SOCIAL SECURITY ADVISORY COUNCIL

I. Summary

The Social Security Advisory Council is expected to release a report on long-term financing of the Social Security system this summer (mid-June at the earliest). They have not reached agreement on a single recommendation, but are expected to release three different options, each of which contains many controversial proposals.

Our position is not to comment on specific proposals, arguing that Social Security is one of our most successful programs, and ensuring its long-term solvency shouldn't be a part election-year politics, but needs a bipartisan solution. While we will not comment now on specific elements of proposals, we believe that Social Security must remain a safety net for all Americans and its financing must be sound. Therefore, we:

- Oppose moving Social Security to a voluntary or private system that would put retirement at risk; and
- Oppose Proposals That Would Make It Less Dependable for All Recipients.

Background on the Council, details on the options, expanded talking points, and questions and answers follow.

II. Background

Recent estimates suggest that Social Security's total income, including interest on accumulated assets, will continue to exceed payments until 2020, and that the shortfall will be covered by drawing down assets until the trust fund is exhausted in 2030. Even after that, the revenues would meet about 75% of the program's costs. Under the current economic assumptions, the 75 year projection shows a deficit of 2.17% of taxable payrolls. (Currently, the employee and employer each pay 6.2% -- or 12.4% cumulatively. The 2.17% refers to how much the 12.4% payroll taxes would have to be raised to maintain 75 year solvency.)

The Quadrennial Advisory Council on Social Security is an independent, bipartisan council appointed by Secretary Shalala and approved by the President in 1994 to consider long-term issues related to the Social Security system -- specifically, which approaches are best to ensure solvency over a 75 year forecast period. We expect the Council to release a report this summer (mid-June at the earliest). At that point, the Administration will review their options or recommendations.

III. Recommendations

Our current understanding is that no consensus recommendation will be reported from the Advisory Council, but that they will instead report three separate plans. Listed below are the main items that are considered in each plan.

The recommendations in all three options are:

- ✓ Expand coverage to excluded state and local employees
- ✓ Increase the extent to which Social Security benefits are counted as taxable income.
- Reduce CPI used to compute COLAs by 0.21% (accepts the technical adjustment announced by BLS in March 1996)

↑ + ↑ age

In addition to these common elements, the following elements are recommended by some of the members:

Maintain Benefits

Option 1: This plan includes no private accounts.

- ✓ Increase length of period used to compute benefits from 35 to 38 years of earnings (in effect, lowering benefit 3% slightly) – tightens rel'ship btwn contribs + benefits
- Invest a portion of Trust Fund in equities → would elim remaining .8% payroll deficit after 50 yrs → everything else elims (2.17 - .8)

Option 2:

- Raise the retirement age to 67 by 2011
- Reduce benefits for average and upper–income recipients
- Require 1.6% increase in payroll taxes above the current amount which would be put into private accounts

· survivors protection ↑'d + dep't spouse benefit decreased

Option 3: This is the farthest move toward privatization[1].

new benefit shld phased in

- Raise the retirement age to 67 by 2011
- 5% of current payroll tax is put into a private IRA and managed by private investment companies that would fund annuities.
- The remaining 7.4% would cover a smaller, flat retirement benefit plus survivors' and disability benefits.

elim retirement earnings test

[1]Privatization refers to proposals to establish mandatory savings with the individual investing the savings and in retirement getting back whatever the investment yields. Privatization is not meant to refer to proposals to invest part of Social Security funds in equities.

IV. Talking Points

The Administration has not taken a position on the specific proposals expected to be recommended by the Advisory Council. All questions about specific reforms should be responded to with the following points/principles.

Social Security is One of Our Most Successful Programs.
It is the bedrock of retirement for tens of millions of Americans. It is all that keeps 13 million older Americans from poverty. It has helped cut elderly poverty by more than half since the 1960s. In 1966, the poverty rate among older Americans was 28.5%; today, it is 11.7%.

We Have Time. Social Security Reform Shouldn't Be Part Of Election-Year Politics.
Social Security is on firm financial footing well into the next century. It will be able to pay benefits through the year 2030. We should take advantage of the time we have to address its long-term financing in a reasoned, rational, and bipartisan manner that will maintain the existing broad national support for the Social Security program. It should not be caught up in election-year politics.

Need Non-Political, Bipartisan Process To Ensure Social Security's Long-Term Viability. Securing Social Security's long-term financing while maintaining the existing broad national support for the program will require a bipartisan common ground plan developed in a non-political process.

Would Be Counterproductive to Comment Now -- in the Middle of an Election Year -- on Specific Elements of Proposals. Any discussion of specific proposals should take place in a non-political context where elements are *judged in the context of overall bipartisan plans* to secure Social Security.

While We Will Avoid Commenting Now on Specific Elements of Proposals, the Administration Has Some Guiding Principles. Social Security must remain a safety net for all Americans and its financing must be sound and prudent. Therefore, we:

- **Oppose Privatizing Social Security or Making It Voluntary.** We oppose moving Social Security to a voluntary or private system that would put retirement at risk.

- **Oppose Proposals That Would Make It Less Dependable for All Recipients.** We oppose proposals that would not provide the same true security that the program has provided for millions of older Americans for decades.

V. Questions and Answers

Q: ***Will the Administration even consider the proposals in the Advisory Council's report?***

A: We need non-political, bipartisan process to ensure Social Security's long-term viability. Securing Social Security's long-term financing while maintaining the existing broad national support for the program will require a bipartisan common ground plan developed in a non-political process.

It would be counterproductive to comment now -- in the middle of an election year -- on specific elements of proposals. Any discussion of specific proposals should take place in a non-political context where elements are *judged in the context of overall bipartisan plans* to secure Social Security.

Q: ***Does the Administration support the proposals by Forbes, Senate Kerrey and others to allow people to use a portion of their payroll tax to set up their own IRAs?***

A: Our general position is that we oppose proposals that seek to privatize Social Security or make it voluntary. We oppose proposals that would put benefits at risk.

Yet it is our policy not to comment on specific elements of proposals. We want discussion to take place in a non-political context where elements are judged in the context of overall bipartisan plans.

Q: ***Does the Administration support proposals to allow Social Security funds to be invested in the stock market in order to bring the Social Security system higher returns?***

A: We will oppose proposals that undermine the current publicly managed and collective nature of Social Security or proposals that would make it less dependable for all Social Security recipients. There are some very serious questions that would have to be answered before any of these proposals could be recommended. Again, we believe the best way for this discussion to take place is in a bipartisan, non-political context where we are looking at the viability of the whole plan and not have debate over hypothetical elements in the middle of an election year.

Q: ***Would the Administration consider including an adjustment in the CPI as part of an overall plan to secure Social Security's long-term solvency?***

A: Our position is simple. Any change in the CPI and cost-of-living adjustments should be *based on economics and not politics*. Any change affects the standard of living of millions of Americans. Therefore, changes should be made when experts in the field reach consensus on the size of any bias in CPI, *not* when budget savings are needed. There is currently no consensus on the size of the CPI's bias.

Q: ***But there are serious problems with Social Security. Is the President going to have recommendations this year on how he would handle this? Isn't it irresponsible for him not to address these recommendations during the Presidential campaign?***

A: As the President has long said, there are long-term financing concerns, and they need to be dealt with in a bipartisan context in the most non-political atmosphere possible. But we have time. The Social Security system is sound well into the next century; it will be able to pay benefits *through the year 2030*.

Ensuring the long-term solvency of Social Security is a complicated and important issue. It shouldn't be part of election-year politics. We should take advantage of the time we have to address it in a reasoned, rational, and bipartisan manner.

This year's Congress would do well to focus on the urgent issues before it, such as balancing the budget, welfare reform, and health care insurance reform.

ATTACHMENT 2

Summary of Advisory Council Plans

Maintenance of Benefits Reform Plan (Bob Ball Plan)

- Relatively small changes in the basic structure of the program
- Assumption of a lower CPI for future COLAs - all assume 1/2% ↓ in CPI
- Partial investment of the trust fund in equities (37% of assets) - would resolve 3/4 of LT financing
- Full taxation of benefits in excess of contributions and transfer revenue to OASDI (Benefit tax revenue is currently deposited in the Hospital Insurance Trust fund)
- Expand coverage to all state and local workers

- leave @ 67, just get there faster

Individual Accounts Reform Plan (Ned Gramlich Plan) "Little PIP" - maintains current structure

- Assumption of lower CPI for future COLAs
- Includes a new mandatory private investment plan funded by a 1.6 % payroll tax forced saving
- Gradual increase in the normal retirement age (NRA) to 68
- Full taxation of benefits in excess of contributions
- Scale back benefits to high wage workers
- Reduce future benefit levels by extending the benefit computation period from 35 years to 38 years
- Expand coverage to all state and local workers

Syl Schieber

Personal Security Accounts Plan (Carolyn Weaver Plan) "Big PIP"

- A more aggressive partial privatization scheme that diverts five percentage points of the current 12.4% combined employer/employee payroll tax into private savings accounts
- The remainder of the payroll tax funds a minimum flat benefit plus disability and survivors benefits
- A new tax equal to 1% of GDP (about 2% of payroll) would be created to fund the transition to the new system
- Gradual increase in the NRA to 68, fully tax benefits in excess of contributions, and expand coverage to all state and local workers

- All s'pose to give 75 yr balance
- fund'l diffs remaining

E X E C U T I V E   O F F I C E   O F   T H E   P R E S I D E N T

25-Mar-1996 07:03pm

TO: (See Below)

FROM: Desiree Filippone
Office of Mgmt and Budget, HRD

SUBJECT: Advisory Council Hearing

Hearing on the Social Security Advisory Council Report

I attended the hearing on the Social Security Advisory Council Report today held by the Subcommittee on Social Security and Family Policy. Senator Simpson stated that he was holding this hearing before the official release of the report because there had already been so many leaks to the press. Senator Moynahan was pushing the CPI adjustment issues again throughout the hearing and Senator Breaux was mostly interested in the more incremental reform proposals such as raising the NRA.

Panel I

The hearing was broken up into two panels. The first panel was meant to give the general overview of the state of Social Security and whether there was a necessity for reform.

Henry Aaron - Director, Economic Studies Program, Brookings Institute. Dr. Aaron had five points to make. 1) The younger generation does not believe there will be Social Security when they retire, but they do want it and they are overwhelmingly willing to have an increase in taxes to get there. 2) Actuarial estimates that we currently use are very conservative and should be changed to a 25 year projection like the rest of the world - then we would be in actuarial balance right now. 3)The current state of Social Security should not be labeled a crisis, it isn?t. 4)Long run deficits should be seen as basis for remedial reform to ensure public confidence in the program. 5)The financial challenge of Social Security is modest compared to health care and Medicare. At the end he stated that no radical change needed to be made since the program deficit is small, but that private individual accounts or mandatory savings should be discussed above and beyond the current system.

Olivia Mitchell - Co-Chair, Technical Panel on Trends and Issues on Retirement Savings of the Advisory Council. She stated that the panel she chaired was unanimous that reform was imperative and that therefore it should happen soon to reduce the pain involved. She stated that they believed raising the NRA was the best way to implement a benefit cut. She stated privatization looked like a good idea if the rest of the aspects of a change in the program led to increased savings. She also emphasized the need for indexed bonds.

Howard Young - Chair, Technical panel on Assumptions and Methods of the Advisory Council. He stated that there was division within the panel on what CPI adjustments to consider for the basic assumptions. They went with a 0.2% reduction in December 1997 and a 0.5% reduction in December 1998. He stated the long range projections were questionable. They should be maintained, however, stochastic modeling should also be used.

Panel II

Edith Fierst - Attorney of Law, Fierst and Moss - She presented the Ball plan. Her first statement was that all of the Advisory Council proposals supported investment in private equities. This drew much attention from Moynahan and Simpson. The plans differ on who should bare the risk of privatization. Ms. Fierst stated that the Ball plan lets the Trust Fund bare the risk instead of individuals. She had 12 points explaining the strengths of her plan and the weaknesses of the Weaver plan primarily.

1)Risk of getting below average return on private investment are all on the individual with the private investment programs.
2)Average earners would gain nothing from the private investment and low earners would gain little.
3)Payments from Social Security have always been on time. No scandals.
4)75 million workers would not know how to invest and wouldn?t have to in Ball plan.
5)Admin costs for Social Security are 0.8 of 1%, much lower than private sector.
6)Private plans do not require retirees to annuitize.
7)The private accounts reduce spousal benefits or even eliminate them.
8)Divorces would lead to fights over benefits in private plan.
9)COLAs would not be payable on private plans.
10)High cost of transition in private individual investment plans.
11)Invasion of private accounts before retirement.
12)No disabled benefits in the private investment accounts.

Edward Gramlich - Chairman of Advisory Council - Stated that his plan was very close to the Ball plan, just without the investment of the Trust Funds in equities. He had six points about why his plan was better.

1)It preserves all provisions of Social Security, unlike the Weaver plan.
2)It clearly raises national savings.
3)It provides a convenient way to invest.
4)It raises the money?s worth ratios.
5)It avoids the transition costs of the Weaver plan.
6)It converts the individual accounts into indexed annuities upon retirement.

Sylvester Schieber - Vice President, Watson Wyatt Worldwide - He presented the Weaver/Schieber plan. He basically presented nothing new here. He just outlined the plan emphasizing that there could be adjustments within the program to address the concerns of Edith Fierst. For example, spouses would get their own personal account and divorced people would be forced to split their benefits in half automatically. He stated that this plan does create real savings for the nation and this is important for increasing economic growth.

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April 10, 1996

Mr. Gene Sperling
Deputy Assistant to the President
for Economic Policy

Dear Mr. Sperling:

The advisory council on Social Security is having its last meeting on Saturday, April 13. The attached describe the position that six out of the thirteen members are taking-the three labor members, the president of TIAA/CREF, Edith Fierst, a D.C. Lawyer, and myself. The other seven are broken into 2 groups--one is for a major privatization of Social Security (four or five) and one for shrinking social security and financing a compulsory savings plan from an increase in social security deductions from the present 12.4% of earnings to 14%.

We are now writing a supplementary statement for the report and would like to talk to the administration about it.

April 9, 1996

R.M. Ball
Telephone/Fax:
703-768-3438

A PROPOSAL FOR THE ADVISORY COUNCIL ON SOCIAL SECURITY
BY ROBERT M. BALL, MEMBER[1]

There is No Social Security Crisis

There is no financial crisis in Social Security. The Trustees -- three Cabinet officers, the Commissioner of Social Security, and two representatives of the public, appointed by the President and confirmed by the Senate -- keep careful watch on the financing of Social Security and report on it every year in great detail. Every four years, as required by law, a council of private citizens has also audited the program's financial condition.

The current Council appointed an outside group of economists, actuaries, demographers, sociologists, and other experts to help it evaluate the program's financing situation. The Council and the expert group concur in the evaluation of the Trustees who found that without any change in law, full benefits as defined in the Social Security Act, can be paid on time for about 35 years.

The System Does Face a 75-Year Financial Shortfall

The Trustees also reported, and the Technical Panel and the Advisory Council agree, that looked at over the 75 years for which estimates are traditionally made in the United States -- a much longer period than in almost all other countries -- the system has a financial deficit. Although not a crisis, this situation needs to be addressed in the near term, because any deficit can be eliminated with more moderate changes if action is taken early, and people under the system can be given advance notice of any changes that may affect them.

The Rate of Return on Contributions Has Declined

Although when it comes to judging Social Security, the criterion of "money's worth" to individuals is not as important as the usefulness of the system to the nation as a whole, it is important that people see themselves as being treated fairly. Young workers now face a lifetime of contributions at a higher rate than workers in the past, and increasing attention is being focused on the ratio of lifetime protection to lifetime contributions plus interest. Proposals for changes in Social Security financing need to address this issue as well as the 75-year fund balance.

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[1]Five other members of the Advisory Council generally support the views expressed here, although there are differences on some points.

How to Proceed

We should ask Congress to proceed promptly with three legislative changes quite within Social Security traditions, changes which would reduce the Social Security 75-year deficit from 2.17 percent of payroll to about 0.80 of payroll and would postpone the date estimated for Trust Fund exhaustion from 2030 to 2050.

I would also like to see put into effect in the near term the proposal of six members of the Council to invest part of the fund in private stocks, indexed and managed passively by one or more of the leading passive equity index portfolio managers experienced in serving large institutional accounts. This would eliminate the remaining long-term deficit and greatly improve the contribution/benefit ratio for young workers and future generations.[2]

But this is a new idea to most people and it should be studied thoroughly along with any other proposals to close the 0.80 gap. And we should try to reach a considerable consensus before making substantial changes in this program which affects just about every American family. However, the three steps well within the Social Security tradition need not wait until this evaluation of equity investment is completed.

Immediate Steps to Greatly Reduce the Deficit

The proposals I back to greatly reduce the deficit immediately -- from 2.17 percent of payroll to 0.80 -- do not increase Social Security deductions from wages or the matching contributions of employers and reduce benefits only an average of 3 percent below present law.

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[2] It is important not to confuse this proposal to invest part of Social Security funds in passively-managed indexed equities with the various privatization proposals being discussed. The sole purpose of Social Security's investment in equities is to secure a higher return than can be obtained from the present practice of investing everything in government obligations. Otherwise, in every respect, Social Security would continue as it is -- a defined benefit plan with the amount of benefits and the conditions under which they are paid, and the definition of who pays in and how much would continue to be a matter of Federal law and the program would continue to be administered by the Federal government. The only change that would be made in the Titles of the Social Security Act that govern the program would be in the section on investment policy.

The privatization proposals, by definition, establish compulsory savings plans with the individual investing the savings and in retirement getting back whatever the investment yields. In other words, privatization shifts from a defined benefit plan to a defined contribution plan like a 401(k) or an IRA. The difference between our plan and privatization is much more important than the common feature that in our plan Social Security invests in common stocks and in privatization plans some individuals will also invest in stocks.

The proposed changes are: 1. The extension of coverage to those 3.7 million state and local employees who are still excluded from the Social Security program (most are covered). 2. An increase in the period over which benefits are computed from 35 years to 38 years. 3. A change in the policy governing the taxation of Social Security benefits so that the income tax is applied individually to benefits in excess of what the worker paid in, as is now true for other contributory defined benefit plans. Also, when Medicare is refinanced, at least by 2010 to 2020 when the baby boom generation is retiring, the part of the tax on Social Security benefits now going to Hospital Insurance should be redirected to Social Security. (Many members of the Council do not agree on this last point.) When these changes are added to the correction in the upward bias in the CPI as announced in March 1996 by the Bureau of Labor Statistics (CPI -0.21), the deficit of 2.17 is reduced to 0.80, and the date of Trust Fund exhaustion moves from 2030 under present law to 2050.

RECOMMENDED FOR IMMEDIATE ACTION ON THE 75-YEAR DEFICIT
(Shown as a Percent of Payroll)

Reduction in Deficit		75-Year Deficit
		2.17
Extension of coverage to excluded state and local employees	-0.22	
Increase in length of computation period from 35 to 38	-0.28	
Change in benefit taxation	-0.62	
Correction of CPI by BLS	-0.29	
Interaction among the proposals	+0.04	
Total		1.37
New deficit		0.80

These three legislative changes are within the scope of traditional Social Security changes and should be enacted as soon as possible.

It is also of both short-term and long-term importance that the Social Security system depart from the pay-as-you-go financing of the past and turn to partial advanced funding. Developing a substantial and permanent reserve fund would reduce the size of the ultimate contribution rate that would be necessary and would have the baby-boom generation pay more of its own cost as compared to requiring a higher contribution rate from the smaller generation that follows them.

The fund, which early in 1996 was almost $500 billion, but represented only about 138 percent of the following year's outgo, was not yet above a contingency level appropriate for a pay-as-you-go system (100 to 150 percent of the next year's outgo). Under present law, however, and with the above changes, it will very quickly exceed 150 percent and soon build to the place where earnings on the fund will contribute importantly to long-range financing.

Total Elimination of the Deficit and Improvement in the Benefit/Contribution Ratio for Young Workers

Since Social Security in the past has never developed a reserve for advance funding the rate of return on the fund has made little difference in long-range financing. Thus, it was reasonable to invest the fund in special obligations of the United States, paying a low return equal to the average on all long-term outstanding debt of the United States. Now that the system is rather quickly moving toward partial advance funding, the rate of return does make a major difference.

Under these circumstances, a portion of the funds should be invested so as to earn a higher return. Like the assets of other pension funds, some of Social Security's reserves should be invested in the stocks of private industry. A policy of diversity in investments should be followed, and thus the amount in private stocks should be limited, perhaps to about 40 percent of the total Social Security fund. This proportion should be reached gradually, starting perhaps in the year 2000, by putting 40 percent of the additions to the Trust Fund buildup in stocks. Under this plan, the total fund would always exceed the size of the fund expected under present law and the part of the fund investment in government securities would always be larger than a contingency reserve for a pay-as-you go system.

As in the case of the Federal Employees Thrift Plan, we would suggest the appointment of an independent "Investment Policy Board" made up of experts nominated by the President and approved by the Senate. This body, perhaps three in number, would operate under the statutory fiduciary standard of "requiring that Trust Fund investment policy be solely for the economic benefit of Social Security participants and not for any other economic, social, or political objective." We also suggest that by law Social Security investment holders would be barred from exercising stockholder rights to vote on company policy.

The Board would have only three functions: One, it would select an appropriate passive market index which would govern the investment of Social Security in stocks: For example, the Russell 3,000, or Wilshire 5,000.

Second, the Board would select, through bidding, one or more of the leading passive equity index portfolio managers experienced in serving large institutional accounts. The manager would also have the function of maintaining the proportion of Social

Security's total funds at roughly a 40 percent level in stocks and a 60 percent level in corporate bonds, instrumentalities of the United States, such as Fannie Mae, and Social Security's traditional investment in long-term government obligations.

Third, it would monitor portfolio management and set up impartial reviews to evaluate the overall operation of the plan. From time-to-time the Board would consider changes in the passive index or portfolio manager as appropriate.

The difference for Social Security financing in having part of the fund invested in equities and private obligations is substantial. First, it would reduce the 75-year deficit by about 0.90 percent of payroll. When added to the other proposals, investing in equities would completely eliminate the 75-year deficit and produce a modest surplus.

Beyond that, the twin proposals of partial advance funding and investment in stocks would greatly improve the benefit/contribution ratio for younger workers and future generations. These improvements, in fact, on average produce a better deal for just about all workers over 30 as compared to either of the partial privatization plans discussed by the Advisory Council. For those who enter the labor market, say, 10 years from now, this improved plan does about the same for average and below average earners as the plan requiring private investment of 5 percentage points, but the privatization plan by that time begins to do better for the higher paid.

The Value of Social Security

The individualized test of "money's worth," is not, by any means, the most important criterion in evaluating Social Security, but it is nevertheless important that young workers see their generation as being treated fairly, and our proposal does that.

The more important criteria for judging the usefulness of the program are the contributions of the program to society as a whole: For example, the fact that it provides disability and life insurance protection without regard to the health of the individual, and that it reduces the need for the less desirable means-tested programs such as SSI.

Social Security keeps some 15 million people above the poverty line and millions more from near-poverty. As recently as 1959, the poverty rate among the elderly was twice as high as for the rest of the population. Social Security has been the key factor in bringing this rate down to below 13 percent (on a par with rates among other adults). Without Social Security, about half of the elderly would have incomes below the Federal government's rock bottom definition of poverty.

But Social Security is much more than an antipoverty program. Because Social Security benefits are not means-tested, those who are above the poverty level are able to add other income to Social

Security, and thus provide a level of living in retirement that is not too far below what they were used to while working. This is a major objective of Social Security as the basic tier in a three-tier system which includes private pensions and individual savings.

Social Security is just about universal. Of those 65 and over, 92 percent are receiving benefits, with another 3 percent eligible to do so when they retire. Social Security follows the worker from job-to job and the protection before retirement rises as wages rise. After benefit receipt begins, benefits are inflation proof, a guarantee that no private pension has made.

Social Security is an earned right growing out of past work and contributions, self-financed entirely by dedicated deductions from workers' earnings matched by the employer, by taxes on Social Security benefits and earnings on the Trust Funds. Administrative expenses, also financed entirely from the above sources, take less than one cent out of every dollar paid in.

Social Security is not just saving for the future. It is a mechanism today for sharing among all working families the burden of caring for the current elderly and those with disabilities. Because of Social Security, no one family has to bear alone what could be the huge cost of caring for parents who are sicker than average or who outlive their savings. As with all insurance, families pooled together are protected by having to pay for only the average risk. Social Security is our family protection program.

Because Social Security spreads the risk and because of the nearly universal coverage today, relatively few older retired people have to move in with their children to make a go of it. Similarly, millions of married couples are spared the pain of periodically having to arrive at mutually acceptable decisions about how much of the family income should go to supporting elderly parents and grandparents rather than being used for themselves and their children.

Social Security also provides current family protection by providing ongoing insurance against loss of family income due to death or disability. Among the 43 million Americans receiving monthly benefits, over 3 million are children under 18, mostly children of deceased workers, and nearly 6 million adults are being paid because they have disabilities or are dependents of those with disabilities.

Social Security provides $12.1 trillion in life insurance protection, an amount which exceeds by $1.3 trillion the combined value of all private life insurance policies of all types in force in the United States in 1993. The protection for young families is very substantial. For example, a 27-year-old couple with two small children and earning average wages in the event of the death of either would have survivors' protection worth $307,000. Disability protection for the same family amounts to $207,000.

The contributions to society are the most important ways of judging money's worth under Social Security, but the recommendations described here greatly improve "money's worth" in the narrow sense of the contribution/benefit ratio for individuals as well as in the larger societal sense.

It is extremely important that Social Security, the basis for all retirement planning continue to be in the form of what the pension experts call "a defined benefit plan" promising specific benefits that are not affected by market fluctuations. The individual's voluntary investments in IRAs or 401(k) plans, for example, may reasonably form an additional tier of protection which varies by investments returns. But this is desirable only if on top of a reasonably adequate Social Security system that covers just about everyone.

Basic protection one can count on is particularly important in a dynamic, risk-taking economy such as ours, where long-established businesses may fail even as new ones are springing up and where whole industries may find themselves quite suddenly in decline. More than most, our economy rewards rapid adaptation to changing conditions. That is one reason why it functions well at the aggregate level -- but the more dynamic the economy, the greater the need for individual protection against major economic hazards. We need the security that Social Security supplies regardless of downsizing, mergers, bankruptcies, and volatile employment levels.

Social Security is far from being broken and requiring major change. It keeps up-to-date with wages and thus with increases in productivity prior to benefit payment and the benefits, payable for life, are protected against inflation wherever it goes. The benefits are modest but the protection is secure.

The situation with Social Security is similar to that of homeowners with a sound house they very much like but with a need to refinance the mortgage. They do not need to tear anything down. They do not need to restructure or repair. They need only to improve the financing.

FYI
RG.

...and the State Legislature would be wise to reinstate at least some of the money.

The CUNY branch presidents say the cuts will result in a $97 million shortfall, causing the elimination of 1,300 faculty and staff positions — between 10 and 18 percent of the system's full-time workers.

system's ...
this week's vote puts her on notice ...
administrators are nervous about the ...
suspicious of her motives. The only way to allay that suspicion is by allowing a broad and open debate on CUNY's future.

N.Y. Times
3-27-96

A Fresh Look at Social Security

A Federal advisory panel unanimously recommended to Congress this week that Social Security payroll taxes be invested in stocks, reversing a 60-year policy of investing only in low-yield Government bonds. This radical idea met with surprising acceptance on Capitol Hill, testimony to how scared Congress is about the system's financial future.

Social security pays benefits to current retirees out of payroll taxes on current employers and workers. For now, revenues exceed expenditures, generating surpluses that are used to buy Government bonds. But by about 2030 the system is expected to run deficits — leading to tax increases and benefit cuts. Some economists also say that the system depresses the nation's already low savings rate. It relieves families of some of the need to save for retirement and turns over surplus money to the Treasury, rather than to private capital markets.

The panel split on how to move to a new system. One group would allow workers to direct their payroll taxes into individual retirement accounts that would invest in stocks or bonds. Over time, stocks typically generate more profit than bonds. But stocks can be riskier, especially in the short term. This risk largely diminishes, however, for longer-term investments — the proper investment horizon for retirement.

Yet this partial privatization of Social Security creates grave problems. Private accounts would be enormously expensive to administer, as millions of workers would continuously be directing small amounts of new money into stocks and bonds. By tying retirement benefits to the individual's own contributions, the plan strips away much of Government's ability to subsidize low-income families.

A better plan was proposed by a group led by Robert Ball, a former Social Security Commissioner. This group also would invest a substantial fraction of payroll taxes in the stock market. But in this plan, the Government, not individuals, would do the investing — saving overhead costs and preserving the option to redistribute retirement benefits to poorer workers. Under this plan, Government would invest passively — putting money in funds that mirror all companies represented in the stock market — in order to keep politics out of retirement decisions.

A third group on the panel would impose a small additional payroll tax, to be invested in stocks. This is attractive because it could do more than the other plans to cut the Federal deficit, but it is also politically unlikely.

What Congress has to ask of any plan to reform Social Security is not only that it provide for low-income retirees but also that it boost national savings. Future retirees live off food and other goods that they no longer produce. That puts a burden on workers unless they are highly productive. The best protection, then, is for society to save and invest.

The advisory panel has started a conversation about how Social Security can contribute to this need. But as Prof. Peter Diamond of M.I.T. points out, the panel's options are complex and incompletely fleshed out. He advises Congress to appoint another, technical panel to sort out the pros and cons. There is no crisis that warrants Congress's making hasty changes.

New Money for Old, With Care

The Treasury has introduced a new $100 bill without withdrawing the old. This is a delicate long-...

find their way home through banks to the Federal Reserve System, which will destroy them. That is ...

... concourse, and a ... for the dilapidated but still ... landmark.

More recently a sadder change rattled the regulars — the closing of Grand Central Books, one of the most popular of the many small businesses that thrive in the terminal. The renovators needed the space. In coming weeks there will be more dislocations and closings. Some stores will take up temporary residence in the refurbished waiting room near the 42d Street entrance.

It will be worth the pain. The plans for the station include removal of the ceiling over the walkway that leads to the Oyster Bar, leaving the ramp open to the 120-foot ceiling, and a new life for the lower level, converting it into a food market and something of an urban living room.

The original plans for the station, which opened in 1913, included a matching staircase for the one leading to Vanderbilt Avenue. This has been dusted off, and where a Chemical Bank branch stands at the east end of the concourse, stairs will ascend to the opposite balcony. All concourse balconies will house restaurants — of various price ranges, the planners assure us — from which to eat and survey

Grand C... also one of the world... monument to New York's ... The only danger is that the ma... station of its more prosaic but im... The planners have vowed to avoid ... mall feel of Washington's Union Stati... Central needs, along with fancy restaura... shoe repair shops and newsstands.

The displaced businesses will have the oppor... nity to bid for the new retail space, but many fea... they will not be able to afford the new, higher rents. It would be a pity to lose independent operators like Grand Central Books in favor of the big chains. The Metropolitan Transportation Authority's director of real estate, Susan Fine, says the agency is committed to New York-based stores.

Scaffolding has already appeared on the north and east balconies, and commuters will be subjected from now on to varying amounts of chaos, confusion and noise. They can comfort themselves with thoughts of air-conditioning in the summer, adequate access for the handicapped, new exits, a place to shop for food on the way home — and all those constellations alive on the ceiling once again.

Abusing the Debt Bill

3-25-96

The House Republican leadership has loaded up a bill to raise the Federal debt limit — which Congress must pass if the Federal Government is to pay its bills — with two offensive provisions.

One provision would lower taxes on Social Security beneficiaries by raising the amount they can earn without losing benefits from about $11,000 to $30,000. At a time when Congress is slashing Federal programs for many Americans, and especially for low-income families, it should not hand out tax breaks to a group that already reaps the lion's share of Federal handouts.

Worse yet, Congress wants to pay for this tax cut by trimming Social Security payments to some disabled individuals. But the savings from those trims was already targeted as a way to pay for welfare reform. If Congress uses the savings to help the elderly, it will almost certainly be forced to make more severe cuts in welfare.

The House debt bill also includes a line-item veto, with which the President could nix individual items from spending bills rather than vetoing the entire bill. The proposed line-item veto would massively shift political power toward the White House, giving Presidents a hammer with which to bring individual representatives — many of whom would have pet projects at risk — in line.

Sadly, both the Senate and President Clinton, who welcomes the line-item power, seem willing to go along. The country would be better served by removing these harmful provisions from the debt limit bill.

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Mr. Latzer appare... the statement by the ... agement and Budget ... that the pending bill ... potentially meritoriou... al challenge." The bill ... Mr. Latzer defend pr... struct the Federal cour... sions those courts sh... the meaning of the ... Therein the constituti... the O.M.B. statement ...

Neither Mr. Bibas n...

Senate Hears Idea to Invest Some Money For Pensions

By ROBERT PEAR

WASHINGTON, March 25 — Members of a Federal advisory panel told Congress today that a portion of Social Security payroll taxes should be invested in the stock market, and several senators expressed cautious support for the idea.

The proposal, which represents a radical change in Social Security policy, survived its first test on Capitol Hill without criticism from any member of Congress or any of the experts on pension policy who testified before a Senate subcommittee.

Details of the proposal have not been worked out, and Congress is not expected to take action this year.

But lawmakers were clearly intrigued with the possibility that Social Security could earn a higher rate of return by investing some of its trust fund assets in common stocks and mutual funds. Since creation of the Social Security program in 1935, the money obtained from payroll taxes and not immediately needed for benefits has been invested in Government securities.

Members of the advisory panel said stocks had outperformed bonds over long periods of time. The return on Government securities, while relatively low, is guaranteed. The panel acknowledged that stock investments would entail a slight increase in risk for Social Security, but said the risk was manageable.

After hearing from 3 of the 13 members of the panel, the Advisory Council on Social Security, Senator John B. Breaux, Democrat of Louisiana, said: "There is agreement that the trust fund could be invested in equities. The question is, who controls those investments?"

The hearing today was held by the Finance Subcommittee on Social Security and Family Policy, headed by Senator Alan K. Simpson, Republican of Wyoming. The council, appointed in June 1994 by Donna E. Shalala, the Secretary of Health and Human Services, includes business executives, union leaders and pension experts chosen to represent self-employed workers and consumers in general.

David Scull/The New York Times

Members of a Federal advisory panel told Congress today that part of Social Security payroll taxes should be invested in the stock market. They were, from left, Sylvester Schieber, Edward Gramlich and Edith U. Fierst.

Some council members said that Social Security payroll taxes should be kept in one big pool, and that a portion should be invested by Federal officials or their agents in a broad selection of stocks intended to mirror the overall performance of the market. Other council members want to create an investment account for each person covered by Social Security. Workers could then decide for themselves how the money should be invested, though the Government would still provide some basic Social Security benefits.

Edith U. Fierst, a member of the advisory panel, testified: "All members of the advisory council favor private investments. That's a very significant change. The difference among us is whether investments in equities should be made by individual workers or by the trust fund."

Mrs. Fierst said she believed that the money should be invested by the trust fund because many workers had no experience in the stock market and could not make sophisticated investment decisions. In addition, she said, private investment options would be more vulnerable to scandals and swindles than the current Social Security system.

Cautious support for a radical shift in Social Security policy.

Senator Daniel Patrick Moynihan, Democrat of New York, said he was surprised and pleased that council members, though divided on details, were "unified in support of the principle that some portion of the retirement system should go into private investment."

"I represent New York City," the home of many stockbrokers, investment advisers and mutual funds, said Mr. Moynihan, a longtime student of Social Security. Mr. Moynihan said he was not shocked, but delighted and surprised by the broad support for the recommendations among council members.

Senator Breaux said, "If we can encourage investment in equi[illegible] it's a good idea, but we also want maximum protection" for Social Security beneficiaries.

The Social Security trust fund now takes in more money in t[illegible] and interest than it pays out in [illegible]efits. But Federal officials say the program will not be able to pay all the benefits earned by members of the baby-boom generation because, under the latest estimates, outlays will exceed income starting in 2020, and the trust fund will be depleted in 2030.

Mr. Simpson said: "A yawning chasm is not far down the road. The sooner we address this problem, the less painful the solution will be."

Mr. Moynihan said Congress could alleviate the problem by slowing the growth of Social Security benefits paid to 43 million people. He said the Government could reduce the annual cost-of-living adjustment in such benefits because the current formula overstated inflation.

News Digest

SOCIAL SECURITY
Shirley S. Chater, Commissioner

THURSDAY, MARCH 14, 1996

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Social Security advisory panel proposes radical changes

Investment in stocks seen as way to increase revenue as workers age

By JOHN B. O'DONNELL
SUN NATIONAL STAFF

WASHINGTON — For years, Washington has considered Social Security sacrosanct, and any changes in it taboo.

But now, a proposal that would be truly revolutionary — investing some of the giant pension fund's assets in the stock market and giving workers control over their own investment accounts — is gaining credibility, thanks to a Clinton administration advisory group.

Six of the 13 members of the Advisory Council on Social Security want to keep the existing system but would invest excess Social Security tax revenue in the stock market, which, in the long run, would produce higher returns.

The seven other members would go further.

They would require that some of all revenue be invested in stocks and bonds, but have each worker manage his or her own account, as many people do now in 401(k) company retirement accounts.

"That's never happened before," said Sen. Daniel Patrick Moynihan, a New York Democrat, alluding to the council's proposals.

"It would have been unimaginable ... 20 years ago," he told a Social Security subcommittee hearing this week.

"Privatization" — the self-management of Social Security money — long "has been considered a kooky right-wing idea," Sylvester J. Schieber, a council member, said in an interview. "But now, I think we're going to get a legitimate political debate."

Investing in stocks entails "some risk factor," Harry C. Ballantyne, Social Security's chief actuary, cautioned yesterday, because in the short run, stock investments can lose money.

"But it [the risk] may be worth taking," he said, citing the long-term record of stock market gains.

Responded Mr. Moynihan: "The 1990s have been great; the 1930s weren't so good" for the stock market.

Fueling the engine of change is a stark demographic fact: Without revision, the Social Security system is headed for big trouble once the huge baby boom generation, now beginning to turn 50, begins to retire. Moreover, young workers have little faith in the system.

"None of my clients under 35 believe Social Security will be around for them," says Michael Engler, a Baltimore financial planner.

ASSOCIATED PRESS

Daniel Patrick Moynihan, *the New York Democrat, said changes such as those being considered would have been "unimaginable" 20 years ago.*

Social Security is a pay-as-you-go system, financed by a 12.4 percent payroll tax, half paid by the worker and half by the employer. An average of 3.3 workers support each retiree.

Once baby boomers begin retiring, there will be only 2.7 workers for each retiree. And by 2040, there will be only 1.6 workers for each retiree, according to the trustees of the system.

Revenue exceeds expenses by $34 billion a year, and the trust fund's surplus is $500 billion. That money is invested in government securities, with an average return above inflation of 2.3 percent. Stocks would pay a much higher rate, on average, in the long run.

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Beginning in 2013, payroll tax revenue will no longer cover the cost of benefits. At that point, the Treasury will have to begin paying billions of dollars in interest and principal on the securities held by the trust fund. To do that, the Treasury will have to raise taxes or borrow money, thus swelling the budget deficit.

"We'll have a real crisis," Mr. Moynihan said this week.

Advisory council members would get at this problem in a variety of ways, including trimming benefits, raising taxes and increasing returns on Social Security investments.

The quadrennial council, whose report is expected by early April, is likely to outline three alternative approaches.

Mr. Schieber and Carolyn Weaver, a scholar at the conservative American Enterprise Institute, favor the most far-reaching proposal.

They would require workers to invest in equities $4 of every $10 that the worker and employer pay in Social Security taxes. Each worker would make investment decisions, becoming more responsible for the amount that is available at retirement.

The remaining payroll tax payments would go into the Social Security trust fund, as all revenue now does, and would go to pay a sharply lower pension benefit.

The Schieber-Weaver plan would require a transition from a pay-as-you go system. They propose a 1 percent national sales tax for 70 years to finance the shift.

"What they really want to do is abolish Social Security as we have known it," complains Robert M. Ball, a council member.

Mr. Ball, a former Social Security commissioner, is pushing his own proposal to preserve the current system while increasing its earnings. He has the support of five other council members.

Mr. Ball would maintain the current benefit structure but make changes to raise revenue, increase taxation of Social Security benefits and reduce cost-of-living increases.

He would invest the Social Security surplus in stocks, starting small and gradually building to 40 percent of the trust fund.

His plan, Mr. Ball says, would increase the after-inflation rate of return on the entire trust fund from 2.3 percent to 3.8 percent.

A third proposal that includes individual investment accounts has been put forward by Edward Gramlich, dean of the University of Michigan School of Public Policy and chairman of the advisory council. Only one other member supports it.

Mr. Gramlich would continue to put the 12.4 percent payroll tax revenue into the trust fund and would slightly cut benefits financed by the payroll tax. He would require each worker to put an additional 1.6 percent of pay into an investment account and give the worker a limited range of investment options.

There's no chance that Congress will do anything in an election year. Still, some Republican lawmakers have advocated partial privatization.

Senate Majority Leader Bob Dole has said the idea should be considered.

Sen. Alan K. Simpson, the Wyoming Republican who will retire in January, is sponsoring legislation that includes some privatization and is pressing his case.

"The longer we wait to take corrective action, the greater the crisis will become," he said.

A2 THE WALL STREET JOURNAL THURSDAY, MARCH 14, 1996

GOP Eases Demands in Balanced-Budget Battle

By DAVID ROGERS
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – Republicans are retreating from earlier demands that major budget legislation must be attached to any long-term bill to extend the government's borrowing authority.

Instead, GOP leaders have lowered their sights, focusing instead on more moderate, bipartisan initiatives such as relaxing the Social Security earnings test and enacting the line-item veto promised in the House GOP's "Contract With America."

Both measures could be attached to a bill this month that would give the Treasury sufficient borrowing authority to carry the government into mid-1997. By taking that approach, the GOP hopes not only to avoid another veto standoff with President Clinton but also to show some progress on its own agenda going into the fall elections.

The shift, reflected in a meeting yesterday between the House and Senate GOP leadership, contrasts with the confrontational rhetoric of the past year. Republicans had once sought to use debt-ceiling bills to force Mr. Clinton to accept all or part of their ambitious seven-year balanced budget plan. While there is still a desire to pursue welfare and Medicaid reforms in this Congress, the leadership has apparently decided it has neither the time nor the will to link these with the debt-ceiling legislation.

"As our case is new, so we must think anew and act anew," said Tony Blankley, Speaker Newt Gingrich's spokesman, quoting Lincoln.

The Treasury, under a short-term bill signed by Mr. Clinton Tuesday, has sufficient borrowing authority now to carry the government through the end of this month. Republicans hope the new long-term bill will resolve the issue until July 1997. But based on prior estimates, this might require raising the current debt ceiling to about $5.5 trillion from $4.9 trillion.

Among the amendments under discussion, the line-item veto remains controversial because it surrenders power from Congress to the executive branch. But the president and many Democrats have come to embrace the concept, and Senate Majority Leader Robert Dole, the presumptive GOP presidential nominee, said yesterday that House and Senate negotiators are near agreement on a compromise bill.

Relaxing the Social Security earnings test is a popular issue as well with elderly voters. Under current law, seniors age 65 through 69 lose $1 of benefits for every $3

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DRAFT ADVISORY COUNCIL REPORT

RECOMMENDATIONS REGARDING THE OVERALL SOCIAL SECURITY SYSTEM

Since its inception, the Social Security system has tried to insure both social adequacy and individual equity. By the first is meant insuring a minimum standard of living in retirement for American workers and their families, along with protection against inflation, disability and the financial "risk" of living a very long life. By the second is meant assuring, within some limits, that workers who have paid more into the system in the form of payroll taxes receive higher benefits than those who have paid less.

In the early years of the system, these adequacy and equity goals were easily compatible. Low-wage workers could receive benefits that replaced a relatively larger share of their preretirement earnings than for high-wage workers, though high-wage workers still received higher absolute benefits. But all groups of workers could receive benefits that clearly exceeded the present value of the taxes that they had paid in to the system and that their employers had paid on their behalf.

Because the program has now matured to the point that almost all workers pay taxes for their whole working careers, and because underlying rates of economic and population growth have levelled off, it is no longer possible to achieve both objectives simultaneously. Were low wage workers to continue receiving present levels of benefits relative to their preretirement wages, high wage workers could no longer receive benefits that clearly exceeded the present value of the taxes they and their employers paid in.

These underlying trends are complicated by another factor. As the nation looks ahead, using reasonable economic and demographic assumptions, future expenditures under the Social Security cash programs -- Old-Age, Survivors, and Disability Insurance (OASDI) -- are now projected to exceed income. Under the intermediate assumptions set by the Board of Trustees, average expenditures over the next 75 years are projected to exceed average revenues by about 14 percent of total expenditures. For the first 25 years of this forecasting horizon there will actually be a slight surplus in the system, but once the enormous Baby Boom generation begins retiring, large deficits ensue. As the nation looks out 75 years and beyond, the deficits get steadily larger.

This long term financial solvency issue complicates further the problem of trying to achieve both social adequacy and individual equity. Were benefits to be cut for current retirees and older workers to bring the system into long term balance, the expected lifetime retirement benefits of older workers would be less. Were taxes to be raised to bring the system into long term balance, all future retirees would be paying in more lifetime taxes.

These were the issues that confronted the 1994-95 Quadrennial Advisory Council. For the most part the Council agreed to use the same economic and demographic assumptions that were used by the Trustees. There is one tangible reason why these assumptions could be unduly pessimistic -- the possibility that as a result of the report of the Advisory Commission to Study the Consumer Price Index, there could be a downward adjustment in the way retirement benefits are adjusted for inflation -- and the Council did make an adjustment for this possibility in comparing different policy approaches.

The Council expressed interest in three different approaches for insuring social adequacy while improving individual equity. One approach involves a slight increase in taxes on benefits, and then letting the Social Security system invest these and other funds directly in common stocks, or equities. Historically, returns on equities have exceeded those on government bonds (where all Social Security funds are now invested), and if this *equity premium* persists, it would be possible to increase benefits for future retirees without worsening social adequacy protections against low wages and retirement benefits, disability, and the financial risk of a very long life.

Another very different approach is to create individual accounts within or alongside the Social Security system. One option here would involve a slight reduction in the future growth of Social Security benefits alongside a mandatory contribution of 1.6 percent of covered payroll to individual accounts. These individual accounts would be held by the OASDI Trust Funds but with constrained investment choices available to individuals. If individuals were to devote the same share of the funds to equities as they do in private funds they already own and manage, it would be possible to raise benefits for future retirees, again without harming social adequacy protections.

A third approach would go even further down this road of creating individual accounts by devoting a much larger share, 5 percent of covered payroll, to these individual accounts. Were this approach to be followed, for younger workers the present Social Security system would move gradually in the direction of just providing a flat benefit to full career workers, along with disability and survivor's protection. The individual accounts might be held by the central system or they might be held privately. Again, individuals would have constrained choices on how the funds were managed. There would need to be a tax of the equivalent of 1.56 percent of payroll necessary to finance the transition to this new regime, though the tax would not actually have to be a payroll tax.

All of these approaches have in common that they involve higher national saving for retirement, with some way to get some of this higher national saving invested in the stock market. At the same time, the approaches involve very different visions for the future evolution of the U.S. retirement system. Individual Council members want it understood that while they all endorse at least one of the suggested approaches, they may not want to endorse in any way, shape, or form the other approaches.

This report first outlines those principles on which there was broad agreement within the Council. It covers recommendations for the general Social Security system, recommendations regarding research and data, and recommendations regarding private pensions. It then describes the three different approaches in more detail. There are then further supplementary statements from individual Council members. Finally, the report includes summaries of reports of two technical panels of experts commissioned by the Council: one involving the assumptions and methods used by the Trustees, and one involving trends and issues in retirement saving.

The Council affirms the desirability for the nation to maintain a universal and mandatory retirement, survivors, and disability program.

The Council rejects the proposition that Social Security will "not be there" for future generations. Changes can be made to balance the program in ways that preserve both individual equity and social adequacy, and provide for continued protection against inflation, disability and for workers who live very long lifetimes. These changes, if made soon enough, can provide for significant increases in the benefits received by younger workers.

The Council urges that early action be taken to reform and supplement Social Security.

While OASDI revenues are expected to exceed expenditures for another two decades, the Council urges that early action be taken to correct the actuarial imbalance in the system. Expenditures begin to rise rapidly once the Baby Boom generation begins retiring in little more than a decade. Actions taken now to cut benefits or raise taxes can generate revenues right away, these revenues can be invested in equities right away (whether directly or through individual accounts), and these investments can raise benefits for younger workers. The younger the worker, the more there is to be gained from early action.

The Council expresses its concern about the increasing cost of the Disability Insurance (DI) program, and urges that the new Advisory Board work with the Social Security Administration (SSA) and Congress to manage these costs.

As is common practice, the Council considered forecasts for the combined OASDI program, and all three approaches for balancing the system over the long run contain explicit disability insurance policies. But beyond that the Council did not study the DI program, and urges only that SSA and Congress be concerned about its increasing cost. Its caseloads are likely to grow because of the same demographic factors that affect the forecasts for the Old-Age and Survivors Insurance program.

The Council believes that the traditional 75-year forecasting horizon should be buttressed with additional measures of long term stability.

The Board of Trustees now relies on a number of demographic and economic assumptions in projecting the long-term balance of the OASDI Trust Funds 75 years in advance. Because of underlying demographic and economic trends, if the programs were otherwise brought into financial balance for 75 years in 1997, after that date the passage of time alone would change the forecasting period and put the system out of balance.

The Council therefore urges that forecasts still be done for the 75 year horizon, but that instead of just arriving at actuarial balance for 75 years, these forecasts in addition assure that the ratio of fund assets to annual expenditures, known as the trust fund ratio, be stable over the last two decades of the forecast horizon. All the plans discussed above satisfy this requirement.

The Council agrees that the current practice of annual cost-of-living adjustments should continue according to an automatic formula.

The Council believes that annual adjustments for inflation, especially for older retirees, help maintain their real living standards. The Council affirms that one of the important protections of Social Security is against inflation in the post-retirement years. Under the current structure of Social Security, the Council believes that a program with lower initial benefit levels coupled with predictable cost-of-living adjustments is superior to one that promises higher initial benefits but leaves those benefits hostage to inflation.

The Council has discussed the interim report of the Advisory

Commission to Study the Consumer Price Index, which finds that the Bureau of Labor Statistics (BLS) estimates of the Consumer Price Index (CPI) are biased upward by about one percentage point per year. The Council understands that the BLS may already be in the process of revising the CPI to correct for some of this bias, and that further corrections could be made. In keeping with this expectation, the Council factors a slight reduction in inflation into its forecasts. In order to be prudent, however, this reduction is only one-half percentage point per year.

All plans

The Council rejects conventional means testing of Social Security.

Social Security already takes income into account in determining eligibility. Benefits already depend on life-time earnings, a key component of life-time income. The Council rejects the further proposition that Social Security should also condition benefits on other income in retirement - popularly known as "means-testing". Means-testing on the basis of other retirement income would create saving and work disincentives, particularly as individuals approach retirement.

The Council recommends that benefits for low wage retirees be protected.

The Council recognizes that some cuts in benefits, as compared to current law, may be necessary to achieve long-term actuarial balance. At the same time, the Council is mindful of numerous statistical data that report very high rates of poverty among certain groups of older beneficiaries, much higher rates than in other developed countries.

If and when benefits are to be cut, the Council prefers to protect benefits for workers with low to average wages, to avoid sacrificing on the goal of social adequacy. Workers at the top of the wage scale still can be protected by a combination of policies to control tax increases and by retirement fund investment policies, along with private pensions.

Moneys Worth

The Council recommends that if benefits are to be cut as compared to current law, they be cut in a way that avoids real declines in benefits, or notches.

Previous reductions in Social Security benefits have sometimes involved real cuts in benefits, situations where younger retirees with the same relative earnings records as older retirees received lower real benefits. These real benefit reductions, or notches, have been perceived to be inequitable among retirees. The Council urges that benefit changes be made in a way that avoids real reductions in benefits for similarly-situated workers retiring later in time.

The Council believes that the structure of family benefits in Social Security should be revised and recommends a change in the relative level of spouse and survivor benefits.

Statistical studies imply that it costs retired survivors about three-quarters as much to live as retiree couples. On the basis of this information, the Council believes that the benefit structure for spouses and widow(er)s should be revised. Spouse benefits (benefits payable to a wife or husband when both spouses are alive) should be gradually reduced, so that they are either a smaller fraction of the benefit paid to the principal earning spouse or a flat dollar amount.

The Council also believes that survivors' (widow or widower) benefits should be increased as a fraction of what a couple was receiving before one spouse died. In the current structure of Social Security, the Council recommends gradually increasing survivor benefits to the higher of the decedent's benefit (that is, the present-law survivor's benefit), or 75 percent of the combined benefit that the survivor and decedent spouse were receiving when both were alive.

The Council recommends that, effective in 1998, all new hires in now uncovered state and local government jurisdictions should be brought within Social Security.

The one remaining sector of the economy with less than virtually complete Social Security coverage is the state and local sector. Since the Council believes that all working Americans should both receive and pay for Social Security's protections, the Council recommends that all new state and local hires be brought within Social Security, beginning in 1998.

As when Social Security coverage was extended to other sectors, this expansion of coverage will entail some transition difficulties. In particular, the Council recognizes that this change could adversely affect the financing of some less-than-fully-funded state and local pension plans. But the Council sees the long run advantages of complete coverage outweighing the costs, which should be moderate in any case because only new employees are required to be brought into the system.

The Council recommends that the retirement earnings test be substantially modified.

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The Council recommends substantially modifying the

retirement earnings test. As a result of earlier legislative changes, the long-term actuarial cost of such a modification is negligible. The Council approves of efforts currently under discussion in Congress to raise the retirement earnings test exempt amount for beneficiaries who have attained normal retirement age. Under this legislation, the exempt amount would be increased in steps to $30,000 in 2002, with subsequent adjustments based on the growth in average wages.

The Council recommends that there be no, or very little, general revenue financing for Social Security.

Social Security has worked well as an actuarially sound program insuring social adequacy and individual equity among American workers. As discussed above, it will be harder to promote these goals from now on within a constant payroll tax, but the Council still does not wish to use general revenues to finance the system.

The one exception to this principle pertains to the income taxation of benefits. As a result of previous legislative changes, revenues from taxing Social Security benefits are credited both to the OASDI Trust Funds and the Health Insurance (HI) Trust Fund. While all three plans mentioned above would continue or expand this tax treatment for regular Social Security benefits (not the proceeds from individual accounts), some Council members would favor crediting the federal treasury, not the OASDI and HI Trust Funds, with any benefit tax revenues at the earliest opportunity.

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RECOMMENDATIONS REGARDING RESEARCH AND DATA

The Council recommends that SSA enhance its research and analysis capabilities with greater in-house resources and outside consultant services.

The Council has become aware that the resources available within the SSA to provide research and analysis are not sufficient to address adequately the problems facing the program over both the short- and long-term. Sophisticated research and analysis must be readily available to policy-makers to promote sensible policy changes.

The Council believes that the research and analytical capacity of the agency, particularly the Office of the Actuary, should be enhanced with additional in-house resources as well as outside consultant and contractual research services. This assistance would be helpful not only in understanding financing implications of reforms, but also in determining distributional impacts of various proposals.

The Council supports the use of stochastic simulation modeling as a tool for recognizing explicitly the uncertainty surrounding the Trustee's demographic and economic assumptions.

The Council feels that projections for the 75-year horizon should be made through the use of stocastic simulations. This technique employs probability distributions rather than point estimates of the possible future trends to derive potential future outcomes. It allows for correlations between combinations of assumptions. The technique also recognizes the impossibility of exactly predicting future long-term macroeconomic and social trends. It permits policy analysis to be conducted in a way that more richly and robustly incorporates this uncertainty into its measures of long-term financial viability.

The Council recommends that private researchers be granted greater access to agency data.

The Council believes that the value of research and analysis of Social Security data will be enhanced by providing private researchers with greater access to these data as well as to the economic and actuarial models used in forecasting and analysis. This access will facilitate collaboration of outside research with SSA research for an exchange of ideas, analysis, and findings.

Greater access to data, however, would mean providing additional security to protect confidentiality of records. It is possible to ensure tight security through a variety of mechanisms while facilitating research projects using these data. This access may require legislative changes and assurances by private researchers of confidentiality. Greater access also may mean better documentation of files.

The Council recommends that a technical panel of experts be appointed periodically (say every five years) to conduct a comprehensive review of the assumptions and methodology used in evaluating the financial status of the OASDI Trust Funds.

The Advisory Council has appointed a technical panel of experts to review the assumptions and methods used in evaluating the financing of the OASDI Trust Funds. The Council believes that it is highly desirable to continue the periodic appointment of actuaries, demographers, economists, and other experts to a panel for such a review.

POLICIES REGARDING OTHER RETIREMENT INCOME

The Council supports the creation of inflation-indexed bonds.

The Council recommends the creation of inflation-indexed Treasury bonds to enable individuals and pension plans to protect retirement income against inflation. Indexed bonds could be issued by the Treasury and their real interest rates could be determined in a competitive auction. The Council believes these bonds could make it easier to plan for retirement by translating lump sum accumulations into retirement income flows. Indexed bonds would also make it easier for private pension plans to convert lump sums into lifetime benefits and for private insurers to offer indexed life annuities.

The Council believes that government and employers should provide workers with adequate and realistic retirement income information.

The Council supports the initiative of the Departments of Labor and Treasury to raise each individual's awareness of how much needs to be saved for retirement. The SSA's distribution of "Personal Earnings and Benefit Estimate Statement" to those age 60 and over in 1995 under current law, and to everyone over age 24 after the year 2000, is a helpful first step. The Administration and Congress should work on measures that enable employers to provide more retirement planning assistance, including investment allocation and returns.

Information is also needed on how to save and how to allocate retirement savings distributions over remaining lifetimes. Enhanced education on the advantages of maintaining retirement savings distributions in tax-free accounts along with the creation of a market in Treasury indexed bonds would help to counter the tendency of younger individuals to consume their distributions.

The Council feels that retirement pension plans should be encouraged to cover a larger portion of the labor force and to meet more of the need for increased retirement savings.

The Council believes that the elaborate retirement plan rules that have been added since the early 1980s should be streamlined and revised to encourage more growth of private pension plans. Legislative proposals to permit small business to adopt simplified pension plans (such as the Administration's National Employee Savings Trust, or "NEST") and simplified "safe-harbor" rules for all businesses maintaining a salary reduction plan should be enacted promptly. Redundant and overlapping rules should be considered for simplification or elimination. Policy should be aimed at providing consistent contribution and benefit limits across various types of retirement savings plans.

In the light of the revised ages for full or early Social Security benefits in present law and in some of the illustrative plans recommended by the Council, there might have to be changes in the rules related to retirement ages and integration of Social Security benefits. The Council believes that any such changes in the rules should be aimed at making it easier for the employer plans and individuals to adjust to the new Social Security benefits and conditions.

The Council endorses rules that permit "full funding" of private defined benefit pension plans.

The Council feels that changes since 1987 that have limited the funding of the obligation of defined benefit plans are unwise. The Council urges that employers be allowed to fund fully their on-going qualified benefit obligations calculated with reasonable economic assumptions and some margin for risk. Projected benefit obligations should include anticipated pay increase effects in both salary-related and flat-dollar defined benefits.

The Council favors rules that would encourage or require workers to maintain their retirement saving in tax-free accounts until retirement.

The Council supports changes that would eliminate the remaining access to employer-made contributions during employment with the employer who made the contributions ("in-service" withdrawals). The Council recognizes that increased restrictions on withdrawal or loans of employee-made contributions could discourage participation in some plans. The Council supports efforts to maintain retirement savings in tax-free accounts after employment ceases, especially prior to early retirement age, and expresses concern about the growing trend of converting lifetime benefits to lump sum distributions.

The Council believes that pension plan managers should consider the interest of participants in making investment decisions.

The Council opposes legislation that would require pension managers to invest for social objectives, and also legislation that would permit such investments at the cost of pension participants' economic interests. The Council is not against investments that have social benefits, as long as those investments are otherwise prudent.

The Council feels that more of the provisions of the Employee Retirement Income Security Act of 1994 should apply to state and local government plans.

The Council agrees that the time has come to apply the Title 1 provision on disclosure, fiduciary standards and spousal protection (pre and post-retirement survivor annuities and qualified domestic relation orders) to these plans to protect the benefits of the workers and their survivors. The Council does not recommend extending the minimum funding standards to state and local governments at this time in light of the effects on some jurisdictions of the recommendation to cover all new hires at the state and local level.

MAINTENANCE OF BENEFITS REFORM PLAN

One group of Council members favors a maintenance of benefits plan. It maintains the present Social Security benefit structure essentially as is. This structure has worked well for a long time now, and the plan does not change it. The plan gains some revenue by more complete federal income taxation of current Social Security benefits. Implicit in this taxation policy is an eventual diversion of some revenues now going to the HI Trust Fund. It envisions a large scale investment of OASDI Trust Fund monies in the equity market.

The important specific provisions are as follows:

Tax Social Security benefits under income tax principles.

The plan would repeal the present provision whereby from 50 percent to 85 percent of Social Security benefits are subject to federal income taxes, above some thresholds. It would replace this taxation scheme with an entirely different approach, under which all Social Security benefits in excess of already taxed employee contributions would be included in the taxable income of beneficiaries. This is the standard income tax principle for taxing the benefits of retirement saving, though it should be noted that today retirement saving is now often taxed under consumption tax principles (which basically imply that 50 percent of Social Security benefits should be taxed).

This change requires several further adjustments. For one, the income thresholds below which Social Security benefits are now not subject to federal income taxes would be gradually phased out, resulting eventually in the complete and consistent income tax treatment of all Social Security benefits. For another, the revenue from this taxation that now goes to the OASDI Trust Funds (basically from the 50 percent inclusion of benefits) would continue to be credited to these funds. For a third, the revenues that now go to the HI Trust Fund (basically from the difference between 50 percent and 85 percent inclusion shares) would be gradually diverted to the OASDI Trust Funds.

Cover state and local employees.

There would be mandatory coverage under Social Security for all state and local government employees hired after 1997.

Invest a portion of the trust fund in equities.

The OASDI Trust Funds would begin devoting a share of their financial assets to the equity market. Eventually this share would build up to about 37 percent of the Funds' assets, an amount that would be tantamount to one-seventh of GDP at today's rates (a lower share of the likely aggregate value of common stock). Since the return on equities has historically outpaced that on government bonds that the system now holds, this equity investment would make it possible to pay higher benefits or have lower taxes than would otherwise be the case. The Council has done simulations indicating that from the standpoint of the OASDI portfolio alone, such equity investments entail a slight increase in portfolio risk, but a risk that is probably manageable.

Since equity investment by Social Security would now be considered as outlays under federal budget scoring rules, this change would require either a change in federal budget scoring rules, or it would require that Social Security's finances be entirely removed from the federal budget. Such a removal might be undertaken at some point in the future, so as not to complicate present federal budget balancing efforts.

Stabilize the trust fund ratio.

To stabilize the trust fund ratio there would need to be a 2 percentage point increase (to 14.4 percent combined employer-employee rate) in 2050.

INDIVIDUAL ACCOUNTS REFORM PLAN

Another group of Council members favors an individual accounts plan. It tries to preserve the social adequacy protections of the present Social Security benefit system, though benefits are scaled back slightly as compared to present law. Part of this reduction in benefits is standard for all workers resulting from a gradual increase in the Normal Retirement Age (NRA). Part is specific to high wage workers coming from a slight adjustment in the benefit schedule, though with an improvement in survivor's protection. There would be a mandatory contribution of 1.6 percent of covered payroll that would be held by the OASDI Trust Funds as individual accounts. Individuals would have constrained investment choices on how these funds were to be invested -- ranging from a portfolio consisting entirely of safe bonds to common stock index funds that replicate the behavior of the entire stock market. The accumulations from the individual accounts would be converted to minimum guarantee indexed annuities when the individual elects retirement, which could happen any time after the present age of earliest eligibility (EEA) for Social Security benefits.

The important specific provisions are as follows:

Create mandatory individual accounts in the amount of 1.6 percent of covered payroll.

Individual accounts in the amount of 1.6 percent of covered payroll would be created. Individuals would have constrained choices on how the funds were to be invested. The accumulated funds would be converted to minimum guarantee indexed annuities when the individual elects retirement, any time after the EEA. These individual accounts would *not* be included in the federal budget, though the rest of Social Security would remain on-budget.

Gradually increase the NRA.

The NRA would increase by one month a year from year 2000 through year 2035, at which point it would be 68. This means that the NRA would be about the same as under present law until year 2011. After 2035, the NRA would be keyed to increases in longevity, which means that it would increase by about one month every two years under present demographic forecasts. The EEA would remain unchanged at age 62.

Scale back benefits for high wage workers.

The 32 and 15 percent conversion rates in the present benefit schedule would be gradually lowered over time to 25 and 12 percent, respectively. In combination with the change in the NRA, benefits could be financed with a stable trust fund ratio by the 12.4 percent payroll tax. The combination of all changes in benefits would mean that for low wage workers Social Security benefits would grow nearly as rapidly as overall wages, while for high wage workers Social Security benefits would grow slightly more rapidly than prices. Benefit changes would be phased in to avoid notches, or drops in real benefit levels.

Increase survivors protection and alter spousal benefits.

A surviving spouse's benefit would be based on the highest of (1) his or her own basic benefit, (2) the deceased spouse's basic benefit, or (3) 75 percent of the couple's combined basic benefits. The spousal benefit would be gradually phased down from 50 percent to 33 percent.

Tax Social Security benefits under income tax principles.

All Social Security benefits in excess of already taxed employee contributions would be included in federal taxable income. The income thresholds would be gradually phased out. This revenue would be credited to the OASDI Trust Funds, with the HI Trust Fund credited with the same revenue it is now getting.

Cover state and local employees.

There would be mandatory coverage under Social Security for all state and local employees hired after 1997.

Extend the computation period to 38 years.

The Social Security benefits computation period would be raised from the present level of 35 years to 38 years.

Eliminate income taxes on the proceeds of individual accounts.

Since the individual accounts could be invested in equities, they would not be included in the federal budget. To avoid short-term revenue loss, contributions to individual accounts would not be deductible under the present federal income tax, but when benefits from these individual accounts are received, these benefits would be exempt from all federal income taxes.

PERSONAL SECURITY ACCOUNTS

A third group of Council members favors a personal security account (PSA) plan. It would create mandatory PSAs dedicated to retirement saving and financed by a rebate of 5 percent of covered payroll. The PSAs would not be held by Social Security but they would be subject to necessary regulatory restrictions to make sure they were invested in reputable financial instruments. They would be available to workers at the EEA -- the Social Security Trust Fund would be required to create actuarially fair indexed annuities for these PSAs, but individuals would not be required to receive their PSAs in the form of indexed annuities. The 7.4 percent of covered payroll still devoted to Social Security would be used to cover a flat benefit available to all full career workers, plus continued survivors and disability coverage. Present day retirees would be left unaffected by the plan, and present day workers over 30 would receive credits based on present day benefits. There would be an additional tax in the amount of about one percent of GDP to finance the transition, along with some additional borrowing.

The important specific provisions are as follows:

Create the PSAs.

The plan creates mandatory PSAs in the amount of 5 percent of covered payroll. The accounts would be held privately, though they must be invested with regulated private firms and they would not be available to individuals any time before the EEA. Individuals would have the option of buying actuarially-fair, minimum guarantee indexed annuities from SSA at that time, but they would not have to use their PSAs in this way. They could also retain their PSAs and include them in their estate.

Increase the NRA.

It is necessary to specify the NRA in such a plan because the credits due workers from the existing system depend on this NRA. The NRA will be increased by two months each year beginning in 2000 through 2017, at which point the NRA would be 68. After that time the NRA would be keyed to increases in longevity and would rise by about one month every two years. The EEA would remain unchanged at 62.

Alter the benefit schedule.

For individuals age 55 and older at the beginning of 1998, benefits would be unchanged from present law except as implied by changes in the NRA. For individuals under age 30 at the beginning of 1998, benefits would consist of the accumulations from their PSA, plus a flat benefit. At today's levels this flat benefit would be $2475 per year for workers with at least ten years of coverage, rising in steps up to $4950 per year for workers with at least 35 years of coverage. Both amounts would be wage indexed from 1998 until the year the worker retires.

Workers between the age of 30 and 55 would receive a first tier benefit under Social Security that was a combination of their accrued benefit under the existing system at the point of transition, price indexed until their year of retirement, and their prorated share of the flat benefit that would be provided under the new system. They would also receive accumulations from their PSAs.

Finance the transition.

Differences between the present system credits of workers over 30 and disabled workers and the 7.4 percent of covered payroll now devoted to Social Security will be met by a *liberty* tax. This tax will be in the amount of about one percent of GDP. Additional borrowing of a like amount would be necessary in the early years of the system, though these borrowings will be completely repaid beginning in about 40 years. All of the costs of the flat benefit, survivors and disability costs, and present system credits, along with the 7.4 percent payroll tax and the liberty tax, will remain in the federal budget. The PSAs will not be included in the federal budget.

Tax Social Security benefits under income tax principles.

All Social Security benefits in excess of already taxed employee contributions would be included in federal taxable income. The income thresholds will be gradually phased out. This revenue would be credited to the OASDI Trust Funds, with the HI Trust Fund credited with the same revenue it is now getting.

Cover state and local employees.

There would be mandatory coverage under Social Security for all state and local employees hired after 1997.

Eliminate income taxes on the proceeds of individual accounts.

Since the individual accounts could be invested in equities, they would not be included in the federal budget. To avoid short-term revenue loss, contributions to individual accounts would not be deductible under the present federal income tax, but when benefits from these individual accounts are received, these benefits would be exempt from all federal income taxes.

COMPARISON OF PLANS

The following charts compare these three plans. These comparisons are shown separately for single and married workers with low, average, and high wages. All workers are assumed to have normal incidence of disability and normal mortality.

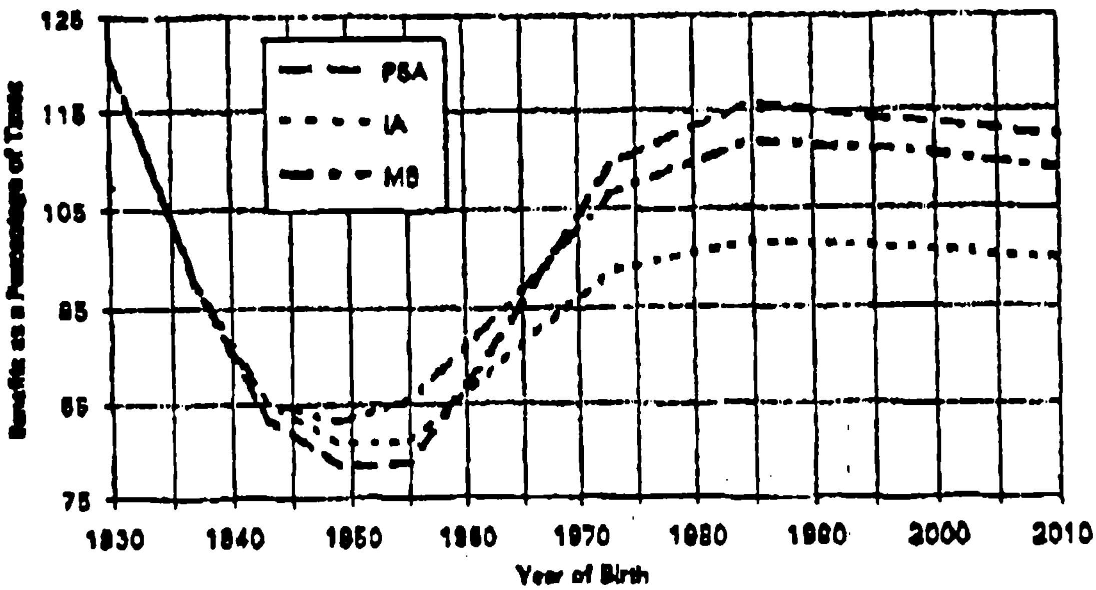
The charts show what are known as the money's worth ratios, the ratio of the present value of expected benefits to the present value of expected taxes paid by the employee and the employer on behalf of the employee. The liberty tax of the PSA plan is also included on the tax side. These money's worth ratios are given by year of birth, for cohorts born as late as year 2010.

When these money's worth ratios equal 100 percent, the relevant worker gets, on average, the same return in Social Security as he or she would get in the government bond market. But since Social Security provides several protections that are not available elsewhere -- against inflation, against disability, and actuarially fair insurance for extremely long lives -- Social Security is still often a very good deal for workers whose money's worth ratios are below 100 percent. Added to this is the communitarian satisfaction in knowing that all American workers are well taken care of. The difficulty in quantifying these insurance and communitarian values for Social Security should make one cautious about interpreting too much from precise levels of these ratios, though trends in the ratios could still be meaningful.

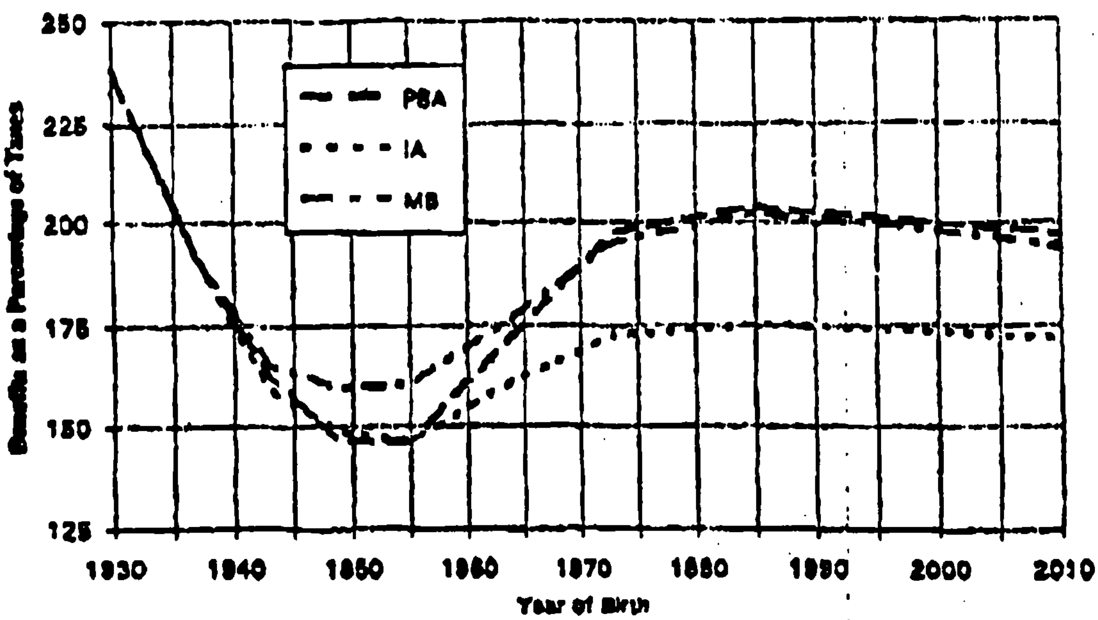
It can be seen that for all classes of workers these money's worth ratios are gradually dropping. They will stay roughly at present levels, with some cycles due to past movements in wages and interest rates, unless changes are made in Social Security. But if changes are made, both to raise aggregate saving for retirement and to plow some of the funds into common stocks, the money's worth ratios will rise for workers born after about 1955. All three plans described in the earlier sections make the requisite changes, and all three are responsible for rises in the money's worth ratios for younger workers. This is the reason for acting now, whichever plan one favors. Early action protects the retirement income of our children and grandchildren.

In terms of the specific plans, the money's worth ratios depend both on the structure of benefits and the amount of funds invested in the equity market. For workers with steady low earnings, shown in Chart 1, the Maintain Benefits (MB) plan and the Personal Security Accounts (PSA) plan do about equally well. Both preserve low wage benefits (the PSA largely because of the flat benefit) and both invest a large share of retirement funds in the equity market. For workers with average earnings, the MB plan has a slight edge because of the benefit structure, while for workers with steady high earnings the accumulations from the PSA are sufficient to give that plan an edge. The Individual Accounts (IA) plan does not show as high money's worth ratios as either of the others, but it might be viewed as a reasonable second choice in the event that some of the legislative changes implicit in the other plans prove to be stumbling blocks.

Chart 1 Benefits as a Percentage of Taxes -- Single Workers with Steady Low Earnings

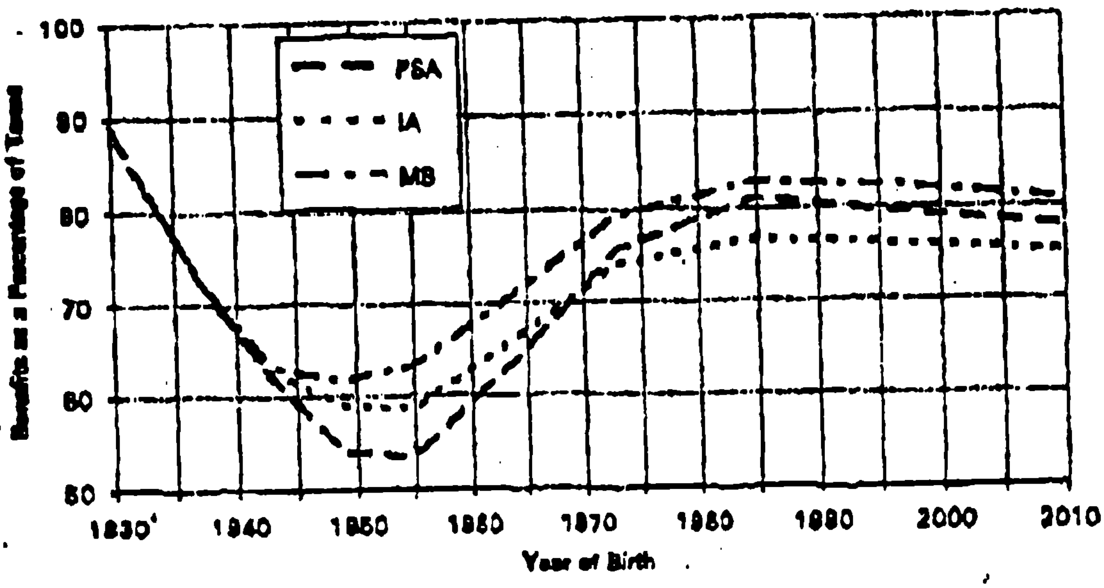


Married with One Steady Low Earner

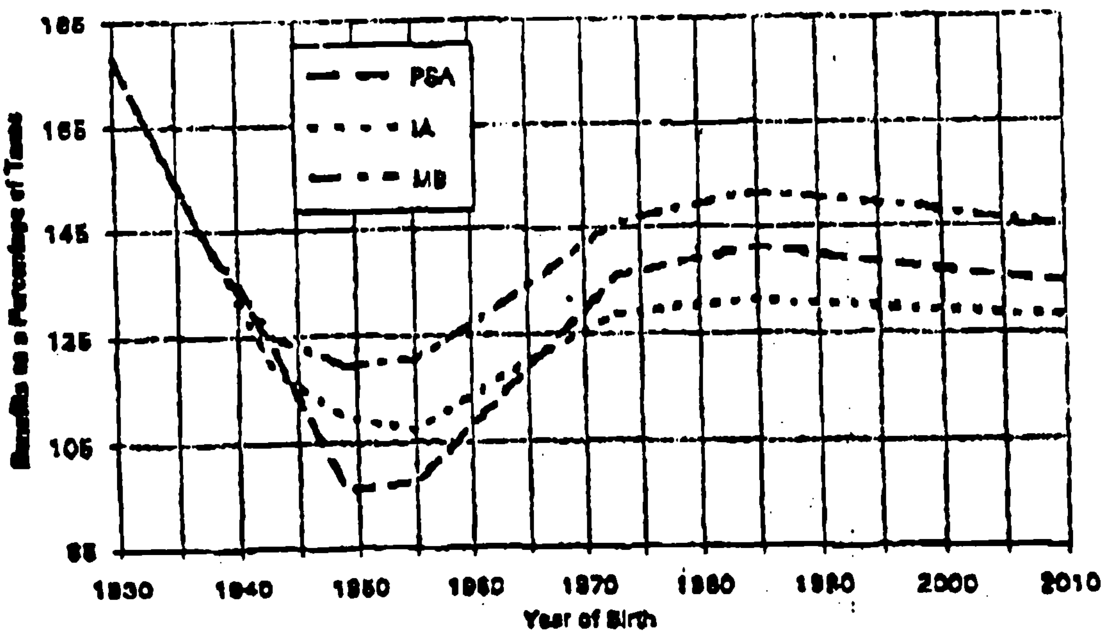


OACT/SSA Jan 19, 1996

Chart 2 Benefits as a Precentage of Taxes --
Single Workers with Steady Average Earnings

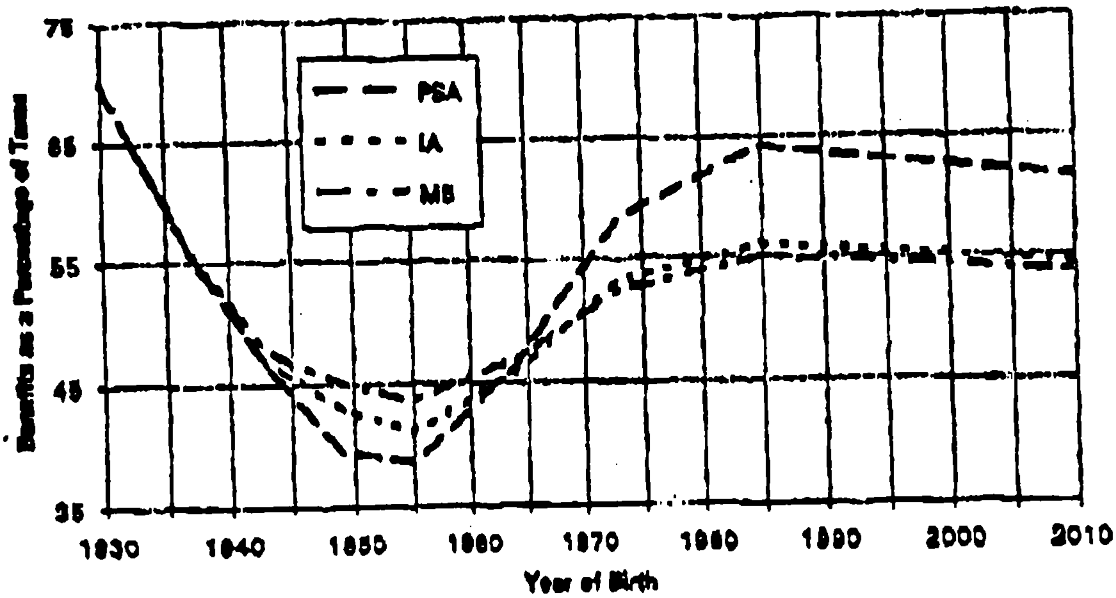


Married with One Steady Average Earner

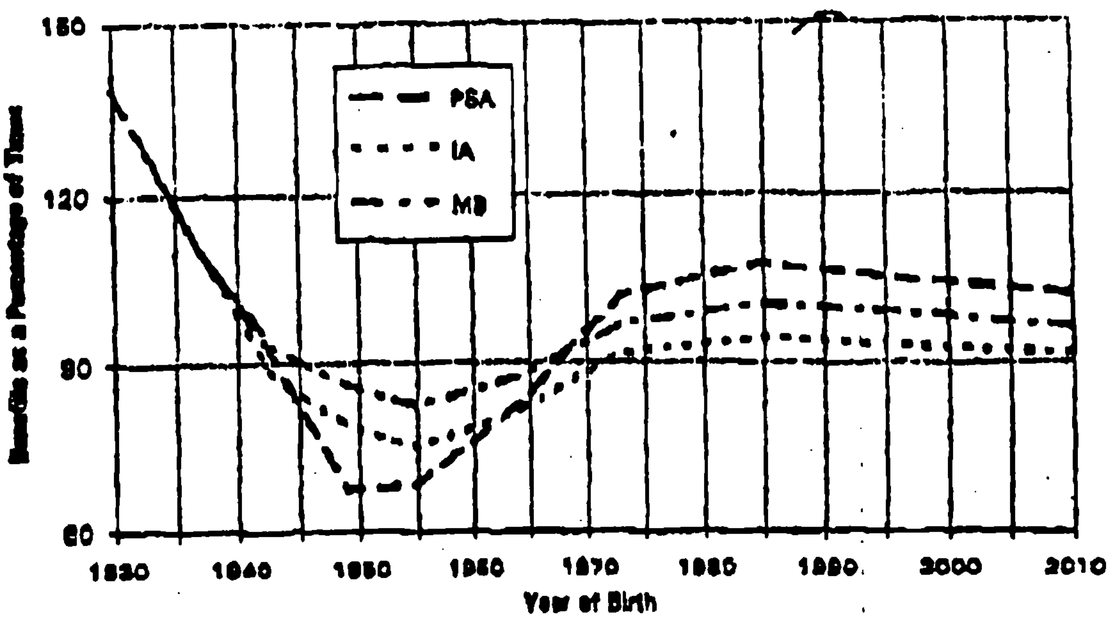


OACT/SSA Jan 19, 1996

Chart 3 Benefits as a Percentage of Taxes --
Single Workers with Steady Maximum Earnings



Married with One Steady Maximum Earner



OACT/SSA Jan 18, 1998

SUPPLEMENTAL STATEMENTS BY COUNCIL MEMBERS

EXECUTIVE SUMMARY OF THE TECHNICAL PANEL ON TRENDS AND ISSUES IN RETIREMENT SAVING

EXECUTIVE SUMMARY OF THE TECHNICAL PANEL ON ASSUMPTIONS AND METHODS

SS Adv Council Rpt

Preamble - General statement explaining evolution of social adequacy and individual equity goals in the framework of achieving long-term balance within the Social Security system.

Section I - Consensus Principles - General principles and specific recommendations on which the Council agrees:

Universal & Mandatory OASDI

Mix of Current Cost & Advance Funding

Action Sooner rather than Later

More Measure of 75-year Status

Efficient Management of DI Caseload

Burden-sharing by Today's Retirees (Near Retirees) - Benefit Taxation & Threshhold Repeal

Continue Full COLAs

Reject Means-Testing

Decrease Spouse/Increase Survivor

Include All Earnings in Computation

Include New State & Local Hires

Modify RET

Segregate Social Security Reserves

Phase-in Off Budget

Reject General Revenue Financing

More Research Resources

Stochastic Simulation Modeling

Private Access to Data

Review Panel on Assumptions & Methods

Include All Other Retirement Income Rec's

Section II - Majority Principles - General principles and specific recommendations on which a majority of the Council agrees:

No Payroll Tax Increase

Raise NRA to 68 and Use Indexing Formula Therafter

Raise EEA to 65

Invest in Equities/Corporate Bonds

Section III - Illustrative Reform Plans

Plan I - Leaves benefit structure essentially unchanged, increases some taxes & cuts some benefits.

Plan II - Moves in the direction of safety net program, holds down benefits & tax rates for high-wage workers, gradually converting to a double-decker system.

Plan III - Moves more toward conversion to safety net program, creating individual accounts for earnings-related portion, called Personal Investment Plans (PIP).

Section IV - Supplemental Statements by Council Members

Section V - Chairman's Annexes - Based on sections dealing with these issues from the original staff draft long report as well as additional material provided by agency staff.

Economic and Demographic Annex

Benefit Structure Annex

Private Saving

Section VI - Technical Panel Exective Summaries

12/5

Chair Gramlich – pushing for Consensus
Ball – talking up divided

3 plans – 1 – Ball: Δ's + revenues
*Aaron → find
2 – Gramlich → benefit cuts
*Eric Berman
3 – Carolyn Weaver – Personal private investment accts

Dec. 14 – next mtg
Rpt describing majority support for diff. principles – e.g ↑'g payroll taxes

5 votes – 3 CoSec, Ball, Tom Jones

then describing 3 plans

Supplement → doesn't address solvency
Ball → ~~privatizing~~ invest surplus in private mkt

= what is Pres'l response? SSA response?
= likely Cong'l hrgs
= what if Dole picks it up?
– Can we inoculate ourselves w/ version?
– impt message abt personal savings
No means testing
PIP as supplement, not subst
Soc Sec – social ins, not priv investment
– why Chile + US diff. countries
April 4 → Trustees Rpt (strong economy + illegal imm improved last time) by LUC

options :– What does Pres do?
– Asked Comm to hold town mtgs
– Continued discussion
– ask Adv Bd to explore PIP options
→ up/down not known

* – Commissioner has been Still → middle ground – she can talk about Pros/Cons theoretically/intellectually

on line → wnt → dial → conf

EXECUTIVE OFFICE OF THE PRESIDENT

11-Oct-1995 10:00am

TO: Molly Brostrom

FROM: Diana M. Fortuna
Domestic Policy Council

SUBJECT: <u>conflicts for meeting</u>

My conflicts next week are few:

Not Monday 10/16 after 3:30
Not Wed 10/18 from 12-3

The week after that is totally open!

Brian?

410/965-7767

2 press calls ⇒
disc's w/in WH on privatization of SocSec
- OMB said no
- ... press
- informal, off-record conversation
- Month + half ⇒ Adv Comm Rpt
@ OMB/NEC)

• SSA: Judy Chesser + Brian
• 1-2 others

DPC Mtg: Brian or
- or Carolyn Colvin, Depty Comm for Policy, Progs + eval
(formerly Sec Hum Services, MD)
7/16

Please do not distribute

DRAFT ADVISORY COUNCIL REPORT

RECOMMENDATIONS REGARDING THE OVERALL SOCIAL SECURITY SYSTEM

Since its inception, the Social Security system has tried to insure both social adequacy and individual equity. By the first is meant insuring a minimum standard of living in retirement for American workers and their families, along with protection against inflation, disability and the financial "risk" of living a very long life. By the second is meant assuring, within some limits, that workers who have paid more into the system in the form of payroll taxes receive higher benefits than those who have paid less.

In the early years of the system, these adequacy and equity goals were easily compatible. Low-wage workers could receive benefits that replaced a relatively larger share of their preretirement earnings than for high-wage workers, though high-wage workers still received higher absolute benefits. But all groups of workers could receive benefits that clearly exceeded the present value of the taxes that they had paid in to the system and that their employers had paid on their behalf.

Because the program has now matured to the point that almost all workers pay taxes for their whole working careers, and because underlying rates of economic and population growth have levelled off, it is no longer possible to achieve both objectives simultaneously. Were low wage workers to continue receiving present levels of benefits relative to their preretirement wages, high wage workers could no longer receive benefits that clearly exceeded the present value of the taxes they and their employers paid in.

These underlying trends are complicated by another factor. As the nation looks ahead, using reasonable economic and demographic assumptions, future expenditures under the Social Security cash programs -- Old-Age, Survivors, and Disability Insurance (OASDI) -- are now projected to exceed income. Under the intermediate assumptions set by the Board of Trustees, average expenditures over the next 75 years are projected to exceed average revenues by about 14 percent of total expenditures. For the first 25 years of this forecasting horizon there will actually be a slight surplus in the system, but once the enormous Baby Boom generation begins retiring, large deficits ensue. As the nation looks out 75 years and beyond, the deficits get steadily larger.

This long term financial solvency issue complicates further the problem of trying to achieve both social adequacy and individual equity. Were benefits to be cut for current retirees and older workers to bring the system into long term balance, the expected lifetime retirement benefits of older workers would be less. Were taxes to be raised to bring the system into long term balance, all future retirees would be paying in more lifetime taxes.

These were the issues that confronted the 1994-95 Quadrennial Advisory Council. For the most part the Council agreed to use the same economic and demographic assumptions that were used by the Trustees. There is one tangible reason why these assumptions could be unduly pessimistic -- the possibility that as a result of the report of the Advisory Commission to Study the Consumer Price Index, there could be a downward adjustment in the way retirement benefits are adjusted for inflation -- and the Council did make an adjustment for this possibility in comparing different policy approaches.

The Council expressed interest in three different approaches for insuring social adequacy while improving individual equity. One approach involves a slight increase in taxes on benefits, and then letting the Social Security system invest these and other funds directly in common stocks, or equities. Historically, returns on equities have exceeded those on government bonds (where all Social Security funds are now invested), and if this *equity premium* persists, it would be possible to increase benefits for future retirees without worsening social adequacy protections against low wages and retirement benefits, disability, and the financial risk of a very long life.

Another very different approach is to create individual accounts within or alongside the Social Security system. One option here would involve a slight reduction in the future growth of Social Security benefits alongside a mandatory contribution of 1.6 percent of covered payroll to individual accounts. These individual accounts would be held by the OASDI Trust Funds but with constrained investment choices available to individuals. If individuals were to devote the same share of the funds to equities as they do in private funds they already own and manage, it would be possible to raise benefits for future retirees, again without harming social adequacy protections.

A third approach would go even further down this road of creating individual accounts by devoting a much larger share, 5 percent of covered payroll, to these individual accounts. Were this approach to be followed, for younger workers the present Social Security system would move gradually in the direction of just providing a flat benefit to full career workers, along with disability and survivor's protection. The individual accounts might be held by the central system or they might be held privately. Again, individuals would have constrained choices on how the funds were managed. There would need to be a tax of the equivalent of 1.56 percent of payroll necessary to finance the transition to this new regime, though the tax would not actually have to be a payroll tax.

All of these approaches have in common that they involve higher national saving for retirement, with some way to get some of this higher national saving invested in the stock market. At the same time, the approaches involve very different visions for the future evolution of the U.S. retirement system. Individual Council members want it understood that while they all endorse at least one of the suggested approaches, they may not want to endorse in any way, shape, or form the other approaches.

This report first outlines those principles on which there was broad agreement within the Council. It covers recommendations for the general Social Security system, recommendations regarding research and data, and recommendations regarding private pensions. It then describes the three different approaches in more detail. There are then further supplementary statements from individual Council members. Finally, the report includes summaries of reports of two technical panels of experts commissioned by the Council; one involving the assumptions and methods used by the Trustees, and one involving trends and issues in retirement saving.

The Council affirms the desirability for the nation to maintain a universal and mandatory retirement, survivors, and disability program.

The Council rejects the proposition that Social Security will "not be there" for future generations. Changes can be made to balance the program in ways that preserve both individual equity and social adequacy, and provide for continued protection against inflation, disability and for workers who live very long lifetimes. These changes, if made soon enough, can provide for significant increases in the benefits received by younger workers.

The Council urges that early action be taken to reform and supplement Social Security.

While OASDI revenues are expected to exceed expenditures for another two decades, the Council urges that early action be taken to correct the actuarial imbalance in the system. Expenditures begin to rise rapidly once the Baby Boom generation begins retiring in little more than a decade. Actions taken now to cut benefits or raise taxes can generate revenues right away, these revenues can be invested in equities right away (whether directly or through individual accounts), and these investments can raise benefits for younger workers. The younger the worker, the more there is to be gained from early action.

The Council expresses its concern about the increasing cost of the Disability Insurance (DI) program, and urges that the new Advisory Board work with the Social Security Administration (SSA) and Congress to manage these costs.

As is common practice, the Council considered forecasts for the combined OASDI program, and all three approaches for balancing the system over the long run contain explicit disability insurance policies. But beyond that the Council did not study the DI program, and urges only that SSA and Congress be concerned about its increasing cost. Its caseloads are likely to grow because of the same demographic factors that affect the forecasts for the Old-Age and Survivors Insurance program.

The Council believes that the traditional 75-year forecasting horizon should be buttressed with additional measures of long term stability.

The Board of Trustees now relies on a number of demographic and economic assumptions in projecting the long-term balance of the OASDI Trust Funds 75 years in advance. Because of underlying demographic and economic trends, if the programs were otherwise brought into financial balance for 75 years in 1997, after that date the passage of time alone would change the forecasting period and put the system out of balance.

The Council therefore urges that forecasts still be done for the 75 year horizon, but that instead of just arriving at actuarial balance for 75 years, these forecasts in addition assure that the ratio of fund assets to annual expenditures, known as the trust fund ratio, be stable over the last two decades of the forecast horizon. All the plans discussed above satisfy this requirement.

The Council agrees that the current practice of annual cost-of-living adjustments should continue according to an automatic formula.

The Council believes that annual adjustments for inflation, especially for older retirees, help maintain their real living standards. The Council affirms that one of the important protections of Social Security is against inflation in the post-retirement years. Under the current structure of Social Security, the Council believes that a program with lower initial benefit levels coupled with predictable cost-of-living adjustments is superior to one that promises higher initial benefits but leaves those benefits hostage to inflation.

The Council has discussed the interim report of the Advisory

Commission to Study the Consumer Price Index, which finds that the Bureau of Labor Statistics (BLS) estimates of the Consumer Price Index (CPI) are biased upward by about one percentage point per year. The Council understands that the BLS may already be in the process of revising the CPI to correct for some of this bias, and that further corrections could be made. In keeping with this expectation, the Council factors a slight reduction in inflation into its forecasts. In order to be prudent, however, this reduction is only one-half percentage point per year.

The Council rejects conventional means testing of Social Security.

Social Security already takes income into account in determining eligibility. Benefits already depend on life-time earnings, a key component of life-time income. The Council rejects the further proposition that Social Security should also condition benefits on other income in retirement-- popularly known as "means-testing". Means-testing on the basis of other retirement income would create saving and work disincentives, particularly as individuals approach retirement.

The Council recommends that benefits for low wage retirees be protected.

The Council recognizes that some cuts in benefits, as compared to current law, may be necessary to achieve long-term actuarial balance. At the same time, the Council is mindful of numerous statistical data that report very high rates of poverty among certain groups of older beneficiaries, much higher rates than in other developed countries.

If and when benefits are to be cut, the Council prefers to protect benefits for workers with low to average wages, to avoid sacrificing on the goal of social adequacy. Workers at the top of the wage scale still can be protected by a combination of policies to control tax increases and by retirement fund investment policies, along with private pensions.

The Council recommends that if benefits are to be cut as compared to current law, they be cut in a way that avoids real declines in benefits, or notches.

Previous reductions in Social Security benefits have sometimes involved real cuts in benefits, situations where younger retirees with the same relative earnings records as older retirees received lower real benefits. These real benefit reductions, or notches, have been perceived to be inequitable among retirees. The Council urges that benefit changes be made in a way that avoids real reductions in benefits for similarly-situated workers retiring later in time.

The Council believes that the structure of family benefits in Social Security should be revised and recommends a change in the relative level of spouse and survivor benefits.

Statistical studies imply that it costs retired survivors about three-quarters as much to live as retiree couples. On the basis of this information, the Council believes that the benefit structure for spouses and widow(er)s should be revised. Spouse benefits (benefits payable to a wife or husband when both spouses are alive) should be gradually reduced, so that they are either a smaller fraction of the benefit paid to the principal earning spouse or a flat dollar amount.

The Council also believes that survivors' (widow or widower) benefits should be increased as a fraction of what a couple was receiving before one spouse died. In the current structure of Social Security, the Council recommends gradually increasing survivor benefits to the higher of the decedent's benefit (that is, the present-law survivor's benefit), or 75 percent of the combined benefit that the survivor and decedent spouse were receiving when both were alive.

The Council recommends that, effective in 1998, all new hires in now uncovered state and local government jurisdictions should be brought within Social Security.

The one remaining sector of the economy with less than virtually complete Social Security coverage is the state and local sector. Since the Council believes that all working Americans should both receive and pay for Social Security's protections, the Council recommends that all new state and local hires be brought within Social Security, beginning in 1998.

As when Social Security coverage was extended to other sectors, this expansion of coverage will entail some transition difficulties. In particular, the Council recognizes that this change could adversely affect the financing of some less-than-fully-funded state and local pension plans. But the Council sees the long run advantages of complete coverage outweighing the costs, which should be moderate in any case because only new employees are required to be brought into the system.

The Council recommends that the retirement earnings test be substantially modified.

The Council recommends substantially modifying the

retirement earnings test. As a result of earlier legislative changes, the long-term actuarial cost of such a modification is negligible. The Council approves of efforts currently under discussion in Congress to raise the retirement earnings test exempt amount for beneficiaries who have attained normal retirement age. Under this legislation, the exempt amount would be increased in steps to $30,000 in 2002, with subsequent adjustments based on the growth in average wages.

The Council recommends that there be no, or very little, general revenue financing for Social Security.

Social Security has worked well as an actuarially sound program insuring social adequacy and individual equity among American workers. As discussed above, it will be harder to promote these goals from now on within a constant payroll tax, but the Council still does not wish to use general revenues to finance the system.

The one exception to this principle pertains to the income taxation of benefits. As a result of previous legislative changes, revenues from taxing Social Security benefits are credited both to the OASDI Trust Funds and the Health Insurance (HI) Trust Fund. While all three plans mentioned above would continue or expand this tax treatment for regular Social Security benefits (not the proceeds from individual accounts), some Council members would favor crediting the federal treasury, not the OASDI and HI Trust Funds, with any benefit tax revenues at the earliest opportunity.

RECOMMENDATIONS REGARDING RESEARCH AND DATA

The Council recommends that SSA enhance its research and analysis capabilities with greater in-house resources and outside consultant services.

The Council has become aware that the resources available within the SSA to provide research and analysis are not sufficient to address adequately the problems facing the program over both the short- and long-term. Sophisticated research and analysis must be readily available to policy-makers to promote sensible policy changes.

The Council believes that the research and analytical capacity of the agency, particularly the Office of the Actuary, should be enhanced with additional in-house resources as well as outside consultant and contractual research services. This assistance would be helpful not only in understanding financing implications of reforms, but also in determining distributional impacts of various proposals.

The Council supports the use of stochastic simulation modeling as a tool for recognizing explicitly the uncertainty surrounding the Trustee's demographic and economic assumptions.

The Council feels that projections for the 75-year horizon should be made through the use of stocastic simulations. This technique employs probability distributions rather than point estimates of the possible future trends to derive potential future outcomes. It allows for correlations between combinations of assumptions. The technique also recognizes the impossibility of exactly predicting future long-term macroeconomic and social trends. It permits policy analysis to be conducted in a way that more richly and robustly incorporates this uncertainty into its measures of long-term financial viability.

The Council recommends that private researchers be granted greater access to agency data.

The Council believes that the value of research and analysis of Social Security data will be enhanced by providing private researchers with greater access to these data as well as to the economic and actuarial models used in forecasting and analysis. This access will facilitate collaboration of outside research with SSA research for an exchange of ideas, analysis, and findings.

Greater access to data, however, would mean providing additional security to protect confidentiality of records. It is possible to ensure tight security through a variety of mechanisms while facilitating research projects using these data. This access may require legislative changes and assurances by private researchers of confidentiality. Greater access also may mean better documentation of files.

The Council recommends that a technical panel of experts be appointed periodically (say every five years) to conduct a comprehensive review of the assumptions and methodology used in evaluating the financial status of the OASDI Trust Funds.

The Advisory Council has appointed a technical panel of experts to review the assumptions and methods used in evaluating the financing of the OASDI Trust Funds. The Council believes that it is highly desirable to continue the periodic appointment of actuaries, demographers, economists, and other experts to a panel for such a review.

POLICIES REGARDING OTHER RETIREMENT INCOME

The Council supports the creation of inflation-indexed bonds.

The Council recommends the creation of inflation-indexed Treasury bonds to enable individuals and pension plans to protect retirement income against inflation. Indexed bonds could be issued by the Treasury and their real interest rates could be determined in a competitive auction. The Council believes these bonds could make it easier to plan for retirement by translating lump sum accumulations into retirement income flows. Indexed bonds would also make it easier for private pension plans to convert lump sums into lifetime benefits and for private insurers to offer indexed life annuities.

The Council believes that government and employers should provide workers with adequate and realistic retirement income information.

The Council supports the initiative of the Departments of Labor and Treasury to raise each individual's awareness of how much needs to be saved for retirement. The SSA's distribution of "Personal Earnings and Benefit Estimate Statement" to those age 60 and over in 1995 under current law, and to everyone over age 24 after the year 2000, is a helpful first step. The Administration and Congress should work on measures that enable employers to provide more retirement planning assistance, including investment allocation and returns.

Information is also needed on how to save and how to allocate retirement savings distributions over remaining lifetimes. Enhanced education on the advantages of maintaining retirement savings distributions in tax-free accounts along with the creation of a market in Treasury indexed bonds would help to counter the tendency of younger individuals to consume their distributions.

The Council feels that retirement pension plans should be encouraged to cover a larger portion of the labor force and to meet more of the need for increased retirement savings.

The Council believes that the elaborate retirement plan rules that have been added since the early 1980s should be streamlined and revised to encourage more growth of private pension plans. Legislative proposals to permit small business to adopt simplified pension plans (such as the Administration's National Employee Savings Trust, or "NEST") and simplified "safe-harbor" rules for all businesses maintaining a salary reduction plan should be enacted promptly. Redundant and overlapping rules should be considered for simplification or elimination. Policy should be aimed at providing consistent contribution and benefit limits across various types of retirement savings plans.

In the light of the revised ages for full or early Social Security benefits in present law and in some of the illustrative plans recommended by the Council, there might have to be changes in the rules related to retirement ages and integration of Social Security benefits. The Council believes that any such changes in the rules should be aimed at making it easier for the employer plans and individuals to adjust to the new Social Security benefits and conditions.

The Council endorses rules that permit "full funding" of private defined benefit pension plans.

The Council feels that changes since 1987 that have limited the funding of the obligation of defined benefit plans are unwise. The Council urges that employers be allowed to fund fully their on-going qualified benefit obligations calculated with reasonable economic assumptions and some margin for risk. Projected benefit obligations should include anticipated pay increase effects in both salary-related and flat-dollar defined benefits.

The Council favors rules that would encourage or require workers to maintain their retirement saving in tax-free accounts until retirement.

The Council supports changes that would eliminate the remaining access to employer-made contributions during employment with the employer who made the contributions ("in-service" withdrawals). The Council recognizes that increased restrictions on withdrawal or loans of employee-made contributions could discourage participation in some plans. The Council supports efforts to maintain retirement savings in tax-free accounts after employment ceases, especially prior to early retirement age, and expresses concern about the growing trend of converting lifetime benefits to lump sum distributions.

The Council believes that pension plan managers should consider the interest of participants in making investment decisions.

The Council opposes legislation that would require pension managers to invest for social objectives, and also legislation that would permit such investments at the cost of pension participants' economic interests. The Council is not against investments that have social benefits, as long as those investments are otherwise prudent.

The Council feels that more of the provisions of the Employee Retirement Income Security Act of 1994 should apply to state and local government plans.

The Council agrees that the time has come to apply the Title 1 provision on disclosure, fiduciary standards and spousal protection (pre and post-retirement survivor annuities and qualified domestic relation orders) to these plans to protect the benefits of the workers and their survivors. The Council does not recommend extending the minimum funding standards to state and local governments at this time in light of the effects on some jurisdictions of the recommendation to cover all new hires at the state and local level.

MAINTENANCE OF BENEFITS REFORM PLAN

One group of Council members favors a maintenance of benefits plan. It maintains the present Social Security benefit structure essentially as is. This structure has worked well for a long time now, and the plan does not change it. The plan gains some revenue by more complete federal income taxation of current Social Security benefits. Implicit in this taxation policy is an eventual diversion of some revenues now going to the HI Trust Fund. It envisions a large scale investment of OASDI Trust Fund monies in the equity market.

The important specific provisions are as follows:

Tax Social Security benefits under income tax principles.

The plan would repeal the present provision whereby from 50 percent to 85 percent of Social Security benefits are subject to federal income taxes, above some thresholds. It would replace this taxation scheme with an entirely different approach, under which all Social Security benefits in excess of already taxed employee contributions would be included in the taxable income of beneficiaries. This is the standard income tax principle for taxing the benefits of retirement saving, though it should be noted that today retirement saving is now often taxed under consumption tax principles (which basically imply that 50 percent of Social Security benefits should be taxed).

This change requires several further adjustments. For one, the income thresholds below which Social Security benefits are now not subject to federal income taxes would be gradually phased out, resulting eventually in the complete and consistent income tax treatment of all Social Security benefits. For another, the revenue from this taxation that now goes to the OASDI Trust Funds (basically from the 50 percent inclusion of benefits) would continue to be credited to these funds. For a third, the revenues that now go to the HI Trust Fund (basically from the difference between 50 percent and 85 percent inclusion shares) would be gradually diverted to the OASDI Trust Funds.

Cover state and local employees.

There would be mandatory coverage under Social Security for all state and local government employees hired after 1997.

Invest a portion of the trust fund in equities.

The OASDI Trust Funds would begin devoting a share of their financial assets to the equity market. Eventually this share would build up to about 37 percent of the Funds' assets, an amount that would be tantamount to one-seventh of GDP at today's rates (a lower share of the likely aggregate value of common stock). Since the return on equities has historically outpaced that on government bonds that the system now holds, this equity investment would make it possible to pay higher benefits or have lower taxes than would otherwise be the case. The Council has done simulations indicating that from the standpoint of the OASDI portfolio alone, such equity investments entail a slight increase in portfolio risk, but a risk that is probably manageable.

Since equity investment by Social Security would now be considered as outlays under federal budget scoring rules, this change would require either a change in federal budget scoring rules, or it would require that Social Security's finances be entirely removed from the federal budget. Such a removal might be undertaken at some point in the future, so as not to complicate present federal budget balancing efforts.

Stabilize the trust fund ratio.

To stabilize the trust fund ratio there would need to be a 2 percentage point increase (to 14.4 percent combined employer-employee rate) in 2050.

INDIVIDUAL ACCOUNTS REFORM PLAN

Another group of Council members favors an individual accounts plan. It tries to preserve the social adequacy protections of the present Social Security benefit system, though benefits are scaled back slightly as compared to present law. Part of this reduction in benefits is standard for all workers resulting from a gradual increase in the Normal Retirement Age (NRA). Part is specific to high wage workers coming from a slight adjustment in the benefit schedule, though with an improvement in survivor's protection. There would be a mandatory contribution of 1.6 percent of covered payroll that would be held by the OASDI Trust Funds as individual accounts. Individuals would have constrained investment choices on how these funds were to be invested -- ranging from a portfolio consisting entirely of safe bonds to common stock index funds that replicate the behavior of the entire stock market. The accumulations from the individual accounts would be converted to minimum guarantee indexed annuities when the individual elects retirement, which could happen any time after the present age of earliest eligibility (EEA) for Social Security benefits.

The important specific provisions are as follows:

Create mandatory individual accounts in the amount of 1.6 percent of covered payroll.

Individual accounts in the amount of 1.6 percent of covered payroll would be created. Individuals would have constrained choices on how the funds were to be invested. The accumulated funds would be converted to minimum guarantee indexed annuities when the individual elects retirement, any time after the EEA. These individual accounts would *not* be included in the federal budget, though the rest of Social Security would remain on-budget.

Gradually increase the NRA.

The NRA would increase by one month a year from year 2000 through year 2035, at which point it would be 68. This means that the NRA would be about the same as under present law until year 2011. After 2035, the NRA would be keyed to increases in longevity, which means that it would increase by about one month every two years under present demographic forecasts. The EEA would remain unchanged at age 62.

Scale back benefits for high wage workers.

The 32 and 15 percent conversion rates in the present benefit schedule would be gradually lowered over time to 25 and 12 percent, respectively. In combination with the change in the NRA, benefits could be financed with a stable trust fund ratio by the 12.4 percent payroll tax. The combination of all changes in benefits would mean that for low wage workers Social Security benefits would grow nearly as rapidly as overall wages, while for high wage workers Social Security benefits would grow slightly more rapidly than prices. Benefit changes would be phased in to avoid notches, or drops in real benefit levels.

Increase survivors protection and alter spousal benefits.

A surviving spouse's benefit would be based on the highest of (1) his or her own basic benefit, (2) the deceased spouse's basic benefit, or (3) 75 percent of the couple's combined basic benefits. The spousal benefit would be gradually phased down from 50 percent to 33 percent.

Tax Social Security benefits under income tax principles.

All Social Security benefits in excess of already taxed employee contributions would be included in federal taxable income. The income thresholds would be gradually phased out. This revenue would be credited to the OASDI Trust Funds, with the HI Trust Fund credited with the same revenue it is now getting.

Cover state and local employees.

There would be mandatory coverage under Social Security for all state and local employees hired after 1997.

Extend the computation period to 38 years.

The Social Security benefits computation period would be raised from the present level of 35 years to 38 years.

Eliminate income taxes on the proceeds of individual accounts.

Since the individual accounts could be invested in equities, they would not be included in the federal budget. To avoid short-term revenue loss, contributions to individual accounts would not be deductible under the present federal income tax, but when benefits from these individual accounts are received, these benefits would be exempt from all federal income taxes.

PERSONAL SECURITY ACCOUNTS

A third group of Council members favors a personal security account (PSA) plan. It would create mandatory PSAs dedicated to retirement saving and financed by a rebate of 5 percent of covered payroll. The PSAs would not be held by Social Security but they would be subject to necessary regulatory restrictions to make sure they were invested in reputable financial instruments. They would be available to workers at the EEA -- the Social Security Trust Fund would be required to create actuarially fair indexed annuities for these PSAs, but individuals would not be required to receive their PSAs in the form of indexed annuities. The 7.4 percent of covered payroll still devoted to Social Security would be used to cover a flat benefit available to all full career workers, plus continued survivors and disability coverage. Present day retirees would be left unaffected by the plan, and present day workers over 30 would receive credits based on present day benefits. There would be an additional tax in the amount of about one percent of GDP to finance the transition, along with some additional borrowing.

The important specific provisions are as follows:

Create the PSAs.

The plan creates mandatory PSAs in the amount of 5 percent of covered payroll. The accounts would be held privately, though they must be invested with regulated private firms and they would not be available to individuals any time before the EEA. Individuals would have the option of buying actuarially-fair, minimum guarantee indexed annuities from SSA at that time, but they would not have to use their PSAs in this way. They could also retain their PSAs and include them in their estate.

Increase the NRA.

It is necessary to specify the NRA in such a plan because the credits due workers from the existing system depend on this NRA. The NRA will be increased by two months each year beginning in 2000 through 2017, at which point the NRA would be 68. After that time the NRA would be keyed to increases in longevity and would rise by about one month every two years. The EEA would remain unchanged at 62.

Alter the benefit schedule.

For individuals age 55 and older at the beginning of 1998, benefits would be unchanged from present law except as implied by changes in the NRA. For individuals under age 30 at the beginning of 1998, benefits would consist of the accumulations from their PSA, plus a flat benefit. At today's levels this flat benefit would be $2475 per year for workers with at least ten years of coverage, rising in steps up to $4950 per year for workers with at least 35 years of coverage. Both amounts would be wage indexed from 1998 until the year the worker retires.

Workers between the age of 30 and 55 would receive a first tier benefit under Social Security that was a combination of their accrued benefit under the existing system at the point of transition, price indexed until their year of retirement, and their prorated share of the flat benefit that would be provided under the new system. They would also receive accumulations from their PSAs.

Finance the transition.

Differences between the present system credits of workers over 30 and disabled workers and the 7.4 percent of covered payroll now devoted to Social Security will be met by a *liberty* tax. This tax will be in the amount of about one percent of GDP. Additional borrowing of a like amount would be necessary in the early years of the system, though these borrowings will be completely repaid beginning in about 40 years. All of the costs of the flat benefit, survivors and disability costs, and present system credits, along with the 7.4 percent payroll tax and the liberty tax, will remain in the federal budget. The PSAs will not be included in the federal budget.

Tax Social Security benefits under income tax principles.

All Social Security benefits in excess of already taxed employee contributions would be included in federal taxable income. The income thresholds will be gradually phased out. This revenue would be credited to the OASDI Trust Funds, with the HI Trust Fund credited with the same revenue it is now getting.

Cover state and local employees.

There would be mandatory coverage under Social Security for all state and local employees hired after 1997.

Eliminate income taxes on the proceeds of individual accounts.

Since the individual accounts could be invested in equities, they would not be included in the federal budget. To avoid short-term revenue loss, contributions to individual accounts would not be deductible under the present federal income tax, but when benefits from these individual accounts are received, these benefits would be exempt from all federal income taxes.

COMPARISON OF PLANS

The following charts compare these three plans. These comparisons are shown separately for single and married workers with low, average, and high wages. All workers are assumed to have normal incidence of disability and normal mortality.

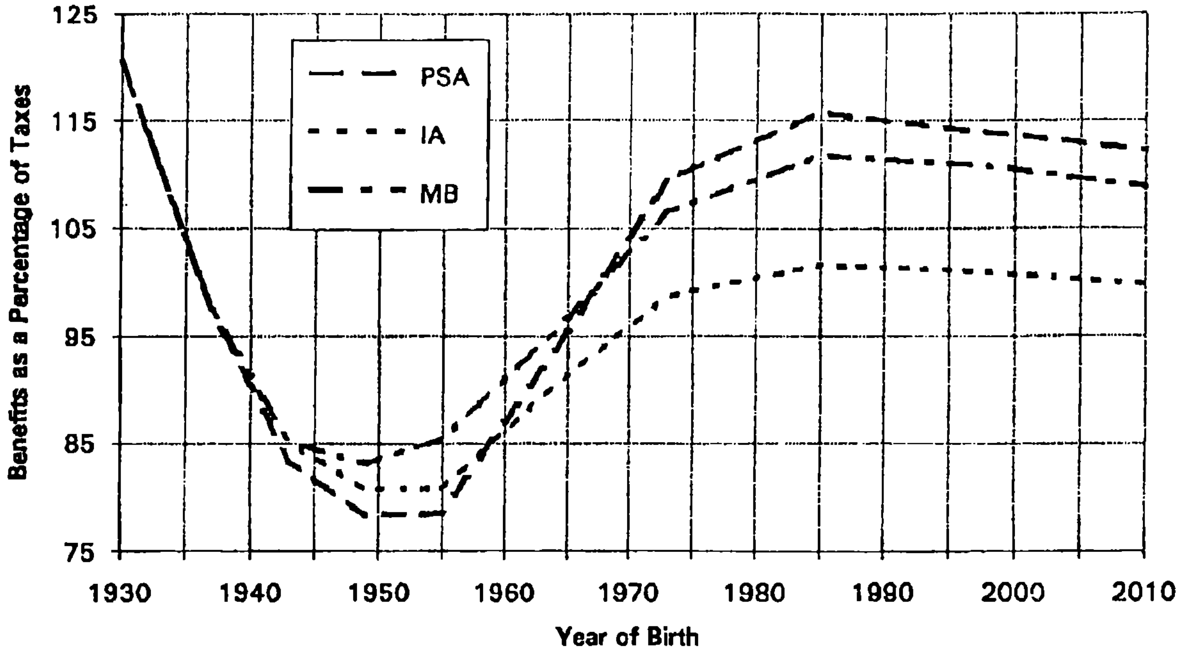
The charts show what are known as the money's worth ratios, the ratio of the present value of expected benefits to the present value of expected taxes paid by the employee and the employer on behalf of the employee. The liberty tax of the PSA plan is also included on the tax side. These money's worth ratios are given by year of birth, for cohorts born as late as year 2010.

When these money's worth ratios equal 100 percent, the relevant worker gets, on average, the same return in Social Security as he or she would get in the government bond market. But since Social Security provides several protections that are not available elsewhere -- against inflation, against disability, and actuarially fair insurance for extremely long lives -- Social Security is still often a very good deal for workers whose money's worth ratios are below 100 percent. Added to this is the communitarian satisfaction in knowing that all American workers are well taken care of. The difficulty in quantifying these insurance and communitarian values for Social Security should make one cautious about interpreting too much from precise levels of these ratios, though trends in the ratios could still be meaningful.

It can be seen that for all classes of workers these money's worth ratios are gradually dropping. They will stay roughly at present levels, with some cycles due to past movements in wages and interest rates, unless changes are made in Social Security. But if changes are made, both to raise aggregate saving for retirement and to plow some of the funds into common stocks, the money's worth ratios will rise for workers born after about 1955. All three plans described in the earlier sections make the requisite changes, and all three are responsible for rises in the money's worth ratios for younger workers. This is the reason for acting now, whichever plan one favors. Early action protects the retirement income of our children and grandchildren.

In terms of the specific plans, the money's worth ratios depend both on the structure of benefits and the amount of funds invested in the equity market. For workers with steady low earnings, shown in Chart 1, the Maintain Benefits (MB) plan and the Personal Security Accounts (PSA) plan do about equally well. Both preserve low wage benefits (the PSA largely because of the flat benefit) and both invest a large share of retirement funds in the equity market. For workers with average earnings, the MB plan has a slight edge because of the benefit structure, while for workers with steady high earnings the accumulations from the PSA are sufficient to give that plan an edge. The Individual Accounts (IA) plan does not show as high money's worth ratios as either of the others, but it might be viewed as a reasonable second choice in the event that some of the legislative changes implicit in the other plans prove to be stumbling blocks.

Chart 1 Benefits as a Percentage of Taxes --
Single Workers with Steady Low Earnings



Married with One Steady Low Earner

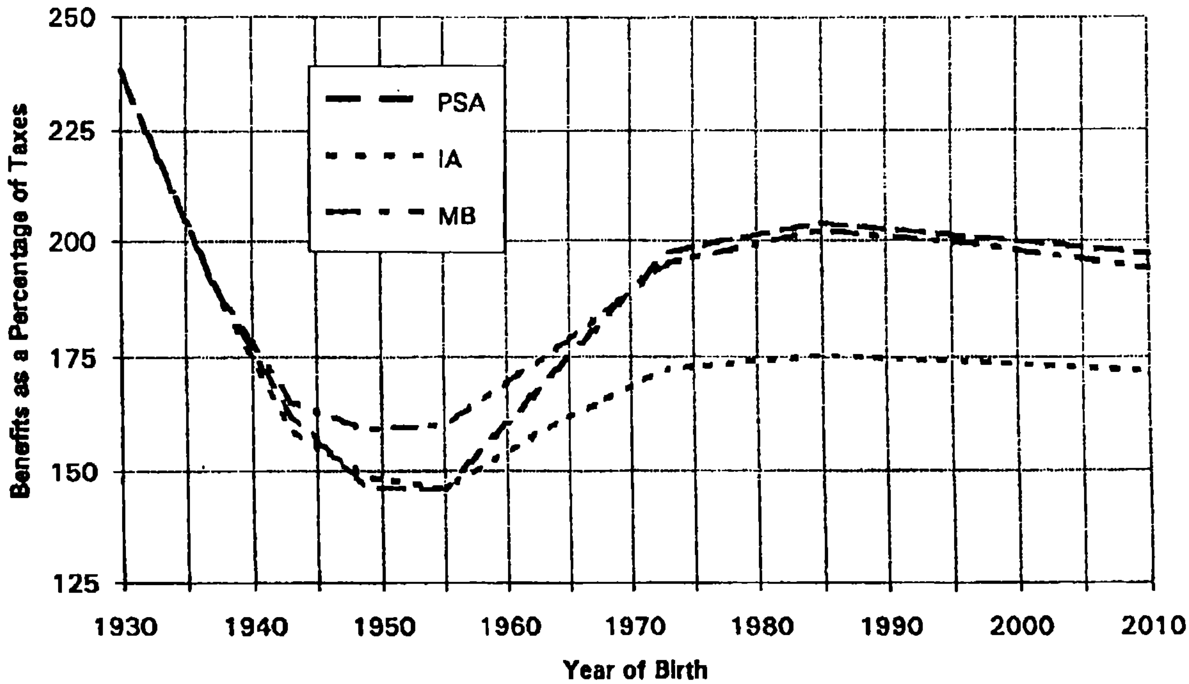


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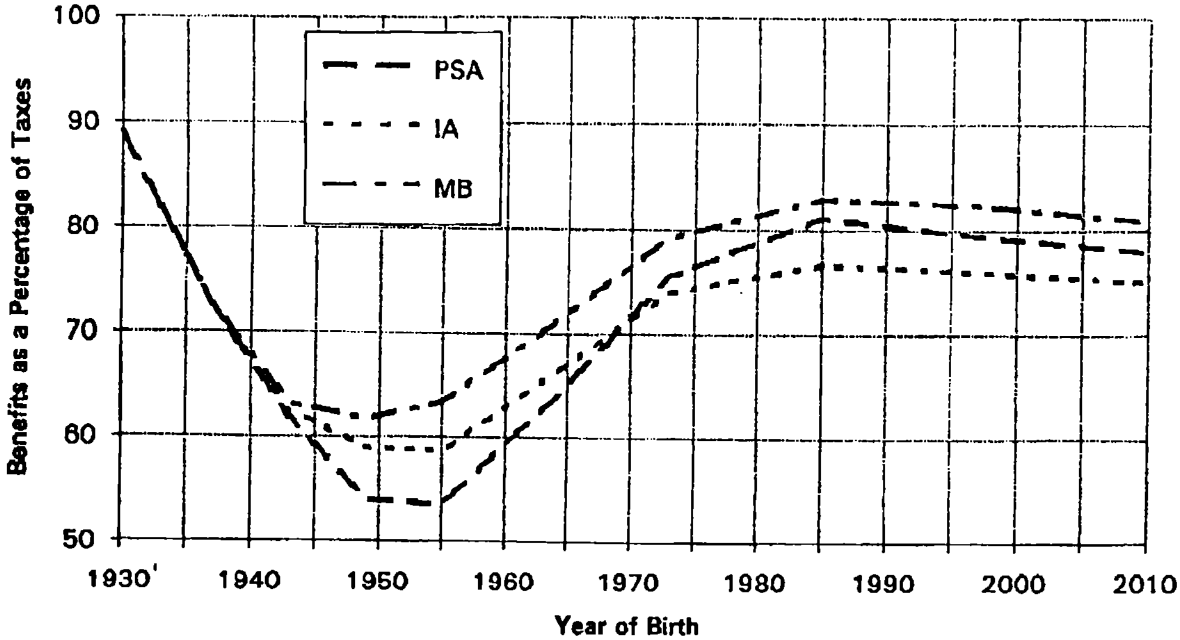
**Chart 2 Benefits as a Precentage of Taxes --
Single Workers with Steady Average Earnings**



Married with One Steady Average Earner

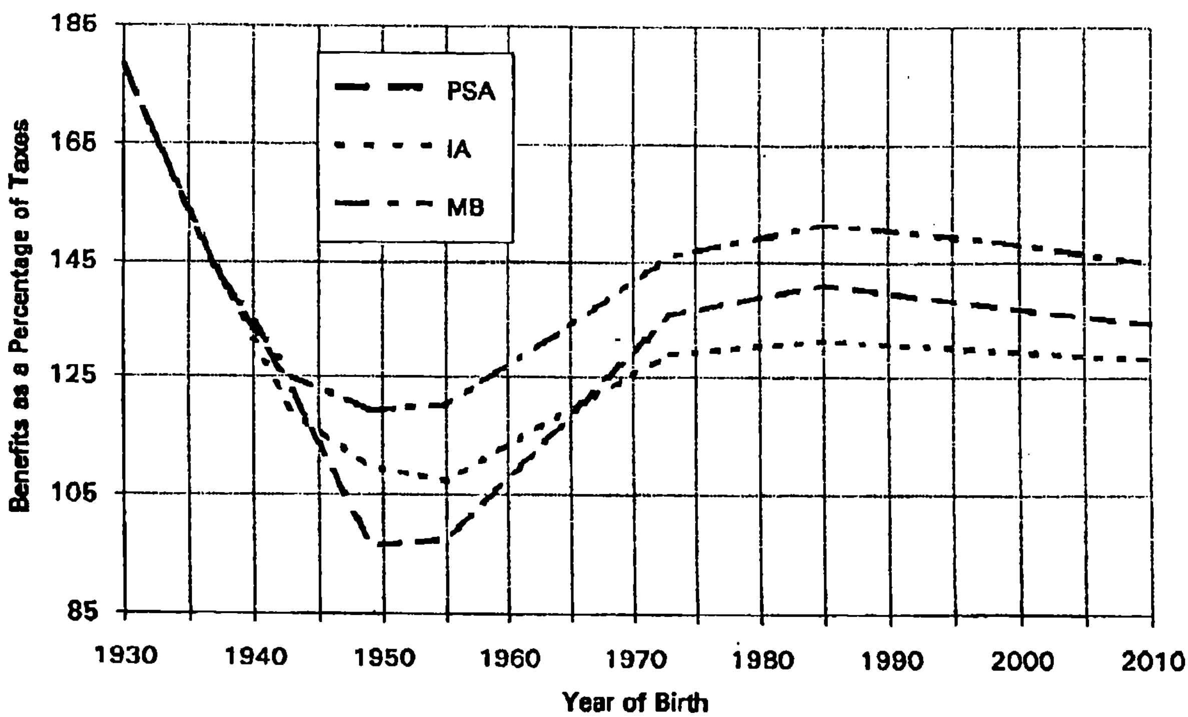


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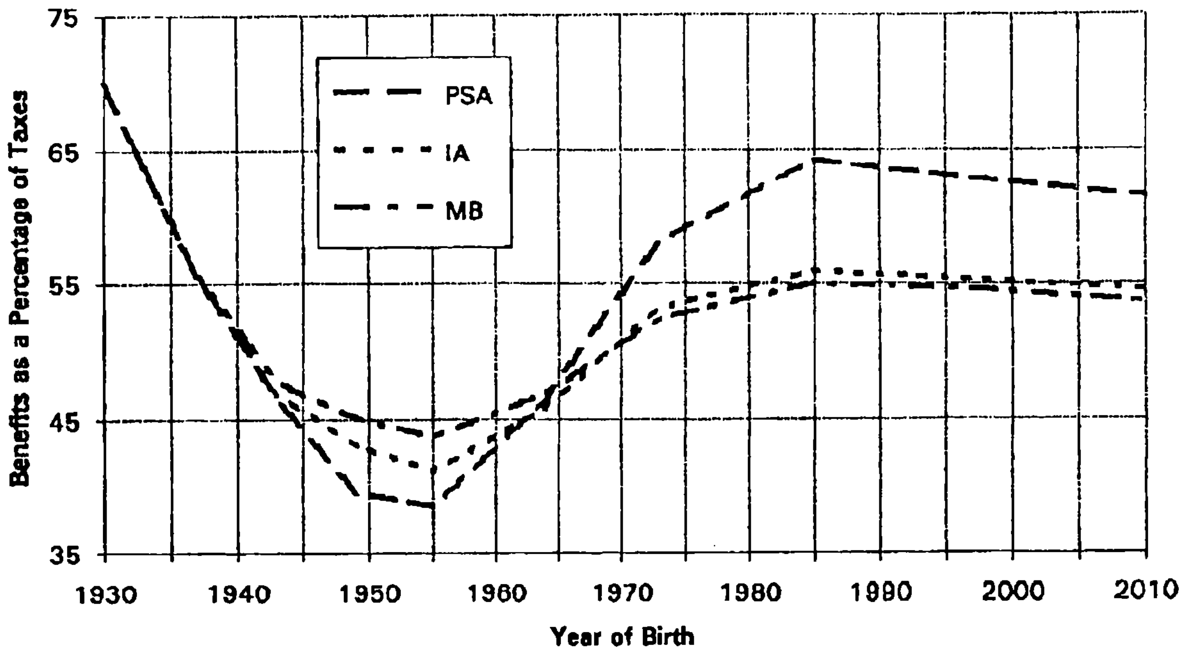
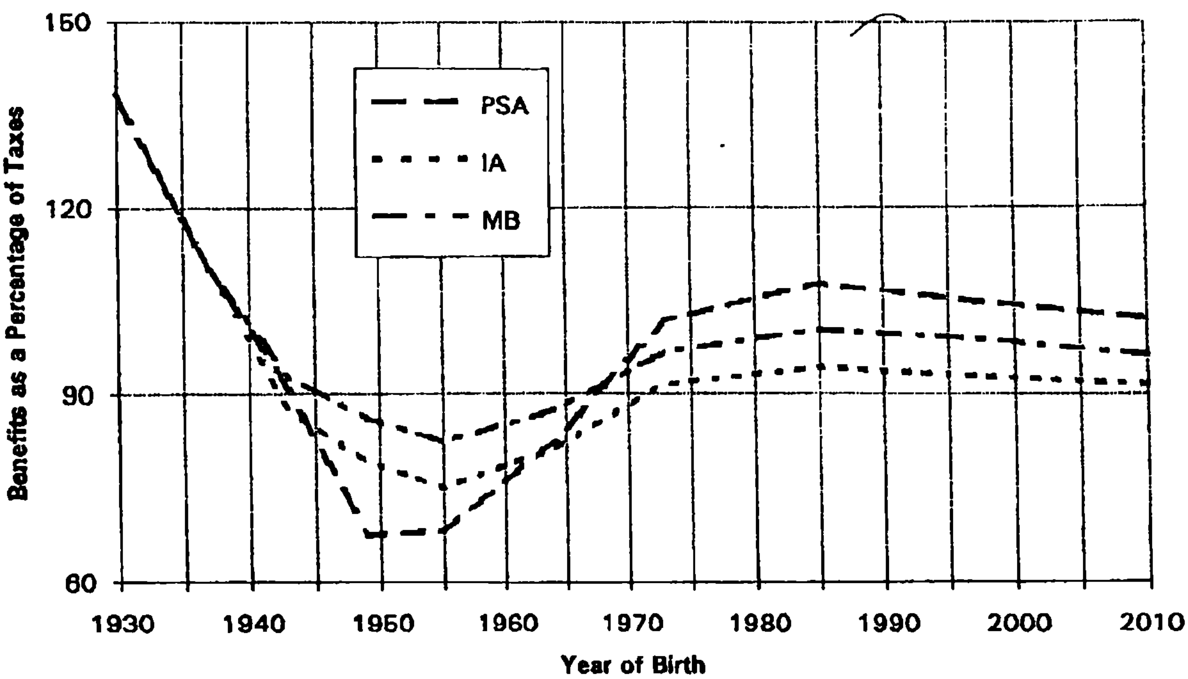
Chart 3 Benefits as a Percentage of Taxes --
Single Workers with Steady Maximum Earnings



Married with One Steady Maximum Earner



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SUPPLEMENTAL STATEMENTS BY COUNCII MEMBERS

EXECUTIVE SUMMARY OF THE TECHNICAL PANEL ON TRENDS AND ISSUES IN RETIREMENT SAVING

EXECUTIVE SUMMARY OF THE TECHNICAL PANEL ON ASSUMPTIONS AND METHODS

Side-by-Side Chart

Provision	Current Law	Rostenkowski	Pickle
1. Old-Age Benefit	Current PIA--90% of first $426 of average indexed monthly earnings (AIME), plus 32% of AIME over $426 up to $2,567,plus 15% of AIME over $2,567, based the number of years after 1950--or age 21, if later--up to age 62, minus "dropout years" (up to 5 years) with maximum of 35 years.	Create a fourth PIA formula bracket with a factor of 10% applicable to the highest marginal average earnings. This change would be effective for workers newly eligible in 2002 and later. Gradually reduce, between 2002 and 2051, the relative level of the earnings thresholds used in all but the first bracket.	Provide a 5% benefit increase for individuals who are aged 85 and over in 2024 or later. (Phased in beginning in 2020.) Gradually lower the age for receipt of SSI benefits on the basis of age from 65 to 62, with a phase-in period beginning in the year 2000 and ending with the year 2011.
2. Retirement Ages	NRA, for workers 62 in 2000, increases 2 mos/yr until NRA is 66 for workers 62 in 2005 & remains 66 until 2017 (the "hiatus"). NRA increases again, for workers 62 in 2017, 2 mos/yr until NRA becomes 67. Earliest Eligibility Age (EEA) remains 62 for retired workers and spouses and 60 for widow(er)s.	Accelerate the increase in the NRA already scheduled in the law by eliminating the "hiatus".	Raise normal retirement age for persons who reach age 62 after 1999 by 2 mos/yr until it reached aged 70 for people reaching 62 in 2029 and later. Modify reduction factors for retired-worker beneficiaries, aged-spouse beneficiaries, and widow(er) beneficiaries to soften the effects of the increase in NRA. Once NRA reached age 70, retired workers and aged spouses retiring at age 62 would receive 60% and 55%, respectively of PIA. Widow(er)s at age 60 would receive 60% of the PIA.
3. Spouse/Survivor Benefit	Spouse receives 50% of worker's PIA, subject to early retirement reductions (either spouse or worker). Widow(er) receives 100% of deceased worker's PIA, subject to early retirement reductions (either widow(er) or deceased worker).		Gradually reduce the percentage of PIA payable to spouse 50% to 33%. Phase in change for newly eligible, 2000-2016. Repeal the provision that requires a reduction in a widow(er)'s benefits if the deceased worker received benefits prior to NRA. Effective for persons reaching 60 after 1999. For persons 85 and over, recompute reduction in widow(er)'s benefit at 1/12% per month of benefit entitlement prior to reaching NRA. Once NRA reaches age 70, maximum reduction applicable at age 85 or later would be 10% so that at least 90% of the PIA would be payable to widow(er)s at this point. Increase the percentage of PIA for a surviving child from 75% to 90% in 2025 and later.

Side-by-Side Chart

Provision	Current Law	Rostenkowski	Pickle
4. Disability Benefit	Disability benefits are converted to retirement benefits at NRA and generally equal 100 percent of the PIA.		Provide for disabled-worker conversion to retirement benefits at age 65 (rather than NRA), and provide that the percentage of PIA payable to all disabled-worker beneficiaries who become newly eligible after July 2003 would be equal to the percentage of PIA payable to all retired-worker beneficiaries newly entitled at age 65 in the same year. Repeal the current variable drop out year provision and, instead, provide 5 drop out years for all disabled worker beneficiaries regardless of age, and eliminate the child-care drop out provision. Effective for workers who become eligible for disability benefits after July 2003.
5. Individual Accounts	No current-law provision for individual accounts under Social Security.		
6. Payroll Taxes	Current OASDI rate is 6.2% for employers & employees (each) and 12.4% for self-employed. HI rate is 1.45% for employers & employees (each) and 2.9% for self-employed.	Provide for a gradual increase in the OASDI payroll tax rate for employers and employees, each, from its currently scheduled level of 6.2% in 2020 to 8.15% in 2058. The tax rate for self-employed would increase from 12.4% in 2020 to 16.3% in 2058 and later.	
7. Taxable Earnings Base	OASDI taxes are paid on earnings up to $61,200, adjusted annually balance to increases in average wages. HI taxes are paid on total covered earnings, without limitation (starting in 1994).		
8. Taxation of Benefits	Up to 50% of benefits taxable with income $25,000-$34,000 (singles) and $32,000-$44,000 (couples). Up to85% of benefits taxable with income over $34,000 (singles) and income over $44,000 (couples). Proceeds from the 50% taxation are credited to the OASDI Trust Funds and proceeds from the 51% to 85% taxation are credited to the HI Trust Fund.	Lower the threshold at which 85% of OASDI benefits must be included in taxable income from $34,000 for individuals and $44,000 for joint tax filers, to $25,000 and $32,000 respectively, effective January 1995.	

Side-by-Side Chart

Provision	Current Law	Rostenkowski	Pickle
9. COLA/CPI	Benefits indexed to CPI-W. COLA of 2.8% paid January 1995.	Reduce the December 1994 COLA by 0.5 percentage points.	Beginning in 2000, delay the COLA to the following June with a corresponding shift in the computation period and pay the COLA biennially, reflecting 2 years of increase in the CPI, unless the increase over the 1-year period since the last COLA exceeds 4%. As a result, no COLA would be payable for the first year of eligibility beginning with 2000.
10. Investment Policy	A portion of Trust Funds not required to meet current costs may be invested. Investment of the funds must be made only in interest-bearing obligations of the US or guaranteed as to principal and interest by the US.		
11. Coverage of State & Local Workers	State/local employees not under a retirement system are covered mandatorily under Social Security and Medicare since 1990. Employees hired after March 31, 1986, are mandatorily covered under Medicare.	Provide mandatory coverage for all State and local employees hired after 1994.	Provide mandatory coverage for all State and local government employees hired after 1999.