is outrageous to say that poor people are dumb and don't know how to invest their money. Buying a Lotto ticket may be someone's desire to get out of the poverty in which they have been enmeshed. There's a better way to do it, and that is to allow them the freedom to take their payroll tax, which is now at 12.4 percent for Social Security and another 2 percent for Medicare, and get a better rate of return. We don't try to privatize public housing.

Chairman ARCHER. With all due respect, the gentlewoman's time has expired.

Reverend JACKSON. I say to play a Lotto over a bull market is dumb.

Mr. KEMP. It is dumb.

Reverend JACKSON. Thank you.

Mr. KEMP. But they don't have a chance to invest in the market because we don't give them a chance.

Chairman ARCHER. The Chair would encourage the gentlemen to continue their discussion after the hearing.

Mr. KEMP. In the Cloakroom. It is going to go on a long time.

Mr. WELLER. Thank you, Mr. Chairman. I also want to express gratitude for your bottom-up approach today in questioning, giving those of us at bottom the opportunity to begin in questioning.

I also want to salute our two witnesses today. Of course, Secretary Kemp, representing the Chicago area, I just want to salute you, because it is your leadership when you were HUD Secretary that is now producing results with the changes that have come about in the CHA, and I want to thank you for that.

Reverend Jackson, of course, I grew up watching your leadership over the years. I also, as you know, share the south side of Chicago and the south suburbs with your son, Jesse, and I just want you to know he is an articulate, energetic partner, and I enjoy working with him on many, many projects. I am very proud of him, as your family is.

Social Security, of course, is an important issue for every working American, and from a selfish standpoint, I suppose, when I think of Social Security, I think of my own mom and dad, how they have worked hard to get into the middle class. They have worked hard all their lives. Fortunately they are healthy.

I think of a lot of widows that have come to town meetings and I have sat down with and talked about how important Social Security is for them and sometimes how Social Security has shortchanged them.

I also want to salute President Clinton and Chairman Archer. I think they have given us a tremendous opportunity for a bipartisan effort to really save Social Security. There has been a lot of rhetoric about saving Social Security, but I think President Clinton and Chairman Archer have given us, as Mr. Rangel says, the opportunity to build a framework to save Social Security, not just for today's seniors, people like my mom and dad, but for every working American, particularly like, as J.D. pointed out, the young man in the back of the room who is just going to probably be entering the work force.

I was pretty proud last year, this Committee and the House of Representatives made a commitment, and, of course, we passed out of the House of Representatives a plan that made a commitment to give back the surplus of surplus tax revenue to the people, by setting aside 90 percent of surplus tax revenue to save Social Security and giving back the remaining 10 percent in tax relief, of course, working to eliminate the working tax penalty for the majority of those that suffer.

Now the President in his speech this week says we only need 60 percent of the surplus to save Social Security, and he proposes spending the rest on new spending initiatives. I thought with my opportunity to ask questions, I would focus on one of the President's ideas, which is a big one, and that is where the President proposes taking 25 percent of Social Security Trust Funds and investing them in private business.

Reverend Jackson, you have been an advocate of using leverage of stock ownership to achieve various goals. In fact, in Ebony magazine, the February issue, you are quoted as saying, "Just as you vote with a ballot in a political election, you vote with shares of stock in this arena."

They also point out you say stock ownership is a great opportunity to have a say, not to quote "great opportunity," but you say, "to have a say in who corporate chief executive officers hire, fire and promote, the type of work environment they encourage, and where corporate money is invested.

Now, both you and Secretary Kemp in the past have expressed a desire to serve in the Oval Office, and I am going to just propose a hypothetical situation. I know some have speculated you may have an interest in that job again.

Reverend JACKSON. It will be vacant soon.

Mr. WELLER. It could be, in about 2 years.

Reverend JACKSON. Two years, that is right.

Mr. WELLER. Of course, Reverend, say you were in the Oval Office, and for the last couple years the Federal Government had been investing 25 percent of the Social Security Trust Fund in shares of corporate stock in the private sector. What type of opportunity, and particularly the leverage in your agenda as President, would this give you in working with corporate America to pursue some of the goals that you would pursue as President?

Reverend JACKSON. Clearly if you are willing to take the market risk that we see in the bull markets, some outstanding numbers, we don't know how long those numbers will last, I am not willing to do to a Social Security safety net what I would do to other moneys. That is where I come down on the conservative side of that. That is why his idea of 4 percent, even Rubin, who is relatively conservative, would say that is worth the risk, because it is even lower than what we do in States already, and that is where I have that sense of tension.

If I were in the White House as the President of the country today, I would come down on the conservative side of use the surplus to save Social Security first, and then exercise my other options.

Mr. WELLER. But, Reverend, you said, and you were quoted in Ebony magazine as saying that stock ownership gives you an opportunity to have a say in how corporate business is managed. Do you believe you could use that leverage as a way of pursuing an agenda?

Reverend JACKSON. Well, as an individual, pursuing more stock for more individual wealth does not put upon me any obligation to secure people unable to secure themselves. The pursuit of private individual risk and wealth does not take into account my obligation to 4 million children, for example, or to disabled seniors, for example.

So my reference to leveraging stock to open up corporate boardrooms, to move from sharecropper to shareholder and make these companies more accountable because of our consumer power, that approach is quite different. That is almost bottom up. As President I would be looking top down, and I say to you that just as I would be willing to use some tax cuts or incentives to remove the roof for the creative, for the creative and entrepreneur and risk takers, let the sky be the limit. But for the less able, there must be a floor beneath which none of them fall.

Chairman ARCHER. The gentleman's time has expired.

Mr. KEMP. Could I just take 1 minute to agree with that floor under the rich?

Chairman ARCHER. Jack, we are not going to be able to get around to all the Members. I have an obligation to try to let the Members inquire.

Mr. KEMP. It should not go unsaid, though, that all of us who are talking about personal savings and retirement accounts favor guaranteeing the safety net under which people shouldn't be allowed to fall. But I want to reiterate what Jennifer Dunn said the other night on television; the surplus was not created by President Clinton, any more than it was created by Ronald Reagan or George Bush. It was created by the American people. It is their money. Give it back to them.

Chairman ARCHER. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman.

It is great to have you gentleman here. Thank you for giving us your time.

I want to talk just briefly about the politics of Social Security and then the policy. My colleague from Illinois mentioned, a year ago, in the State of the Union Address, the President said we should save every dime of the surplus for Social Security. In response to that, this Committee pushed through a proposal to set aside 90 percent of the proposed surplus, and it was passed primarily along party lines. In fact, we were vilified on the floor of the House of Representatives across the street that we were raiding the trust fund for trying to set aside 90 percent and then let the American people keep a little bit of what they earned.

I think we have already seen in this hearing this morning how easy it is for politics to rear its head. Hopefully, in the words of former President Ford, I think the challenges before us, where he said that we should take this third rail, Mr. Kemp, as you mentioned, this third rail of politics and rebuild tracks of reform, and I think, as he said, that our conscience demands what our children deserve, and, God willing, we will disappoint neither.

Let's talk about the policy. Reverend Jackson, I couldn't agree more with you in your testimony. This has been the most successful antipoverty government program that we could conceive, and were it not for the demographic realities that we have, that is an aging population, Mr. Kemp, as you mentioned, and a smaller work force coming up behind, we probably wouldn't have to talk about significant structural changes. Yet, even with the successful program, there are inequities.

The gentlelady from Washington State has been so eloquent on this—that women on average leave the work force for about 11 years to devote to family, and, as a result of that, they play catch-up. As the gentlewoman also points out, women live longer than men. I personally would like to explore some legislative corrections to that, but I am not sure that we can do that, we can change that inequity.

Mr. KEMP. The Reverend can.

Mr. HULSHOF. The other way the system is unfair, Reverend Jackson, as you know, is that the life expectancy for an African-American male is in the low sixties. So here is a young man who has worked his entire life paying into the Social Security system, and yet, at the time of retirement, on average, isn't able to get out of the system anything close to what he has put in. So I think that as we try to fashion some solutions, I hope that we can be good enough and courageous enough to put the politics aside.

With that, Mr. Kemp, here is my question: With your outstanding career here in Washington, 18 years, you are undoubtedly familiar with the Thrift Savings Plan that Federal workers have. Essentially, and for those who are not familiar with that plan, it allows workers to invest up to 10 percent of workers' salaries with a corresponding government match in stocks and bonds and T-bills.

Now, if this were a town meeting in the Ninth District of Missouri, here is the question I get: Let's take a normal family in my district, perhaps a family farm, a couple that still is in good health and still active in the family farm, don't own a computer in their household, and who may be uncomfortable—and this goes to Mr. Rangel's question—may be uncomfortable, it is not that they are uneducated, but maybe just not comfortable with opening up the pages of the Wall Street Journal and trying to decide or decipher or even decide, make a decision, on how those moneys should be invested.

Could we not move to some plan like a thrift savings plan that would still allow choice; that is, that we could direct certain investments?

Mr. KEMP. The answer is demonstrably yes. That does go to the heart of not only your question, but several other questions today. What we should be thinking about is democratizing this capitalist system. The way to do it is to give people access to capital. The only thing a poor person has is his or her labor. This idea allows you to convert labor into capital.

It is not class warfare. On the contrary, it would be a rising tide that could lift every boat. And where there is a boat sunk, I have been reminded, that is where the government does come in and provide a floor below which, people should not be allowed to sink further. That would be a government guarantee of that net.

But let's give people a better rate of return. I think a thrift savings plan or an individual Roth IRA would be a far better way to do it.

Mr. HULSHOF. Mr. Jackson.

Reverend JACKSON. Government should not impose a roof and limit creativity. It offers a safe foundation, which is our launching pad. That is why I believe in choice schools. I think all schools should be choice and all children chosen. That is the American dream, to include all at the basic level and leave none behind. You can go from a log cabin to White House, but you must at least have guaranteed logs, something basic. That is why I am very sensitive to putting at risk Social Security in exotic ideas.

I like the idea. And politics is not a bad thing. There are good politics, and there are decisive politics. How can anything you do not be political? But are your politics driven by something moral or something messy? One sense within us, vanity, asks the question, is it popular? That is a brand of politics. Another brand of politics asks, will it work? Can I get over? Another brand of politics asks, is it right? Politics at its best—while you help that lady and man in Missouri, politics at its best don't follow opinion polls, they mold opinion, if they have an opinion and have convictions.

I say we can do for the average American what they cannot do for themselves, create a structure that protects them, that they tend to agree. There is consent and agreement that Social Security is fundamentally a sound idea. So let's fix that, and let's expand that, but don't put that at risk.

Chairman ARCHER. The gentleman's time has expired.

Mr. Tanner.

Mr. TANNER. Thank you very much, Mr. Chairman. I want to, with your permission, continue on a theme from Chairman Greenspan's remarks yesterday when he said let the surplus run was his priority or his preference in this matter regarding the surplus, projected surplus, in saving Social Security, in "saving it first" and all the other rhetoric that we have heard.

Both of you gentlemen are leaders in the marketplace of public opinion, and we appreciate you being here. I guess there are probably 435 different ideas as to what to do with the projected surplus in the House, from giving it back in the form of tax cuts of some sort to saving Social Security first, more military spending, a lot of things, targeted tax programs of some kind. There is no shortage of ideas.

The one thing that has struck me has been the lack of the words "the Federal debt" mentioned here. I understand we have privately placed Federal debt of over $3 trillion.

Now, where I come from, it is considered poor form if you owe someone some money, and you come into money, as they say, and you don't pay your debt.

I consider this $3.5 trillion private placed—there is more, but it is publicly accounting, interagency, Social Security Trust Fund, earned interest from the Treasury and so forth. But this privately held debt, it seems to me, is a debt that we owe our children and grandchildren.

You heard a lot about that back when we were running these deficits in the late seventies, eighties, some Democratic administrations, some Republican, some Democratic Senate, some Republican Senate, some Democratic House—most Democratic House. But anyway, I don't think either party comes to this with clean hands, as they say in a court of equity.

How would you rank, because it is going to get into the marketplace of public opinion as to what to do with this projected surplus, how would you rank paying off at least the privately placed debt of this country as it relates to some of these other programs and tax cuts and so forth?

With that, Mr. Chairman, I will yield the balance of my time.

Chairman ARCHER. Can the Chair ask of his friend, Mr. Tanner, what is the connection to Social Security?

Mr. TANNER. Well, Mr. Chairman, I think the projected surplus as it relates to either a tax cut or spending or saving Social Security first, all of those things have to do with money and demographics. If we pay down debt, there are some, including Chairman Greenspan, who said that is in effect saving Social Security first.

Mr. KEMP. That is what I understood Chairman Greenspan to say. I don't often disagree with the Chairman, but I do on this one. The only way retiring debt can help save Social Security is if it increases the level of economic growth in the country.

I want to say it again: If you look at the Social Security actuaries, they predict the economy going into 1.3-percent growth for the next 65 years. That is a greater threat to Social Security than the demographics, albeit both of them impact the negative side of Social Security. That is why people say it won't be there when you retire.

So what will get the economy growing? If retiring debt would do it, I would be in favor of it. Unfortunately, it doesn't. It won't. So I favor lowering the tax rate on capital gains, expanding Roth IRAs, taking its rate back to 28, where it was in 1987 and doing some things to make sure that our economy grows in the next century as well as it has from the fourth quarter of 1982 until today.

We can have a golden age if we do it right. We can also give low-income people access to property ownership and capital. I submit that doing so would do more for people of color than to put them into a government trust fund that forces them to get a 1.3, 1.4-percent rate of return, as is being done today.

Reverend JACKSON. I am amazed that Congressman Kemp is obsessed with fixing what is working.

Mr. KEMP. What is working?

Reverend JACKSON. The economy is working, and it is growing. Reducing the debt obviously gives us more strength. It helps our surplus. And with that surplus, many of the other intended concerns that you raised, for example, because we have a surplus, we can now speak of investing in Social Security. Because we have it, we can now speak of refurbishing rural and urban schools, which may be an alternative to more rural and urban jails. Because we have a surplus. Part of this comes by growth on the one hand, but clearly the debt is no asset to growth.

Mr. KEMP. The answer to debt is growth and reducing debt as a percentage of the pie. We grew out of World War II's debt. The deficit in 1946 was 50 percent of GNP, 50 percent of GNP! The only reason we could have a Marshall plan is that somebody suggested we should invest in war-torn Europe, war-torn Japan.

Mr. TANNER. Mr. Secretary, would both of you gentlemen agree that the payment of debt will free forever some of the 200-plus billion dollars a year we are paying in interest that could then be used for some of these programs that you suggest? As you both probably know, one of the third or fourth items in the budget is interest. That is gone. That is money we are paying interest on forever if we don't begin to somehow reduce the debt.

I understand what you are saying, but it seems to me——

Reverend JACKSON. You are right. I think Congressman Kemp doesn't understand what you are saying. Say that one more time. Reducing the debt does what?

Mr. TANNER. It relieves one from paying interest next year to the extent the principle has been retired, which frees money.

Reverend JACKSON. We have a shared understanding.

Mr. KEMP. I totally understand. I have a mortgage. Do you have a mortgage, Congressman?

Mr. TANNER. I have two, one here and one in Tennessee.

Mr. KEMP. And you pay it off in regular installments. I favor debt for highways, I favor debt for aircraft carriers, I favor debt for schools. I don't favor debt for food stamps or welfare or current expenditures.

The answer to debt is a bigger pie. We are reducing the debt by rolling it over, paying it off, and keeping our economy on a growth track. It is doing well today, but I tell you, my friend, Reverend Jackson, the actuaries of Social Security are scaring the American people by coming to the conclusion that if our economy slips to 1.3-percent growth over the next 65 years, the retirement will not be there for them. That is what I am talking about. I hope you will understand that.

Chairman ARCHER. The gentleman's time has expired.

Mr. McInnis.

Mr. McINNIS. Thank you, Mr. Chairman.

The first point, on the President's speech the other night, I thought it was well delivered, but I thought it was full of fluff, and I would like you to follow me through.

I have a question for both of you, first of all for Reverend Jackson, but then I am going to also ask a question of Congressman Kemp to answer.

But before I ask either of you to answer, the President's plan—follow me through with this—the President's plan says no cuts in benefits, that sounds good; no payroll tax increase, I certainly agree; no tampering with retirement age, and no tampering with not just a cut in benefits, but no tampering with the benefit structure.

Now, you have to contrast that with the financial realities that we are dealing with. First, we have an increase in lifespan. Since Social Security was conceived, we now average 13 to 16—I forget the exact number—13 or 16 more years in lifespan. No adjustment has ever been made for the increase in lifespan. In fact, it has probably gone the other way.

Second of all, the current retirees, the people currently on the system, on average, take out much more than they have put into the system.

Third, the ratio of retirees to workers takes a dramatic jump in the very near future. Now, that is not a wash, it is a loss.

Reverend Jackson, from what I understand from your comments and the President's comments, you would pay for these dynamic opposites, you will pay for them with the surplus. In my opinion, the surplus is a temporary supplement upon which you pick up these long-term commitments. These are long-term commitments, extending lifespan, more retirees and workers and so on. So you have the temporary benefit of the surplus.

The question then to you is, what happens when the surplus dissolves or if the economy slows down? Then how do you meet those commitments?

Then the question for Congressman Kemp. I completely agree with your personal choice, and I think that is a big difference between the Republican and the Democratic philosophy. The Democratic philosophy, as reflected by the President the other day, is let the government go out and become a massive stockholder in the market. I can't think of anything more disruptive to the market or more disruptive to the concept of capitalism than letting the government become the majority stockholder in corporations.

They tried it in Colorado by letting the government become the majority landowner in Colorado, and then political correctness begins to dictate what ought to happen with that land instead of what is the best use of that land. So I completely agree with you.

But I do have one slight concern with your comments, and that is that we should not consider—you didn't say you shouldn't consider—but you said you don't think we should adjust the age eligibility.

My kids are 18 years old. They are just now entering the workplace. They are not all 18, but one of them is 18. If their lifespan is going to be 20 years longer—because not only of the increase in lifespan, but we are also finding people living into their eighties and nineties now are healthier during that period of time than they were—I am sure my son will say, Hey, I would like to work until I am in my eighties. It is very likely. The generation behind him is very likely to go into their hundreds.

Why shouldn't we have some kind of proportion or expansion or extension of the eligibility of the age eligibility for Social Security? You could do it in such a way that your most immediate adjustment would be minimal, maybe add a week a year for those closest to it, but those 40 years out from it, which would be likely, because of the increased lifespan, why not increase that?

So, first to Reverend Jackson, and then to Congressman Kemp.

Reverend JACKSON. Let me say this: The reason I am quick to defend government roles and responsibilities, Congressman Rangel, government at its worst supports slavery; government at its best supports emancipation.

In some sense, we look at 1932, to buy a house you had to put up 50 percent with a 3- to 5-year mortgage. And the government brought in something called Freddie Mac and Fannie Mae. With an implied government guarantee, you get 30-year mortgages. That is government. Without government, we wouldn't have public accommodations. My high school senior class could not take a picture on the State lawn in South Carolina. Dogs could. Government came to our rescue. Without government, all of us would not have the right to vote. Without government, most of us could not use a public hospital.

Mr. MCINNIS. With all due respect, Reverend——

Reverend JACKSON. All I am saying is government has a place in this. The President didn't say massive, he said 4 percent, and less than many States, which put 10 percent.

Mr. MCINNIS. With due respect, my question to you is not the philosophy which you have expressed earlier, not that I necessarily disagree with all of it, though a portion of it.

Reverend JACKSON. Which portion of it?

Mr. MCINNIS. My question specifically, Reverend, was what happens when the surplus expires? How are you going to meet the commitments that you have spoken of?

Reverend JACKSON. The only way, it seems to me——

Chairman ARCHER. Unfortunately, there is not adequate time for the gentleman to get a response. Perhaps Reverend Jackson or Congressman Kemp will submit in writing a response.

[No response had been received at the time of printing.]

Reverend JACKSON. There is a respectful tension here. I can only say that for your 18-year-old kid, if he is educated and becomes a productive worker, he will be a part of growth which helps the surplus. If he, in fact, does not have that education and goes to jail for the rest of his life, he will cost us, rather than contribute to us. Therefore, you cannot separate our growth and assets from what happens to our youth in the formative years of their lives.

Chairman ARCHER. The gentleman's time has expired.

Mr. Foley.

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

Let me state that as a Republican Member from the Sixteenth District of Florida, with the seventh largest Medicare-Social Security population in America, what we have heard today underscores why it is a dangerous idea for Washington to invest and control Social Security Funds in the private market. So I would underscore the words of our Chairman, Chairman Archer, no, no, no, 1,000 times no.

In the Sun Sentinel today, an editorial said: "Political pressure for the Federal Government to invest in favored industries or to disinvest in industries that are deemed politically incorrect would be too great for financial managers to resist."

Let me ask Mr. Kemp, and first Mr. Jackson, since Mr. Greenspan and Mr. Rubin have both advocated against this idea, can you give us any illumination of where President Clinton brought this idea forward—who suggested it?

Reverend JACKSON. I do not know. I think that there is obviously a lot of pressure in this bull market to get some of that money for the government. I am sure that is a temptation. That is why I think that the 4 percent is such a modest number as opposed to some big number.

But in the end, even Rubin went along with it because he thinks that margin is not threatening. But I would tend to come down more on the side of keeping Social Security secure and using the front part of that surplus to keep it that way.

But I never separate keeping Social Security secure from the growth that makes the surplus, allows us to invest in Social Security. You cannot have growth without what—some people think it is politically challenging or politically incorrect if a company is not willing to use the minds of all Americans, all the American markets and all the American talent. Then it is not only politically incorrect, it is morally incorrect, and it is also inefficient in the run.

Mr. KEMP. Of course we want corporate America to be inclusionary. Does it have a long way to go? Absolutely. But let's don't forget how far it has come. Their answer to your question, Mr. Congressman, the President wisely, I think, at least has touched that third rail that we talked about today. He has made two very important considerations that go to the heart of his proposal: A, Private markets do better than government bonds. Anybody want to debate it? He suggests that we need to invest in markets. So give him credit for it. I do. Where he goes wrong is wanting the government, rather than individuals to do the investing.

B, He suggests that incentives drive decisions. He has, bless his heart, tax credits for every conceivable idea under the sun. He has tax credits for steel companies that are being competed against by Japan and Russia. He has tax credits for the ozone, tax credits for global warming, tax credits to have babies, tax credits to send them to college, tax credits for working women to stay home after school.

But there is a problem with that: It takes the Code and engineers it to where we end up making people jump through our hoops in order to get what they deserve. Jennifer Dunn talked about that. It is their own money. Cut the rate. Allow the payroll tax rate to come down. Allow the people to have the choice to put their payroll taxes into investments that yield the type of a market return that the President has suggested he wants to do with the trust fund.

And I agree with Jesse to that extent, we want growth. But I want to say that I don't care who is President, left or right. It is not left or right. It is that no power should be entrusted to any government to enrich itself at the expense of the American taxpayer.

Mr. FOLEY. Let me ask you this, because a far better option, as stated by the Sun Sentinel again, would be to earmark a portion of Social Security taxes to accounts conservatively managed through the private sector, as is being done in Britain and other countries.

You like tax cuts. Most of us do. Would you agree to a tax cut that ties the proceeds of that tax cut directly to an earmarked account?

Mr. KEMP. No, no. Absolutely not. Absolutely not. There is too much social engineering. I don't like it from the left, I don't like it from the right. Bring down the rates. Expand IRAs. Eliminate the capital gains tax and eliminate the estate tax. There is too much engineering from Washington, DC.

Reverend JACKSON. Cutting taxes would not incentivize investment in Appalachia.

Mr. KEMP. Oh, yes, it would. What is an empowerment zone then, with all due respect?

Reverend JACKSON. Mr. Congressman——

Mr. KEMP. It is a tax incentive.

Reverend JACKSON. An empowerment zone without an incentive for investment is a hoax.

Mr. KEMP. I just suggested an empowerment zone is an incentive.

Reverend JACKSON. An empowerment zone without a formula for incentivized development is a hood without a motor. We don't offer to Eastern Europe and Southeast Asia an empowerment zone. We offer them an economic stimulus package that includes incentive tax cuts; long-term, low-interest loans; Export-Import Bank; the IMF. America deserves no less than that.

Chairman ARCHER. The gentleman's time has expired.

Mr. KEMP. Don't do to America what we have done to the Third World, put the IMF on them.

Chairman ARCHER. The gentleman's time has expired.

Mr. Matsui.

Mr. MATSUI. Mr. Chairman, thank you very much.

Jack, if you could give me a hint of what is on your mind, I will frame my question to be able to let you answer it. You are really doing a good job on this today, I have to say.

Let me make one observation, because Reverend Jackson made an observation about investments by individuals who perhaps are low-income and perhaps don't have investment experience or background, and you came back and you said, What do you think, that the American people are dumb? You know, they are not dumb.

Mr. KEMP. They are not.

Mr. MATSUI. Let me just make my observation. You can comment any way you want. Reverend Jackson wasn't suggesting these people are dumb. No one is suggesting these people are dumb. We are saying there is an experience issue, there is the inability perhaps to find the right people to help them manage their funds. They have very little income, and perhaps the financial managers that some high-powered folks like you and I and people go to would not want to take care of somebody who may only want to invest $15 a month in the market. So there is that problem.

You mentioned Britain. The British have suffered, you are undoubtedly aware, but there is going to be literally billions of dollars that are going to be paid by insurance companies to bail out some of these investment firms that have mismanaged investments and perhaps committed fraud and deceived people. Arthur Levitt is very concerned about this at the SEC. He has done an analysis of 10 studies on Wall Street. Even Wall Street managers are concerned about this, because it would damage their reputation as well.

I know that 30 or 35 percent of the American people are in the market right now, including you and myself, and we will really be able to do this well, and we probably will get a greater return. The real issue, however, is how do we make sure that you don't create a disabusive system for those 65, 70 percent who aren't in the market? I really need to hear that.

Second, if I can just make one other observation, there was a good article in today's New York Times, and I would really ask Members to look at it. It is written by Teresa Tritch, senior editor of Money magazine. She says the reason that private investment looks so much better than government bonds, and I agree with that, is because they base it on an actuarial factual situation in which somebody puts money in, and they allow the returns to accumulate, and there is no churning. So there is no 20-percent fee or overhead cost, nor any of these kinds of things. Obviously as an individual, many people may churn, if you talk about self-interest, and that is what makes markets run, money managers are going to want churning, because that is how they make their commissions and fees. So we need to really address that issue.

I want to see us move quickly in this area—spring or early summer. But we have got to address this issue.

Let me let you both answer the second part of my question, and if I may, ask you to address the issue Reverend Jackson raised in his opening remarks about the disabled, survivors benefits for widows and widowers and obviously minor children or children under 18.

The Chairman said he was going to address that issue, and I am happy to hear that, but what we need to know, one, is whether that is going to be an entitlement program or subject to annual appropriations. We need to know whether it is going to be the same level of benefits. We need to also know how we are going to pay for it. Because of all of the funds we are talking about, the whole Social Security system, one out of every three dollars goes into those various areas. In other words, it is not all for retirement. And so that is a large sum of money. We need to really address this—perhaps both of you can address that.

Mr. KEMP. I would say the answer to that question is guarantee it. The government should guarantee that.

Mr. MATSUI. I love that, and I don't mean to interrupt you, but you did say we are going to guarantee so nobody really loses any money. The real danger in what you are saying is that you might as well take major risk in your investments. You are going to be guaranteed——

Mr. KEMP. Bob, let me answer that question real quick.

I am not suggesting nor do I think that any man or woman on the panel or anybody who believes as I do that we ought to give people better rates of return. I believe they should be investing in LTCM, long-term capital management.

Mr. MATSUI. If you guarantee they won't lose, that is what they are going to do.

Mr. KEMP. With all due respect, the Thrift Savings Plan the government now runs is a good example of how the government can provide more continuity, more assurances and a better rate of return. We are not talking here about LTCM. We are not talking about hedge funds. We are not talking about investing in yen and deutsche marks or euros I should say.

Mr. MATSUI. Can you answer my question about how you protect these folks and things of that nature? I really need to hear that from you.

Mr. KEMP. I am sorry?

Mr. MATSUI. How do you protect these folks from what happened in Britain? How do you make sure that the people who invest $20 a month get the right kind of investment advice? Is there any——

Mr. KEMP. The same way we do in the Thrift Savings Plan that is now run by the government except it allows more choice for the individual working woman or man.

Mr. MATSUI. You don't want the government involved in this, it is my understanding, because we can put all kinds of conditions on this stuff.

Mr. KEMP. I trust the American people——

Mr. MATSUI. Please. We may want to say you can't invest in bad——

Mr. KEMP. I know there is a certain amount of frustration because there is not enough time, and I respect the time that everybody has.

Mr. MATSUI. I would appreciate hearing from you.

Mr. KEMP. I have suggested a range, a plethora of choices that is higher than T-bills and lower than LTCM trying to leverage at 100 percent to the dollar.

Mr. MATSUI. You have got to answer that question, Jack. Because if you want private investments, you have got to answer that question.

Mr. KEMP. I can pick, you can pick, the government can pick. They can have, as they do in a thrift savings plan, a range of mutual fund investments that would allow for a higher rate of return. You could take the Russell 2000 or the——

Mr. MATSUI. You have got to do better than that.

Chairman ARCHER. The gentleman's time has expired.

The question is a very good question, and there are likely answers to it that are valid answers. I would refer the gentleman to the Chilean experience, which is now 19 years old, where a secretary making $16,000 a year currently will retire at age 60 with $200,000 in her account and can purchase an annuity which will pay her for the rest of her life 100 percent of what she earned in the last year that she worked. And without getting into the details because we don't have time for that, the Chilean system does have certain protections that are in their system.

Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman; and I want to express appreciation to Reverend Jackson and to Jack for being here today.

Reverend Jackson, I want to remind you and Jack that when you go back to when Bismarck started this kind of a retirement program, he set that 65 age limit for benefits, and the average lifespan was about 52. So, obviously, one of the ways we can resolve this is to say you don't get your benefits until you are 85 or 90; and we have eliminated any of the insecurity anyone feels right now.

In that connection, though, there is something we probably should have done in the thirties and that is to index the benefit age so that, as the average lifespan keeps ratcheting up, it is indexed, and you are put off yet another year and another year before you get your benefits.

But the other alternative that has been tossed out there is tax increases. Would you favor a tax increase?

Reverend JACKSON. I wouldn't.

Mr. CRANE. You would not?

Reverend JACKSON. No. I am not quite sure where you are going, but one thing I know is that many African-Americans and Latinos tend not to live to 65. And raising that limit won't make them live any longer, and that is not an answer to that situation. People live longer when they have stronger foundations of education and opportunities and balanced diets. That is what makes people live longer, bottom up, not top down.

Mr. CRANE. Well, there apparently is some discussion as to the reduction in our infant mortality rate having an impact on what that average lifespan is; and I haven't seen all the figures on that.

But one of the things that is interesting is our next witness who has indicated that if you just raised taxes 1.1 percent on individuals and 1.1 percent on your employer, that that would guarantee the solvency of the program for at least another 75 years. But you would not favor considering that option?

Reverend JACKSON. No. I am not inclined to consider any other tax raise without a radical reassessment of how the high tax raise would be spent. I think that would be a death blow to the Social Security debate to inject into this raising taxes as a form of salvation. I think that is a death knell to the whole debate.

Mr. CRANE. Very good. I am glad to hear that.

Now, I have just received a Heritage Foundation study, and the thing that is interesting is that they have the breakdown of the investment of Social Security taxes into a portfolio composed of Treasury bonds for the average working American. And then they have the portfolio composed of 50 percent Treasury bonds and 50 percent large business equities. And the thing that is interesting is the latter are almost double. I mean, the totals, dollar figures, are almost double what the existing totals are when invested exclusively in Treasury bonds. So are you leaning in that direction of making the investments go beyond the Treasury bonds and considering large business equities?

Reverend JACKSON. You know, I am not familiar enough with that to answer that question.

Mr. CRANE. Notwithstanding those figures?

Reverend JACKSON. Notwithstanding those figures. Because some of the figures I need a better context to have a grip on to be safe to make a public statement on it.

Mr. CRANE. How about you, Jack?

Mr. KEMP. Well, everyone would want a mix in their portfolio. My argument is not so much that it wouldn't be better to invest in equities, because it would over time. But my argument is that it shouldn't be used to enrich government. It should be used to enrich and empower working men and women and families giving them more choice and a higher rate of return. So I favor allowing them to do so either through the government Thrift Savings Plan or into Roth IRAs.

I am a big fan of Roth IRAs. I didn't invent it. Bill Roth did. But if you expand it and lift the lid then a lot more people will put money in, savings will rise and the growth of the economy will be better, particularly if you bring the capital gains rate down. It should be eliminated. Stupid tax. Not a tax on the rich. It is a tax on the poor who want to get rich.

Eleanor Holmes Norton, our colleague from the District of Columbia who is on the Democratic side of the aisle, wants to eliminate it altogether to help the District of Columbia. If it will help the District of Columbia why won't it help Motown, Chitown, Overton, South Central L.A., every town in America and rural Appalachia as well?

Chairman ARCHER. The gentleman's time has expired.

Mr. Shaw.

Mr. SHAW. Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Would the gentleman suspend for just a moment? The Chair would like to inquire of the two witnesses what the confines of their schedule are today and how much longer they can comfortably be with us?

Reverend Jackson, did you have—can you stay for a significant additional time with us?

Reverend JACKSON. I need to go, but I am so glad to be here. I just change everything to be around you.

Chairman ARCHER. You are willing to stay on for some additional time?

Reverend JACKSON. Yes.

Chairman ARCHER. Jack, what about you?

Mr. KEMP. My wife and I are leaving for a ski trip vacation, but——

Chairman ARCHER. How much longer can you——

Mr. KEMP. Until 12:30, quarter to 1—1 o'clock.

Reverend JACKSON. 12:30, please.

Chairman ARCHER. That is good. That gives us some timeframe to work in, and we will be prepared to excuse you at 12:30.

Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman.

I want to redirect our attention back to where you started this hearing, and that is the question of looking back at the possibility of government investment, direct investment.

Reverend Jackson, you very eloquently expressed the question of morality and its connection with proper investment by the Federal Government. I can see this filtering down into much debate within the House and the Senate as to what we should and should not invest in. To give you an example, in some areas, to invest in a company that is strip mining might be a terrible thing to invest in. Or investing in a company that stores nuclear waste or that runs nuclear plants can be a problem. It can be a huge political problem. Or to have invested in a company innocently enough where the chief chief executive officer gets indicted can be a terrible problem and can result actually in a political scandal for those in charge of the government and running the government even though they had absolutely nothing to do with it.

Also, I have heard people say, Well, why don't we invest in index funds? You would have to sanitize those index funds to be sure you weren't investing in something that is offensive to some part of the population.

Unfortunately, morality is in the eyes of the beholder. For many of the American people, investing in tobacco companies is a bad thing, but for someone who smokes, they may not see anything in the world wrong with that. So this really puts us on the horns of a dilemma.

And I think that when you start getting into this, you are almost putting a Good Housekeeping Seal of Approval on certain companies and then blacklisting other companies, which I think could create a real big problem and a dilemma inside the market.

I am glad you brought this up, because I think this is something that Congress really has to look at. And I think as we go forward and as my Subcommittee on Social Security has hearings on the President's plan, I would want to get into that and see what effect this could have on the market.

Reverend JACKSON. I think that raises the point that we could have argued why not invest in the Marshall plan.

But the board, if you will, were credible eminent persons, those making that decision, which is where I thought Congressman Rangel was going. Those who would make those decisions must be credible persons because you have to have—it would never be riskproof or be flawless, but clearly it should be a stimulus to companies to qualify for the royal American investment. That should be a stimulus.

So I do not see that as being a deterrent. Because I think if a company wants to be in good favor with our government, if both morally right and it is efficient, then I think it is an economic stimulus.

Mr. SHAW. We in the Subcommittee, Bob Matsui and I, the Ranking Democratic Member on that Subcommittee, at this point have asked Congressional Research to compose a list of all the alternatives that we have. And I can tell you that some of them are pretty bleak, and some of them will automatically be off the table.

The two right now that I think are at the bottom of the score list which I don't see any support for is raising the taxes, the President has come out against that, and certainly on our side of the aisle we are against that. You have indicated that you are against that, and I am sure both of our witnesses are against that.

Also——

Reverend JACKSON. I will tell you what I am working on with Congressman Kemp, if I might say.

Mr. SHAW. Let me finish. I am going to draw a red light in just 1 minute and have to stop.

Nobody in the Congress that I am aware of is in any way in favor of tampering with its existing benefits. We have to preserve those. We are not going to steal from our grandmothers and grandpas, our mothers and our fathers in order to solve the problem. They are already in the system; and, as far as I am concerned, they have a sacred contract. Although it is not legally contractual, it is certainly morally contractual with the Congress, not to change that.

But we are going to have some tough decisions to make, but it becomes very clear to me in this hearing that part of the solution is looking toward the private sector, looking toward investment in equities. The question is how to get there.

Now I am impressed with your comment with regard to the Lotto. Obviously, we are going to have to put restraints on the system so people can't take that money and throw it in the Lotto or can't give it to their brother-in-law to invest in some cockamamy stock. Even though we do have faith in the people, we have to put certain constraints on it so they are going forward with a responsible plan preparing for their own retirement.

Chairman ARCHER. The gentleman's time has expired.

Let's see.

Mr. Houghton.

Mr. HOUGHTON. This is such a far different hearing than I ever would have expected. We are talking about anticipating 15 years out a crisis. Unusual. We are talking about a surplus. Never had it before. We are talking about dissembling the unified budget. And we are talking about what Albert Einstein said was the most powerful form of energy in the universe, which is compounding interest. I wonder whether we are not 90 percent of the way there because we are talking about the things we all hoped we could talk about but never been able to.

So now the issue really is, where does the money go and who invests it? Now, if I get the money, I have to choose somebody, because I am unable to know where to invest this money. I have to choose somebody to do it. Now, do I choose a government agency? Do I choose a nongovernment agency?

And let me pose this question to you. Suppose you had a rotating series of financial managers, and that would be maybe Bear Stearns and Charles Schwab and Goldman Sachs and Paine Webber, and then it would rotate the next quarter or the next half? What difference does it make whether that money goes to the government to put into those people's hands which ultimately go to the individual or whether I as an individual make that decision?

Mr. KEMP. Can I take a shot at that?

Are you asking what the difference is? Do you mean between the government investing and personal investment?

Mr. HOUGHTON. Not the government investing. The government asking a rotating group of private investors to make those decisions.

Mr. KEMP. I was talking about the revenues going into government or going to mom and pop and to people. I don't think there is any question, is there? Wouldn't we want the individual working men and women to get that power of compounded rates of return? The government is in the business of redistributing wealth.

Mr. HOUGHTON. The people are going to get that money. They are going to get the result of that money. The question is, who does the investing?

Mr. KEMP. Well, I would much rather have Bear Stearns and Schwab and Fidelity and the mutual funds you alluded to or money managers you alluded to doing that on behalf of the working people of America rather than allowing the enrichment to go to government. Because government has an insatiable appetite——

Mr. HOUGHTON. The enrichment is not going to go to the government. The enrichment is going to go to the individual person. So the question is election.

Mr. KEMP. How is it if the government invests the money even with private investors or money managers that the money gets to the people? How is it?

Mr. HOUGHTON. The ultimate end of the investment is to have a risk fund alongside the Social Security Fund, OK? So that—the whole purpose is not to keep the money in the government in the unified budget. The whole purpose is to give it to the individual. And you are using the private system and also the compounding concept to do that.

So I ask you, if the Federal Government decides to appoint a group of private investors rather than me deciding who those private investors are, I may get the money anyway.

Mr. KEMP. How so? Under Social Security?

Mr. HOUGHTON. Absolutely. Social Security and also this risk fund.

Mr. KEMP. I just make an a priori case that the government can't do it or distribute it as well as the private sector can distribute it if the people have the right to property rights. It is a property right. When you give it back to the people, they have an individual property right. And I want to make an argument that a property right is a human right. It is a civil right. It is a legal right.

Mr. HOUGHTON. How do you feel about that, Dr. Jackson?

Reverend JACKSON. You see, the case I want to make is an addendum. When we mention these companies, there is a whole body of women and minority handling some money who may be creative enough but who may not qualify enough to be in the elite circle. I would be concerned about who, in fact, would be doing the distributing.

The point I keep trying to make is the assumption of Social Security is to protect those people who need a safety net. If we expand the tent to include more people in their formative years, there will be more focus on the roof than on the net.

We are paying a terrific price now for not adjusting our system to include marginalized America. That is why I say a bridge from Wall Street to Appalachia, a bridge from Wall Street to Harlem or a bridge from Wall Street to East Los Angeles. If we expand the tent of inclusion, there are more people educated, more people working, more productive, more high-volume consumers, more economic growth. And when there is growth, everybody is a winner.

I do not want to accept the assumption it would somehow take care of those who are locked out. I say, let those in who are locked out, and they can help better take care of themselves and the government than the government taking care of them.

Chairman ARCHER. The gentleman's time has expired.

Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Welcome to both witnesses and thank you for your testimony.

Reverend Jackson, you had talked in your testimony about possibly mandating a beneficiary impact statement, and I was just wondering if you could let us know why you find that necessary and how you think it would work?

Reverend JACKSON. Because there is so—as we were just reminded, some are projecting on the surplus we never had before and the future that is not yet. So we need some reasonable projection context to make intelligent decisions. With each of these ideas must come some benefit impact study of the cost benefit of a given idea. That is my point.

Mr. COYNE. Thank you very much.

Chairman ARCHER. Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman.

Thank you, gentlemen, for sticking around. It is really a treat for us to hear your points of view on some of these issues that are so important to us.

I think the very exciting thing for me as we move into an indepth discussion on Social Security is the fact that we seem to have reached critical mass on this issue and, for me, that is very hopeful. In the legislative process, we know that compromise is imperative, but still to be able to talk about these issues and know that folks out there are saying the time has come, we really need some change, to me that is very exciting.

But it also puts a great task before us, and so as I think about this issue, I am sort of with Mrs. Thurman on some of it because I am a single mom and I worry a lot about retirement. I am really very, very worried about retirement, worried about putting enough money aside, worried about getting into a job where you can afford to put some money aside for retirement, worried about the safety net, very concerned about wanting this system updated. And so I think, in terms of what we have to watch, to remember the women in this.

And I would say as we move into this discussion we ought to, first of all, say we will keep our commitment to the senior citizens out there who are depending on Social Security as part of their retirement income. It is very important that we reassure everybody that that is first and foremost in our minds. But the system is 60 years old, and it needs to be remodeled, and it needs to be brought up to date.

So what do we do as we go into this great opportunity to revise it?

First of all, it seems to me we have to keep in place the safety net. And women particularly as I talk with them want to know that we are not saying it is an either/or proposition. We are not saying you have your own private investment account, which I certainly would like to have as part of the system, or you have the safety net of the current Social Security. You keep the benefits at their current amount out of Social Security but also provide some options.

So Jack Kemp has talked about the difference in the amount of return we get with the current system, maybe 2 percent a year. That is not enough of a return compared to what you can get out of the private—the markets or private investments, 7 to 8 percent return is vitally important. I think we have to work that into things.

And so my third point would be, how am I and other people under this system allowed to make Social Security more secure? And that is where I see the combination coming together. Current Social Security benefits but you also have the option to invest in something.

Now, I am working as part of the government elected by my constituents but paid by the House of Representatives; and for me the thrift savings account is an option. So the thrift savings account is really what I am looking at for the major part of my retirement, and I like to know that it is connected to me directly, that if something were to happen to me, as happens to some people in this life, they don't live into the retirement years, those dollars are still my dollars that I could leave to my heirs, and that is a very good feeling that I have.

I also like the thrift savings account because I have the right to choose which of several different management teams are going to invest in several different accounts for me; and I think that is vitally important so I like that, too.

But I guess what I would like to ask you both to consider, are there other elements of this that we should add in? For example, we talked about women who step away from the work force for a number of years to take care of their children, take care of their aging parents, wives who 70 percent of the time outlive their husbands so are retired for many more years on many fewer dollars. Should we be promoting catchup IRAs, for example, for those women who step away? What is it we can do to allow particularly women to make their Social Security more secure? And I ask each of you to respond to that.

Mr. KEMP. Well, this goes back to the question that was asked earlier and I answered earlier. Basically, the question was about, how can you help women? How can you help women and men? How can you help workers who are female? Let them get a higher rate of return on their payroll tax. I am sorry I can't come up with anything more sophisticated. Allow them to put it into a Roth Ira or Thrift Savings Plan. Let them take advantage of this.

I can tell you, since leaving Congress I have assured my retirement and the college education of all 12 grandchildren because we cut tax rates in 1981 and you guys cut the capital gains tax just a couple of years ago. Frankly, we have got a rising stock market. We have got to get the growth of the economy to such where we can take this debate to the next level. That is what the surplus does. It allows us to debate things we could never debate before.

Now we are debating what to do with the surplus. I am suggesting that we give it back to the working men and women of America and allow them to get a better rate of return. Please don't let this administration or the next administration or any administration get a hold of corporate business in America. That would be——

Reverend JACKSON. Jack Kemp can now educate all of his grandchildren because there are no longer caps on speaking fees. It has nothing to do with what we are discussing, for the record.

Chairman ARCHER. The gentlelady's time has expired, and we are at 12:30, and the Chair is extremely grateful to both of you for spending this time with us today. I think all of us have benefited by this diversity of ideas and exchange of views and——

Mr. KEMP. We compliment the Chair for bringing these hearings to the American people.

Reverend JACKSON. Thank you.

Chairman ARCHER. The Chair wishes you both well.

Reverend JACKSON. Thank you very much.

Mr. KEMP. Mr. Matsui and Mr. Rangel and Mr. Coyne and Mr. Doggett.

Chairman ARCHER. The next witness and the last witness for today is Alicia Munnell—Dr. Munnell, the Peter Drucker Chair of Management Sciences from Boston College. Welcome, Ms. Munnell.

And the Chairman of the Social Security Subcommittee will preside over the balance of the hearing today.

Mr. Shaw.

Mr. SHAW [presiding]. Ms. Munnell, you may proceed.

STATEMENT OF ALICIA H. MUNNELL, PETER F. DRUCKER PROFESSOR OF MANAGEMENT SCIENCES, BOSTON COLLEGE CARROLL SCHOOL OF MANAGEMENT

Ms. MUNNELL. Thank you, Mr. Chairman.

I am a professor at Boston College currently, but I was also Assistant Secretary of the Treasury for Economic Policy and a Member of the President's Council of Economic Advisers. I am delighted to have the opportunity to appear before you today to discuss proposals to preserve and strengthen Social Security.

In my view, the best way to ensure that all Americans have a basic adequate retirement income is to maintain the current Social Security Program. That is, maintain a system where benefits are based on lifetime earnings, not move toward a system of personal accounts. And it is for that reason that I applaud the President's proposals that he described in the State of the Union.

Let me very briefly explain why I think the President is on the right track and in turn respond to the three questions that you raised in the notice for this hearing.

The first question you asked was, does Social Security have to be restructured; and the answer is no. Social Security is not facing a crisis. It is facing a long-run, projected deficit that is manageable. It can be fixed within the current framework of the existing programs. Much of the shortfall can be eliminated with the President's proposals and other proposals that not only raise money and cut benefits in an appropriate way but also are good policy.

Second, do we need to replace or should we replace part of the Social Security's current defined benefit plan with personal security accounts? I think the answer to that is no, and that is where the President has come out after considering whether or not he should cut back on Social Security defined benefits and replace them with individual accounts.

The individual accounts are risky. They are costly, and they could hurt women and the disabled. The whole point of having a Social Security system is to provide workers with a predictable retirement benefit. Social Security benefits are very modest. The average worker who retired last year at the age of 62 received a monthly benefit of $780 a month. That is less than $9,400 a year. This modest benefit should be an amount that people can count on and to which they can add income from private pensions and other savings. It cannot depend on the individual's independent decisions on stock—picking stocks in a volatile stock market.

Another risk with personal savings accounts is that they are unlikely to be kept until retirement. As in the case of IRAs and 401(k) plans, people will insist on some access to their accounts in order to cover emergencies and other important expenses. No matter how good the case for withdrawals prior to retirement might be, those withdrawals will mean inadequate retirement income.

A third risk with a personal savings account is people may outlive their savings. In contrast, Social Security provides retirees with inflation-indexed annuities so that it guarantees benefits keep pace with inflation so long as a person lives.

Personal savings accounts are also likely to be very expensive to administer. We can talk about that later, if you would like, but the estimates are that they could well equal a 20-percent cut in benefit.

Disabled workers are likely to receive sharply lower benefits under most proposals for personal savings accounts. The reason is that these proposals generally involve a cutback in Social Security benefits that are made up from a payment from accumulated assets. But if you become disabled midlife, you don't have enough time to accumulate enough assets. Therefore, persons with disabilities would be put at risk.

Finally, women and low-income people generally have the most to lose from moving from the current system to a system of personal savings accounts. To the extent that personal accounts are substituted for Social Security, they would lose the progressive benefit formula. They would lose some spouses' and widows' benefits. They would lose the guarantee of inflation-indexed annuities.

Instead of personal savings accounts we should do as the President suggested. We should increase national saving and diversify investments within the context of the current program.

We know how to build up reserves at the Federal level. They do it at the State level, and we know how to invest in equities without having the government in the business of picking winners and losers. Nobody wants that. That is not a sensible proposal.

We can invest in a broad index through an independent investment board and delegate all voting rights down to independent fund managers.

There is no reason, in short, to move toward a system of personal savings accounts. We can increase national saving and improve returns within the context of the existing program.

Social Security's current defined benefit arrangement is the best way to ensure basic retirement protection. We should stick with it.

We should modify the financing. We shouldn't change the program fundamentally.

Thank you.

[The prepared statement follows:]

Statement of Alicia H. Munnell, Peter F. Drucker Professor of Management Sciences, Boston College Carroll School of Management

Mr. Chairman and Members of the Committee, I am delighted to have the opportunity to appear before you today to discuss proposals to preserve and strengthen Social Security. In my view, the best way to ensure that all Americans have an adequate basic retirement income is to maintain the current Social Security program, which pays benefits based on lifetime earnings, and not to move toward a system of personal savings accounts. Let me provide a brief summary of the reasoning behind that conclusion and, in the process, answer the three questions you raised in the notice for this hearing.

I. Social Security is not facing a crisis and does not need major reform. The projected increase in Social Security spending due to the aging of the population is neither enormous nor unprecedented.

- The cost of the program is projected to rise by 2 percent of GDP. Budget changes equal to 2 percent of GDP are not uncommon; defense spending increased by 5 percent of GDP at the start of the cold war and declined by 2 percent between 1991 and 1998. The financing shortfall is manageable and does not require radical change in the program.
- Much of the projected shortfall can be eliminated with good policy options. For example, extending coverage to new state and local workers, increasing the maximum taxable earnings base, and reflecting corrections to the CPI in the COLA are all consistent with the goals of the program and will help close the financing gap. Investing the trust funds in private stocks and bonds will increase the return on fund reserves and close much of the remaining gap.

II. Replacing all or part of Social Security's current defined benefit plan with personal savings accounts is risky, costly, and will hurt the disabled and women.

- The whole point of having a Social Security system is to provide workers with a predictable retirement benefit. Social Security benefits are quite modest; the average worker retiring at age 62 last year got $780 per month. That modest benefit should be an amount that people can count on and to which they can add income from private pensions and other sources. It should not depend on investment decisions in a volatile stock market.
- Another risk with personal savings accounts is that they are unlikely to be kept until retirement. As in the case of IRAs and 401(k) plans people will insist on access to their accounts in order to cover emergencies or to meet expenses. No matter how good the case for withdrawals prior to retirement might be, those withdrawals will mean inadequate retirement income.
- A third risk with personal savings accounts is that people may outlive their savings. In contrast, Social Security provides retirees with inflation indexed annuities, so that it guarantees benefits that keep pace with inflation for as long as a person lives.
- Personal savings accounts are likely to be expensive to administer. Studies show that administrative costs could well equal a 20-percent cut in benefits. Data from the U.K. and Chile, countries that have adopted personal saving accounts, suggest that the costs could be even higher. Annuitizing individual accumulations in the private market reduces benefits by another 10 percent. Social Security keeps administrative costs low by pooling investments, and low administrative costs ensure a higher net return to workers.
- Disabled workers are likely to receive sharply lower benefits with personal savings accounts. They will not have time to build up adequate reserves under a system of personal saving accounts. In contrast, Social Security provides full benefits for disabled workers.
- Finally, women have the most to lose from moving to a system of personal savings accounts. To the extent that personal accounts are substituted for Social Security, they would lose the progressive benefit formula that provides proportionately higher benefits for low earners than for high earners; women are more likely to be low earners. They would lose spouses' and widows' benefits, which help support women who spend time out of the labor force taking care of their families. They would lose the guarantee of inflation indexed monthly benefits for life, which is particularly valuable to women who on average live longer than men. Personal savings accounts would put these protections at risk.

III. Instead of personal savings accounts, we can increase national savings and broaden investment options for workers—changes that have been used to justify personal savings accounts—within the structure of the current program.

- The federal government can accumulate reserves. The non-Social-Security portion of the budget is headed for balance in 2002, probably sooner. We can keep it there and build up reserves in the Social Security trust funds. The states do it for their pension funds; the federal government should be able to do it for its major retirement system.
- Investing a portion of the Social Security trust funds in private stocks and bonds is both desirable and feasible. We know how to prevent interference in private sector activity: set up an independent investment board, invest in a broad index, and delegate voting rights to independent fund managers.

In short, there is no reason to move toward a system of personal savings accounts; we can increase national saving and improve returns within the context of the existing Social Security program. Social Security's current defined benefit arrangement, where benefits are based on lifetime earnings, is the best way to provide basic retirement income. Social Security has served us well for nearly sixty years; let's modernize its financing but keep its benefit structure in place. Social Security is not broken; it just needs fine-tuning.

I. Social Security is Not Facing a Financing Crisis

Social Security is not facing a financial crisis. Rather, the current projections show a financing gap in the long run unless remedial action is taken, as it almost certainly will be. According to the Trustees' 1998 Report (intermediate assumptions), between now and 2013 the Social Security system will bring in more tax revenues than it pays out. From 2013 to 2021, adding interest on trust fund assets to tax receipts produces enough revenues to cover benefit payments. After 2021, annual income will fall short of annual benefit payments, but the government can meet the benefit commitments by drawing down trust fund assets until the funds are exhausted in 2032. It is important to remember that the exhaustion of the trust funds does not mean the program ends in 2032, and nothing is left. Even if no tax or benefit changes were made, current payroll tax rates and benefit taxation would provide enough money to cover roughly 75 percent of benefits thereafter. It is this long-run gap between 75 and 100 percent that needs to be filled.

Over the next 75 years, Social Security's long-run deficit is projected to equal 2.19 percent of covered payroll earnings. That figure means that if the payroll tax rate were raised immediately by 2.19 percentage points—roughly 1.1 percentage point each for the employee and the employer—the government would be able to pay the current package of benefits for everyone who reaches retirement age at least through 2075. While such a tax increase is neither necessary nor desirable, it provides a useful way to gauge the size of the problem.

It is also useful to look at the program as a percent of GDP. The cost of the program is projected to rise from 4.6 percent of GDP today to 6.8 percent of GDP in 2030, where it is projected to remain. This increase is due primarily to the aging of the population. A 2-percent-of-GDP increase in Social Security costs is significant, but hardly qualifies as a "demographic time bomb."

Although Social Security's financing problems are manageable and do not require radical changes in the system, two considerations are receiving more attention today than in 1983 when Congress last passed major financing legislation. The first is the so-called "money's worth" issue. Unlike earlier generations that received large benefits relative to the taxes they paid, today's workers can expect to receive relatively low returns on their payroll tax contributions. Since raising taxes or reducing benefits will only worsen returns, almost all reform plans involve trying to increase returns through equity investment in one form or another. The second factor influencing the Social Security reform debate is increasing concern about our low levels of national saving. This concern along with the desire to avoid high pay-as-you-go tax rates in the future has led to considerable interest in some prefunding.

Almost all proposals to restore financial balance to Social Security respond to concerns about rate of return and national saving. Both proposals to maintain Social Security's existing defined benefit plan and proposals to institute personal saving accounts involve a substantial accumulation of assets. Similarly, most proposals provide that those covered by Social Security should have access to the higher returns associated with equity investment either through investments in personal savings accounts or through broadening the investment options available to the trust funds. Because it is possible to have equivalent amounts of funding in the Social Security program and in a system of personal savings accounts and because equity investment is possible in either scenario, the question comes down to which arrangement is better for people's basic retirement income.

II. Personal Savings Accounts are Risky, Costly, and Hurt the Disabled and Women

Here the economics are clear: the current Social Security program, where benefits are based on lifetime earnings, is the best way to provide the basic retirement pension. Personal savings accounts are risky, costly, and likely to hurt the disabled and women.

Personal Savings Accounts Are Risky.

Personal savings accounts expose workers to three risks: market risk, the risk of using their savings before retirement, and the risk of outliving their resources.

With personal savings accounts, individuals' basic benefits would depend, at least in part, on their investment decisions. What stocks did they buy? When did they buy them? When did they sell? Uncertain outcomes may be perfectly appropriate for supplementary retirement benefits, but not for the basic guarantee. Herb Stein, Chairman of the Council of Economic Advisers under President Nixon, summarized the argument best.

> "If there is no social interest in the income people have at retirement, there is no justification for the Social Security tax. If there is such an interest, there is a need for policies that will assure that the intended amount of income is always forthcoming. It is not sufficient to say that some people who are very smart or very lucky in the management of their funds will have high incomes and those who are not will have low incomes and that everything averages out."

Retirement income that depends on one's skills as an investor is not consistent with the goals of a mandatory Social Security program. Remember that Social Security is the major source of income for two-thirds of the 65-and-over population and virtually the only source for the poorest 30 percent. The dollar amounts are not very large: the benefit for a low-wage worker who retired at age 62 in 1998 was only $473 per month or $5676 per year and for a worker with a history of average wages was $780 per month or $9360 per year. Does it really make sense to put these dollar amounts at risk?

Personal saving accounts also create a very real political risk that account holders would pressure Congress for access to these accounts, albeit for worthy purposes such as medical expenses, education, or home purchase. Although most plans prohibit such withdrawals, our experience with existing IRAs and 401(k)s suggests that holding the line is unlikely. To the extent that Congress acquiesces and allows early access—no matter how worthy the purpose—retirees will end up with inadequate retirement income.

Another risk is that individuals stand a good chance of outliving their savings, unless the money accumulated in their personal savings accounts is transformed into annuities. But few people purchase private annuities and costs are high in the private annuity market. The reason for the high costs is adverse selection: people who think that they will live for a long time purchase annuities, whereas those with, say, a serious illness keep their cash. Private insurers have to raise premiums to address the adverse selection problem, and this makes the purchase of annuities very expensive for the average person. Moreover, the private annuity market would have a hard time providing inflation adjusted benefits. In contrast, by keeping participants together and forcing them to convert their funds into annuities, Social Security avoids adverse selection and is in a good position to provide inflation-adjusted benefits.

Personal Savings Accounts Would Be Costly.

In addition to making the basic retirement benefit dependent on one's investment skills, personal savings accounts would be costly. The 1994–96 Social Security Advisory Council estimates that the administrative costs for an IRA-type individual account would amount to 100 basis points per year. A 100-basis point annual charge sounds benign, but estimates by Peter Diamond of MIT show that it would reduce total accumulations by roughly 20 percent over a 40-year work life. That means benefits would be 20 percent lower than they would have been in the absence of the transaction costs. Moreover, while the 100-basis-point estimate includes the cost of marketing, tracking, and maintaining the account, it does not include brokerage fees. If the individual does not select an index fund, then transaction costs may be twice as high. Indeed, costs actually experienced in the United Kingdom, which has a system of personal saving accounts, have been considerably higher than the Advisory Council estimate. Finally, because these transaction costs involve a large flat charge per account, they will be considerably more burdensome for low-income participants than for those with higher incomes.

In addition to costs, a recent study by the Employee Benefit Research Institute (EBRI) has raised real questions about the ability, in anything like the near term, to administer a system of personal savings accounts in a satisfactory way. Unlike the current Social Security program that deals with the reporting of wage credits, a system of personal accounts would involve the transfer of real money. It is only reasonable that participants would care about every dollar, and therefore employer errors in account names and numbers that arise under the current program would create enormous public relations problems under a system of individual accounts.

Personal Savings Accounts Would Hurt the Disabled and Women.

Most proposals that move toward personal savings accounts involve a cut in benefits for disabled workers. These proposals typically involve a reduction in Social Security benefit levels for both disabled and retirees that, in theory, will be made up through the accumulations in their personal savings accounts. Thus, projections for the various reform proposals generally show that the combined payment from the personal saving account and the reduced Social Security program equals the benefit currently promised under Social Security for the average retiree. Unlike retirees, however, disabled workers will not have time before their disability to build up any significant reserves in their personal saving account to finance a full supplementary benefit. As a result, disabled workers are likely to experience a substantial reduction in benefits.

For different reasons, personal savings accounts would also likely hurt women and low-earners generally. Although Social Security's benefit rules are gender-neutral, they are particularly helpful for women. First, the progressive benefit formula provides proportionately higher benefits for low earners than for high earners, and women are more likely to be low earners. Second, for women who spend their careers taking care of their families, Social Security provides retirement benefits equal to 50 percent of their husbands' benefits. Divorced homemakers (married least 10 years) can also get these benefits. Third, for older women whose husbands die, Social Security provides widows' benefits equal to 100 percent of their husbands' benefits. This is important because women tend to outlive their husbands. Fourth, if children are getting survivors' benefits, younger widows who stay home to care for them also receive benefits.

Even with more women in the labor force, these family benefits remain important. In 1996 the majority (63 percent) of women beneficiaries aged 62 and older were receiving wives' or widows' benefits; 37 percent had no earnings history and were entitled only as a wife or widow, and 26 percent had a higher benefit as a wife or widow than as an earner.

In addition to a progressive benefit structure and family benefits, Social Security has two other features that help women. First, Social Security pays monthly benefits for life, which is particularly valuable to women who on average live longer than men. Second, Social Security adjusts benefits annually for changes in the cost of living to protect their buying power against inflation. This protection matters more for women than for men because women live longer.

All the protections of the current program would be put at risk if reform moved toward personal savings accounts. First, unless special provisions were enacted, a woman's retirement benefit would depend—at least in part—on her contributions into her personal account and the earnings on those contributions. Because women tend to have lower wages and less time in the labor force, their contributions and earnings would, on average, produce low retirement benefits. Second, many of the family benefits currently provided by Social Security would likely be cut back. Third, with individual accounts the money is not automatically converted to a lifetime annuity or protected against inflation. If people get their money back in a lump sum, they could use it up before they die and leave nothing for their widow. This risk is compounded by the absence of inflation protection. In short, the present Social Security system offers a range of protections that are of great importance to women and are not duplicated by any of the proposals to privatize the system.

What then is the best approach?

III. Fund Social Security and Invest in Private Stocks and Bonds

The alternative to personal savings accounts is to accumulate reserves in the Social Security trust funds and invest part of those reserves in private stocks and bonds. This approach offers many of the advantages of personal saving accounts without the risks and costs. It has the potential to increase national saving and offers participants the higher risk/higher returns associated with equity investment. But, unlike personal saving accounts, a partially funded Social Security program with equity investments ensures predictable retirement incomes by maintaining a defined benefit structure that enables the system to spread risks across the population and over generations. In addition, pooling investments keeps transaction and reporting costs to a minimum, producing higher net returns than personal saving accounts.

Accumulating Reserves.

Would it really be possible for the federal government to accumulate reserves? A key requirement for success is separating Social Security completely from the rest of the budget. To date, increasing saving through accumulations in the Social Security trust funds has produced ambiguous results. Critics contend that the existence of Social Security surpluses encourages either taxes to be lower or non-Social-Security spending to be higher than it would have been otherwise. Although little evidence exists to support this contention, a unified budget and large deficits have blurred the picture to date. But the fiscal outlook is changing; the unified budget is in surplus and the Congressional Budget Office projects that the non-Social-Security portion of the budget will be balanced by 2002, if not sooner.

Revising the presentation of government accounts to separate Social Security completely from the rest of the budget also would clarify the extent to which the system is adding to national capital accumulation. Technically, the Social Security Amendments of 1983 already have placed the Social Security trust funds “off-budget.” This legislation reversed the reliance on the concept of the unified budget first used by Lyndon Johnson in FY1969. The difficulty is that, while Social Security is exempt from most enforcement procedures, budget targets are always stated in terms of the unified budget and the budget numbers reported by the Administration, Congress, and the press always include the balances in the trust funds. Thus, separating Social Security from the rest of the budget requires changing culture more than changing legal requirements.

Is it realistic to evaluate the budget without Social Security? Comparisons of the federal government with the states are always tricky, but states have been successful in this endeavor. They accumulate reserves to fund their pension obligations but generally present their budgets excluding the retirement systems. Their non-retirement budget balance has remained positive, while annual surpluses in their retirement funds have been hovering recently around 1 percent of GDP. Thus, states are clearly adding to national saving through the accumulation of pension reserves. With a commitment to balance the non-Social-Security portion of the budget, the same should be achievable at the federal level.

Investing in Equities.

Equity investment for Social Security is also a feasible option, and a partially funded Social Security program with private stocks and bonds is the realistic alternative to personal saving accounts. Everyone involved in the debate recognizes that having the federal government in the business of picking winners and losers and voting on corporate proposals is undesirable. Thus, it is essential to establish mechanisms to ensure that the government does not interfere in private sector decisions, and we know how to do that.

For example, trust fund equity investments would be indexed to a broad market average, and the goal of investment neutrality be established in law. An expert investment board, similar to the Federal Retirement Thrift Investment Board that administers the Thrift Savings Plan for federal employees, would be responsible for selecting a broad market index, such as the Russell 3000 or the Wilshire 5000, for trust fund investments. This board would also be responsible for choosing, through competitive bidding, several portfolio managers to manage the accounts, and for monitoring the performance of these managers. To ensure that government ownership does not disrupt corporate governance, the investment board would be required to delegate voting on proxy issues to the individual portfolio managers. Caps on the holdings in any individual company can be introduced to ensure that Social Security does not disrupt financial markets. Moreover, the investment in stocks would occur gradually over a 10- or 15-year period.

Even though equity investment by Social Security would not disrupt the markets, some critics still worry that it could have a substantial effect on relative rates of return, perhaps driving up government borrowing costs. The portfolio restructuring would be expected to have some effect on relative returns. The equity premium would decline to reflect the increased efficiency of risk bearing in the economy. Some movement would also be expected in interest rates. One study that has estimated the effect on relative returns concluded that the shift to equities in the trust funds would lower the equity premium by 10 basis points and raise the interest on Treasury securities by roughly the same amount (Bohn 1998). With current levels of federal debt, this increase in Treasury rates should have a relatively small effect on the federal budget. As the economy grows and the debt declines, the effect should be negligible.

While Social Security investment in equities is unlikely to disrupt financial markets or cause major shifts in rates of return, many people are concerned that Social Security investment in equities could lead to government interference with the allocation of capital in the economy and with corporate activity.

In the Social Security debate, both supporters and opponents of trust fund investment in equities point to the performance of public pension funds to argue their case. Supporters cite the success of federal plans, particularly the federal Thrift Savings Plan (TSP). The TSP has established a highly efficient stock index fund and has steered clear of any issues of social investing. TSP designers insulated investment decisions by setting up an independent investment board, narrowing investment choices, and requiring strict fiduciary duties. The TSP also operates in a political culture of noninterference. Its creators made clear from the beginning that economic, not social or political, goals were to be the sole purpose of the investment board. The TSP has perpetuated this norm by refusing to yield to early pressure to invest in "economically targeted investments" or to avoid companies doing business in South Africa or Northern Ireland. It has avoided government interference with private corporations by pushing proxy decisions down to independent portfolio managers.

Opponents of trust fund investment in equities point to state and local pension funds. They contend that state and local pensions often undertake investments that achieve political or social goals, divest stocks to demonstrate that they do not support some perceived immoral or unethical behavior, and interfere with corporate activity by voting proxies and other activities. Opponents charge that if the investment options are broadened at the federal level, Congress is likely to use trust fund money for similar unproductive activities.

My view is that the social investing activity of state and local pension plans has been grossly exaggerated, and that any such activity would be even less likely to occur at the federal level. For example, using a very comprehensive definition, a 1993 study for Goldman Sachs reported that economically targeted investment totaled less than 2 percent of total state and local pension fund holdings. Similarly, most of the divestiture activity, which centered on firms doing business in South Africa, ended in 1994. Proxy voting activities would not occur at all in the case of Social Security, since all advocates support the notion of delegating voting to the independent pension fund managers.

In short, a partially funded defined benefit plan with equity investment is feasible and can do everything that privatized accounts can do but at lower costs, thus yielding higher net returns. A recent GAO report did not identify any insurmountable hurdles with direct trust fund investment in equities. Canada should provide some good information about the feasibility of this type of equity investment since is in the process of setting up a board that will oversee the investment of its Social Security trust funds in equities.

IV. CONCLUSION

Let me conclude. Most plans being discussed today involve both prefunding and equity investment. In economic terms, the goals of prefunding and broadening the portfolio can be achieved either within the context of Social Security's defined benefit program or in personal saving accounts. The question becomes which is the best benefit structure for people's basic retirement income. Here the economics are clear. A defined benefit plan allows for better risk spreading, lower costs, and better protection for disabled workers and women than personal saving accounts.

Once balance is restored to the existing program, it is possible to consider changes that would improve the likelihood that future retirees will have adequate incomes. One option is to introduce voluntary supplemental personal saving accounts coordinated with Social Security for those who would like to set aside more money. Thus, the debate is not about whether personal saving accounts are good or bad in general. With people assured basic retirement protection, personal saving accounts may be a perfectly reasonable addition. What opponents of personal saving accounts object to in the context of Social Security reform is cutting back on existing basic Social Security benefits and replacing those benefits with a risky and costly alternative which leaves a lot of people behind. Introducing personal saving accounts as an add-on to Social Security is a good idea; substituting personal saving accounts for existing Social Security benefits, which needlessly undermines long-standing basic protections, is a bad idea.

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Mr. SHAW. Thank you, Dr. Munnell.

A couple of questions.

As I understand your testimony, you are in support of the President's position with regard to direct investment. You are against the individual accounts, and you stated your three reasons as to your opposition.

With regard to the President's position and direct investment in the private sector by the Federal Government, how do you counter, or do you agree with, the argument that Reverend Jackson made as to the morality of investments? I think you talk about index funds. How would you sanitize them to be sure there is nothing in there that is offensive to any part of the population, and who would decide what is offensive to a certain part of the population? This is a very, very difficult question which I think has really been left unanswered at this point.

Ms. MUNNELL. I agree with you, Mr. Chairman. Those are really important issues, and I also think that the proposal was not described in the best possible way. Nobody is advocating—nobody, not the administration, not any supporter—is advocating the government investing in equities.

The way the proposal should have been framed is to change the management of current Social Security reserves. And the way the management would be changed is to hand it over to an independent board very like the Federal Reserve Board; and that board would pick a very broad index of equities, such as the Wilshire 5000 or Russell 3000 or whatever, that reflects the entire cross-section of American industry. That board would then give the money to independent pension fund managers, the same managers that manage private pension fund money. These private pension fund managers would mingle the government money with their private money, and they would invest as instructed to follow this index.

In terms of the other thing that makes business very nervous, which is the prospect of the government voting proxies and interfering with corporate governance and other issues, the proposals all involve delegating the proxy voting down to these individual pension fund managers. They do it now for State and local funds and for private pensions. They have fiduciary responsibility to earn the maximum return, so they are not going to be fooling around.

Mr. SHAW. So you do not believe that the Congress would come forward and put investment guidelines based upon morality as we may individually see it here in the Congress, but not necessarily in the other world. Whatever we develop is going to be a product of legislative edict. There is no question about that. So what would prevent the Congress from putting guidelines into the investment provision which are largely more political than practical as far as good investment practices are concerned? As I understand your testimony, you are saying the Congress wouldn't do it, but as I understand what Reverend Jackson's testimony was is that we need to put moral restraints on investment.

Let me go to another point, because I don't want to prolong this since this has already gone on very long. Onto the three points that you talk about as far as private investment is concerned on individual investment accounts.

One, you talk about the question of fluctuation of the market. Obviously, that can be a problem. But there could be guarantees put in which would negate that problem.

The other is early withdrawal. I would think that if we did go that route as far as our Social Security legislation, that we would prohibit early withdrawal and would put guidelines on it that would keep that from happening. Otherwise, you would end up with a large number of people facing a crisis, taking out of their individual retirement account or even borrowing against it and then would hit hard times and have nothing then when they reached retirement.

I missed your third point. What was it?

Ms. MUNNELL. I am concerned about women and low-income people generally in the sense that——

Mr. SHAW. That is something that we are going to have to be facing and we will be taking a close look at during the deliberations of the Subcommittee on Social Security.

Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

You know, if we are going to guarantee investment and guarantee that the beneficiaries not have their benefits cut, I think you have got a winner with me. I don't see how you can do all these things. Just like Mr. Matsui said, if you are going to let people go in and take high risks and know they are going to be guaranteed, it will be difficult. I don't know what regulations we are going to have.

But I tell you this. If you are saying that if you carve out a piece of the contribution and put that into the private sector and find a way not to reduce present benefits for the future and not to lose the returns on the investment, that sounds like something I wish I had a long time ago.

Mr. SHAW. If the gentleman would yield to me. I am not suggesting that we have a program that would allow high-risk investment. There would be restraints put on the type of investments that would be made, and they would have managers of the account which would in some way be somewhat certified. So I think that you are going into——

Mr. RANGEL. If you have those restrictions, why can't the government then have the same restrictions and go into the marketplace—as the President recommended—and, therefore, not have undue influence.

Chairman SHAW. Let me also be very clear on this, if you would indulge me for a moment.

I am not at this point prepared to endorse any plan. I am just simply trying to respond to the objections and concerns that our witnesses have so that we can continue the hearing process so then we, our Subcommittee with Mr. Matsui, can then get together and draw up a plan that is fair and it would answer many of the concerns that we have. But at this point I want to be very, very clear I am not endorsing any plan, nor am I taking anything off the table.

Mr. RANGEL. Well, I want to join with you in that effort, because I think that is the way the entire Committee should go.

And, Dr. Munnell, we appreciate the contribution you have made based on your experience as Assistant Secretary of the Treasury. You have raised a lot of problems that this Committee can resolve if we have the will. And I want to thank you for your contribution because we have had a great diversity of ideas from the witnesses, but once we make a commitment that we are going to take care of this system first and then move onto Medicare and then move onto tax cuts, we have come a long way. The question is, how do we find that mix? And we thank you for your support and your testimony.

And I want to thank you, Mr. Chairman.

Mr. SHAW. Thank you, Mr. Rangel.

Mr. Houghton.

Mr. HOUGHTON. Thank you very much.

I see us on the verge of something really very important because, at the moment, money comes into the Social Security system, that money is put into special Social Security Treasury bonds, then is spent. Under the new system, the way we comprehend it now, it will go under the Social Security system. Part of the money will be invested in Social Security bonds but will be kept there, not spent, and then another portion of that money will go into private investment. So really we are talking about who invests that money.

Ms. MUNNELL. Exactly.

Mr. HOUGHTON. You talk about Herb Stein here in your paper saying that the Social Security system ought to be an amount of money which is always forthcoming. You will have that——

Ms. MUNNELL. Right.

Mr. HOUGHTON [continuing]. If nothing is changed.

Ms. MUNNELL. Right.

Mr. HOUGHTON. Forget about the private market. Because you will be separating that unified budget, and those moneys will go in and start accumulating their own increases through the compounding effect.

Ms. MUNNELL. But the benefits would continue to be based on people's lifetime earnings, not on what happens to the stock market.

Mr. HOUGHTON. Exactly. Exactly. However, if somebody—and this is a question. If somebody invests in a private fund or the government does it through whatever means, through a consortium of individual investors, whatever it is, they will be looking periodically. You will have a book on the Chilean system, I will have a book and I will look at your book to see who is making the most money and who is accumulating what for themselves or their children or their mothers or their fathers and things like that.

Now, why isn't it possible to not only have government investors but also me as an individual have a personal retirement account so I can make that decision? If I am unsure about my ability to invest, if I am unsure about what money will come back to me, I can put it with the government, but if I want to take a risk or I see I can make more money, why isn't it a good idea to have that option?

Ms. MUNNELL. I think the key debate here is the extent to which you want to cut back on promised Social Security benefits and substitute individual investing decisions for that. And I think that is what the administration has been considering for a year, and they have come down on the side of not cutting back on Social Security. And I think the reason is that Social Security benefits are so modest that, for the average individual, you just do not want to put some of that money at risk. And if you leave it up to individuals, whether they want to opt out of the system or not, what is going to happen is the high-income individuals are going to opt out of the system and start investing on their own, and that is going to undermine the financing of the system going forward.

Could I just take the opportunity to make one analytical point? This is not a personal judgment. This is just a point that all economists agree on. But it came up this morning again and again and again, and it just seems very important to clarify.

Congressman Kemp suggested that if we just started sending our payroll taxes to Fidelity or State Street instead of sending them to the Treasury that we could all start earning 7 percent instead of the 2 percent we get under Social Security. That is just analytically wrong. It is true that we will get a higher return on that little bit of account that we have at Fidelity, but we are not going to shut down the existing retirement system. We are going to continue to pay benefits for those people who are already retired and to those who will retire.

And what we have to subtract from the higher returns we get on the individual accounts is the cost that we are going to have to pay to keep the benefit promises to those people who are currently receiving benefits and about to receive benefits. So just diverting money away from the Social Security system doesn't solve the problem because we have this unfunded liability that we are going to have to pay off. So it is not correct to say, just redirect our money; we will be fine.

Mr. HOUGHTON. Just to reclaim my time.

Ms. MUNNELL. I am sorry.

Mr. HOUGHTON. I wonder, in terms of the totality, the arithmetic here, whether you will be doing that because you will be taking the dollar that comes into the system and you will be dividing it, but the process, even if you only take 80 percent of that dollar or 80 cents, that amount will be compounding and that will be creating far more wealth in the system just on its own. So you have an opportunity to do something with the other.

Ms. MUNNELL. I think that investing in equities within the current structure is a very good idea because you will get a higher return which means you won't have to raise taxes as much or cut benefits as much in the future and people will get a higher return on their Social Security benefits.

I am very skeptical, sir, about saying let people not send their money into the Social Security Program. Let them send it into individual accounts. I think that is a different game, and I think it is full of risks.

Mr. HOUGHTON. Thank you.

Mr. SHAW. Mr. Matsui.

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

I would like to thank you very much, Dr. Munnell, for being here today. I know you came in from Boston, and we appreciate it. Even though the hour is a little late, I hope this doesn't disrupt your schedule.

Ms. MUNNELL. I understand. Thank you.

Mr. MATSUI. You have had a great deal of experience as a Member of the Council of Economic Advisers and other areas of the government and, obviously, with your role now as a Peter Drucker Professor in Boston. Could you perhaps discuss with all of us the public pension programs?

We have CALPERS, P–E–R–S, in California and a number of others. My understanding, if you add up all of these public pension investments throughout the United States, that equals about 10 percent of the current stock market, the equity market, and do you find that there is interference by the political system in these various jurisdictions with investment patterns? And perhaps you can just kind of give us a point of view on that.

Ms. MUNNELL. Actually, I am doing a study right now looking at what is happening at the State and local level. I had done an earlier study in the eighties, and there was a lot of hanky panky going on at that time that could make one cautious. So it seemed appropriate to go back and look again.

Basically, you have three things that happen that could fall under the heading of social investing.

One, you target specific investments that are seen to have collateral benefits; and at the State and local level, this involves targeting instate investment.

The second thing is what Reverend Jackson was talking about this morning, saying you have to get rid of companies doing business in South Africa or tobacco stocks or something else.

And the third thing is that you vote the proxies in a way that interferes with corporate decisionmaking.

Let me just tell you, one, in terms of the targeting, there is very, very little of that going on at the State and local level now. A study that was done for Goldman Sachs in 1993, and they were trying to show there was a market there for Goldman Sachs services, so I think it is a very comprehensive survey. This survey showed there was less than 2 percent of State and local pension fund assets involved in targeted investments.

I have done some empirical work just recently to see if those plans that undertook this kind of targeting sacrifice returns at all. They did not. But I think the most important point is that there is much less going on than you would expect.

The second thing, in terms of divestiture, that ended pretty much with the end of apartheid in South Africa. But even in the case of South Africa there was a compromise in adopting the "Sullivan principles" rather than actually selling. There is some discussion about tobacco, but there is just not a lot of divestiture activity.

And the third component, this voting proxies like the California pension system does, that just would not happen at all at the Federal level because the proxy voting would be delegated down to the independent fund managers. I think personally you could avoid all this activity. We have—the Thrift Savings Plan, which has the government in the position of appointing a board that hires the managers to invest the funds, have avoided all this type of social activity.

Now, just to go back to Reverend Jackson's comment. Everybody has a different job to do here. His job is to draw attention to the moral issues in society. The labor union's job is to draw attention to firms that are not prolabor. It is the job of health advocates to rail against the tobacco companies. But it would be the job of Congress to set up a board that is insulated from that type of pressure, and you have done it with the Federal Reserve Board. You have done it with the Federal Thrift Savings Plan.

It can be done. I don't think this is really a big deal, and I don't really think that the risks are great here at all, with all due respect to Chairman Greenspan.

Mr. MATSUI. I would like to just follow up on that as well, because both Bob Reischauer and Bob Ball, both of them experts in the area of social policies, Social Security and, obviously, health care, have come up with a plan that they feel would in fact insulate the fund managers from the political system. Could you comment on that?

Ms. MUNNELL. Yes. I think you are absolutely correct. They have done just that—modeled it on the Thrift Savings Plan and the Federal Reserve Board so Congress appoints a board with long and staggered terms. The responsibility of that board is to select an index. They take the money. They do not do anything with the money themselves. They give it to individual pension fund managers, and they give the pension fund managers the voting rights, and it is managed just like private pension fund money and other moneys that the private pension fund managers have.

So we have really gotten ourselves off on the wrong foot here in terms of talking about government investment in equities. No one is proposing that. That is not what the President is proposing. He is saying that the government would hand over the management of these funds to private-sector management, but it would be kept in one big pool rather than in individual accounts.

Mr. MATSUI. If I could just follow up on this, because one of the big concerns in the seventies and early eighties was the fact that labor unions were in control of many of the private pension programs in the United States. And everybody was—not everybody but many people were concerned about labor unions using its dominance and affecting corporate America, and I didn't see any of that happen because the prudent person test obviously came into play. These fund managers had to make sure they got the highest return for their investment. Obviously, even the employees wanted to make sure they got a high rate of return—they made sure their pensions were protected, and perhaps in conclusion you can comment on that.

I want to thank you very much for your testimony.

Ms. MUNNELL. I think even those people who support targeted investment, and I am not one of them, always start with saying that the investment has to earn a market return for a given level of risk and then let's look for some collateral benefits. But the whole culture has changed. No one is out there thinking that they can sacrifice return for social considerations.

Mr. MATSUI. Thank you very much.

Mr. SHAW. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Dr. Munnell, you spoke about the larger investment, that the President has proposed having private investment firms invest that money, and there has been some concern expressed about that idea relative to dictating those investments or guiding where those investments go. And then we have the USA accounts that the President has proposed as well. Couldn't one make the same argument about the USA accounts—that part of that will be government money and that if Congress was of a mind to, it could say that you shouldn't invest any of that money into politically incorrect companies. Is there an analogy there?

Ms. MUNNELL. Yes, there is a total analogy. To the extent that the government is actually in the position of selecting—through a board selecting the index fund, even if afterward the index fund is divided up so that people have their individual names on them, the same issues arise. And so if you are concerned about one, you should be concerned about the other. I am not concerned; I think the protections can be built in.

Mr. COYNE. For both.

Ms. MUNNELL. For both.

Mr. COYNE. Thank you.

Mr. SHAW. If I could just follow up on that for just one moment, that last question with regard to USA accounts. Is the President's proposal based upon Federal control of those accounts as it would be in the other? You have got some details that we don't have.

Ms. MUNNELL. Sorry, Mr. Shaw. No, I think that this is still a very vague proposal. But to the extent that they go the route, that it involves all the money coming into the government and then the government delegating the investment management down. Somebody is going to have to decide which index fund, stock index fund, which bond index fund.

Mr. SHAW. USA accounts would have the same control as the investment accounts in Social Security or is this work in progress?

Ms. MUNNELL. Work in progress.

Mr. SHAW. Fine. Thank you.

Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Dr. Munnell, would those USA accounts still be part of a unified budget and then under the unified budget structure, could those funds then be used to cover deficit spending?

Ms. MUNNELL. My understanding, and this is, as we just agreed, it is a work in progress, is that the expenditures that are involved in putting the initial amount into the individual accounts plus the match that the government would make would be expenditures under the unified budget.

Mr. COLLINS. So, therefore, they could be used as the current—under the current structure of the unified budget where we have the positive cash flow in the trust funds, it could be used to offset deficit spending.

Ms. MUNNELL. This is an expenditure. It would reduce the surplus.

Mr. COLLINS. I caution my colleagues, too, about comparing several thousand State, local or other type pension funds as having 10 percent of the combined control of the market versus 4 percent from one voice, which would be the Federal Government, because that one voice of 4 percent rings a lot louder than combined efforts of several thousand of 10 percent.

I had a few comments I wanted to make to the previous panel, but they are gone, so I hope you will bear with me to make them to you. It might take me a couple extra minutes, Mr. Chairman. I talk a little bit on the southern side.

Dr. Munnell, I enjoy talking about Social Security, maybe a little different from some of my other colleagues, because Social Security is my old age pension. It is also the old age pension of my wife. I turned down the congressional pension and, by turning that down, I am denied access to the thrift plan, so I don't have either of those. Nor does my small business have any type of retirement plan, including the 401(k).

As I look at Social Security though, I see three age groups. The current beneficiaries, I see no change for current beneficiaries. I see very little, if any, change there would be under an option for the next generation or my generation of beneficiaries.

But then I see the third group, the generations behind us. That is where the focus really needs to be, if you are going to talk about a retirement system, as well as a safety net system.

We have three forms of insurance today that are government controlled: Social Security, socialized insurance; disability insurance; and health insurance, or Medicare.

In the area of the Social Security insurance, I believe we can work toward a division of those dollars that would actually allow an individual to have an option for part of those funds to be invested either in the market or all into an interest-bearing account.

The other half, or other part, not a division of half, but the other part would continue to sustain a social insurance plan. That is your safety net. That is for income for those who may have had some event in their life that jeopardized their retirement income. Their disability would continue as it is. We probably are going to have to do some reforming in that area, and we do have some reforms in mind that would continue to assist those that have some happenstance in their life that puts them at disadvantage.

Medicare, as Chairman Greenspan suggested yesterday, that is our greatest challenge facing us as far as insurance. Today we have a budget with a positive cash flow. I shy away from the word "surplus." But until we resolve the Social Security issue, I really think that that cash flow, the positive portion of it coming in through the payroll tax, should be set aside. I also think the interest accruing on those funds now invested in government securities should too be set aside. In other words, we are disassembling the unified budget.

The purpose of this is to build confidence in the people. I have held several townhall meetings, and I love to talk about Social Security, but I can talk until I am blue in the face. I can show all of the slides, all of the presentation, all the prior want, but when I am finished the first question I ask is is it true that you, Congress, you all have robbed the Social Security Trust Fund and spent the money?

We have to build the confidence of the people to begin with to get anywhere with this issue.

If there is a positive cash flow after we do this, then we really have a surplus. Much of the surplus then would be in the area of general funds, and we should look at tax relief. When you look back at the 1997 tax relief bill that was enacted without a positive cash flow, it had real positive effects on those insurance programs that we are talking about, and reforms that took place, other than the tax bill, were the welfare reforms, the Medicare reform, we corrected some spending habits of the taxpayers' money. And when we did those things, the positive effect it had on the trust funds were, the report prior to those activities by the Trustees of the Social Security Fund was all of the reserve resources would deplete themselves by the year 2029. The most recent report has upped that now to 2032. So those efforts have had a positive effect.

So I think, too, we need to look forward to how we can enhance the economy more so with some specific tax relief, as Chairman Greenspan alluded to yesterday.

But truthfully, the debate has just begun on this issue. As Mr. Holden says, that is 90 percent of the effort. I just hope that this debate will continue with all sincerity, and not become politicized. Trust. We must have trust in ourselves, we must have trust among those who are beneficiaries today, future beneficiaries, and the Congress and the administration, or we get nowhere with this issue.

I thank you for your endurance.

Mr. SHAW. Thank you, Mr. Collins. I think we all at this point can associate ourselves with your remarks and, hopefully, it will come to fruition.

Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman. Dr. Munnell, first of all, for the viewing audience out there still and the cameras, one of the things I would like you to do is tell us where you work and who you are with, so that there is no belief that you are here with the President's plan, this is something you are just looking at.

Ms. MUNNELL. I am Peter F. Drucker Professor of Management Sciences at Boston College, and I can quite honestly say for the past year I have been very concerned about what the administration was going to come out with, and I was not a participant in that debate, since I left the administration more than 1½ years ago. But I am very pleased with how they have come down on these issues.

Mrs. THURMAN. I think that is important for people to know, because it is almost like you are having to answer the questions for the USAs without having much knowledge, other than what the rest of us know.

Second, I would like to say during the discussion, and this kind of goes back to trust and everything that has been kind of talked about here, there was other research done, and particularly it is called the 2030 Center Social Security poll, and I just kind of want people to know that I think there is more of a concern out there, or at least more of a feeling, that this could be around. One of the things it says is Americans believe in Social Security. Fully 73 percent say that Social Security can work for young people when they retire if Congress will strengthen that system's finances.

So to this kind of doldrum out there that says this is awful, we are never going to have it, I don't think that is true, and I think that is why this debate becomes important.

Third, and this goes to the women's issues, I think, I would like you to discuss with us the Social Security system as we know it today and the positive effects that it has for women.

Somehow I am getting this feeling that we are kind of drifting off, that the system we have doesn't work and it is not going to work. So if you could just, please, talk a little bit about what are the positives of the system and why are we arguing so strongly at any changes that will be made, that we are only strengthening what is already available.

Ms. MUNNELL. The current system is extremely important for women. It takes into account two factors that characterize women. Unfortunately, they on average earn less than men, and then, I guess fortunately, they live longer than men.

Mrs. THURMAN. Fortunately.

Ms. MUNNELL. Which is a good thing. In terms of what women gain from the current system: It has a progressive benefit formula. That means it provides proportionately higher benefits for low-income earners than for high earners, and women tend to be on average low earners. Women tend to spend a lot of time out of the labor force taking care of their families, and for those women who don't have an earnings record of their own, they provide spouse's benefits, and then the system provides widow's benefits when the husband dies, and the usual pattern is for the woman to outlive the husband.

Factors that benefit women because they live longer are that the benefit payments are in the form of an annuity. That is your guaranteed monthly amount, no matter how long you live. And also the benefits are indexed for inflation, and that is a provision that is much more important the longer you live, because the longer inflation goes on, the more it erodes your benefits.

So these are guarantees. These are in the law. These are provisions that protect women, and to the extent we change the current system, that is, we divvy it up and make it two parts, one of individual accounts and the other the current system, we lose those protections.

Mrs. THURMAN. Then on top of that we have the situation of disabilities. If somebody were to be injured and hurt we have some provisions in there to help them. The woman who might lose her spouse and has children, young children, we have provisions to provide for the family.

So when we then go into this next discussion of these special accounts, private investments, whatever, then where our real concern is really comes down to the demographics you just suggested, could be actually things that work against them.

Ms. MUNNELL. I think that individual accounts put protections that women and low-income people generally receive under the current program at risk.

Mrs. THURMAN. The next question is, and this is the one that in every plan that we are looking at is this kind of carve-out situation, where we take money away. What do you see as the effects if we do nothing but take 3 percent of this payroll tax and move it over? What happens to Social Security in these kinds of situations as we know it today?

Ms. MUNNELL. The current gap in the Social Security Program is roughly 2 percentage points of payroll. So you start 2 percentage points in the hole. If you then say I am going to take 3 percentage points off the taxes currently in place and send that to an individual account, you have made your hole 5 percent. If you are going to have your Social Security part of your program balance, that means you have got to cut back benefits to make it fit inside that very much smaller fraction.

Mrs. THURMAN. Could you say that again?

Ms. MUNNELL. If you give 3 percent away to individual accounts, you have to cut back benefits in the current Social Security Program to make it fit within the lower revenues that you have on hand. That means you cut back on the guaranteed protections, and then you do something else, you allow people to take risks with the rest of it. But the basic program has to be cut back.

Mrs. THURMAN. OK. Thank you.

Mr. SHAW. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. First of all, thank you for your patience, Dr. Munnell, for being here. To follow up on my friend from Florida as far as some of the things that we have not been discussing, and, Mr. Chairman, one of the things that has not yet been discussed are other retirement systems. There are certain segments of our population who have chosen to establish their own retirement systems.

For instance, in the State of Missouri, our teachers association has opted out of the Social Security system because they prefer to have their own. The rail industry is important in my particular part of Missouri, and the Railroad Retirement System is something that is separate and apart from Social Security.

Mr. Chairman, I would, as the newly elevated Chairman of our Committee, I would hope we could in our Subcommittee have hearings about these folks? Because the majority of constituent contacts I have had from these retirees is they don't want to be forced into Social Security. So I think there is another component there, other constituencies there we need to consider.

The other thing, and the gentleman from Georgia mentioned this, and he is exactly right, again I alluded earlier with our other panel, were this a town meeting in the Ninth District of Missouri, the first question that I get is, or the comment that I get is that we don't yet have a surplus because we continue at least for purposes of discussion of a surplus, we continue to include Social Security Trust Fund excess receipts in that unified surplus. So I think that is the first issue that we must address, we as policymakers.

Now, Dr. Munnell, your testimony extols some of the dangers of privatization and, not to sound Clintonesque, I think it depends on your definition of privatization. I don't think anybody, certainly in this body on this Committee, I have not yet seen any plan suggesting full privatization.

But I put this question to you, because we have had some discussions, and you were a spectator to earlier discussions about the Thrift Savings Plan. Once again, this is something that we enjoy, something that other Federal workers enjoy, that you enjoy, you are pointing at yourself, that allows workers to invest up to 10 percent of salary, and then those funds then are matched, an employer matched by stocks, bonds and T-bills.

Is that privatization? Does that fit within your definition? Or is this something that we might explore, that is, a change in the structure of the Social Security system, including something like a thrift savings plan that you are familiar with?

Ms. MUNNELL. There is an array of proposals, and if we go back to the Advisory Council, it had a proposal that kept the system exactly where it is, and that is sort of where the President came down.

There was something called the Gramlich proposal, for Ned Gramlich, who is currently a Governor on the Federal Reserve Board, that seems to be what you are talking about. Under the Gramlich proposal, you basically raise the new taxes of 1.6 percent, and you send the money into the government. The government would then pick a series of index funds for stocks, for bonds, for fixed income, and you could choose where you were going to put this additional 1.6 percent. That is very much like the thrift plan.

Then there was a more extreme proposal, which is personal savings accounts, you basically took 5 percentage points of the current tax and put it any place that you wanted.

My concern with the centrist or compromise proposal, is it is a slippery slope; that people are going to, especially high-income people, are going to make this comparison of how well they are doing in Social Security and how well they are doing in their supplementary plan. And if that were a fair comparison, then the conclusion they came to would be legitimate. But the comparison is biased, because Social Security is left with the burden of paying off this unfunded liability, it is left currently with the burden of investing only in bonds, it is left with the burden of doing some income redistribution. So you are really making a false comparison when you are looking at how well you are doing in Social Security and how well you are doing in these individual accounts. Nevertheless, I am concerned that that visual is going to make people want to have more and more and more and more of individual accounts, and you will undermine this collective arrangement that has served this Nation so well.

Mr. HULSHOF. I see the red light just came on. As a final comment, I could not agree more that certainly encouraging savings in the private sector is something else we need to consider.

Ms. MUNNELL. Yes.

Mr. HULSHOF. Line 8 of my 1040 that I just got in the mail says interest income, and right now our tax policy certainly punishes thriftiness in the sense that the IRS continues to take some of our savings. So I agree with you on that.

Mr. Chairman, with that, I yield back.

Mr. SHAW. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman. Thank you so much not only for your comments here but for your written statement. Over these last 2 days we have had a rather amazing contrast regarding the best approach to our current happy economic times.

Mr. Kemp, who you heard this morning, voiced the oft stated Republican view that if we will just cut taxes enough, everyone will live happily ever after. On the other hand, Alan Greenspan, who spoke to us yesterday and has been an advocate of some tax cuts in the past, repeatedly, with questions coming from both sides of this Committee, and unequivocally rejected the idea of even growth-oriented tax cuts at this time in favor of what he said would be best for our economy, and that is to let the Federal surpluses build, to address some of these issues like retirement security.

I am wondering from your perspective where you come down, between the Kemp approach and the Alan Greenspan approach?

Ms. MUNNELL. I have never thought of myself between Kemp and Alan Greenspan.

Mr. DOGGETT. I shouldn't think you would.

Ms. MUNNELL. It is a very complicated issue. Mr. Collins actually brought up the fundamental thing that everyone is going to have to decide on when dealing with the Social Security issue. Whether you use the framework of the unified budget or whether you separate Social Security from the rest of the budget, and my personal preference, not one that Congress is using and not one that the President is using, is actually to take Social Security out of the budget and to have its accounting separate.

So the way I would approach it would be to fix up the Social Security system, get more money in there, make the cuts that you have to make. It has to be balanced, so that you restore balance and confidence in that system.

Then you look at the rest of the budget. I am not in favor of spending every dollar in the rest of the budget on the elderly. We have got a lot of priorities going forward. Just roughly speaking, once you have taken care of Social Security, for the rest of it, I would give half of it in a tax cut, and then the other I would use for priorities such as Medicare, education, low-income programs, Defense, anything else that needs to be done.

So I think that there are two really hard decisions, what do you do with Social Security, and then how do you allocate the budget generally going forward?

You can see what is going on now. There is great concern that the surpluses are going to be all given away in tax cuts. That would definitely be undesirable. So there is a great desire to allocate them all on spending initiatives, so that the number becomes zero.

But if the pressure for massive tax cuts could die down, then I think it would be possible to think of doing this in a way that meets an array of needs.

Mr. DOGGETT. Regarding your comments earlier concerning keeping the benefit promises that we have already made, I have seen estimates that reach up to I think $8 trillion in terms of the amount of benefits that people have already paid for in the system. I don't think even Mr. Kemp or some of those who want to reject the Social Security system that we have had for the last six decades propose to deny people the benefits that they have already paid into the system.

Assuming that you stand by that $8 trillion in accumulated benefits, what impact is that likely going to have on a totally privatized system?

Ms. MUNNELL. I think that is such an important point, and I tried to make it before, because some people make it sound as if this is a very simple thing. Instead of sending your payroll taxes to the Treasury, you just send them to Fidelity, and, lo and behold, you become rich.

The problem is the one you bring up, that we have promised $8 trillion of benefits, and we are going to have to get the money to pay for that somehow. When you take how much it costs to raise that money to pay those benefits, and subtract that from your great return at Fidelity or State Street, you are pretty much back where we are now. So there is no easy, quick way out of this. We can think of some investing to improve returns, but it is not a simple thing of just redirecting your payroll tax money.

Mr. DOGGETT. In addition to taking that $8 trillion of accumulated benefits, there is the disability and survivors side of OASDI. Is there an estimate of how much it would take to provide comparable disability and survivors benefits if we split that out?

Ms. MUNNELL. My understanding, I guess I am not sure. Can I get a response to you?

Mr. DOGGETT. It is a substantial amount, is it not? It is a very substantial amount to provide disability and survivors coverage for everyone who has it in America today, and a benefit that many people forget as they focus on Social Security as only a retirement system.

Ms. MUNNELL. True.

Mr. DOGGETT. I would welcome your follow-up information. Thank you very much. Thank you, Mr. Chairman.

[The following was subsequently received:]

The net present values of future promises for October 1, 1999 are $7.997 trillion for Old-age and Survivors Insurance and $722 billion for Disability Insurance, making a total of $8.719 trillion. (These projections are attested to by Joe Faber, Actuary, Social Security Administration).

Mr. SHAW. Thank you, Dr. Munnell. You made a very good point which is going to haunt our Subcommittee and Full Committee: If we do come up with a solution, what do we do with the transition? There is going to be a great deal of pain and problem in that. I would like to recall Chairman Greenspan's testimony from yesterday for the record, which wasn't that far from you except in one area. He said the best thing to do with the surplus is to pay off the accumulated debt; the second best thing to do would be a tax cut. He said spending was a nonstarter. So on the latter, you have pointed out a difference with Chairman Greenspan as to that area.

I want to thank the Members for staying. I want to thank you, Dr. Munnell, for staying with us as long as you have, the first panel, Mr. Kemp and Reverend Jackson, for being with us. We certainly have gotten some contrasting views this morning. Thank you much.

The Committee is adjourned.

[Whereupon, at 1:22 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Jim Jontz, President, Americans for Democratic Action, Inc.

Chairman Archer, Members of the Ways and Means Committee, thank you for allowing me to submit testimony on Social Security. I am Jim Jontz, President of Americans for Democratic Action, the nation's premier liberal, multi-issue public policy organization. Founded in 1947, ADA is dedicated to promoting economic and social justice in America.

Since its enactment in 1935, Social Security has been the most successful engine for social justice in America. Its cash benefits are essential to the economic security of millions of America's elderly, disabled, and surviving minors and widows.

Almost two-thirds of retirees depend on Social Security for more than half their total income. Without Social Security, about half of all retirees would fall below official poverty levels.[1] Whereas 35 percent of the elderly lived in poverty in 1959—twice the rate for all other Americans—today less than 12 percent of all elderly live in poverty—somewhat lower than the rate for other adults. Today, less than half of American workers have private pensions, and that proportion is declining. Only 13 percent of women have private pensions. Social Security, therefore, is more than ever the bedrock of security in old age.

IS SOCIAL SECURITY IN DANGER OF COLLAPSE?

Alarmists have raised the specter of doom for Social Security. The Social Security Trustees have, indeed, projected that if no action is taken, based on certain economic assumptions, the Social Security Trust Fund will run out of money around the year 2032. Under this worst-case scenario, income from contributions of current workers at that time would cover only 75 percent of benefits owed to retirees. For the 75 years after 2032 income from the fund will be only 2 percent short of what is needed, so modest steps, rather than drastic, dangerous ones, are called for.

The worst-case scenario, however, is seriously misleading. While we do not quarrel with the Trustees' desire to make their projections extremely conservative in order to ensure that prudent steps can be considered in a timely manner, we have reason to think the projections are wrong. They assumed that future growth of the U.S. Gross Domestic Product, adjusted for inflation, would average only 1.5 percent from 1997 to 2029, whereas the GDP's current growth rate is 3.8 percent. The growth rate from 1960 to 1974 averaged 4.1 percent; from 1975 to 1996 it was 2.7 percent—a period that included a prolonged recession.

While we do not suggest that today's growth rate will continue forever, a realistic projection would be 2.4 percent.[2] We think that wiser government fiscal and invest-

[1] Henry J. Aaron and Robert D. Reischauer, *Countdown to Reform*, the Brookings Institution, 1998.

[2] Estimate provided by James K. Galbraith, Professor of Economics, University of Texas at Austin.

ment policies that I will not dwell on here are important to improve on that growth rate, which in turn could greatly strengthen the Social Security program and take care of our aging population.

WHICH PROPOSALS ENDANGER SOCIAL SECURITY?

1) Cutting Benefits.

All proposals that would cut benefits are unjust, unwise, and self-defeating. They are unjust because they would harm those elderly who could least afford lower benefits, persons who count on Social Security to pay for food, the rent or property taxes and fuel, and other necessities. Cuts would reduce to poverty levels persons who have contributed to their own future security. Cuts are unwise and self-defeating because relegating the elderly, survivors and disabled to below poverty levels would only transfer the burden of providing for them from Social Security to welfare programs. Social Security was designed so all workers would contribute, but benefits would tilt in favor of lower-paid wage earners to prevent this very indignity.

2) Limiting COLAs.

Tinkering further with the Cost of Living Adjustment would be a mistake. Enactment of the COLA in 1972 has saved millions of Social Security recipients from poverty. Many more Americans these days survive to age 65 than did when the first beneficiaries retired, and those who survive to 65 are living longer (see tables 1 and 2). Although benefits are still very low compared to many private pensions and annuities, most of these private schemes lack COLAs. Without COLAs, a benefit that is barely adequate at retirement age of 65 becomes an unlivable pittance, even with low levels of inflation, by age 85. Again, failure to allow benefits to keep up with inflation would throw the elderly onto SSI rolls. Inflation protection is essential to security for the remainder of one's life.

Life Expectancy by Age Cohort

Year turn 65	Percent Survive From Age 21 to 65	
	Men	Women
1940	54	61
1990	72	77
2030 (est.)	80	89

Average Years of Remaining Life Expectancy at age 65

	Men	Women
1940	13	15
1990	15	20
2030 (est.)	17	22

Source: Social Security Administration

3) Privatization

All privatization schemes create intolerable risks, threatening the future of the elderly, survivors, and the disabled.

• First, they would take the "security" out of Social Security. Privatization schemes are rooted in several false assumptions: that the stock market will always go up; that an average rise in the stock market would bring benefit to everyone; that we're all capable of being shrewd investors; and that we can divert Social Security contributions from the Trust Fund to individual accounts and still pay for current retirees.

If the stock market happens to be in a slump when an individual dies, becomes disabled, or retires, that family would be out of luck. It would matter little that *on average* the stock market does well. Some will do well; others will not. Many would be left in poverty, with a paltry basic benefit and a skimpy retirement account. Moreover, not all of us know how to invest. Even the most experienced investors can and do suffer great losses or become victims of poor management, changing market conditions, and scams. For the wealthy, these ups and downs of the market are simply unpleasant experiences. For 80 percent of the population, these contingencies would be calamities if they occurred at the time of retirement. To place the average retiree at such risk is irresponsible. Finally, if some contributions are diverted from the Trust Fund to private accounts, not enough money will remain to pay benefits of retirees on a pay-as-you-go basis in the transition to privatization. Fulfilling our commitment to them would require substantial additional government borrowing or higher taxes.

• Second, individual accounts would also be far more costly to administer than Social Security. The grant would incur additional expenses by sending money into millions of individual accounts, and needing to keeping tabs on whether the funds are in fact saved for retirement. Despite its complexity (dealing with more than 6 million employers, tens of millions of beneficiaries, and more than 100 million taxpayers) Social Security costs less than one percent of benefits. No private plan comes close to this low overhead.

The cost to employers of the current system is relatively low, dealing only with the federal government. Costs would surely increase were they required to deal with multiple financial institutions.

Further, the Social Security Administration's under-one-percent cost contrasts sharply with the fee small investors would pay to brokerage firms and financial institutions to handle their accounts. The fee would necessarily take a disproportionate amount from smaller accounts, eating into the return. In fact, in Chile and Great Britain, where private accounts have been tried, the rate of return is between one and two percent (lower than the Trust Fund currently receives from Treasury bills), once administrative fees are taken into account. [3]

• Third, individual accounts are critically risky for the disabled and survivors. Social Security is much more than a retirement program; it is insurance against premature death and disability. A wage earner can die or become disabled any day. Even if the wage earner has been one of the lucky or skillful investors, when he or she dies or becomes disabled, the private account might not have had time to accumulate enough to live on. Thus the guaranteed Social Security benefit, complete with inflation protection is essential to survival with dignity.

• Fourth, there is no guarantee that private accounts, no matter how well invested, will provide income for life. If a person decides to convert an account into an annuity at the time of retirement, it will cost about 20 percent of the investment and will lack inflation protection. What starts as an adequate income will diminish over the years.

What Positive Steps Can We Take?

Several options are available that are equitable and do not entail untoward risk to individuals. Following are some choices to be weighed and from which a selection can be made.

• As the President has proposed, up to 25 percent of the Trust Fund could be invested by the federal government in a relatively safe broad index fund.[4] Appropriate steps can be taken to insulate such a fund from politics. The politics-free management of government employees' Thrift "C Fund" provides one model that proves it can be done. Because these index funds have a good earnings record over many years, they could be a solid investment. The President's proposal avoids the pitfalls of private accounts. It ensures that the risk of the vagaries of the market is shared, rather than borne by the individual—an approach appropriate to a social insurance program. The proposal is not without some risk, however.

• Consistent with equity principles, we could raise the amount of the wage base that is subject to the Social Security contribution by the worker and employer. The base for the payroll deduction can be raised to $100,000. Wages exceeding that amount would be untaxed, and all income from sources other than wages would remain untouched—still leaving better-to-do individuals in a favored status.

• Coverage could be extended to the 3.7 million state and local government employees whose positions are not yet covered by Social Security. Adding these workers as new employees are hired would strengthen the system and benefit these workers.

• The wage-base could be computed using average indexed wages over 38 years, rather than the current 35. This option must be analyzed carefully, however, to en-

[3] Dean Baker, economist with the Economic Policy Institute, *The Washington Post*, December 23, 1998.

[4] The budget surplus today consists of Social Security contributions. We find it more useful to view public investment of these funds in terms of a portion of the Trust Fund, rather than the budget surplus.

sure that it does not unfairly disadvantage women who have remained at home for several years to take care of young children.

• Most important, we must adopt policies that will ensure continued high economic growth. If we were to maintain the current 3.8 percent rate of GDP growth, any Social Security funding shortfall would disappear. While continuation of this high rate is unlikely without changed economic policies, even a lower figure would largely eradicate any Social Security deficiency. A progressive economic program would include low interest rates, substantially increased investment in education, child care, health insurance, industrial and high-tech research, and sorely needed infrastructure.

CONCLUSION

Private accounts are no "fix." For average Americans, they're tickets to a train wreck. Each and every month, for six decades, in peace and war, in prosperity and recession, Social Security has provided cash benefits on schedule. The program is sound in concept, essential, fair and well run, providing real economic security. Benefits are inflation-proof for life. The present defined-benefit form and structure can and must be preserved for baby boomers, our children and grandchildren.

Statement of Yung-Ping Chen, Gerontology Institute, University of Massachusetts, Boston

Mr. Chairman and Members of the Committee: My name is Yung-Ping Chen. I am the Frank J. Manning Eminent Scholar's Chair in Gerontology at the University of Massachusetts Boston. My academic and professional experience in the field of Social Security financing and economics of aging includes serving as member of the technical panel of actuaries and economists of the 1979 Advisory Council on Social Security, and as consultant on retirement income to both the 1971 and 1981 White House Conferences on Aging, as well as faculty appointments at several colleges and universities. I am a fellow in the Gerontological Society of America and a founding member of the National Academy of Social Insurance. The views I express here, however, are those of my own and do not necessarily represent the positions of any organization with which I am affiliated.

In summary, while I agree that we must preserve and strengthen Social Security, we must also strengthen private pensions and individual savings so that more future retirees could derive more meaningful supplements to Social Security. Therefore, I am proposing a method to create a pension supplement account for every worker covered under Social Security without imposing additional taxes or contributions—by diverting part of the FICA tax rate.

In what follows, I first point out the need to strike a better balance between Social Security and other sources of income, including some comments on the President's approach in this regard. I then present a plan to universalize pension supplement accounts for Social Security participants, as it restores the 75-year solvency to the program.

NEED FOR A BETTER BALANCE BETWEEN SOCIAL SECURITY AND OTHER INCOME SOURCES

Many Social Security reform plans exist, but few would change our retirement income policy in a way that would achieve a better balance between Social Security and other sources of income. Among the current elderly, far too few have much income from sources other than Social Security (Chart 1). Looking toward the future, we can anticipate subsequent problems because many of today's workers lack pension coverage and their savings are meager. In short, if we do not strengthen all these sources of income for future retirees, we would be perpetuating the current condition, which in my opinion is undesirable, a condition in which too many elderly are relying too heavily on Social Security. Moreover, this condition is likely to put pressure on Social Security to raise benefits in the future, further threatening the financial health of the program. Mandating pensions or mandating savings would be possible solutions, but it is quite likely that many low-wage workers and small businesses simply could not afford, or would not be willing, to comply.

Chart 1. Shares of income by quintiles of total income of the elderly, 1996

Source	Lowest	Second	Third	Fourth	Highest
Social Security	81%	1 80%	66%	47%	21%
Pensions*	3	7	15	24	21
Asset Income	3	6	9	15	25
Earnings	1	3	7	12	31
Public assistance	11	2	1	**	**
Other income	1	2	3	2	2
Total	100	100	100	100	100

Notes: *Includes private pensions and annuities, government employee pensions, Railroad Retirement, and IRA, Keogh, and 401(k) plan payments. Excluding government employee pensions, this source accounts for only 10% of total income of the elderly as a group. Statistics by quintiles are not available, however.

**Less than 0.5%.

Percents may not sum to 100 due to rounding.

Source: Social Security Administration (1998), *Income of the Aged Chartbook, 1996*, SSA Publication No. 13–11727, May, p. 16.

In his State of the Union address on January 19, 1999, the President proposed allocating $2.8 trillion, or 62% of the projected budget surpluses over the next 15 years, to Social Security. One quarter of that amount, about $700 billion, would be invested in stocks for higher returns.

In addition, about $500 billion, or 11% of the projected surpluses, would be used to fund "universal savings accounts," modeled after 401(k) plans, separate from Social Security. It is an incentive plan for low-and middle-income workers to save and invest more. The government would match deposits by each individual based on income. According to a news story by Richard W. Stevenson (*New York Times*, January 20, 1999, p. A19), administration officials envisioned a plan under which a worker earning $40,000 a year would get a $100 grant to start an account, and then could deposit up to $600 a year. At that income level, the government might match 50 cents on every dollar deposited, or up to $300 a year. At the end of the year, the worker would have $1,000 in the account, $400 of which from the government. According to another news story, by Bob Davis, Greg Hill, and Greg Ip (*Wall Street Journal*, January 20, 1999, p. A8), a lower-percentage match or none at all would be available for high-income workers.

The President is to be commended for recognizing the need for a better balance between Social Security and other sources of retirement income, as well as the need to shore up Social Security's long-range solvency. However, his plan falls short for the following reasons. One, without investing the trust funds in stocks, the solvency date would be pushed out only to 2049, from 2032. Even with trust fund investment in stocks, the solvency date would be pushed out only to 2055, short of the long-range solvency date by 20 years. Even assuming Congressional authorization for central investing by Social Security, other measures to increase revenue or reduce benefits would be necessary to restore 75-year solvency. Moreover, the incentive approach to 401(k)-type of accounts may help, but it would still encounter the problems of willingness and affordability.

The key to creating pension coverage in the short term lies in overcoming the problems of willpower and affordability. And the key to restoring long-range solvency is to change a number of program variables affecting income and outgo under Social Security. My proposal provides these two keys, as described below.

"SOCIAL SECURITY PLUS PENSION SUPPLEMENT (SS-PS) PLAN"

What I propose is called "Social Security Plus Pension Supplement" or SS–PS Plan. This plan would divide the current Social Security program in two: a defined-benefit social insurance component, like the one we have now, and a defined-contribution pension supplement account, which would be new. The social insurance benefit would preserve the traditional old-age, survivors and disability (OASDI) protections, to be funded on a pay-as-you-go (PAYGO) basis using 10.8 percentage points of the current FICA for the next two dozen years. The pension supplement account would be funded by 1.6 percentage points carved out of the current FICA tax without additional taxes or contributions. Such financing is feasible because we do not need these funds to pay benefits during the next couple of decades or so. The current FICA rate of 12.4% would remain.

Because the carve-out would be using Social Security surpluses, which have already been borrowed by the Treasury, implementing the carve-out immediately would complicate Treasury funding operations. For that reason, we should wait until the non-Social Security budget is also in surplus. Non-Social Security budget surpluses are estimated to occur in a few years. I therefore urge you to recommend that Congress pass legislation now for carrying out the SS-PS plan later.

As shown in Chart 2, this plan would remove the unfunded liabilities under the current Social Security program, keep the progressive benefit formula that protects low-income and disabled persons, cut the FICA tax rate in order to create pension supplement accounts, repeal the earnings test, and set moderate PAYGO rates over the next 75 years. To complement the PAYGO rates in shoring up the long-range financing, this plan also incorporates several provisions common to other plans, such as gradually increasing the retirement age, moderately raising the wage cap, covering state and local new hires, extending the benefit computation years, and taxing Social Security benefits like other pensions.

Chart 2 Estimated Long-Range OASDI Financial Effect of "Social Security Plus Pension Supplement" (SS-PS) Plan

	Provision	Estimated Change in Long-Range OASDI Actuarial Balance[1] (percent of payroll)
1.	Cover State and local government employees hired after 2000.	0.25
2.	Tax OASDI benefits like benefits from private and government employee defined pension plans, beginning in 1999. (Eliminating current threshold levels for taxing OASDI benefits)	0.40
3.	Increase benefit computation years from 35 to: 36 for those first eligible in 2001; 37 for those first eligible in 2002; and 38 for those first eligible in 2003 and later.	0.27
4.	Eliminate the earnings test for beneficiaries age 62 and older, effective 1/1/2003.	0.00
5.	Increase the normal retirement age to 68 for those who attain age 62 in 2017. Thereafter, indexed to projected increases in longevity.	0.69
6.	Raise the OASDI contribution and benefit base to 90 percent of covered earnings beginning in 1999; index as under present law thereafter.	0.50
7.	Maintain full COLA using CPI and accept the lower growth rate of CPI by 0.2 percentage points for 1998 and later, as announced by BLS in April 1998.	0.28
8.	Redirect revenue from the income taxation of part of OASDI benefits from HI (Medicare Part A) Trust Fund to OASDI Trust Funds, phased in between 2010 and 2019.	0.31
Total for provisions 1 through 8 (adjusted to take account of interactions)		2.50
9.	Change the OASDI payroll tax rates beginning in 1999 as follows:	−0.25
Total for provisions 1 through 9 (adjusted to take account of interactions)		2.25

Years	Rate
1999-2022	10.8
2023-2032	12.4
2033-2042	13.2
2043-2052	13.5
2053-2062	13.9
2063+	13.9

[1]Based on the 1997 Trustees Report, under the intermediate projections: Long-range actuarial balance for the 75-year period (1997-2071) is −2.23 percent of taxable payroll. Implementation of these 9 provisions would remove the long-range actuarial imbalance and, in addition, result in stable trust fund ratios.

Source: Yung-Ping Chen (1998), A New Social Security: An Alternative to the Moynihan Plan, Contingencies, November/December, p. 45.

Pension Accounts Mandatory Now but Voluntary Later

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

Pension Accounts As An Experiment

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

Concern with Retirement Income Safety

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

Modeled after the Federal Thrift Savings Plan

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

Responsible Pay-As-You-Go

Another distinguishing feature of this plan is the use of pay-as-you-go (PAYGO) method to finance Social Security. Some disapprove on the ground that future tax rates would be exorbitant. However, PAYGO will not entail high tax rates if the growth in benefits is moderated as under this plan. Moreover, using PAYGO, this plan will not involve sizable trust fund investments, so concerns about political interference in investment decisions and about government influence over corporate governance would become moot. Moot also will be controversies about the use of budget surplus and about whether the trust fund is real or illusory.

In conclusion, I have proposed a way to create pension supplement accounts without imposing additional taxes or contributions on workers or their employers. I also propose to finance the traditional Social Security on a responsible pay-as-you-go basis. My plan is designed to strike a better balance between Social Security and pensions. It would restore long-range solvency to Social Security while offering the possibility for improving the rates of returns for future beneficiaries. This plan can combine the best of both public and private approaches: the financial guarantees that only a public social security system can provide, coupled with an opportunity to achieve the higher investment returns offered in the private market.

Statement of Star Parker, President, Coalition on Urban Renewal & Education (CURE)

My name is Star Parker and I am the president of CURE, the Coalition on Urban Renewal and Education. Thank you for allowing us to submit this statement for The Congressional Record about the negative affects of the current social security payroll tax on Black Americans and other low-income workers. CURE is a 501(c)(3) nonprofit education and research foundation, which provides information on how social policies impact America's inner cities and the poor.

As a former welfare mother, I understand first hand the devastating affects of government dependency. Since the inception of CURE in 1995, we have sponsored a national campaign to promote personal responsibility and self-sufficiency called: "From Entitlement to Empowerment." We conduct workshops in housing projects for women leaving welfare, inner city roundtables for pastors and faith-based leaders, and lectures at colleges and churches across the country.

Our concern with the current social security system is that it immobilizes massive numbers of poor people to move from entitlement to empowerment. Black Americans and the working poor fair miserably under the current payroll tax system yet, these individuals can achieve real wealth under a private, personal retirement plan.

According to Health, United States, 1998, published by the Department of Health and Human Services, blacks and lower-income people live shorter lives than whites and higher-income people. Because Social Security is essentially an annuity payment for those who live past age 65, the program shortchanges people with shorter life spans. Social Security pays the most to those that live the longest. Thus, old white women gain at the expense of young black males. On a lifetime basis, Social Security creates a perverse wealth transfer form blacks to whites of as much as $10,000.

Social Security was not designed to be a poverty insurance plan or the chief source of retirement income for Americans. Social Security was established to provide a safety net, keeping the elderly from being trapped and dying in a state of poverty. The current system has failed in its attempt to lift Black Americans out of poverty because Social Security is perceived as retirement savings, not a tax on wages. Statistics and census data show that roughly one-third of elderly African Americans live below the poverty level. Overall, 11 percent of all elderly Americans and 19 percent of all widows have become victims to poverty due to the perceived safety net extended through Social Security. As is, the present Social Security tax abandons the low-wage worker, thus hitting blacks the hardest. Many financial planners have publicly expressed their belief that for a retiree to maintain his or her current standard of living, a retiree needs between 60 and 85 percent of pre-retirement income. Many studies have shown that low-wage workers receive approximately 58 percent of pre-retirement income through Social Security benefits.

An African American male in his mid-twenties, with an annual income of $12,862, in 1996, can expect a return of less than 88 cents for every dollar he invested in Social Security, as noted in a study by from The Heritage Foundation. This means that for every dollar he is taxed to pay into the Government's Social Security plan, his tax has a negative -1.2% rate of return. This negative rate of return, in 1997 dollars, translates into $13,377 of cash losses paid by both the employee and employer. A black male under age 38 who stays in the current system until retirement age will lose $160,000 in a lifetime's worth of income.

Black females also experience a low rate of return from Social Security. A single black mother, 21 years old, who in 1996 had an annual income of just under $19,000, realizes an actual rate of return of only 1.2 percent. If this same black female invested her current social security taxes into a private retirement plan similar to an Individual Retirement Account (IRA), she could realize as much as 4.5% rate of return.

The fact that the current Social Security tax system does not take into consideration life expectancy rates is another strike against African Americans. The average life expectancy for black males by 2000, is 64.8 years, down from 65.4 in 1995. With the retirement age at 65 and rising, few black males will live to receive any payment from years of contributions. At the going rate, few African American males will live to retirement. Life expectancy for African Americans has not increased in 15 years. Current census data shows that Forty percent of black males die between the ages of 55 and 75. Only 349 out of 1,000 black men will reach their 75th birthday. Comparably, 712 out of 1,000 white females celebrate their 75th birthday, more than twice the number of African American males.

Although poverty rates have decreased dramatically across the country, in 1992, 12.9 percent of those in poverty were over the age of 65, compared to 11.7 percent of individuals 18 to 65 years of age. Today poverty rates remain higher for those over the age of 65 than those aged 18 to 65.

The number of Black Americans between the ages of 65 and 74 who receive Social Security benefits and live below the poverty line is 25.1 percent and 37.3 percent live below 125 percent of the poverty line. For white Americans, 8.8 percent live below the poverty line and 16.3 percent live 125 percent below the poverty level.

In the State of the Union address on Tuesday, January 19, 1999, President Clinton called for expanding the government's monopoly over retirement savings for the average American workers, by creating Universal Savings Accounts (USA). Not only would this proposal have a crippling affect on the free market system, but it also will insure more poverty for blacks and other low-income workers upon retirement. If USA accounts are established, only people with money left over after household expenses and taxes can take advantage of them. Far too many blacks and other low-income workers are living paycheck to paycheck, and would therefore be unable to invest in this USA option. Only 33 percent of older black households have any saving at all.

Yet, the bottom 20 percent in economic status use Social Security for 81 percent of their post-age 65 income. The working poor are just not financially able to pay additional payroll taxes into yet another government-run entitlement program. We need real empowerment, real reform.

Instead of President Clinton proposing to levy more payroll taxes against low income workers, real social security reform should allow all working Americans to invest in personal, private retirement accounts, similar to an Individual Retirement Account (IRA) or a 401(k). Instead of this panel looking to save the current system, it would better to allow all workers to transfer their retirement investments into personalized, private accounts.

Privatization of the Social Security system is the only answer in solving this crisis. Social Security payroll taxes can be replaced with a mandatory retirement savings account, which would be invested in mutual funds, stocks, bonds, and other wealth accumulation plans.

Requiring individuals to pay into a personal retirement account similar to a 401(k) or an Individual Retirement Account (IRA) would offer higher returns and greater benefits for retirement security income. Personal retirement accounts offer each individual an opportunity to own his or her account and be able to pass on their assets to family members. Privatization would offer low-wage workers and minorities an opportunity to acquire personal property, something many low-income workers rarely experience in their lifetime.

The United States Supreme Court ruled in the 1960 case Fleming v. Nestor, individuals do not have a right to any Social Security contributions paid into the system. Politicians can, at any time, cut or eliminate Social Security benefits. Social Security is not an insurance program. It is nothing more than a tax paid into the United States Treasury. The benefits received by retirees upon retirement are nothing more than a long-waited tax refund, often compensate at a negative rate of return. Social Security works in the same respect as someone who has a large amount of their income withheld from their paychecks and, after reporting their income for the year with the Internal Revenue Service (IRS), receives a tax refund from the U.S. Treasury. The problem with this scenario is that the U.S. Treasury is allowed to accumulate and hold a high percentage of the workers income all year, and then return overpayments with no interest. Under a private retirement savings plan, a worker could deposit the social security portion of taxes higher interest retirement savings account.

Low-wage workers would have the opportunity to accumulate real wealth and assets under a privatized retirement savings plan. Like high wage earners, these workers would have the opportunity to participate in inheritance transfers through private retirement investments. The overall economy would also greatly benefit by this increase in savings and investments as a result of low wage earners participating in private retirement accounts.

Personal retirement accounts offer individuals an opportunity to receive higher retirement benefits. Low wage earners could realize significant investment returns form Personal Retirement Accounts (PRAs). Upon retirement, these workers would have a higher monthly benefit, as much as three times as that provided by Social Security today.

As noted in a study by the Cato Institute, if a 28-year-old worker with an annual income of $13,500 invested his payroll taxes in a personal retirement account, through his lifetime, he would accumulate $290,628 by age 67. This would be possible, assuming he invested in a personal retirement account which consisted of a mixed fund of 50 percent bonds and 50 percent stocks and received returns of 4 percent and 7.5 percent, respectively. Upon retirement, he would be able to purchase an annuity, which would provide monthly payments of $2,292, nearly three times the benefit currently promised by Social Security.

Personal retirement accounts would greatly benefit the individual, the community and the nation's economy. As economist Martin Feldstein noted personal retirement accounts would help the Gross Domestic Product (GDP) increase five percent, permanently. Additionally, the net value to the economy would be a gain between $10 trillion and $20 trillion. These macro-economic effects would benefit poor neighborhoods by creating new business within these communities and providing additional jobs at these business establishments.

Critics of privatization argue that the poor are not educated enough to make wise investment decisions and privatization is risky and gambles with their retirement security. But the fact of the matter is that Social Security has become the largest government program in existence. The 65-year-old retirement tax program originally designed to be a government-run old-age pension program has since become a bad investment for Americans.

For more than four decades, payroll taxes have increased 17 times, forcing Americans across the country to invest in a system which provides very little, if any, financial return. Social Security was the largest federal expenditures in 1995, totaling $334 billion or nearly 22 percent of total federal spending of $1.53 trillion. The current Social Security system does not provide Americans with secured income during their retirement years; and in fact, Social Security has been proven to be a worse investment for African Americans and the poor.

Privatization of Social Security will benefit all Americans, including blacks and the poor. Privatization will provide an opportunity for low-wage workers to achieve the American dream, acquire investment capital and ownership of private property. Privatization of Social Security will provide blacks and other low wage workers with actual retirement security income, and equity accumulation for inheritance transfers.

The Social Security system has evolved into another means of levying a tax on American citizens. Social Security contributions are not paid into an insurance program, but to the U.S. Treasury. The stated goal of Social Security was to provide a safety net to prevent the elderly from being trapped in a state of poverty, yet has been proven to be simply an additional payroll tax with low if any rate of returns.

The current Social Security tax has financially harmed African Americans especially those entering into retirement or already retired. The Government's retirement system yields negative rates of return for blacks and other low wage earners. Africans Americans and the poor are paying into a system that does not allow them to accumulate wealth to be passed on to their heirs.

African Americans need to invest in a system which would allow an opportunity to invest in not just their retirement future, but the future of their spouse and children. The current system does not allow that option. A retirement plan, which encourages individual savings, will provide Americans with real retirement income and security. Replacing the current Social Security payroll tax with a system of personal savings accounts would increase America's savings and benefit the economy as a whole.

Private retirement accounts will provide individuals an opportunity to accumulate wealth and pass it on to their heirs at death. Additionally, private retirement accounts will assist those retirees in purchasing their dream home or establishing a small business. The economy overall would profit from personal retirement accounts through increased savings and investment and the creation of more jobs.

Privatization of Social Security would provide the poor with an opportunity to be self-sufficient and enjoy a more prosperous retirement than that allowed by the current system. Social Security privatization will offer blacks and the poor the opportunity to accumulate real wealth, participate in the U.S. economy and pass on an inheritance to their heirs. The current system prevents them from doing such. The current system is out-dated and only hampers low-income wealth accumulation. Social Security provides nothing more than a "retirement tax refund" to its current beneficiaries.

Instead of levying additionally taxes against the poor and low-income workers to save the current social security system, real retirement security will be provided through a privatized retirement saving plan. Real retirement security through Personal Retirement Accounts (PRA's) would allow low-income workers the opportunity to enjoy their retirement, as opposed to struggling while waiting for that "first of the month check." PRA's will allow low wage retirees the opportunity to leave an inheritance for their grandchildren, as opposed to being a financial drain on their children. Social Security Privatization provides retirement options and these financial independence opportunities.

If Social Security payroll taxes went directly into personal retirement accounts, every working American would have money to save and invest, including the working poor. If these individuals and families were allowed to invest their current payroll taxes into private, personal retirement accounts, they would accumulate real wealth: wealth for a financially secure retirement, and the ability to leave a financial portfolio to their heirs.

Proverbs says that a good man leaves an inheritance for his grandchildren. Privatizing Social Security will allow ALL Americans—not just the rich—but poor, hard working Americans—to flourish in financial independence and to tap into the American economic dream. CURE is standing today in support of Social Security Privatization.

Statement of Steven H. Johnson, Director, Collaborative Democracy Project

SYNOPSIS.

The Two-Track Savings Solution achieves permanent and lasting solvency for Social Security, while protecting long-run benefit levels and avoiding an increase in the 12.4% payroll tax. The Two-Track Savings Solution accumulates two pools of capital, one in Personal Retirement Accounts, one in the Social Security Trust Fund. A creative approach to the structuring of PRA's eliminates issues of longevity risk, market risk, and high fees. A creative system for managing Trust Fund investments disposes of the government meddling issue. A modest Federal Budget subsidy is used to get the Two-Track Solution rolling, then terminated once it's no longer needed. On balance, the Two-Track Savings Solution outperforms all other proposed solutions.

CLARIFYING THE GOAL—A SOLUTION THAT "FUNDS THE GAP"

An effective solution for Social Security should be defined as one that protects retiree benefits, avoids stiff increases in the payroll tax, and achieves lasting solvency. These three objectives cannot simultaneously be achieved so long as Social Security continues to be financed almost wholly on a pay-as-you-go basis. In a pay-as-you-go system, with a progressively aging population, one of those three objectives must inevitably be sacrificed.

On the other hand, it is possible to achieve all three objectives simultaneously if a different approach is taken, if pay-as-you-go financing is augmented with a strong saving and investment program. No, it's not possible for Social Security to be fully funded, in the same sense that many pension programs are fully funded, with retiree benefits paid exclusively by earnings on capital. There simply isn't enough financial capital in the American economy for Social Security to be fully funded.

What can be funded, however, is "the gap," the spread between Social Security expenditures and Social Security receipts. Social Security expenditures, the benefits going to retirees, are projected to hit 19% of taxable payroll in decades to come. Social Security receipts, meanwhile, are set to remain at 12.4% of taxable payroll. This is quite a gap, yet most of it can be funded effectively within the limits of the American economy's capital base. An effective Social Security solution is one that accumulates enough capital so that the earnings from capital are sufficient to "fund the gap." Once the gap is funded, all three objectives are achievable. Payroll taxes can be held at a reasonable level, retiree benefits can be protected, and Social Security's solvency can be assured.

The Two-Track Savings Solution does exactly this. It funds the gap and achieves all three of these key objectives. How? By combining the strongest features of the conservatives' approach with the strongest features of the liberals' approach. By combining a Personal Retirement Account savings track with a Trust Fund savings track.

TRACK ONE—PERSONAL RETIREMENT ACCOUNTS

The Two-Track Solution begins by establishing a system of Personal Retirement Accounts, managed by employee-selected Fund Managers, for the purpose of accumulating employee-owned assets that cannot be touched except in the event of death or retirement. Over time, PRA capital contributes mightily to the task of funding the gap.

The Two-Track Savings Solution makes several important adjustments to the PRA concept. On retirement, new retirees are not asked to make their PRA savings stretch to cover the rest of their lives. Nor are they told that, thanks to the funds they've accumulated in their PRA's, their basic Social Security benefits will be reduced for the entire period of their retirement.

Instead, the Two-Track Solution reduces Social Security benefits for the first ten years of retirement only. And it encourages new retirees to convert their PRA assets into fixed ten-year annuities, rather than lifetime annuities. In the eleventh year, once an individual's PRA-financed annuity expires, Social Security benefit payments kick in at their full earned level.

The ten-year PRA approach is a sensible solution to what is otherwise a vexing dilemma. No one, at retirement, knows exactly how much longer they're going to live. Draw down your savings too fast, and you risk going broke in the later years of your retirement. Draw down your savings too slowly, and you risk dying before you've taken full advantage of the money you've saved. The Two-Track Solution does away with this dilemma. Retirees get the full benefit of their PRA savings during the first few years of retirement, while they're also assured that Social Security will be there for them in the latter years of their retirement.

In other words, the Two-Track Solution uses an investment approach to help in financing retirement's early years, then switches to an insurance approach for financing retirement's later years.

To assure average market returns for all employees, the Two-Track Savings Solution encourages all employees to place their PRA assets in index funds.

Then, to protect employees against market risk, the Two Track Savings Solution operates according to the following rule: Regardless of what's happening in the stock market at the time you retire, your Social Security benefit payment, when combined with ninety percent of your PRA annuity, will add up to the full Social Security benefit you would be receiving, if there were no PRA program in force.

Suppose that your earned Social Security benefit, at retirement, is calculated to be $1000 a month. If you retire when the market is doing well, and draw an annuity from your PRA of $600 a month, Social Security would pay you $460 a month. [90% of your PRA $600 is $540. $1000 minus $540 yields your Social Security payment of $460.] You'd be receiving a total of $1060 a month.

If, on the other hand, you retire when the market is doing poorly, and you draw an annuity from your PRA of only $300 a month, then Social Security will pay you $730 a month. [90% of your PRA $300 is $270. $1000 minus $270 yields your Social Security payment of $730.] You'd be receiving a total of $1030 a month. In the eleventh year of your retirement, and thereafter, you'd receive $1000 a month, prior to any adjustment for inflation.

Note the ten percent PRA incentive that's built in. Social Security counts only ninety percent of your annuity in figuring out your benefit check, not one hundred percent. This is analogous to Feldstein's suggested PRA incentive.

The PRA component of the Two-Track Solution avoids, however, the moral hazard that appears to be associated with Feldstein's proposal. In Feldstein's proposal, the dumber the investor, the greater the protection. Someone who blew almost every cent of his PRA savings on bad investments, and who retired with a monthly annuity of only one dollar, would under Feldstein's plan see his regular Social Security benefit docked by only 75 cents.

The Two-Track Solution does, however, place limits on the amount of protection offered. If some individuals elect not to invest in index funds, and then reach retirement with less money than they would have accumulated as index fund investors, they will not thereby be entitled to a corresponding increase in their Social Security benefits. Their Social Security benefit checks, for the first ten years, will be keyed only to the amount of money they would have been receiving, had they been index fund investors. If they fall short, through their own misjudgment, Social Security will not make them whole. (If they come out ahead, Social Security will not penalize them, either.)

This Two-Track approach to PRA's effectively answers the key objections that have been raised against PRA's by their critics.

Key Issue—Longevity Risk. Longevity risk is a very real issue when PRA's are meant to cover all the years of a person's retirement. When a PRA is meant to finance only the first ten years of a person's retirement, though, the issue of longevity risk essentially evaporates.

Key Issue—Market Risk. Market risk is a significant issue if Social Security makes no allowance for the fact that people retiring in different years are sure to face very different investment outcomes. When Social Security does make allowance for this, as proposed, the issue of market risk also goes away.

Key Issue—High Management Fees. Any employee who places his or her PRA with a typical stock-picking mutual fund can expect to pay high management fees, one percent of assets, perhaps one and a half percent of assets. These fees can eat up a substantial portion of a person's assets over the years. But employees who direct their Fund Managers to invest their PRA assets in index funds will pay much less. Fees currently charged on index fund accounts are already as low as two-tenths of one percent of assets. Once Social Security's bargaining power is brought to bear, such fees will almost certainly fall to one-tenth of one percent, or less. By steering almost all employee investments toward index funds, the Two-Track Solution essentially eliminates the issue of high management fees.

Key Issue—the Redistributive Character of Today's Social Security Program. Many critics of PRA's have voiced concern about the adverse impact of PRA's on lower income participants. In the Two-Track Solution, the redistributive nature of the Social Security program is fully preserved.

Key Issue—the Camel's Nose of Full Privatization. What about the "camel's nose under the tent" concern voiced by some liberals? One must be blunt. Liberal critics haven't done their math. Even if the Democrats and Republicans alike sought to privatize all of Social Security, they wouldn't be able to do it. Is there any scenario under which the nation could tolerate having PRA's acquire more than a third of the entire stock market? No. Of course not. Establish a one-third stock market ownership ceiling for PRA's, then, and it's simply impossible for an all-out privatization strategy to replace more than about a quarter of the entire Social Security program.

Liberals should stop worrying themselves about the camel's nose under the tent. The camel is really quite tiny. It's much too small to run away with the tent.

TRACK TWO—TRUST FUND EQUITY INVESTMENTS

In the Two-Track Savings Solution, the second savings track accumulates an additional pool of capital in the Social Security Trust Fund. Just as the Track One capital pool accumulated in PRA's helps in financing the first ten years of each individual's retirement, the Track Two capital pool accumulated in the Trust Fund helps in financing the later years of each person's retirement.

The Two-Track Solution authorizes the Trust Fund to invest in stocks as well as bonds. If stock market conditions are favorable, the Two-Track Solution authorizes the Trust Fund to invest as much as sixty percent of its assets in stocks, forty percent in bonds.

The point, of course, is to create a permanent pool of capital, whose earnings can make a strong contribution to the task of funding the gap. The larger its pool of capital, of course, the more effective the Trust Fund will be in funding the gap.

The Two-Track Savings Solution adopts a unique approach to the issue of how this pool of capital should be managed. All of the Trust Fund's securities would be farmed out to the same group of firms that are functioning as Fund Managers for employee PRA's. The securities would be allocated to these firms in proportion to the rate at which employees have selected them to serve as their Fund Managers.

In other words, if two percent of all employees have selected Merrill Lynch as their PRA Fund Manager, two percent of all Trust Fund assets would be placed with Merrill Lynch. If one percent have selected Charles Schwab, one percent of all Trust Fund assets would also be placed with Charles Schwab. And so on.

All Trust Fund stocks would, by law, be invested in very broad index funds, much broader than the S&P 500. Responsibility for voting those stocks would be divided among all the firms serving as Fund Managers.

As the PRA program unfolds, it is likely that at least a hundred different firms would get into the business of managing PRA's. Given the multitude of mutual funds in today's market, the total number of firms handling PRA's might ultimately number in the hundreds, perhaps even in the thousands. From a corporate governance standpoint, the end result is clearly positive. Responsibility for voting the Trust Fund's stocks would be very widely dispersed. Under the Two-Track Solution, corporate executives would wind up having much the same relationship with their stockholders as they do today.

As a result of this arrangement, the Two-Track Savings Solution effectively addresses the key concern that is triggered whenever the notion of allowing the Trust Fund to invest in stocks is raised, the issue of stock ownership becoming highly concentrated in the Social Security Trust Fund.

In a one-track investment environment, this is a difficult problem to resolve. Leading supporters of a Trust Fund investment strategy have suggested the appointment of a Federal Reserve-like investment management board. This board would appoint a small number of independent Fund Managers to handle the Trust Fund's stocks, and those managers would be required to keep Social Security's stocks safely invested in broad index funds.

Such a proposal might turn out to be workable. But it is not a program that inspires confidence. And, like the sword of Damocles, the threat of Congressional tampering would hang perpetually over the stock market.

The Two-Track Solution provides the nation with the opportunity to use a significantly less risky strategy for managing Trust Fund assets. Dispersing the management of Trust Fund assets among hundreds of employee-selected Fund Managers insulates those assets from the threat of Congressional tampering much more effectively. Tens of millions of PRA-owning employees will serve as a powerful buffer, creating a perpetual barrier against meddling that no Congress would dare to breach. It's something of a happy surprise that the best way to harness the Trust Fund's capacity for funding the gap is to combine a track two Trust Fund investment strategy with a parallel track one PRA investment strategy.

KEY ISSUE—REAL RETURNS ON STOCKS

When asked about future returns on stock investors, most forecasters will say, as though it were a mantra, "We've had seven percent return on stocks for the last seventy years. There's no reason we can't have seven percent return on stocks for the next seventy years."

One should think long and hard before accepting this assertion at face value. In fact, a more reasoned reading of the historic data argues strongly for a more conservative forecast.

We must begin by taking a closer look at the 7% number. First of all, it refers only to the S&P 500, not to the entire market. It's unlikely that the market as a whole performed to the same level as the S&P 500.

Second, the S&P's seven percent growth rate is much less dependent on price growth than people realize, much more dependent on reinvested dividends. Real price appreciation for S&P 500 stocks averaged only 2.3% over the past seven decades. It was the dividend reinvestment rate of 4.6% that did two-thirds of the work in delivering seven percent returns. That's right. From a 7% return perspective, two-thirds of the heavy lifting was done by reinvested dividends.

The prudent forecaster has to look carefully at both of these elements. Will long-run price appreciation rates rise, stay the same, or fall? Will long-run dividend reinvestment rates rise, stay the same, or fall?

Will price appreciation rise, stay the same, or fall? We've had quite a run-up in stock prices over the past decade and a half. Total market capitalization, relative to GDP, has risen to astonishing levels. The Market Capitalization-to-GDP Ratio has risen from 45% in the mid-eighties to 155% in the late nineties. Nearly a full generation of brokers and investors has come of age in an environment where the market every year has grown faster than the GDP.

Such a trend is not sustainable. Common sense tells us that, over the long run, the total value of the stock market is ultimately going to grow at roughly the same rate as the GDP. After all, the key elements of market value—corporate revenues, corporate earnings, and corporate dividends—are all nested within GDP. As corporate America grows, GDP grows. And so does the stock market. Stock market growth can't outrun GDP growth forever.

[When investors do act on the belief that stock prices will always grow faster than GDP, as they seem to be doing now, the market eventually turns into a vast Ponzi swindle, with this year's suckers turning a fast profit only if next year's suckers buy in at even sillier prices.]

It is also worth noting, as Wharton's Jeremy Siegel has pointed out, that individual stock indexes, such as the S&P 500, won't grow quite as fast as the growth rate of the entire market. When new firms are listed, the market grows, but an index fund does not. When new shares are sold by an existing firm, the total size of the market grows, while index funds remain the same size. Over the past seventy years, GDP grew at an inflation-adjusted rate of 3.3% a year. Stock prices in the S&P 500 grew at an inflation-adjusted rate of only 2.3% a year. There's a natural lag between the GDP growth rate and long-term index fund growth.

In the future, slowing population growth rates will ripple through the economy in ways likely to slow down the long-term GDP growth rate. A lower population growth rate implies fewer new workers and fewer new customers coming of age each year. It's doubtful that the economy can sustain a GDP growth rate of 3.3% should the nation's population growth rate slow down markedly. Given these circumstances, a prudent forecaster would probably pick 2% annual growth in real stock prices, not 2.3%, as a sensible estimate for the decades ahead.

Will the dividend reinvestment potential rise, stay the same, or fall? Is it reasonable to expect the S&P 500's historic dividend reinvestment rate of 4.6% to hold, for the stock market as a whole, in the decades ahead?

Simply on the face of it, one ought to say no. As a general rule, one wouldn't expect dividend payout rates for the market as a whole to be as strong as the dividend payout rates for those market-leading firms that are listed on the S&P 500.

One also has to look at the historic averages. The Market Capitalization-to-GDP Ratio averaged roughly 65% over the past seven decades. Over the same time period, corporate dividend payouts averaged roughly 2.5% of GDP. What impact did this have upon the dividend reinvestment potential? The dividend reinvestment potential, i.e., the dividend yield, is simply the dollar value of the dividend divided by the dollar value of the stock. For the economy as a whole, dividends equaling 2.5% of GDP, divided by stock values equaling 65% of GDP, implied a market-wide dividend yield, or dividend reinvestment potential, that was just a shade under 4%, slightly lower than the historic dividend yield for firms listed in the S&P 500.

Now consider what's happening to these key variables today. The dividend payout rate hasn't changed much. Corporate dividends are still running about 2.5% of GDP. On the other hand, the Market Cap-to-GDP ratio has skyrocketed. At current stock prices, the Market Cap-to-GDP ratio is running about 155%.

As a result, the market's dividend yield, or dividend reinvestment potential, has taken a hammering. It's now in the one and a half percent range.

On a slightly positive note, sophisticated investors now see share repurchasing playing much the same role as dividends. Corporations that repurchase shares do so as a way of getting capital back into the hands of their shareholders. Since receipts from the sale of shares back to the corporation are taxed to the investor as capital gains, while dividends are taxed as ordinary income, many investors have come to prefer share repurchasing. Though dividend yields are now quite low, share repurchasing does make up a small part of the gap.

A rational forecaster probably would not expect Market Cap-to-GDP Ratios in the 155% range to be sustained indefinitely. Given time, a more rational regime of stock prices is sure to return. On the other hand, 65% Market Cap-to-GDP Ratios may never be seen again. What's the right level of market capitalization to predict for the future? No one can say for sure. An average Market Cap-to-GDP Ratio of 100% is probably a prudent forecast, somewhat higher than the market's historic average, well below today's unsustainable levels.

In other words, with a Market Cap-to-GDP Ratio of 100%, tomorrow's dividend reinvestment potential, with share repurchase results thrown in, is likely to recover slightly from its current lows. On the other hand, dividend yields as high as 4.6% will be little more than a distant memory. A dividend yield forecast of 3% is somewhat more prudent for the decades ahead.

Tomorrow's real return rate. The responsible forecaster looks separately at each element, and then combines them. Real price growth averaging 2% a year. Dividend yields—i.e., dividend reinvestment potential—averaging 3%. When these two estimates are combined, the suggested long-run return for stocks comes in at roughly 5% a year.

Needless to say, this point is extremely important in the Social Security reform debate. Most of the proposals offered to date have placed their bets on a 7% return rate for stocks. This is regrettable, and involves significant overpromising. Social Security proposals based on long run stock returns of seven percent are almost sure to disappoint.

Key Issue—Investment Timing. When should PRA's begin investing in the stock market? When should the Trust Fund begin investing in the stock market? Given the stock market's currently overpriced condition, caution seems advisable. Hardly anyone would encourage Social Security to buy high and sell low. Fund Managers would be well advised to stay away from the stock market until overall stock prices have returned to a somewhat more rational level.

The following guidelines are suggested: Whenever the Market Cap-to-GDP Ratio exceeds 130%, Social Security's Fund Managers ought not invest any new money into the stock market. Whenever the Market Cap-to-GDP Ratio hovers between 100% and 130%, Social Security's Fund Managers should invest cautiously in stock index funds. Whenever the Market Cap-to-GDP Ratio dips below 100%, Social Security Fund Managers should be free to invest heavily in the market.

Over the long run, Social Security's Fund Managers ought to seek a sixty/forty mix between stocks and bonds. In the short run, though, given the market's currently overpriced state, a zero/one hundred mix between stocks and bonds is a more appropriate target.

THE NUMBERS MAKE SENSE

To implement the Two-Track Savings Solution, the following steps are recommended.

1. Establish a system of PRA's (Personal Retirement Accounts). Set the payroll tax rate for PRA's at 1.5%, split evenly between the employee and the employer.
2. Set the remaining payroll tax rate at 10.9%, half from the employee, half from the employer. This keeps the overall payroll tax at 12.4%.
3. Subsidize Social Security from the general funds of the Federal Government in an amount equaling 0.9% of taxable payroll. Begin the subsidy in the year 2000. Terminate it at the end of 2032. (In the year 2000, 0.9% of taxable payroll will be about $34 billion.) The federal subsidy serves two purposes: A) It builds a strong and permanent Trust Fund; B) It covers any shortfalls associated with the early years of PRA's, before they're fully funded.

4. End the practice of diverting a portion of the income taxes collected from Social Security beneficiaries to Medicare. Return to Social Security all income taxes collected from retirees on their Social Security benefits.

5. On a phased-in basis, raise Social Security's taxable income ceiling to a point that expands the total size of the Taxable Payroll pool by six percent. Do not raise benefits accordingly for high income participants.

6. Gradually trim Social Security's overall benefit schedule, so that total benefits six decades from now are between nine and ten percent less than they would otherwise have been. Perhaps the fairest method for doing this is to adjust the formula that ties new benefits to career earnings, so that the growth rate in benefits for new retirees doesn't rise quite as quickly as the growth in total wages.

7. Adjust the benefit calculation rules for the first ten years of a person's retirement, so that they'll be coordinated with Social Security's PRA program. For all those who keep their PRA stock assets invested in stock market index funds, establish the following rule: Ninety percent of a retiree's monthly PRA-financed annuity, plus the retiree's check from Social Security, will equal the normal Social Security benefit that would be paid to the retiree, were there no PRA's. This rule keeps everyone whole, regardless of the state of the market at the time they retire. It also builds in a small incentive for participating in the PRA program.

Corollary: An employee who does not invest in stock market index funds, but who selects a different investment strategy, will on retirement draw Social Security benefits identical to those he or she would be receiving, had that same employee invested their PRA 1.5% in an index fund.

8. Once stock prices return to more reasonable levels, authorize each Fund Manager handling Social Security assets to invest sixty percent of Trust Fund assets in broad stock market index funds, forty percent in bonds. Authorize Fund Managers to invest PRA assets similarly, sixty percent in broad stock market index funds, forty percent in bonds.

Stock Market Implications. In developing Two-Track Savings Solution, the guiding rule has been that Social Security-driven stock acquisition (PRA's and Trust Fund combined) ought to be held to less than a third of all stocks listed on the stock market.

Is such a cap too high? Or too low? Consider the following factors. Stock market size: The stock market really isn't quite as big as people think it is. Social Security's cash needs are really quite massive, relative to the whole stock market. The extent of Social Security coverage: Social Security provides virtually all Americans with retirement benefits. Growth in the retiree population: People over 65 are expected to grow from 12% of the whole population to 23%. Funding the gap: A substantial pool of capital is needed to fund the gap, to protect benefits, avoid payroll tax increases, and ensure solvency.

Given these considerations, it will be an extraordinary accomplishment to hold Social Security's ownership share to less than a third of the total stock market. Yet it can be done.

To begin with, it is assumed that total stock market capitalization will be worth about 100% of GDP over the long run, well below today's highs, yet exceeding the historic average.

As the Two-Track Solution matures, my Solvency Spreadsheet indicates that Social Security's Trust Fund will in time acquire assets equaling 27% of GDP, while PRA's ultimately accumulate assets equaling 20% of GDP. With a 60/40 split between stocks and bond, this implies Social Security-related stock holdings eventually equaling about 28% of GDP, and bond holdings equaling about 19% of GDP.

If such an accumulation of stocks were held and voted as a single chunk of capital, its effects would be overpowering. On the other hand, the stocks that add up to the 28% total will be owned, in part, by tens of millions of Americans. They'll be managed and voted by literally hundreds of different Fund Managers. They'll be held in very broad index funds. In other words, the Two-Track Savings Solution actually produces a highly decentralized program of stock ownership and control.

Comparisons With Other Proposals

The Two-Track Solution compares favorably with all existing proposals for saving Social Security.

Plans That Let GDP Solve It. According to some, strong GDP growth will reduce or eliminate Social Security's insolvency crisis. The anticipated gap won't materialize. Even if these high growth optimists are correct, it's still not a bad idea to have the Two-Track Savings Solution in force. Then, if the optimists do turn out to be right and high GDP growth rates do reduce the pressure on Social Security, these twin pools of capital will enable Social Security to pay stronger benefits, or to reduce the payroll tax, or both. On the other hand, if the high growth optimists are wrong, and the gap does materialize after all, the Two-Track Savings Solution is still there to offer the protection that's needed. In either case, the Two-Track Savings Solution is a smart course of action.

Two Percent Plans. "It's a two percent problem," some have said, referring to the claim that Social Security is out of "actuarial balance" by only two percent of taxable payroll. This view reflects a deep error in judgment. "Actuarial balance" is not a fancy name for solvency, and the attainment of actuarial balance comes nowhere close to assuring solvency. The Two-Track Savings Solution doesn't limit itself to restoring actuarial balance, as the "two percent" proposals try to do. The Two-Track Solution truly produces genuine solvency. Under the Two-Track Solution, Social Security's twin pools of capital will be just as strong in 2075 as in 2050, just as capable of "funding the gap" at the end of the century as they are in the middle of the century.

The Ball-Aaron-Reischauer Strategy. Proposals offered by former Commissioner Ball and by Brookings' experts Aaron and Reischauer lean heavily on allowing the Trust Fund to invest in the stock market. They also offer a number of additional tweaks designed to restore actuarial balance. Their suggested methodology for insulating Trust Fund stocks from the threat of Congressional meddling isn't nearly as strong as the method proposed in the Two Track Solution. And the single pool of capital they'd create doesn't go nearly as far to "fund the gap" as the twin pools of capital called for in the Two-Track Savings Solution.

The Clinton Plan. President Clinton's current proposal might be described as Ball-Aaron-Reischauer Lite. It expands the Trust Fund quite modestly in the short term, but fails utterly in the task of "funding the gap" over the long term. President Clinton's current proposal pushes out the Social Security insolvency date by a meager two decades. In contrast, the Two-Track Savings Solution does in fact deliver long-term solvency. Under the Two-Track solution, Social Security's financial condition will be strong enough to fund the gap between expenditures and receipts for decades and decades to come.

The NCRP Plan. The Breaux-Gregg-Kolbe-Stenholm proposal achieves long-term solvency, but does so at the cost of imposing steep benefit cuts on future generations of retirees. According to the Social Security actuaries who've priced out the NCRP plan, retiree benefits in the year 2075 will be cut by 45%. Proceeds from NCRP-suggested thrift accounts won't make up more than half the difference, at best, leaving a net cut in total benefits of twenty to twenty-five percent. In the Two-Track Solution, by comparison, the ultimate benefit level is 2075 is reduced by not more than ten percent.

The Moynihan-Kerrey Plan. The Moynihan-Kerrey plan also achieves long-term solvency, but only at the cost of raising the combined thrift account-plus-payroll tax rate to 15.4% in decades to come. By comparison, the Two Track Savings Solution keeps the payroll tax at 12.4% in the out-years, and does this without requiring a permanent federal subsidy.

The Feldstein Plan. One serious weakness in the Feldstein plan is that it requires a permanent Federal Budget subsidy, in the form of tax credits that offset employee PRA contributions. Such credits become a never-ending drain on the Federal Budget. The federal budget subsidy called for by the Two-Track Solution is more modest than Feldstein's, lasts only for three decades, and then terminates completely.

A second weakness in the Feldstein plan is its moral hazard problem. As mentioned, the poorer the investment strategy picked by an employee, the more fully the individual would be protected by Social Security. In the Two-Track Savings Solution, only those who invest prudently are fully protected. Those who invest incautiously receive no extra protection.

Full Privatization Plans. Proposals offered in the House and Senate by Gramm, Domenici, Sanford, and Porter, as well as the proposal offered by Sam Beard, push toward the total privatization of Social Security. Even if any of these proposals were to command majority support within the Congress, none could be implemented in the real world. For such proposals to live up to their rosy promises, future retirees would have to accumulate nearly all the stocks and bonds available in the American economy. As a practical matter, a full privatization strategy is totally unworkable.

CONCLUSION—THE TWO-TRACK SAVINGS SOLUTION WORKS BOTH ECONOMICALLY AND POLITICALLY

The Two-Track Savings Solution is significantly superior to all other proposals. It works economically for the nation as a whole, because it's based on realistic economic principles. It doesn't fund the total cost of Social Security, but it does fund the anticipated gap between future expenditures and future receipts. It delivers long-run solvency. It holds the line on payroll taxes. It avoids the creation of a permanent Federal subsidy. It does not assume 7% real returns on stocks, ad infinitum, because such returns are quite unlikely. And its benefit cuts are quite modest, amounting, in the end, to a slowing in the rate of benefit growth.

The Two-Track Savings Solution creatively avoids the design flaws inherent in today's one-track options. It avoids the longevity risk, market risk, and high management fee risks associated with earlier approaches to establishing PRA's. And it neatly disposes of the stock market control concerns that are triggered by the Ball-Aaron-Reischauer proposal for managing Trust Fund stock investments.

The Two-Track Savings Solution works from a liberal perspective. It fully retains the redistributive features of today's Social Security system. And it fully protects everyone—retirees, survivors, and the disabled.

The Two-Track Savings Solution also works from a conservative perspective. It effectively harnesses the power of compound interest to reduce the long-run costs of the Social Security program. Compared with any realistic alternative, the Two-Track Solution significantly improves the amount of value received for each dollar spent.

The Two-Track Solution is more than the sum of its one-track elements. It protects retiree benefits. It holds the line on the payroll tax. It funds the gap and achieves lasting solvency. It is an intelligent compromise that meets the core concerns of Republicans and Democrats alike. The Two-Track Savings Solution is a creative and robust answer that will save Social Security, and keep it affordable, for generations to come.

Statement of Hon. Rosa L. DeLauro, a Representative in Congress from the State of Connecticut

On February 2, I will introduce a resolution recognizing the importance of Social Security, one of our nation's greatest success stories, to women. As the President pointed out in his State of the Union speech, although they make up roughly half of America's population, women 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.

Any changes to the Social Security system must be thoroughly researched and carefully considered to maintain Social Security's guarantee of financial stability in old age. As we begin to debate Social Security reform, Congress and the President must be committed to ensuring that any reform proposal protects the financial security of women in their later years. My resolution recognizes the unique obstacles in ensuring their retirement, survivor and disability security, and the essential role that Social Security plays in guaranteeing inflation-protected financial stability for women throughout their golden years. The bill calls on the Congress and the President to take these factors into account when weighing proposals to reform the Social Security system.

I am proud to have 84 of my colleagues join me in co-sponsoring this important piece of legislation. A copy of my resolution is attached for your reference.

Co-sponsors:

Gephardt, Matsui, Stark, Thurman, Pelosi, Lowey, Morella, C. Maloney, McDermott, Coyne, Neal, Levin, C. Brown, Olver, Sanders, Filner, Meek, Capps, Gejdenson, Serrano, Millender-McDonald, Meehan, Rivers, Kucinich, Clayton, G. Miller, Norton, Kaptur, Frost, Markey, Hinchey, Ford, McKinney, Roybal-Allard, Stupak, Lee, Delahunt, Green, Jackson-Lee, Allen, Velazquez, Woolsey, Slaughter, Bentsen, Bishop, Danner, Mink, Barrett, Kildee, Frank, Lofgren, Pomeroy, C. McCarthy, Nadler, Pallone, Oberstar, K. McCarthy, Wynn, Wexler, Vento, S. Brown, J. Maloney, B. Thompson, Tierney, Sherman, Brady, Sandlin, Dixon, Manzullo, Hooley, Goode, John Lewis, Romero-Barcelo, Kilpatrick, Hinojosa, Schakowsky, Eshoo, Abercrombie, Napolitano, Lantos, Berman, B. Hill, Filner, Crowley

Resolution

Recognizing the unique effects the proposals to reform Social Security may have on women.

Whereas the Social Security benefit structure is of particular importance to low earning wives and widows with 63 percent of women beneficiaries aged 62 or older receiving wife's or widow's benefits;

Whereas three-quarters of unmarried and widowed elderly women rely on Social Security for over half of their income;

Whereas without Social Security benefits, the elderly poverty rate among women would have been 52.2 percent and among widows would have been 60.6 percent;

Whereas women tend to live longer and tend to have lower lifetime earnings than men do;

Whereas women spend an average of 11.5 years out of their careers to care for their families, and are more likely to work part-time than full-time; and

Whereas during these years in the workforce, women earn an average of 70 cents for every dollar men earn: Now therefore, be it

Resolved, That the House of Representatives recognizes the unique obstacles that women face in ensuring retirement security and survivor and disability security and the essential role that Social Security plays in guaranteeing inflation-protected financial stability for women throughout their entire old age, and it is the sense of the House of Representatives that the Congress and the President should take these factors into account when considering proposals to reform the Social Security system.

Statement of Joseph G. Green, Toronto, Ontario, Canada

WEP Modification Proposal

Background

Historically, years ago, government employees in the US, (local, state and federal) could not belong to the Social Security System and also be part of a government pension plan. Since government pensions then were higher, most employees elected to join the appropriate government plan and not social security. As of 1984, Congress mandated that ALL workers must belong to the Social Security System.

However, Congress realized that these civil servants would retire, having paid in only the minimum of 40 quarters or a little more, but at a much higher social security rate than those pensioners who had joined the system 20 or more years before (but contributed when the rate was much less). Therefore, beginning in 1984 and thereafter, the pensioners with a non-covered pension would in effect get their full non-covered pensions plus much higher social security benefits than would those workers who had contributed to social security for many more years before 1984, when maximum was less than half of today's $1,326 (as of Jan. 1997).

Thus, pensioners retiring in the 1990s and thereafter, with a full non-covered pension, would enjoy a proportionately larger social security benefit than those who had contributed for many more years but had contributed less.

To adjust this situation, when Congress amended the Social Security Act in 1983, it wrote into the statue a provision to offset this unintentional oversight for those with a SUBSTANTIAL non-covered pension. This provision is known as The Windfall Elimination Provision (WEP).

The Statute

Provision 113–WEP of the 1983 Social Security Amendments PL98–21, stipulates that a pensioner entitled to social security benefits and also having a non-covered pension (all foreign pensions are obviously non-covered by social security) will have $50 deducted from his/her monthly social security benefit for every $100 he/she receives from the non-covered pension. The law further states that those whose social security computation falls under the WEP cannot lose more than half of their entitled social security benefit. This law went into effect as of January, 1986. Anyone drawing social security benefits prior to that date is not affected.

The Practical Application for Overseas Pensioners

Congress never even considered American pensioners and how WEP would affect them if they are living overseas and are entitled to social security and get also a small or partial foreign pension. We abroad are adversely affected TWICE!.

In the first place, our social security was frozen when we elected to leave the United States and relocated abroad at a time when social security monthly benefits were less than half of what they became in the 1990s. For example, in 1973, maximum social security benefits were only $550 per month. As of Jan. 1997, the maximum Social Security benefit is $1,326. American pensioners abroad entitled to a small or partial foreign pension, have their already frozen social security benefit of $550 or less further reduced up to half as a result of applying the WEP. Thus, anyone falling under the WEP in the United States enjoys a full non-covered pension of a $1,000 or more monthly, and even at maximum, can only lose up to half of today's maximum of $1,326 when applying the WEP formula. However, the overseas pensioner who winds up with a modest foreign pension of as little as $200–400 monthly has his/her frozen social security benefit of 20 or more years ago further reduced, up to half, netting him or her only a few hundred dollars per month.

This is a gross inequity and needs modification. In the first place, many overseas pensioners have paid into the Social Security system for many years. When they relocated abroad, they were certain that upon retirement their full social security due them would be guaranteed. Secondly, the Windfall Elimination Provision was only intended for those with a SUBSTANTIAL, non-covered pension. In today's economy. getting $400–600 of a monthly non-covered pension cannot be considered as being substantial. For many, their meagre foreign pension, together with their low, frozen social security is their only means of income. Having their entitled social security cut in half because they also are entitled to a modest, or partial non-covered pension causes an unfair hardship. This also places the overseas pensioner in an unequal situation relative to his fellow pensioner residing within the United States, falling under the WEP.

Modification Sought

To correct this inequity, Congress is petitioned to modify the Windfall Elimination Provision as follows:

l) Anyone whose non-covered pension is $600 or less shall be exempt from the Windfall Elimination Provision.

2) Anyone whose non-covered pension is between $600–$1,200 shall have his/her first $400 exempt before applying the WEP formula.

3) Anyone whose non-covered pension is $1,200 or above shall have his/her monthly social security benefits fully computed in accordance with the WEP provision.

This proposal would greatly ease the inequity that now exists between pensioners residing at home or abroad. At the same time it would retain the spirit of the law; namely reducing the social security benefits of only those who have a SUBSTANTIAL non-covered pension, in addition to a substantial benefit from social security.

Statement of Heidi Hartmann, Economist, Ph.D., President and Director, Institute for Women's Policy Research, and Chair, Working Group on Social Security, National Council of Women's Organizations

I would like to share with the Committee on Ways and Means my analysis of proposed reforms and suggestions for Social Security changes that would benefit women. This summary is based on the statement I submitted to the White House Conference on Social Security, held on December 8. I have also briefly addressed the proposal the President put forth in his State of the Union speech on January 19. Following my statement and a fact sheet from the Institute for Women's Policy Research is the statement of the working group on Social Security of the National Council of Women's Organizations.

Social Security is a Women's Issue

Sixty percent of Social Security recipients are women. Women are not a side issue in the debate over how best to finance the current system and whether to replace it partially or totally with a system of individualized private accounts or to add-on subsidized voluntary savings accounts. Women are central to the debate. Women's views on financing and benefits are critical to the President's and Congress's ability to pass legislation changing Social Security in 1999 or any other year.

Why Individual Private Accounts or a Substitute for Social Security Won't Work for Women

Women are extremely skeptical that steering payroll taxes into individual private accounts will work for them to provide sufficient security in retirement. Women have lower earnings and live longer than men on average; therefore they have to stretch a smaller income over more years. They save less and have much less access to employment pensions. The security of Social Security as it's presently configured—the life-time guaranteed benefits, the higher returns for lower earning workers, the cost of living adjustments, and the spousal benefits (including benefits for widows and divorced women)—is critical to women. None of the privatization plans put forward provide all these assurances to women.

Moreover, any transition to a system of pre-paid retirement benefits (saving while working to pay for retirement later) while the current pay-as-you-go system is still in place (today's workers pay for today's retirees' benefits), requires the transition generations to pay for two systems at once. This either requires more taxes or other sources of revenue to support both plans or requires that benefits be reduced for the existing plan. This double payment will be particularly disadvantageous to women, since they earn less and have less with which to make the payments. The benefit cuts will affect women disproportionately as well, since they are more dependent on Social Security benefits than are men and since more women than men are in or near poverty even with the current benefit levels. A mandatory "carve out" plan that uses a portion of the payroll tax to create a parallel structure of private individual savings accounts alongside the current insurance-based system is expensive and unnecessarily complicates the Social Security system.

THE PRESIDENT'S PROPOSAL

The Universal Savings Accounts proposed by the President have the advantage of not requiring that Social Security funds be diverted to private accounts. Rather the new accounts are to be entirely voluntary, funded by individuals' savings and matched by tax credits (funded by the budget surplus) using a progressive formula (lower income savers get larger matches). Because of the matching funds, many individuals will prefer to save in these new vehicles than in the many existing alternatives. These individual savings accounts still raise several issues that need to be addressed:

- the administrative costs of having many small individual accounts may be high;
- the ownership of the accounts for married and divorced couples must be addressed;
- the future funding of the credits, when the budget does not have a surplus, is a serious fiscal issue.

The President also proposes to transfer the bulk of the surplus to the Social Security Trust Fund and to allow a small portion of it to be invested in equities. These two strategies ensure the solvency of the system for an additional 20 years, to 2055 approximately.

Both insurance-based systems like our current Social Security system and savings-based systems are valid forms of facing risk and financing retirement. Most families use both insurance and savings to protect against risks and provide for "rainy days." The President's proposal seeks to strengthen both types of protection.

HOW TO REFORM SOCIAL SECURITY TO BETTER MEET WOMEN'S NEEDS

Despite the many protections in Social Security that meet women's needs, there are still ways in which the system's rules, which are gender-neutral on their face, disadvantage women:

- using 35 years of earnings to calculate benefits, when far fewer women than men have that many years of paid work—proposals to increase the number of years of earnings used will disadvantage women further;
- not providing earnings credits for years taken away from paid work to provide family care;
- inequities between one- and two-earner couples such that, for couples with the same total pre-retirement income, those who shared the responsibility for earning more equitably have lower retirement benefits from Social Security than more traditional families in which the husband worked for pay substantially more than the wife;
- a drop of between 33 percent and 50 percent in the surviving spouse's Social Security benefits relative to the couple's benefits when both were alive, even though research shows the surviving spouse needs all but 20 percent of the couple's previous income to maintain the same standard of living; the surviving spouse is most typically a woman and the drop in benefits is largest when she worked enough to contribute substantially to the family income.
- the application of the "earnings test" (which requires benefit reductions when retirees earn more than the allowed amount) indiscriminately, regardless of how much prior work history the retiree has; some women who began work late may wish to keep working as long as they can to increase their future Social Security benefits (the President proposes to eliminate the earnings test entirely);

• the application of the "pension offset" rule indiscriminately, regardless of the size of the government pension and Social Security payments received; many female retired civil servants have small government pensions and small Social Security payments, yet Social Security payments are reduced accordingly. This gender-neutral rule affects women more adversely than men because women's benefits are likely to be much smaller because of life-time low earnings; the loss of even these small benefits hurts them disproportionately. Also private pensions are not required to be offset against Social Security; men are more likely to hold private pensions than are women.

Few reform proposals on the table address any of these issues that affect the size of the benefits women receive. Improving women's benefits is critical to reducing poverty among elderly women. Women over 65 are nearly twice as likely to be poor as men over 65 (13 percent vs. 7 percent), even though without Social Security women's poverty rate would be exceptionally high, 52 percent. Older unmarried women are even poorer, with a poverty rate of 22 percent. Social Security has worked well for women, but it could work even better.

Statement of Dr. John C. Goodman, President, National Center for Policy Analysis, Dallas, TX

Under our present pay-as-you-go system of financing elderly entitlements, taxes collected today are used to pay benefits to today's retirees. Each generation of retirees depends on the government to provide Social Security and health care benefits by taxing the next generation. But in the United States, as in most other developed countries, the number of taxpaying workers for every retiree is falling and is expected to continue falling. When the first Social Security payment was made in 1940, there were 42 workers for every retiree. Today there are about 3.3 workers for every retiree. By the middle of the next century, the ratio is expected to fall to about 1.5 to 2 workers for every retiree. This means that each worker will be supporting two-thirds of the cost of an elderly person in addition to all other taxes and all other family responsibilities.

Given current demographics, the tax burden for workers will continue to rise indefinitely into the future. As a result, our pay-as-you-go approach to elderly entitlements is on a collision course with reality.

The trustees of the Social Security and Medicare funds issue annual reports that include assumptions and projections for the next 75 years. There are three sets of assumptions: "intermediate," "low cost" (optimistic) and "high cost" (pessimistic). Although we are encouraged to assume that the forecast based on intermediate assumptions is the most likely, many students of Social Security and Medicare believe that the pessimistic projection more closely reflects our recent experience. The National Center for Policy Analysis has calculated what both the intermediate and pessimistic assumptions mean in terms of the taxable payrolls of the future.

Spending on Social Security currently takes about 11.5 percent of the nation's taxable payroll. Although Medicare Part A is also funded from the payroll tax, the federal subsidy for Medicare Part B is funded from general revenues. However, if both parts of Medicare are expressed as a percent of taxable payroll, they take about 5.5 percent.

By the year 2045, when today's 21-year-old college student will be eligible for Social Security, 17.42 percent of employee earnings—about 50 percent more than at present—will be needed to pay Social Security benefits, according to the intermediate forecast. We will need almost 30 percent of earnings to pay Social Security plus Medicare Part A and the government's share of Medicare Part B.

Using the pessimistic assumptions, we find that, by the time today's college students retire, the Social Security tax burden will be almost twice its current level—more than 22 percent of taxable payroll. Almost 46 percent of the entire taxable payroll will be required just to fund Social Security and Medicare benefits already promised the elderly under current law.

In addition to Medicare, the government also pays medical bills of the elderly through Medicaid (for the poor), the Veterans Administration system and other programs. When this additional spending is taken into consideration, under the intermediate assumptions more than one-third of the income of workers will be needed to pay retirement benefits to today's college students. Under the pessimistic assumptions, the amount will be more than 55 percent!

Reformers tend to fall into two camps: those who want to preserve the current system's chain-letter structure and patch its defects, and those who want to reform the system in a fundamental way. The underlying strategy of proposals for patchwork reform is to cut benefits, raise taxes or both. However, almost every patchwork reform idea has severe drawbacks. Some countries have already chosen more fundamental reforms.

- Britain allows employers and individual workers to opt out of the second tier of the state pension system.
- Australia requires workers to contribute to privately managed retirement savings plans.
- Chile requires workers to save for their own retirement by making regular deposits to private pension accounts, similar to our Individual Retirement Accounts. These accounts are managed for the individuals by private investment management companies.
- The Chilean system has been copied to one degree or another in Argentina, Bolivia, Colombia, El Salvador, Hong Kong, Mexico, Peru and Uruguay, and it will soon be implemented in Ecuador and Costa Rica.
- Singapore requires employees and employers to contribute jointly to individual investment accounts, which may be used not only for retirement income but also to pay medical expenses, make the down payment on a home or send a child to college.

These systems are fully funded, and each generation provides for its own retirement. They avert the long-term financial crisis inherent in the chain-letter approach of pay-as-you-go systems. The reformed systems also encourage saving, which in turn generates higher economic growth.

We have an opportunity today to reform our elderly entitlements policies, to put them on a fully funded basis and to provide for a transition period during which the existing unfunded liability can be eliminated. If we wait, or if we take half-way measures to try to patch the current unsustainable system, we will be sowing seeds for future hardship for both young and old.