SOCIAL SECURITY
Americans Discuss Social Security

A project funded by The Pew Charitable Trusts

Jen, et al FYI
this looks good
to me. What
do you think?
MV

I agree.
Jen

November 11, 1998

Office of The First Lady
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C.

Dear ~~Mrs. Clinton~~ Hillary:

Americans Discuss Social Security is very excited about our national conference on "Women and Retirement" which will take place on Saturday, January 23, 1999. We are hoping you will chair the event at our D.C. studio.

Social Security—the most successful domestic program in the history of our country – inherently has certain discriminatory effects on women and minorities. *Americans Discuss Social Security*, a non-profit, non-advocacy effort funded by The Pew Charitable Trusts, has been actively promoting discussion of these issues for the past year. We are pleased that our project was already in place when the President called for 1998 to be the year of the national discussion of Social Security, and we have been working extensively with the Administration and the Congress in generating the "national conversation."

"Women and Retirement" will take place in 15 cities across the country, including: Seattle, San Francisco, Detroit, Minneapolis, Cleveland, Miami, Philadelphia, and New Orleans. There will be approximately 200 citizens at each of the 15 sites; in addition, the conference will be broadcast via satellite in all 50 states. We are excited about the event, as it will provide an opportunity to focus national attention on the unique aspects of Social Security/retirement and women.

Americans Discuss Social Security has developed a unique program to generate intense citizen involvement in the issue. Prior to the event we provide educational materials to be read by the participants; however, we primarily provide opportunity for discussion among the participants. Social Security and retirement experts will be present in the Washington, DC studio. They will give brief, informative presentations to the participants, and they will be available to answer any questions that might arise.

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Office of The First Lady
The White House
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A key element of ADSS events is the use of technology in collecting positions and recommendations. We use electronic keypads for the citizens to provide certain information and to vote on priorities, and we use laptop computers for collecting information relative to the discussion. All of this material will be immediately transmitted to the Washington studio for review, and then disseminated to all the sites.

I respect your commitment to issues affecting women, and I sincerely hope that you will be able to chair our event, as I know that it would add tremendously to the interest and excitement of our national conference.

If you have any questions regarding the teleconference, please do not hesitate to call me.

Regards,

Carolyn

Carolyn J. Lukensmeyer
Executive. Director

This event fits your style perfectly!

Shirley

CENTER ON BUDGET AND POLICY PRIORITIES

December 15, 1998

SOCIAL SECURITY PLANS THAT REDUCE SOCIAL SECURITY RETIREMENT BENEFITS SUBSTANTIALLY ARE LIKELY TO CUT DISABILITY AND SURVIVORS BENEFITS AS WELL

by Kathy Larin and Robert Greenstein

The Social Security debate now underway has focused primarily on retirement benefits. Much less attention has been paid to how various changes being proposed in the Social Security benefit structure would affect disability and survivors benefits. To assess any Social Security reform plan fully, however, the impact on disability and survivors benefits should be carefully scrutinized.

This issue is particularly important because Social Security reform proposals that entail large reductions in Social Security retirement benefits generally contain substantial reductions in disability and/or survivors benefits as well. This is a result of the Social Security benefit structure, which uses a common benefit structure to determine monthly benefit levels for retirement, survivors and disability benefits alike.

Various proposals now emerging would shift a portion of Social Security payroll tax revenues from the Social Security trust funds to private individual accounts. Under a number of these proposals, beneficiaries would be guaranteed a "defined benefit" from the Social Security trust fund, as under current law, and receive supplemental income from their individual accounts. Such proposals generally entail quite large reductions in Social Security benefits — those benefits must be cut enough to close the current long-term shortfall in Social Security's finances and then reduced further to make up for the loss of the revenues being diverted from the trust funds to individual accounts. For example, diverting two percentage points of the payroll tax to private accounts, as some proposals do, would nearly double the size of the long-term Social Security shortfall and thus substantially deepen the Social Security benefit reductions required to restore long-term solvency to the system. As a result, proposals that shift revenue from the Social Security trust funds to private accounts generally entail large reductions not only in Social Security retirement benefits, but also in Social Security disability and survivors benefits.

Substantial reductions in disability and survivors benefits pose a particular problem. Although the income from individual accounts may make up for the loss of a substantial portion or all of lost Social Security *retirement* benefits for some individuals, depending on how the stock market performs, the individual's investment decisions, and other factors, income from individual accounts can *not* make up for much of the loss of Social Security disability benefits by workers who become disabled well before retirement age or for the loss of survivors benefits by the spouses and dependents of

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workers who die well before retirement age. The individual accounts of such workers will not have accumulated sufficient assets to make up for the reduction in disability and survivors benefits.

Aggravating this problem and sharpening the impact of the loss of Social Security disability and survivors benefits is the fact that such benefits often involve multiple benefit payments — they entail payments to dependents as well as to the disabled worker or the surviving spouse of a deceased worker. That a death or disabling accident can trigger Social Security benefit payments to *a number* of individuals rather than just to *one* beneficiary makes it even more difficult for the income from a single individual account to compensate for reductions in disability and survivors benefits.

Legislation Based on the NCRP Plan As An Example

To illustrate this problem, we examine legislation introduced by Senators Judd Gregg and John Breaux and Reps. Jim Kolbe and Charles Stenholm (S. 2313 and H.R. 4824). This legislation is based on a Social Security proposal unveiled this spring by the National Commission on Retirement Policy, a panel of Members of Congress and private citizens.[1] Other plans entailing reductions in Social Security retirement benefits also would affect disability and survivors benefits to various degrees, as the box on page ___ explains.

In issuing its plan, the National Commission on Retirement Policy expressed its intention to protect disability benefits from cuts. Subsequent statements by proponents of this legislation also reflect that intent. For example, at the town hall meeting held to discuss Social Security reform in Albuquerque on July 27, 1998, Rep. Kolbe stated, "...our proposal does not touch the disability or the survivors....we keep [disability] intact; it's exactly as it will be."[2]

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[1] This House bill was originally introduced as H.R. 4256 and then re-introduced as H.R. 4824 to reflect technical corrections and correct some drafting errors in the first bill. S. 2313 was introduced at the same time as H.R. 4256 and does not include these corrections. This analysis assumes the same changes will be made to the Senate bill. The bill numbers for both the House and Senate bills will change when the bills are reintroduced during the next session of Congress.

[2] Social Security has two trust funds, the Old Age and Survivors Insurance trust fund, which funds retirement and survivor benefits, and the Disability Insurance trust fund, which funds disability benefits. Both trust funds are projected to become insolvent in coming decades. Because the two trust funds are essentially fungible, Social Security solvency can be restored by making changes that make the overall system solvent and adjusting accordingly the share of Social Security revenues placed in each trust fund. To restore solvency, it is not necessary to reduce disability benefits by some particular amount or percentage. To the degree that disability benefits are shielded, somewhat larger changes likely would be needed in retirement benefits.

But in drafting the legislation based on this plan, the sponsors of S. 2313 and H.R. 4824 found that despite their strong desire not to cut disability benefits, it was not feasible to institute the large reductions in Social Security retirement benefits their plan entailed without making substantial reductions in disability and survivors benefits as well.[3] The only way the NCRP legislation could have made its reductions in Social Security retirement benefits without substantially reducing disability benefits at the same time would have been through measures that would introduce severe inequities and perverse incentives into the Social Security benefit structure.

The NCRP does contain a mitigating provision — it establishes a minimum benefit that would largely or fully shield from these benefit reductions those disabled workers who earned well-below-average wages during their work-years and were employed for most or all of their adult lives before becoming disabled. This provision also would shield survivors of deceased workers who earned very low wages and were employed most of their adult lives, as well as retirees who earned very low wages during their work years. Due to this provision, some retirees, disabled individuals, and survivors of deceased individuals who earned very low wages before retiring, becoming disabled, or dying actually would receive larger Social Security benefits than under current law.

For disabled workers and survivors who would *not* be affected by the minimum benefit provision, however — a group constituting the majority of beneficiaries of disability and survivor benefits — the benefit cuts would be large. For example, when the legislation took full effect, the Social Security disability benefits provided to an individual who had earned average wages before becoming disabled would be reduced nearly 20 percent, as compared to current law.

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[3] In theory, the legislation based on the NCRP plan could have left disability and survivors benefits largely untouched. This could have been accomplished by replacing the plan's changes in the Social Security basic benefit formula and in the annual Social Security cost-of-living adjustment with much steeper increases in the age at which workers can retire and receive full Social Security benefits. Raising the age at which beneficiaries can retire and receive full benefits does not affect disability benefit levels or benefits for survivors of workers who die before reaching retirement.

In practice, however, such a change would hold little attraction. The NCRP plan already contains a larger increase in the age at which beneficiaries can retire and receive full benefits than any other major Social Security plan put forward. Of the three rival Social Security plans advanced by members of the 1994-1996 Social Security Advisory Council, the plan that went farthest in raising the age at which individuals can retire and receive full benefits would increase this age from 65 today (and, under current law, 67 starting in 2022) to age 70 by 2083. By contrast, the NCRP plan would raise the age to 70 *by 2029* and to approximately 72½ by 2075. The NCRP also would raise the age at which *early* retirees can begin to receive reduced Social Security benefits from 62 to 65 by 2029 and to approximately 67½ by 2075. Replacing those provisions of the NCRP plan that would result in substantial reductions in disability and survivors benefits with provisions requiring still greater increases in the retirement age would entail raising the age at which workers may retire and receive full benefits to levels significantly higher than those the NCRP plan already proposes.

The legislation includes a provision calling for an expert panel to study and make recommendations concerning possible future changes that could ease the reductions in disability benefits the legislation contains. This panel, however, would face the same dilemmas that led the sponsors of S. 2313 and H.R. 4824 reluctantly to include substantial disability benefit reductions in their bills, since there is no easy solution that eluded the legislation's framers. Moreover, the legislation specifies that any recommendations the panel might make to ease the legislation's disability benefit cuts after the legislation had been enacted would have to be accompanied by recommendations for offsetting reductions elsewhere in the Social Security Disability Insurance program so that disability insurance costs did not rise above the levels to which the legislation had reduced them.

Background or Disability and Survivors Benefits

The Social Security system provides benefits not only to retirees but also to the survivors of workers who die before reaching age 62 and to workers who become disabled before 62 and their dependents.

- Workers who become disabled before they reach retirement, as well as members of these workers' families, are eligible for benefits under the disability insurance program that is part of Social Security.[4]
- Survivors benefits are available to the children of workers who have died before reaching retirement and the spouses of such deceased workers if the spouses are caring for dependent children, are over 60, or are disabled themselves. Survivors benefits also go to spouses and minor children of workers who die after retiring.

In December 1996, disabled workers and their families comprised more than six million people, or nearly 14 percent of all Social Security beneficiaries. An additional 7.4 million beneficiaries, nearly 17 percent of all Social Security beneficiaries, were survivors and their families. Together, these two components of Social Security account for nearly one-third of Social Security beneficiaries — 13 million to 14 million people.

How Disability and Survivors Benefits are Determined

The level of disability or survivors benefits that beneficiaries receive is determined under the same benefit formula as is used to calculate Social Security

[4] To receive Social Security disability benefits, disabled workers must have worked one quarter for each year between the year they turned 21 and the year they become disabled, with a minimum of six quarters of work. They also must have worked 20 of the 40 quarters before becoming disabled if they become disabled after age 31 and half of the quarters between the time they turn 21 and the time they become disabled if they become disabled before turning 31.

retirement benefits. The benefit formula starts with the calculation of a covered worker's "average indexed monthly earnings"; these are the worker's average wages over his or her work career. Wages for each year from the past are indexed by national wage growth to account for wage inflation between the year the worker earned those wages and the year that falls two years before the time the worker becomes eligible for benefits.

For *retirees*, the highest 35 years of wages are indexed in this manner, averaged and divided by 12 to obtain the worker's "average indexed monthly earnings" (known as the worker's AIME). For the *disabled* and *survivors*, a worker's average indexed monthly earnings are calculated using wages for the years between the time the worker turned 21 and the time the worker became disabled or died. For most Social Security beneficiaries, up to five of the years in which the worker had the lowest earnings are disregarded in these calculations.[5]

The worker's average indexed monthly earnings are then used to determine what is known as the worker's "primary insurance amount" or PIA. A worker's monthly Social Security benefit is based on his or her PIA. Specifically, for workers who retire at age 65, for disabled beneficiaries, and for the survivors of workers who die before reaching retirement, the monthly Social Security benefit they receive when they begin drawing benefits *equals* their PIA, rounded down to the next lowest dollar.

The calculation of the primary insurance amount, which determines the monthly benefit, is done in the same fashion *regardless of whether the beneficiary is a retiree, disabled, or a survivor.*[6]

- For a retiree, a disabled worker, or a survivor of a deceased worker who becomes eligible for Social Security benefits in 1998, the PIA — and hence

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[5] For survivors, the lowest five years of wages (known as "drop-out years") are disregarded in the calculation of the AIME unless the worker died before working seven full years, in which case all but the two highest wage years are disregarded in the calculation. For the disabled, depending on the age of the worker at the time of disability and the number of years worked, up to five years in which the worker earned the lowest wages are disregarded in the computation of the AIME. (As an example, if a worker who worked since age 21 becomes disabled at 31, the highest eight years of wages are indexed and averaged to determine the worker's AIME, while the two years with the lowest wages are disregarded.) By omitting from the AIME calculation the years in which the worker earned the least, the Social Security benefit structure ensures that workers who were either unemployed for brief periods or left the labor force for a few years to provide child care, attend college, or for other reasons are not penalized.

[6] A disabled worker's benefit is equal to 100 percent of the worker's PIA rounded down to the next dollar. Each dependent of the disabled worker is eligible to receive an additional benefit equal to 50 percent of the worker's PIA. Widows and widowers of deceased workers and minor or disabled children of deceased workers are eligible for a survivor's benefit based on a portion of the deceased worker's PIA. The combined benefits of all beneficiaries in a family (except divorced spouses) cannot exceed a maximum level, or cap.

Table 1
Determination of a Worker's Monthly Benefit Under Current Law, for a Worker Becoming Eligible for Benefits in 1998[7]

Formula using worker's Average Indexed Monthly Earnings (AIME)	Worker with AIME of $972 (Low earner)	Worker with AIME of $2,162 (Average earner)	Worker with AIME of $5,225 (Maximum earner)
90% of first $477	$429.30	$429.30	$429.30
32% of AIME between $477 and $2,875	$158.40	$539.20	$767.36
15% of AIME over $2875			$352.50
Primary Insurance Amount (PIA)	$587.70	$968.50	$1,549.16
Benefit Level[8]	$587.00	$968.00	$1,549.00

[7] Table 1 shows monthly benefit calculations for workers with low earnings, workers with average earnings, and workers with "maximum" earnings. The low earner— the worker with an AIME of $972— has an AIME equal to 45 percent of the average earnings level. The "maximum" earner— the earner with an AIME of $5,225 — has an AIME equal to the maximum earnings subject to the Social Security payroll tax. The earnings levels shown here for low earners and maximum earners are the levels the Social Security Administration uses for illustrative purposes.

[8] The benefit level equals the primary insurance amount rounded down to the next dollar.

the monthly Social Security benefit after rounding to the next lowest dollar — equals 90 percent of the worker's average indexed monthly earnings after rounding to the next lowest dollar *if* the worker's AIME does not exceed $477 a month.

- If the worker's AIME falls between $477 and $2,875 a month, the PIA (and, after rounding down, the monthly Social Security benefit) equals 90 percent of the first $477 of the worker's average indexed monthly earnings, plus 32 percent of the worker's average indexed monthly earnings above $477.

- For workers with AIMEs exceeding $2,875, the PIA (and the monthly Social Security benefit after rounding) equals 90 percent of the first $477 in average indexed monthly earnings, plus 32 percent of the next $2,398 of those earnings (the amount between $477 and $2,875), plus 15 percent of the worker's AIME in excess of $2,875.

Table 1 shows the monthly benefit calculations for three workers with different levels of average indexed monthly earnings. The "low earner" is an earner with an

AIME equal to 45 percent of the average earnings level. A "low earner" retiring in 1998 would have average annual pre-retirement earnings of about $12,250. An average earner retiring this year would have average annual pre-retirement earnings of just under $26,000. A maximum earner is one whose average pre-retirement earnings equal the maximum amount of earnings subject to the Social Security payroll tax. Earnings above this level are neither subject to the payroll tax nor used to calculate an individual's Social Security benefit level.

Provisions of the NCRP Legislation that Affect Disability and Survivors Benefits

Most of the remainder of this paper uses the legislation based on the NCRP proposal, the legislation Senators Gregg and Breaux and Reps. Kolbe and Stenholm have introduced, to illustrate how changes in disability and survivors benefits can be intertwined with changes in Social Security retirement benefits. The major provisions of this legislation that relate to Social Security benefit levels are listed in Table 2. Some of these provisions affect only the retirement portion of Social Security, but others impact disability and survivors benefits as well.

Table 2
Major Social Security Benefit Provisions of H.R. 4824 and S. 2313

Provisions	Effect on Disability and Survivors Benefits
Change the formula for calculating the primary insurance amount	Reduces benefits for most beneficiaries, with a reduction of 18.5 percent for a worker earning average wages before becoming disabled or dying
Minimum benefit provision	Protects the benefits of survivors and disabled workers with low earnings and strong labor force attachment
Modify cost-of-living adjustments so they rise more slowly than the current CPI does	Affects benefits of all beneficiaries, including the disabled and survivors
Reduce the number of "drop-out years" and lengthen the wage averaging period	Reduces survivors benefits
Raise the retirement age	Primarily affects retirement benefits and the benefits of survivors of retired workers
Include state and local employees	No effect

Table 3
Benefit Calculations Under NCRP Legislation and Current Law

Under current law, the monthly benefit equals:	Under H.R. 4824 and S. 2313, when fully phased in, the monthly benefit equals:
90% of first $477 in average indexed monthly earnings, plus	Same
32% of AIME between $477 and $2,875, plus	21.36% of AIME in this bracket, plus
15% of AIME above $2,875	10.01% of AIME in this bracket

Change in Benefit Determination Formula

One of the major provisions of this legislation would alter the way in which retirement, disability, and survivors benefits are calculated. The legislation calls for changing the computation of a worker's monthly benefit by reducing, by the year 2023, the 32 percent bracket in the formula for computing a worker's primary insurance amount to 21.36 percent, and reducing the 15 percent bracket to 10.01 percent. Thus, an individual's monthly benefit would be calculated by taking 90 percent of the first $477 of the worker's AIME (in 1998 dollars), the same percentage as under current law, but 21.36 percent of the worker's AIME between $477 and $2,875 instead of 32 percent of this amount, and 10.01 percent of the worker's AIME over $2,875 instead of 15 percent of that amount. The proposed change is shown in Table 3.

For very low-wage earners — those with average indexed monthly earnings of $477 or less — these changes would have no impact. In fact, very low-wage workers who work most or all years between turning 21 and becoming eligible for benefits would likely receive an increased benefit as a result of the legislation's minimum benefit provision, discussed below in more detail. But for beneficiaries with modestly below-average, average or above-average earnings, as well as for most beneficiaries who earned very low wages but were not employed each year between the time they turned 21 and the time they became eligible for benefits, this change would reduce the monthly Social Security benefit. Because this change in the benefit formula would affect the computation of disability and survivors benefits as well as retirement benefits, it would reduce disability and survivors benefits along with retirement benefits.

For many workers, the impact of this change on disability and survivors benefits would be substantial. An analysis by the Social Security Administration's Chief Actuary shows that this change in the monthly benefit formula would reduce benefits to a disabled Social Security beneficiary who earned average wages, which equal

Table 4

Determination of the Monthly Benefit for an Average-wage Worker Who Becomes Disabled Under H.R. 4824 and S. 2313, When Fully Implemented

Formula Using Worker's Average Indexed Monthly Earnings (AIME)	Average-Wage Worker
90% of first $477	$429.30
21.36% of AIME between $477 and $2,875 (worker's AIME is $2,162)	$359.92
10.01% of AIME over $2,875	$0
Monthly benefit under H.R. 4824 and S. 2313	$789.00
Monthly benefit under current law (see Appendix Table 1)	$968.00
Reduction in monthly benefit	-$179.00
Percentage benefit reduction	-18.5 %

$27,894 in 1998, by 18.5 percent when the formula change was phased in fully.[9] (See Table 4.)

Survivors also would face reduced benefits. Under current law, for example, a 60-year-old surviving widow of an average-wage worker is eligible for a monthly benefit of $692. If H.R. 4824 and S. 2313 were law and fully in effect, such a widow would receive a monthly benefit of $564. This, too, is a reduction of 18.5 percent.

The percentage reduction in benefits would be smaller than 18.5 percent for workers with below-average wages. (And as noted, some very-low wage workers would be shielded entirely from this benefit reduction or receive a benefit increase due to the legislation's minimum benefit provision.) The benefit reduction would be greater than 18.5 percent for those who had earned above-average wages.

Because the primary insurance amount is calculated in the same manner for all Social Security beneficiaries, these percentage reductions in benefits would be the same regardless of whether the beneficiary is a retiree, a disabled worker or a survivor. The dependents of disabled workers and the families of survivors also would be affected, since their Social Security benefits equal a specified percentage of the worker's PIA. A reduction of a given percentage in a worker's PIA would cause the benefits for these dependents to be cut by the same percentage.

[9] Social Security Administration, "Impact on Low Earners of Proposals to Address Long-Range Social Security Solvency" unpublished report, 1998.

Proponents of partial privatization plans often argue that reducing the basic guaranteed benefit payable to retirees through the Social Security retirement system will not necessarily reduce retirees' total incomes, because the retirees also will secure retirement income from the savings in their individual accounts. Income from these accounts could offset reductions in Social Security benefits; some beneficiaries would likely come out ahead and others behind, depending on how their investments performed, the costs and fees charged on the accounts, and a number of other factors.[9]

For the disabled and survivors of workers who die before retirement, however, individual accounts generally would fail to bridge the gap between current benefit levels and the benefits available under partial privatization legislation such as

Adults Who Have Been Disabled Since Childhood Would be Affected Most Adversely

One group for whom private accounts are least likely to compensate for the difference between current Social Security benefit levels and the reduced Social Security benefits available under partial privatization plans such as H.R. 4824 and S. 2313 consists of adults who have been disabled since childhood and who become eligible for Social Security when their parents retire, die, or themselves become disabled. "Disabled adult children," as these individuals are known, are eligible for a Social Security benefit equal to a specified percentage of their parent's primary insurance amount.

Both their parents and these disabled adult children would receive lower Social Security benefits under proposals such as H.R. 4824 and S. 2313 than under current law, because of the changes these bills make in determining a beneficiary's primary insurance amount. The parents of these disabled adult children also would accumulate private accounts to supplement their reduced Social Security retirement benefits. (The disabled adult children themselves will have little or no earnings and thus no significant private accounts of their own.) But while the amounts in the parents' private accounts might be sufficient to make up for a substantial portion or all of the reductions in the parents' Social Security benefits, it is unlikely these accounts would make up for the reduction in the benefits of the disabled adult children as well.

As a result, hardship could ensue. Consider, for example, what would occur after the parents of disabled adult children died. By the time of their deaths, many such parents would have largely or entirely depleted their private accounts. That would leave little or no savings to supplement the reduced Social Security benefits upon which their disabled adult children would have to depend for the rest of their lives.

[9] See Kilolo Kijakazi and Robert Greenstein, "How Would Various Social Security Reform Plans Affect Social Security Benefits: An Analysis of the Congressional Research Service Report," Center on Budget and Policy Priorities, September 9, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; and testimony of Henry Aaron before the Senate Committee on the Budget, July 23, 1998.

H.R. 4824 and S. 2313. Workers who become disabled or die at a young age will not have accumulated much in their individual accounts, as they will not have contributed to these accounts for that many years. For many of these individuals and their families, the change that H.R. 4824 and S. 2313 would make in the calculation of the monthly benefit would result in a significant reduction in monthly income compared to what they would receive under current law.[10]

Change in Cost-of-Living Adjustments

These estimates of the percentage amounts by which disability and survivors benefits would fall due to the changes H.R. 4824 and S. 2313 would make in computing the primary insurance amounts do not reflect the full extent of the reductions in disability and survivors benefits that would occur under these bills. Additional benefit reductions would result from other changes the bills would make in determining benefit levels, such as changes in the Social Security cost-of-living adjustment.

Under current law, Social Security benefits rise each year by the percentage increase in the Consumer Price Index. H.R. 4824 and S. 2313 would change this; they would adjust Social Security benefits not by the CPI but by a new "Social Security Consumer Price Index" that the legislation would create. The Social Security CPI would equal the regular CPI *minus* an estimate of the amount of "substitution bias" remaining in the regular CPI.

Substitution bias can occur when consumers substitute lower-cost items for higher-cost items as prices change. For example, if the price of beef increases more than the price of chicken, consumers will tend to purchase less beef and more chicken. Because the CPI measures the change in prices of a fixed "market basket" of goods and services, it assumes the quantities of beef and chicken a typical consumer buys do not change each year. The CPI is adjusted once every 10 years for such changes in purchasing patterns, but this process does not capture changes in purchasing patterns on a year-to-year basis within the 10-year intervals. As a result, the index may overstate inflation to some degree.

H.R. 4824 and S. 2313 would require the Bureau of Labor Statistics, the agency that calculates the CPI, to publish annually the amount by which the CPI has been reduced to correct for substitution bias. BLS also would be required to publish an estimate of the amount of substitution bias remaining in the CPI. Under the legislation, the Social Security CPI would equal the CPI (including whatever corrections the BLS has made in it) minus any substitution bias BLS estimates to remain.

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[10] Workers who become disabled only shortly before reaching retirement age would have accumulated more in their individual accounts and thus would receive more income from these accounts.

The legislation also contains a related requirement — that in calculating the Social Security CPI, the CPI must be reduced *no less than 0.5 percentage points* to compensate for substitution bias, regardless of BLS' estimate of how much substitution bias remains. In April 1998, BLS announced improvements in the CPI that will reduce substitution bias in the index by 0.2 percentage points when the improvements are incorporated in the index in 1999. BLS plans to make additional changes in 2002 that are expected to reduce substitution bias an additional 0.15 percentage points, for a total reduction of 0.35 percentage points.[11] BLS is not planning any further changes to adjust for substitution bias; it estimates the adjustments now in process will resolve the substitution bias problem. In the absence of further changes, however, the Social Security CPI that the NCRP legislation establishes would be set approximately 0.15 percentage points below the CPI, as corrected by BLS, to secure the minimum 0.5 percentage point reduction for substitution bias the legislation requires.[12]

Over time, the effect of such a downward adjustment each year in the cost-of-living adjustment would be to erode the value of Social Security benefits relative to current law. These benefit reductions would tend to be largest for workers who become disabled well before reaching retirement age, since these beneficiaries typically receive benefits for a greater number of years than retirees do.

The provision's impact on a disabled worker who becomes eligible for Social Security at a relatively young age can be seen with an example. Consider a worker with average indexed monthly earnings of $2,083 (equivalent to average annual earnings of $25,000 in 1998 dollars) who becomes disabled at age 30. Under current law, the worker's benefit is $943 a month when he or she begins to draw it. When fully in effect, the provision of H.R. 4824 and S. 2313 that would change the formula for calculating a worker's primary insurance amount would reduce this benefit to $772 a month, an 18 percent reduction. Now assume that inflation as measured by the CPI

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[11] Technically, the substitution bias correction scheduled for 2002 cannot be made in the CPI itself because the data needed to make this correction are not available in a manner that allows them to be reflected in the monthly CPI data. As a result, BLS plans to introduce a second cost-of-living index in 2002 that essentially is the CPI as modified to reflect this substitution-bias correction.

[12] A commission charged with evaluating the CPI and chaired by Michael Boskin concluded in 1996 that the CPI was overstated by approximately 1.1 percentage points per year, with substitution bias accounting for 0.4 percentage points of the total. BLS now estimates that substitution bias causes the index to be overstated by 0.35 percentage points. The change to the CPI scheduled for 1999 will eliminate 0.2 percentage points of this bias, and the introduction of a new cost-of-living index in 2002 will eliminate an additional 0.15 percentage points of bias.

BLS periodically reevaluates and makes changes to the CPI. It is unlikely, however, that the BLS will make corrections for substitution bias that total 0.5 percentage points any time soon. As a result, under H.R. 4824 and S. 2313, the annual Social Security cost-of-living adjustments would be smaller than the CPI, which would result in Social Security benefit reductions compared to current law.

Table 5

Potential Impact of Cost-of-Living and PIA Changes in H.R. 4824 and S. 2313 on Disability and Survivors Benefits

Worker with AIME of $2,083 ($25,000 per year) who becomes disabled at age 30		
	Current Law	**H.R. 4824 and S. 2313**
Benefit at age 30	$943	$772
Average annual cost-of-living adjustment	2.5 %	2.35%
Benefit at age 60	$1,978	$1,550

averages 2.5 percent per year for the next 30 years and BLS does not introduce additional changes to the CPI to reduce substitution bias, beyond the 0.35 percentage point reductions already scheduled. Under the legislation, the worker's benefit would be raised an average of 2.35 percent per year to compensate for inflation rather than 2.5 percent, because the Social Security cost-of-living adjustment would equal the regular CPI minus 0.15 percentage points. By age 60, this would reduce the worker's benefit an additional four percent, bringing the total reduction in Social Security disability benefits paid at age 60 to 22 percent, compared to the benefit payable under current law. Instead of receiving a disability benefit of $1,978 per month at age 60 as under current law, the disabled worker would receive $1,550. (See Table 5.)

Another Change Affecting Survivors Benefits

H.R. 4824 and S. 2313 include another provision that would lower the Social Security benefits of many survivors, although it would not affect the disabled. Under current law, the five years of a beneficiary's lowest earnings are omitted from the calculation of the beneficiary's average indexed monthly earnings. (In Social Security parlance, these are termed "drop-out years.") Under H.R. 4824 and S. 2313, by contrast, the five lowest years of earnings would be counted rather than dropped when computing retirement and survivors benefits. No similar change would be make in computing disability benefits.[11]

[11] Currently, when figuring retirement benefits, the amounts a worker has earned in his or her 35 highest earnings years are indexed, added, and divided by 420 (which equals 35 years times 12 months) to determine the worker's average indexed monthly earnings. Under H.R. 4824 and S. 2313, *all* of a worker's earnings years would be totaled and then divided by 480 (which equals 40 years times 12 months).

For one group of retirees and survivors of retirees, this change could *raise* average indexed monthly earnings and hence Social Security benefits. These are retired workers, and survivors of retired

(continued...)

Most workers do not have the same earnings each year of their working lives; they have low earnings when they are young and higher earnings when they are older. More than 60 percent of workers take at least one year out to raise children, attend school, or for some other reason, and have zero earnings for one or more years. The provision of current law disregarding the five lowest earning years helps these workers. Including rather than disregarding these five years, as H.R. 4824 and S. 2313 would do, would lower average indexed monthly earnings — and hence monthly Social Security benefits — for many retirees and survivors of deceased workers.

Other proposals to reform Social Security that either reduce the number of drop-out years or average the highest 38 years of earnings when computing retirement benefits, rather than the highest 35 years as under current law, also would lower workers' AIMEs and reduce their benefits. For example, the Social Security plan that Robert Ball has developed would calculate the AIME for retirees using their highest 38 years of earnings. This provision of the Ball plan would reduce benefits modestly for most retirees and most survivors of workers who died after reaching retirement age. Because the Ball plan does not reduce the number of drop-out years, however, this aspect of it should not affect the benefits of the disabled or of survivors of workers who die before reaching retirement age (with the exception of some individuals who become disabled very close to retirement age and some survivors of workers who die very close to retirement age).[13]

Minimum Benefit Provision

Although the majority of disabled and survivor beneficiaries would receive reduced benefits under H.R. 4824 and S. 2313, not all beneficiaries would face cuts. Workers with very low earnings and strong labor force attachment would be protected by a provision in the legislation that provides a guaranteed minimum benefit. This

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[11] (...continued)
workers, who began working and earning significant wages before age 21 and who worked most or all of the year in nearly every year until they retired. For these workers, more than 40 years of earnings would be totaled when figuring their AIME, but these total earnings would be divided by 40 years times 12 months, rather than by the actual number of years the individual had worked times 12 months. For some of these workers, this would result in a higher AIME, and hence higher benefits, than under current law. The majority of beneficiaries of Social Security retirement and survivors benefits, however, would not benefit from this change and would face lower benefits as a result of inclusion of their lowest-earning years in the benefit computation.

[13] In addition to the provisions of H.R. 4824 and S. 2313 discussed here, provisions of these bills and of various other Social Security plans that would raise the age at which full Social Security benefits are paid could affect the benefits of some individuals who become unable to work shortly before reaching that age but are not sufficiently disabled at that point to meet the rather stringent Social Security disability test.

How Other Social Security Plans Would Affect Disability and Survivors Benefits

Other Social Security plans that have been proposed also would affect disability and survivors benefits, although they generally would do so to a lesser degree than H.R. 4824 and S. 2313. For example, the plan introduced by Senators Daniel Patrick Moynihan and Bob Kerrey makes considerably larger reductions in the Social Security cost-of-living adjustment than do H.R. 4824 and S. 2313. Under the Moynihan-Kerrey plan, Social Security benefits would be adjusted each year by the CPI minus one full percentage point. Since disabled beneficiaries and the survivors of workers who die well before retirement age often receive benefits for a longer number of years than retirees do, this reduction in the cost-of-living adjustment would reduce their benefits substantially.

At the same time, the Moynihan-Kerrey plan does *not* contain the change in the basic Social Security benefit formula (i.e., the changes in how the primary insurance amount is calculated) that H.R. 4824 and S. 2313 include. As a result, the*overall* reduction in disability and survivors benefits is smaller under the Moynihan-Kerrey plan than under H.R. 4824 and S. 2313. The Moynihan-Kerrey plan does not need as large Social Security benefit reductions as H.R. 4824 and S. 2313 do because, over time, it diverts much less payroll tax revenue from the Social Security trust funds to individual accounts than H.R. 4824 and S. 2313.

A third plan, fashioned by former Social Security Commissioner Robert Ball, would result in small effects on disability and survivor benefits. The Ball plan modestly lowers the cost-of-living adjustment by requiring the Bureau of Labor Statistics to update every three years, rather than every 10 years, the market basket of goods and services on which the CPI is based. The expected impact of this aspect of the Ball plan on the Social Security cost-of-living adjustment would about the same as the expected impact of the cost-of-living provision of H.R. 4824 and S. 2313. The Ball plan contains no other provisions that have substantial effects on disability or survivors benefits. (The Ball plan contains much smaller Social Security benefit reductions than the Moynihan-Kerrey or NCRP proposals both because it does not divert any trust fund revenues to individual accounts and because it closes a little more than half of the 75-year Social Security financing gap by investing up to half of Social Security reserves in the equities markets and securing higher returns for the Social Security trust funds through this mechanism.)

Another plan that could affect disability and survivors benefits is a plan that Senator Phil Gramm has developed but not yet formally introduced. The Office of the Chief Actuary of the Social Security Administration has analyzed the Gramm plan, which is derived from a proposal by Harvard economist Martin Feldstein. The actuaries found that the revenue the Gramm plan allocates for Social Security disability benefits and benefits for survivors of workers who die before reaching retirement age would be insufficient. The amount that the plan allocates for these benefits is only about two-thirds of the amount the actuaries estimate would be needed to finance these benefits.[12] The consequences of this shortfall are unclear, but the shortfall would appear to place disability and survivors benefits at some risk unless a future Congress were willing to redirect some of the resources going into individual accounts back to the Social Security trust funds or to raise Social Security payroll taxes, the Social Security disability insurance program would face a financial cruch that could lead to significant reductions in it.

[12] Memorandum from Stephen C. Goss, Deputy Chief Actuary, Social Security Administration, "Considerations in Evaluating the 'Social Security Preservation Act' Proposed by Senator Phil Gramm," April 27, 1998.

provision would protect some retired, disabled and survivor beneficiaries from part or all of the benefit reductions they otherwise would face under this legislation.

Under this provision, workers who become eligible for Social Security benefits after working a minimum of *two* quarters each year between the year in which they turn 21 and the year they become disabled or die are guaranteed a minimum Social Security benefit equal to at least 60 percent of the 1996 poverty line for a single individual, adjusted for inflation. In 1998, this would equal a monthly benefit of $400. A worker who has worked *four* quarters each year between turning 21 and the year he or she becomes disabled or dies would be guaranteed a minimum benefit equal to 100 percent of the 1996 poverty line for a single individual, as adjusted for inflation. [14] (The 1996 poverty line for a single individual would be adjusted by the Social Security CPI each year through 2009, and by average wage growth in years after that, to determine the poverty line figure used in computing a beneficiary's minimum benefit. [15])

This provision would have a substantial impact on the benefits available to workers who earned very low wages and had strong labor force attachment. If the provision were in effect today, a worker who earned low wages before becoming disabled and who qualified for a minimum benefit equal to 100 percent of the poverty line would be guaranteed a minimum benefit of $666 a month in 1998. This equals the monthly benefit level that a worker who has earned an average of $14,600 per year before becoming disabled would receive under current law.

As a result, workers who worked four quarters each year between age 21 and the onset of their disability and who earned average wages of less than $14,600 would

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[14] The minimum benefit provision also applies to retirees. Retirees would be eligible for a minimum benefit equal to 60 percent of the poverty line if they had worked at least 20 years and to a minimum benefit equal to 100 percent of the poverty line if they had worked at least 40 years. For retirees, the disabled, and survivors alike, once the benefit level of an individual receiving the minimum benefit has initially been set, the benefit would be adjusted for inflation in subsequent years by the Social Security CPI, just as all other Social Security benefits would be.

[15] Between enactment of the legislation and 2009, the minimum benefit would equal modestly less than 60 percent to 100 percent of the poverty line, due to use of the Social Security CPI rather than the regular CPI to adjust the 1996 poverty line for a single individual. The Census Bureau adjusts the poverty line each year in accordance with the regular CPI; the Social Security CPI would rise more slowly than the regular CPI. After 2009, the poverty line figure used to calculate the minimum benefit would be adjusted by average wage growth, rather than by the Social Security CPI. Average wages are expected to rise somewhat faster than the regular CPI since they generally have done so in the past. This means that the minimum benefit eventually would be set somewhat higher than 60 percent to 100 percent of the poverty line.

receive higher benefits than under current law.[16] The same would be true for survivors of deceased workers who had a strong labor force attachment and earned average wages of less than $14,600.[17]

This provision would not benefit low earners with substantial periods out of the labor market before becoming disabled or dying, such as some women who lose some years of employment due to child-rearing or some individuals who experience a prolonged period of unemployment due to an economic downturn and become disabled or die fairly soon thereafter.

Finding a Solution: No Easy Answers

In theory, the disability and survivors benefits of most disabled and survivor beneficiaries (including those not shielded by the proposed minimum benefit) could largely be protected from benefit cuts when Social Security retirement benefits are reduced. This could be done by exempting the calculation of survivors and disability benefits from the various changes in the formulas used to calculate Social Security retirement benefits.

In practice, however, using different formulas to calculate Social Security disability and survivors benefits from the formula used to calculate retiree benefits would lead to a highly inequitable distribution of benefits. Under current law, benefits are directly related to a worker's past wages. Most workers who do not collect Social Security until retirement receive a higher monthly benefit than do disabled and survivor beneficiaries, since workers who do not collect benefits until retirement have spent more years in the labor market and typically have seen their earnings rise over time. This would no longer be true if disability and survivors benefits were held harmless while retirement benefits were reduced substantially. If that occurred, a disabled beneficiary could receive substantially higher benefits than a retiree.

For example, if changes are made to the calculation of retirement benefits but disability and survivors benefits continue to be calculated as under current law, a worker who becomes disabled at age 61 would retire with unreduced Social Security

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[16] Under Social Security law, a worker does not have to work every quarter of the year to receive credit for four quarters of work for the year. A worker who earns $700 in a year is credited with one quarter of work. A worker who earns at least $2,800 in the year is credited with four quarters for that year. These earnings levels are indexed for inflation.

[17] The minimum benefit provision of the NCRP plan also flattens Social Security benefits across the lower part of the wage scale. Workers who had enough quarters of work to receive the minimum benefit and whose average indexed earnings over their work careers were between $2,760 and $19,000 on an annual basis (measured in 1998 dollars) would all receive the same Social Security benefit level.

Implications of Individual Account Plans for the Financing of Benefits for Disabled Workers

The benefits of disabled workers are financed through the Social Security Disability Insurance (DI) trust fund only until workers reach the age of 65. At that point, although the workers' benefit levels remain unchanged, their benefits are financed through Social Security's other trust fund, the Old Age and Survivors Insurance (OASI) trust fund. Any Social Security reform plan that replaces some portion of Social Security retirement benefits with private accounts must take this into consideration, as the Social Security benefits of disabled workers who reach retirement age will still have to be financed through the OASI trust fund. Such a plan must provide adequate resources for the OASI trust fund to fulfill this task. This matter is of particular importance because the individual accounts of workers who become disabled well before retirement age will not have accumulated sufficient funds to provide much supplemental income.

benefits while also having accumulated a significant individual account from which to draw supplementary income. Meanwhile, a worker with a similar earnings history who retired at age 65 could have a similar-size individual account but sharply reduced Social Security retirement benefits. The two beneficiaries would have very different total benefit packages, even though both left the labor market within a few years of each other. Such an inequitable structure could prompt a significant number of individuals to leave work earlier and attempt to claim disability benefits.

At the same time, if the disability benefit calculation is *not* held harmless while benefit changes such as those in H.R. 4824 and S. 2313 are made, a worker who becomes disabled at a relatively young age would not have much of an individual account to draw upon and could face sharply reduced overall benefits.

In short, changing the calculation of Social Security retirement benefits in the manner that H.R. 4824 and S.2313 do either would result in large reductions in Social Security benefits — and overall income — for many disabled beneficiaries and survivors or would introduce substantial new inequities into the Social Security system.

The drafters of the legislation based on the NCRP plan recognized these complexities. They included a provision in their bills that would allow for later changes to be made in the disability insurance program. Under this provision, the Social Security Board of Trustees, in consultation with the National Council on Disability, would be required to submit to Congress and the President recommendations for statutory adjustments in the disability insurance program by May 31, 2001. H.R. 4824 and S. 2313 state that these recommendations may address such issues as the adequacy of benefits, the relationship of disability benefits to retirement benefits, and the process for determining initial eligibility and continued eligibility for the disability program. If the President approved the recommendations, the President would submit them to Congress for consideration. The bill specifies procedures for resolving differences between the President and the Board if the President does not approve the Board's recommendations. It also requires that the recommendations be provided to Congress within a specified period of time if the Board and the President continue to disagree.

While this provision establishes a mechanism for consideration of possible changes in disability benefits, the fact remains that the disability benefits these bills would write into law would represent substantial reductions from the benefits that current law provides. It would take enactment of subsequent legislation to reverse these reductions.

Moreover, any recommendations to improve disability benefits submitted through this process would have to be made "...without reducing the balance ratio of the Federal Disability Insurance Trust Fund." This means the total cost of the Social Security Disability Insurance program could not increase. Any increases in restorations in Social Security disability benefits for some beneficiaries would have to be matched by offsetting reductions in Social Security disability benefits for other beneficiaries.

In addition, the Social Security trustees and other individuals who would be charged with considering and making recommendations regarding possible changes in disability benefits would face the same dilemma that the authors of H.R. 4824 and S. 2313 confronted; were it possible to shield disability benefits from the large cuts H.R. 4824 and S. 2313 make without introducing serious inequities and perverse incentives into the Social Security system, the authors of these bills would have done so. As the original NCRP report indicated, it was NCRP's goal to avoid such reductions in disability benefits. For these reasons, the provision of H.R. 4824 and S. 2313 calling for the submission of recommendations regarding disability benefits cannot be regarded as a safety clause that would ensure cuts in disability benefits are restored.

Finally, this provision would apply only to disability benefits. The legislation does not contain a similar provision establishing a mechanism for developing recommendations to ease the reductions in Social Security benefits provided to survivors of workers who have died before retiring.

Conclusion

Under the Social Security benefit structure, the formulas used to determine disability and survivors benefits are intertwined with the formula for determining retirement benefits. If Social Security retirement benefits are reduced substantially, as they generally would be under plans that shift a portion of payroll tax revenues from the Social Security trust funds to individual accounts, disability and survivors benefits are likely to be reduced substantially as well.

The legislation based on the proposal developed by the National Commission on Retirement Policy illustrates this problem. Commission members intended and desired that disability benefits not be reduced as a result of their plan. But despite their efforts and intentions, they were unable to fashion their plan in a manner that would avert substantial reductions in the basic monthly benefits on which many disabled workers and survivors of deceased workers depend.

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December 15, 1998

THE FELDSTEIN SOCIAL SECURITY PLAN

by Robert Greenstein, Wendell Primus, and Kilolo Kijakazi

Introduction and Overview

Increasing attention is being paid to a Social Security proposal developed by Martin Feldstein, a Harvard economist and former chairman of the Council of Economic Advisers under President Reagan. The Feldstein plan is generally presented as a painless way to restore Social Security solvency without any reductions in the level of benefits the current benefit structure promises, with no tax increases, and, in fact, with almost all retirees receiving *greater* retirement income than under current law. When something appears too good to be true, it usually is. This adage holds for the Feldstein proposal.

While proponents of the plan claim it would restore long-term Social Security solvency with no pain, analyses of the plan — including analyses by the Congressional Budget Office and the Office of the Chief Actuary at the Social Security Administration — show otherwise. The Social Security system faces insolvency because the system has promised more in benefits than it will collect in revenues. The Feldstein plan promises *more* in retirement benefits than current law would provide but collects no more revenue to cover the added costs. The Feldstein plan would devote much of the surplus projected in the unified budget to finance the increases the plan would provide in retirement benefits. These surpluses, however, are uncertain in magnitude, are not expected to last for more than about two decades, and have other claims on them. When the surpluses wane, major new financing would have to be found. That would entail cutting other parts of the federal government heavily, imposing large tax increases, or borrowing substantial sums and swelling the already-large budget deficits that CBO forecasts will return when the baby boom generation has retired. The Social Security actuaries project that in the absence of budget cuts or tax increases to pay for the plan, *the Feldstein proposal would reduce budget surpluses and then increase deficits by $6.4 trillion over the next 25 years.*[1]

The Feldstein plan essentially poses as a "free lunch" entailing no tough choices. This appearance, however, is deceptive. The plan leaves a gaping hole in financing that future Congresses would have to address. The plan is reminiscent in this respect of the

[1] Memorandum from Stephen C. Goss, Deputy Chief Actuary, Social Security Administration, "Long-Range OASDI Financial Effects of Clawback Proposal for Privatized Individual Accounts - INFORMATION," December 3, 1998.

Melanne Verveer

Shirley

done

SOCIAL SECURITY
Americans Discuss Social Security

A project funded by The Pew Charitable Trusts

November 11, 1998

Jen, et al FYI
This looks good
to me. What
do you think?
MV

I agree.
Jen

Office of The First Lady
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C.

Dear Mrs. Clinton:

Americans Discuss Social Security is very excited about our national conference on "Women and Retirement" which will take place on Saturday, January 23, 1999. We are hoping you will chair the event at our D.C. studio.

Social Security—the most successful domestic program in the history of our country – inherently has certain discriminatory effects on women and minorities. *Americans Discuss Social Security*, a non-profit, non-advocacy effort funded by The Pew Charitable Trusts, has been actively promoting discussion of these issues for the past year. We are pleased that our project was already in place when the President called for 1998 to be the year of the national discussion of Social Security, and we have been working extensively with the Administration and the Congress in generating the "national conversation."

"Women and Retirement" will take place in 15 cities across the country, including: Seattle, San Francisco, Detroit, Minneapolis, Cleveland, Miami, Philadelphia, and New Orleans. There will be approximately 200 citizens at each of the 15 sites; in addition, the conference will be broadcast via satellite in all 50 states. We are excited about the event, as it will provide an opportunity to focus national attention on the unique aspects of Social Security/retirement and women.

Americans Discuss Social Security has developed a unique program to generate intense citizen involvement in the issue. Prior to the event we provide educational materials to be read by the participants; however, we primarily provide opportunity for discussion among the participants. Social Security and retirement experts will be present in the Washington, DC studio. They will give brief, informative presentations to the participants, and they will be available to answer any questions that might arise.

2001 Pennsylvania Avenue, NW • Suite 825 • Washington, DC 20006
(202) 955-9000
.americansdiscuss.org

Office of The First Lady
The White House
Page Two

A key element of ADSS events is the use of technology in collecting positions and recommendations. We use electronic keypads for the citizens to provide certain information and to vote on priorities, and we use laptop computers for collecting information relative to the discussion. All of this material will be immediately transmitted to the Washington studio for review, and then disseminated to all the sites.

I respect your commitment to issues affecting women, and I sincerely hope that you will be able to chair our event, as I know that it would add tremendously to the interest and excitement of our national conference.

If you have any questions regarding the teleconference, please do not hesitate to call me.

Regards,

Carolyn

Carolyn J. Lukensmeyer
Executive. Director

This event fits your style perfectly!

Why Social Security Privatization Would Hurt Women

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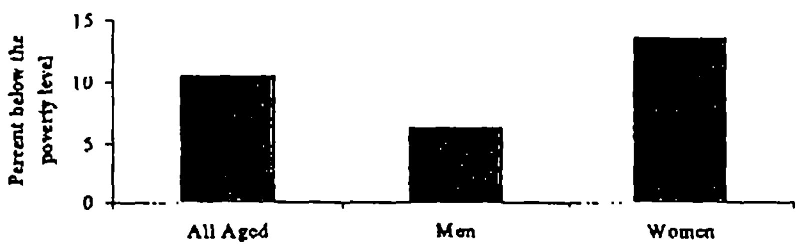
Proposals to replace some or all of the existing Social Security program with a new system of personal retirement accounts would undermine the financial security of older women. Poverty among women over 65 is already twice as severe as among men over 65 (Chart 1). The current Social Security program recognizes this problem, and its benefit structure compensates for two important characteristics of women: They are likely to have earned less than men, and they are likely to live longer. Privatization proposals currently being considered make no provision for these differences, and thus would make the poverty problem for women even worse.

Chart 1. Poverty Status of Persons 65 Years and Older by Sex, 1995

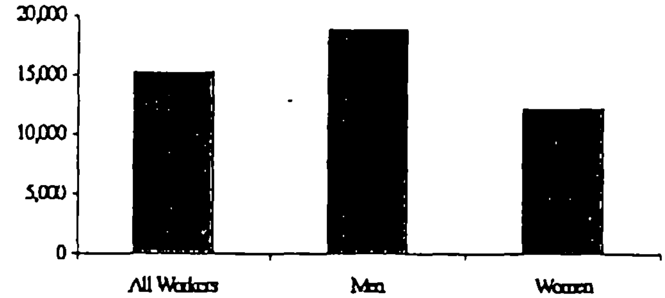


Source: U.S. House of Representatives, Committee on Ways and Means, *1998 Green Book*, May 19, 1998, Table A-6

Although the percentage of working-age women who hold jobs is much higher now than when Social Security was new (60 percent today versus 28 percent in 1940), their careers continue to be different. Women tend to spend fewer years in the workforce than men, since they interrupt their careers to care for young children or elderly parents. For the same reasons, women are also more likely to work at part-time rather than full-time jobs. And even when they work full time, women are likely to be paid less than men. As a result, median earnings for women are far below those for men (Chart 2).

A system relying even in part on personal savings accounts would perpetuate these differences into retirement. Unless special provisions were enacted, a woman's overall retirement benefit would depend on her contributions into her personal account and the earnings on those contributions. Because of lower earnings and less time in the labor force, these contributions and earnings would, on average, produce very low retirement benefits.

Chart 2. Median Earnings of Workers Covered by Social Security, 1994



Source: From the Social Security Administration website, online version of Soci Security Bulletin, *Annual Statistical Supplement, 1997*, Table 4.B6, see: http://www.ssa.gov/statistics/supp97/pdf/t4b6.pdf (as of September 8, 1998).

Although Social Security's benefit rules are gender-neutral, they are particularly helpful for women. First, the progressive benefit formula provides proportionately higher benefits for low earners than for high earners. Second, for the woman who spends her career taking care of her family, Social Security provides a retirement benefit equal to 50 percent of her spouse's benefit. Third, for the homemaker who becomes divorced after at least 10 years of marriage, Social Security provides a retirement benefit based on her former spouse's benefits. Fourth, for the older woman whose husband dies, Social Security provides widow's benefits equal to 100 percent of her husband's benefits. Fifth, if a younger widow's children are getting survivors' benefits, she also receives benefits while she is caring for them and not working.

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

In addition to providing benefits to compensate for lower lifetime earnings, Social Security has two features that compensate for the fact that women live longer than men. Life expectancy at

age 65 is currently 19.2 years for women compared to 15.6 years for men (Table 1). Because Social Security pays benefits for life, it supports women who outlive their spouses. And because benefits are adjusted annually for changes in the cost of living, their buying power is protected against being eroded by inflation — a protection that increases in importance with every passing year. Without such protection, even a modest 3 percent inflation rate cuts the purchasing power of a $100 benefit to $74 after 10 years and to $55 after 20 years.

Table 1. Life Expectancy at Age 65, for Individuals Reaching 65 in Selected Years, 1997-2025

	Life Expectancy (in Years)	
Year	Male	Female
1997	**15.6**	**19.2**
2005	16.0	19.5
2015	16.4	19.8
2025	16.8	20.2

Source: *1998 Green Book*, Table 1-53

With personal retirement accounts, on the other hand, benefits are not automatically converted to a lifetime annuity or protected against being diminished by inflation. If individuals receive their money in a lump sum, they risk exhausting their assets before they die — a risk that is compounded by the absence of inflation protection. In theory, annuity and inflation protection could be purchased separately, but private annuities are very expensive to purchase and inflation-adjusted annuities are nonexistent in the United States.

In short, the present Social Security system offers a range of protections — progressive benefits formula, dependents' benefits, lifetime benefits, and inflation adjustments — that are of great importance to women and are not duplicated by any of the proposals to privatize the system. These are established rights, promised by law. Women should be very reluctant to give them up for an untried system that relies on individual investments for even part of their basic retirement income.

ALICIA H. MUNNELL

Privatization plans hit women hardest

Proposals to replace some or all of the existing Social Security program with a new system of personal retirement accounts would undermine the financial security of older women.

Poverty among American women over 65 is already twice as severe as among men over 66. The current Social Security program recognizes this problem, and its benefits structure compensates for two important characteristics of women: They are likely to have earned less than men, and they are likely to live longer. Most privatization proposals make no provision for these differences and would thus make the poverty problem even worse.

Although the percentage of working-age women who hold jobs is much higher now than when Social Security was new (60 percent today versus 28 percent in 1940), their careers continue to be different. Women tend to spend fewer years in the work force than men, since they interrupt their careers to care for young children or elderly parents. For the same reason, women are also more likely to work at part-time rather than full-time jobs. And even when they work full-time, women are likely to be paid less than men.

A system relying even in part on personal savings accounts would perpetuate these differences into retirement. Unless special provisions were enacted, a woman's overall retirement benefit would depend on her contributions into her personal account and the earnings on those contributions. Because of lower earnings and less time in the labor force, these contributions and earnings would, on average, produce very low retirement benefits.

Although Social Security's benefit rules are gender-neutral, they are particularly helpful for women because:

- The progressive benefit formula provides proportionately higher benefits for low earners than for high earners.
- For the woman who spends her career taking care of her family, Social Security provides a retirement benefit equal to 60 percent of her spouse's benefit.
- For the homemaker who becomes divorced after at least 10 years of marriage, Social Security provides a retirement benefit based on her former spouse's benefits.
- For the older woman whose husband dies, Social Security provides widow's benefits equal to 100 percent of her husband's benefits.

Social Security compensates for extra costs of women.

- If children are getting survivors' benefits, younger widows also receive benefits based on their husbands' earnings while they are caring for the children and not working.

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

In addition to providing benefits to compensate for lower lifetime earnings, Social Security has two features that compensate for the fact that women live longer than men. Life expectancy at age 66 is currently 19.2 years for women compared with 16.7 years for men. Because Social Security pays benefits for life, it supports women who outlive their spouses. And because benefits are adjusted annually for changes in the cost of living, their buying power is protected against being eroded by inflation – a protection that increases in importance with every passing year.

By contrast, personal retirement account benefits are not automatically converted to a lifetime annuity or protected against being diminished by inflation. If individuals receive their money in a lump sum, they risk exhausting their assets before they die – a risk that is compounded by the absence of inflation protection. In theory, annuity and inflation protection could be purchased separately, but private annuities are very expensive to purchase, and inflation-adjusted annuities are virtually nonexistent in the United States.

In short, the present Social Security system offers a range of protections – progressive benefits formula, dependents' benefits, lifetime benefits, and inflation adjustments – that are of great importance to women and are not duplicated by any of the proposals to privatize the system. These are established rights, promised by law. Women should be very reluctant to give them up for an untried system that relies on individual investments for even part of their basic retirement income.

Alicia H. Munnell is a professor at Boston College's Carroll School of Management. She is a former member of President Clinton's Council of Economic Advisers.

Equities for Social Security: Does It Make Sense?
by Alicia H. Munnell*

Two proposals for expanding Social Security investments to include equities -- one through government-managed individual accounts and the other directly through the trust funds -- elicit very different responses. In fact, the two approaches are remarkably similar. They should raise the same issues. If one distrusts the government and fears that politics will affect investment decisions, neither option should be acceptable. If one trusts the government to set up appropriate mechanisms, then the choice should be direct trust fund investment since it will, by maintaining the commitment to a defined benefit plan, produce the best retirement system done the road.

Investing in equities is not necessary to restore long-run balance to the Social Security program; the projected deficit is small enough that conventional fixes could do the job. But the higher expected return on equity investment does reduce the need for tax increases or benefit cuts and improves the rate of return on Social Security contributions. Thus, many have gravitated towards equity investment as one component of a package to bring the Social Security system into long-term financial balance.

Early in the debate, three alternative approaches were on the table. The most extreme was individually managed private accounts similar to IRAs. The IRA approach has been all but eliminated from consideration because of the extremely high administrative costs associated with setting up 150 million individual accounts. These costs have exceed 20 percent of accumulations in Chile and the United Kingdom, countries that have introduced a system of individual accounts, and could be even higher in the U.S. given the small size of the average account.

The remaining candidates are government-managed individual accounts and direct trust fund investment. A system of government-managed individual accounts would work very much like the existing Thrift Saving Plan, which Congress set up a dozen years ago as part of the pension plan for federal employees. The federal government would deposit a worker's contributions in an individual account and, following the worker's preferences, allocate the money among a designated series of index equity funds, bond funds, and fixed-income investments. In the case of direct trust fund investment, the government would invest a portion of payroll tax receipts in an appropriate broad market index, such as the Russell 3000 or the Wilshire 5000.

Those who fundamentally do not trust the government should find neither option appealing. Opponents of investing in equities through the trust funds contend that the government might use its equity holdings to directly influence corporate decisions and might also invest on the basis of social rather than risk and return considerations. For example, the current controversy over tobacco litigation might create pressure to take tobacco holdings out of the index. But note that a system of government-administered

* The author is the Peter F. Drucker Professor of Management Sciences at Boston College Carroll School of Management. Prior to that she was a Member of President Clinton's Council of Economic Advisers and Assistant Secretary of the Treasury for Economic Policy.

individual accounts also requires the government to designate a series of index equity funds for investment. Hence, questions about which stocks to include in the indexes, and how shares are to be voted are just as much issues for the government-administered individual accounts are as for the centrally managed approach. No one wants the government in the business of picking stocks and voting proxies. Anyone who believes that the government will not be able to structure arrangements to avoid this type of activity should oppose any equity investment for Social Security.

Those who do trust the government to design a structure to insulate investments from politics -- through establishing an independent advisory board, picking a broad-based index, and delegating voting rights to pension fund managers -- should favor the approach that will produce the best retirement system for future generations.

Using that criterion, the economics argue strongly for direct trust fund investment and against government-managed individual accounts. Individual accounts would more than double the cost of the current Social Security system, and they would make retirement income unpredictable. Another weakness of such plans is that, although proponents argue against early withdrawals, the law would be changed over time to allow individuals access to these funds before retirement, so that retirees and their families would end up with inadequate retirement income. Individual accounts also would undermine the provisions in the Social Security program that protect low-income workers and women.

In contrast, accumulating reserves in the Social Security trust funds and investing part of those reserves in equities offers many of the advantages of individual accounts without the risks and costs. It ensures predictable retirement incomes, and it keeps transaction and reporting costs to a minimum, producing higher net returns on equity investments than individual accounts. Those who oppose trust fund investing because they fear the government will not be able to insulate investment decisions from politics should question why they are sanguine about government-managed individual accounts.

Maureen T. Shea 11/24/98 12:41:25 PM

Record Type: Record

To: Katharine Button/WHO/EOP

cc:

Subject: USCC

for Social Security conf.

Cynthia Phillips
US Catholic Conference
202-541-3235

Linda Tarr-Whelan
Center for Policy Alternatives

THE WHITE HOUSE

WASHINGTON

November 22, 1998

MEMORANDUM FOR DISTRIBUTION

FROM: GENE SPERLING
JONATHAN KAPLAN

SUBJECT: INVITATION LIST FOR THE WHITE HOUSE CONFERENCE ON SOCIAL SECURITY

Working with the Office of Public Liaison, as well as numerous other White House offices, we have developed the attached draft list of roughly 225 invitees to the White House Conference on Social Security on December 8 and 9. This group of experts, constituency groups, state and local officials, and others will make up the audience for the Conference, which will be held at the Marriott Wardman.

Because we need to begin inviting people on Tuesday, we would very much appreciate your feedback by COB Monday. Please provide your feedback to Jon Kaplan in OEOB 221 (6-5360). Thank you for helping us out with this short deadline.

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Attachment

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Julian	Bond	National Assn for the Advancement of Colored People	Chairman	African American	OPL	Participant	Male	AA	DC
A	Kenneth	Chenault	American Express Company	President and CEO	African American	OPL	Participant	Male	AA	NY
A	Dorothy	Height	National Council Of Negro Women	Former President	African American	OPL	Participant	Female	AA	DC
A	Wade	Henderson	Leadership Conference On Civil Rights	Executive Director	African American	OPL	Participant	Male	AA	DC
A	Jesse	Jackson	Rainbow/ P U S H Coalition	President and CEO	African American	OPL/ NEC	Participant	Male	AA	IL
A	Kweisi	Mfume	National Association For The Advancement Of Colored People	President	African American	OPL	Participant	Male	AA	DC
A	Hugh	Price	National Urban League	President and CEO	African American	OPL	Participant	Male	AA	DC
A	Yvonne	Scruggs-Leftwich	Black Leadership Forum	Executive Director	African American	OPL	Participant	Female	AA	DC
A	Sam	Simmons	National Caucus And Center On Black Aged, Inc	President & CEO	African American	OPL	Participant	Male	AA	DC
A	Eddie	Williams	Joint Center For Political And Economic Studies	President	African American	OPL/ NEC	Participant	Male	AA	DC
A	Phyllis	Campbell	U.S. Bank of Washington	President	Asian	OPL	Participant	Female	A	WA

WHCSS- A group by constituer cy

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Penny	Fukui	Woodburn Co.	Principal	Asian	OPL	Participant	Female	A	WA
A	Chung-wha	Hong	National Korean American Service And Education Consortium, Inc.	Executive Director	Asian	OPL	Participant	Male	A	NY
A	Karen	Narasaki	National Asian Pacific American Legal Consortium	Executive Director	Asian	OPL	Participant	Female	A	DC
A	Beth	Renge	Renge Securities And Co.	President	Asian	OPL	Participant	Female	A	CA
A	Larry	Bossidy	Allied Signal	Chairman & CEO	Business	OPL	Participant	Male	C	NJ
A	Marshall	Carter	State Street Bank	Chairman	Business	NEC	Participant	Male	C	MA
A	Thomas	Donahue	U S Chamber Of Commerce	President	Business	OPL	Participant	Male	C	DC
A	Jack	Faris	National Federatrion Of Independent Businesses	President	Business	SSA	Participant	Male	C	DC
A	Matthew	Fink	Investment Company Institute	President	Business	OPL/ SSA/ NEC	Participant	Male	C	DC
A	Janice	Gregory	ERISA Industry Committee	VP.	Business	NEC	Participant	Female		
A	Patricia	Hanegan	Business Roundtable	Executive Director	Business	SSA	Participant	Female	C	DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Jerry	Jasinowski	N A M	President	Business	SSA	Participant	Male	C	DC
A	Charles	Kolb	Committee For Economic Development	President	Business	SSA	Participant	Male	C	
A	Dana	Mead	Tenneco	Chairman & CEO	Business	OPL	Participant	Male	C	CT
A	Pete	Peterson	Blackstone Group	Chairman	Business	NEC	Participant	Male	C	NY
A	Terje	Anderson	National Association Of People With A I D S		Disability	OPL	Participant	Male	C	DC
A	Marca	Bristo	National Council On Disability	Chair	Disability	SSA/ NEC	Participant	Female	C	DC
A	Tony	Coehlo	President's Commission On Adults With Disabilities	Chair	Disability	SSA	Participant	Male	E	NY
A	Justin	Dart	Justice For All		Disability	OPL	Participant	Male	C	DC
A	Dan	Fisher	National Empowerment Center	Executive Director	Disability	OPL	Participant	Male	C	MA
A	Marty	Ford	The Arc	Assistant Director	Disability	OPL	Participant	Female	C	DC
A	Barbara	Knowlan	Barrier Breakers		Disability	OPL	Participant	Female	C	MN

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Mark	Richert	American Foundation For The Blind		Disability	OPL	Participant	Male	C	DC
A	George	Watters			Disability	OPL	Participant	Male	C	ID
A	Susan	Webb	Arizona Bridge To Independent Living	Executive Director	Disability	OPL	Participant	Female	C	AZ
A	Henry	Aaron	Brookings Institute	Scholar	Expert	NEC	Participant	Male	C	DC
A	Robert	Ball	Fmr. SSA Comm.	Consultant	Expert	NEC	Participant	Male	C	VA
A	Joann	Barnhart	Barnhart Inc, Independent Co.	SS Advisory Board	Expert	SSA	Participant	Female	C	DC
A	Sam	Beard	Economic Security 2000	President	Expert	SSA/ NEC	Participant	Male	C	DE
A	Bradley	Belt	CSIS	Ex-Director	Expert	NEC	Participant	Male	C	DC
A	Michael	Boskin	Hoover Institution	Scholar	Expert	NEC	Participant	Male	C	DC
A	Stuart	Butler	Heritage Foundation	Vice President	Expert	NEC	Participant	Male	C	DC
A	Francis	Cavanaugh	Federal Employees Retire System	Consultant	Expert	NEC	Participant	Female	C	VA

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Shirley	Chater	Social Security	Former Comm.	Expert	NEC	Participant	Female	C	CA
A	Barber	Connable	Former Congressman	Former Head of World Bank	Expert	NEC	Participant	Male	C	
A	Carol	Cox-Wait	Comm. Resp. Budget	President	Expert	NEC	Participant	Female	C	DC
A	David	Cutler	Harvard	Economist	Expert	NEC	Participant	Male	C	MA
A	Dick	Darman			Expert	NEC	Participant	Male	C	CT
A	Peter	Diamond	M I T	Professor	Expert	NEC	Participant	Male	C	MA
A	David	Ellwood	Harvard	Economist	Expert	NEC	Participant	Male	C	MA
A	Louis	Enoff	Grassley SS wk. group	Consultant	Expert	NEC	Participant	Male	C	DC
A	Jeff	Faux	Economic Policy Institute	President	Expert	NEC	Participant	Male	C	DC
A	Martin	Feldstein	National Bureau of Economic Research	Economist	Expert	NEC	Participant	Male	C	MA
A	Peter	Ferrara	Amer. For Tax Reform	Gen. Counsel	Expert	NEC	Participant	Male	C	DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Edith	Fierst	Fierst & Moss, OWL	Attorney	Expert	NEC	Participant	Female	C	DC
A	Betty	Friedan			Expert	SSA	Participant	Female	C	NY
A	Al	From	SS Advisory Board	Social Security Advisory Board	Expert	SSA	Participant	Male	C	DC
A	Ronald	Gebhardtsbauer	American Academy Of Actuaries	Senior Pension Fellow	Expert	OPL/ NEC	Presenter	Male	C	VA
A	Fred	Goldberg, Jr.	Skadden, Arps, Slate, etc	Lawyer	Expert	NEC	Participant	Male	C	DC
A	Richard	Grafmeyer	Ernst & Young / S S Advisory Board	National Director	Expert	NEC	Participant	Male	C	
A	Edward	Gramlich	Federal Reserve Board	Chairman	Expert	NEC	Participant	Male	C	MI
A	Robert	Greenstein	Center on Budget and Policy Priorities	Ex. Director	Expert	NEC	Participant	Male	C	DC
A	John	Gruber	MIT	Economist	Expert	NEC	Participant	Male	C	MA
A	Lori	Hansen	Social Security Advisory Board	Member	Expert	NEC/ SSA	Participant	Female	C	MI
A	Heidi	Hartmann	Institute For Women's Policy Research	Dir. & President	Expert	OPL/ NEC	Participant	Female	C	DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Estelle	James	World Bank		Expert	NEC	Participant	Female	C	DC
A	Tom	Jones	Former TIAA-CREF	President & CEO	Expert	NEC	Participant	Male	AA	NY
A	Steve	Kellison	Variable Annunity Life Insurance Company/Nat. Bur. of Economic Research	VP & Chief Act./S S Board of Trustees	Expert	SSA/ NEC	Participant	Male	C	TX
A	Martha	Keys	Social Security Advisory Board/OWL/ Nat. Multiple Sclerosis Society	Dir. Gvt. Relation/SS Advisory Board	Expert	SSA/ NEC	Participant	Female	C	DC
A	Ken	Kies			Expert	NEC	Participant	Male	C	
A	Kilolo	Kijakazi	Center On Budget And Policy Priorities	Policy Analyst	Expert	NEC	Participant	Female	AA	DC
A	Greg	Kubiak	C S I S		Expert	NEC	Participant	Male	C	DC
A	Pam	Larson	Nasi		Expert	NEC	Participant	Female	C	DC
A	Richard	Leone	Twentieth Century Foundation	President	Expert	NEC	Participant	Male	C	NY
A	Paul	Light	Pew Charitable Trusts	Director	Expert	NEC	Participant	Male	C	PA
A	Lawrence	Lindsey		Former Federal	Expert	NEC	Participant	Male	C	

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Bob	Litan	Brookings Institution		Expert	NEC	Participant	Male	C	DC
A	Carolyn	Lukensmeyer	Americans Discuss Social Security	Executive Director	Expert	OPL/ NEC	Presenter	Female	C	DC
A	Theodore	Marmor	Yale University Political Science Department	Economist	Expert	NEC	Participant	Male	C	CT
A	Will	Marshall	Progressive Policy Institute		Expert	NEC	Participant	Male	C	DC
A	Harlan	Mathews	Lawyer	Former Senator	Expert	NEC	Participant	Male	C	
A	Bruce	Mc Laurey	Committee on Economic Development	Trustee	Expert	NEC/ SSA	Participant	Male	C	
A	Olivia	Mitchell	University of Penn Wharton School	Academic	Expert	NEC	Participant	Female	C	PA
A	Marilyn	Moon	Urban Institute	Researcher/S S Board of Trustees	Expert	NEC/ SSA	Participant	Female	C	DC
A	Stephen	Moore	CATO	Director	Expert	NEC	Participant	Male	C	DC
A	Alicia	Munnell	Boston College-Department of Finance	For. Asst. Sec.	Expert	NEC	Participant	Female	C	MA
A	Robert	Myers	Ret. Chief Actuary SSA	Actuary	Expert	NEC	Participant	Male	C	VA

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Bonnie	O'Day	N R H Research Center	Assistant Director	Expert	OPL	Participant	Female	C/D	DC
A	Van Doorn	Ooms	Committee For Economic Development	Senior Vice president	Expert	NEC	Participant	Male		DC
A	Norm	Ornstein	A E I	Resident Scholar	Expert	NEC	Participant	Male	C	NY
A	Michael	Orszag	University of London	Professor	Expert	NEC	Participant	Male	C	
A	Rudolph	Penner	Urban Institute		Expert	NEC	Participant	Male	C	DC
A	Martha	Phillips	Concord Coalition	Exec. Director	Expert	NEC	Participant	Female	C	DC
A	Jose	Pinero	CATO		Expert	NEC	Participant	Male		
A	Wendell	Primus	Center on Budget & Policy Priorities	Dir. Income Security	Expert	NEC	Participant	Male	C	DC
A	Franklin	Raines	Fannie Mae	Chair	Expert	NEC	Participant	Male	AA	DC
A	Robert	Reischauer	Brookings Institute	Scholar	Expert	NEC	Participant	Male	C	DC
A	Virginia	Reno	NASI	Director	Expert	NEC	Participant	Female	C	DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Stanford	Ross	Social Security Advisory Board/arnold & Porter	Chair/Lawyer	Expert	SSA	Participant	Male	C	DC
A	Dallas	Salisbury	EBRI	President	Expert	NEC	Participant	Male	C	DC
A	Andrew	Samwick	Dartmouth College	Economist	Expert	NEC	Participant	Male	C	NH
A	Sylvester	Schieber	Social Security Advisory Board/Watson-Wyatt	Member/VP	Expert	SSA/ NEC	Participant	Male	C	DC
A	Karl	Scholz	U. Wisconsin	Economist	Expert	NEC	Participant	Male	C	WI
A	Robert	Shapiro	Columbia University	Academic	Expert	NEC	Participant	Male	C	NY
A	Eugene	Steuerle	Urban Institute	Researcher	Expert	NEC	Participant	Male	C	DC
A	Fernando	Torres-Gil	School Of Public Policy And Social Research, U C L A	Associate Dean	Expert	OPL	Participant	Male	H	CA
A	Carolyn	Weaver	AEI	Project Director	Expert	NEC	Participant	Female	C	DC
A	David	Wise	Kennedy School Of Government, Harvard Univ.	Professor	Expert	NEC	Participant	Male	C	MA
A	Kirsten	Kingdon	Parents And Friends Of Gays And Lesbians	Executive Director	Gay And Lesbian	OPL	Participant	Female		DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Kerry	Lobel	National Gay And Lesbian Task Force	Executive Director	Gay And Lesbian	OPL	Participant	Female		DC
A	Beverly	Malone	American Nurses Association	President	Health	OPL	Participant	Female	AA	DC
A	Suleika	Cabrera	Institute For Puerto Rican/ Hispanic El	Executive Director	Hispanic	OPL	Participant	Female	H	
A	Enrique	Dovalina	League of United Latin American Citizens	National President	Hispanic	OPL	Participant	Male	H	
A	Manuel	Mirabal	National Puerto Rican Coalition	President	Hispanic	OPL	Participant	Male	H	
A	Cecellia	Munoz	La Raza	Deputy Vice President	Hispanic	SSA	Participant	Female	H	DC
A	Josephine	Nieves	National Association Of Social Workers	Executive Director	Hispanic	OPL	Participant	Female	H	
A	Dennis	Rivera	Nat'l HSS Employment Union, SEI	President	Hispanic	OPL	Participant	Male	H	NY
A	Elisa	Sanchez	MANA/National Latina Organization	President/Executive Director	Hispanic	OPL	Participant	Female	H	DC
A	Marta	Sotomayor	National Hispanic Council On Aging	President	Hispanic	OPL/ NEC	Participant	Female	H	
A	Raul	Yzaguirre	National Council Of La Raza	President & Director	Hispanic	OPL/ NEC	Participant	Male	H	

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Morton	Bahr	Communications Workers Of America	President	Labor	OPL	Participant	Male		DC
A	George	Becker	United Steelworkers Of America	President	Labor	OPL	Participant	Male		PA
A	Clayola	Brown	Amalgamated Service & Allied Industries Joint Board	International Vice President	Labor	OPL	Participant	Female	AA	NY
A	Robert	Chase	National Education Association	President	Labor	SSA	Participant	Male	C	DC
A	Linda	Chavez-Thompson	A F L - C I O	Executive Vice President	Labor	OPL	Participant	Female	H	DC
A	Sandra	Feldman	American Federation Of Teachers	President	Labor	OPL	Participant	Female		DC
A	Robert	Georgine	Building And Construction Trades Department	President	Labor	OPL	Participant	Male	C	DC
A	Joe	Greene	American Federation Of School Administrators	President	Labor	OPL	Participant	Male	AA	DC
A	Bobby	Harnage, Sr	American Federation Of Government Employees, Afl-cio	National President	Labor	OPL	Participant	Male	C	DC
A	Sumi	Haru	Screen Actors Guild	National Recording Secretary	Labor	OPL	Participant	Female	A	CA
A	Carroll	Haynes	International Brotherhood Of Teamsters Local 237	President	Labor	OPL	Participant	Male	AA	NY

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Roger	Hickey	Campaign For America's Future	Executive Director	Labor	NEC/ SSA	Participant	Male		
A	Gloria	Johnson	Department Of Social Action, International Union Of Electronic, Electrical,	Director	Labor	OPL	Participant	Female	AA	DC
A	John	Joyce	International Union Of Bricklayers And Allied Craftsmen	President	Labor	OPL	Participant	Male		DC
A	William	Lucy	Coalition of Black Trade Unionists/Am. Fed. of State, County & Municipal Employ.	President/Secretary-Tre asurer	Labor	OPL	Participant	Male	AA	DC
A	Leon	Lynch	United Steelworkers Of America	Vice President	Labor	OPL	Participant	Male		PA
A	Jay	Mazur	Union Of Needletrades, Industrial & Textile Employees	President	Labor	OPL	Participant	Male		NY
A	Gerald	Mc Entee	Am. Fed.of State, County & Municipal Employ	President	Labor	OPL	Participant	Male	C	DC
A	Arturo	Rodriguez	United Farm Workers Of America	President	Labor	OPL	Participant	Male	H	CA
A	Gerry	Shea	A F L - C I O	Assistant to the President	Labor	SSA	Participant	Male	C	DC
A	John	Sweeney	A F L - C I O	President	Labor	OPL	Participant	Male	C	DC
A	Robert	Tobias	Nat'l Treasurers Employee Union	President	Labor	SSA	Participant	Male	C	MD

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Richard	Trumka	A F L - C I O	Secretary-Treasurer	Labor	OPL	Participant	Male	C	DC
A	Boyd	Young	United Paperworks International Union	President	Labor	OPL	Participant	Male		TN
A	Diana	Aviv	Council Of Jewish Federations	Executive Vice President- Public Policy	Religious	OPL	Participant	Female	E	DC
A	Kay	Bengston	Evangelical Lutheran Church In America	Chair	Religious	OPL	Participant	Female	C	DC
A	Sharon	Daly	Catholic Charities U S A	Deputy for the President for Social Policy	Religious	OPL/ SSA	Participant	Female	C	VA
A	Cy	Carpenter	National Farmers Union	Past President	Rural	OPL	Participant	Male	C	MN
A	Mel	Aaronson	United Federation Of Teachers	Treasurer	Senior	OPL	Participant	Male		NY
A	Bea	Bacon	National Silver Haired Congress	Chairman	Senior	OPL	Participant	Female	C	KS
A	Pat	Bandich		Volunteer	Senior	OPL	Participant	Female	C	CO
A	Robert	Blancato	Matz- Blancato & Associates/ Matz Shea Blancato	Executive Director	Senior	OPL/ NEC	Participant	Male	E	DC
A	Deborah	Briceland-Bett s	Older Womens League	Executive Director	Senior	OPL	Participant	Female	C	DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Paul	Bridgewater	National Caucus & Center on Black Aged, Inc.		Senior	OPL	Participant	Male	AA	MI
A	Sandra	Butler	United Seniors Association	President	Senior	SSA	Participant	Female	C	VA
A	Eugene	Callender	National Caucus and Center on Black Aged	Chair	Senior	OPL	Participant	Male	AA	NY
A	Yung-Ping	Chen	National Counil On Aging	Chair in Gerontology	Senior	OPL	Participant	Male	A	MA
A	James	DeLaCruz	Quinault Indian Nation	Senior President	Senior	OPL	Participant	Male	NA	WA
A	Neetu	Dhallan-Gray	National Assn Of Area Agencies On Aging	Executive Director	Senior	OPL	Participant	Male	E	MD
A	Jonathan	Edwards	Retirement Security Alliance	Executive Director	Senior	SSA	Participant	Male	C	DC
A	Frankie	Freeman	National Council On Aging	Attorney	Senior	OPL	Participant	Female	AA	MO
A	Burton	Fretz	National Senior Citizens Law Center	Executive Director	Senior	SSA/ NEC	Participant	Male	C	DC
A	Chris	Gianopoulos	National Assn Of State Units On Aging	Director, Bureau of Elder & Adult Services	Senior	OPL	Participant	Female	E	ME
A	Lou	Glasse	OWL	Former President	Senior	OPL	Participant	Female	C	NY

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Elinor	Guggenheimer	Senior Centers And Services Of New York	Founding President Council	Senior	OPL	Participant	Female	C	NY
A	Gordon	Jones	Seniors Coalition	President	Senior	SSA	Participant	Male		
A	George	Kourpias	National Council Of Senior Citizens	President	Senior	OPL		Male	E	MD
A	Carmela	Lacayo	Asociacion Nacional Pro Personas Mayores	President & CEO	Senior	NEC	Participant	Female	H	CA
A	Chuck	Loveless	American Federation Of State, County & Munipal Employees	Director Department of Legislation	Senior	OPL	Participant	Male	C	DC
A	Peter	Luciano	National Alliance Of Senior Citizens	CEO	Senior	SSA	Participant	Male	E	DC
A	James	Martin	60 Plus	President	Senior	NEC/ SSA	Participant	Male	C	DC
A	Martha	Mc Steen	Nat'l Comm. To Preserve Social Security & Medicare	President	Senior	OPL/ NEC	Participant	Female	C	DC
A	Evelyn	Morton	American Association Of Retired Persons	Legislative Representative	Senior	OPL	Participant	Female	C	DC
A	Robert	Normandie	National Ass. Of Retired Federal Employees		Senior	OPL	Participant	Male	C	VA
A	Betty	Ongley	Older Women League	Board President	Senior	OPL	Participant	Female	C	DC

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
A	Joseph	Perkins	American Association Of Retired Persons	President	Senior	OPL	Participant	Male	C	DC
A	Steve	Protulis	National Council Of Senior Citizens	Executive Director	Senior	OPL	Participant	Male	E	MD
A	Max	Richtman	Nat'l Comm. To Preserve Social Security & Medicare	Executive Vice-President	Senior	OPL	Participant	Male	C	DC
A	Michael	Rodgers	Am Ass. Of Homes & Svcs. For The Aging	Senior Vice President	Senior	OPL	Participant	Male	C	DC
A	John	Rother	A A R P	Director of Legislation & Public Policy	Senior	OPL/ NEC	Participant	Male	C	DC
A	Jule	Sugarman	Gray Panthers	Executive Director	Senior	SSA	Participant			
A	Rosalie	Whelan	Service Emp. Int. Union	Ret. Members Program Coordinator	Senior	OPL	Participant	Female		DC
A	Ron	Allen	Jamestown S'Klalum	Chairman	State/local	IGA	Participant	Male	NA	WA
A	Norma	Anderson	SS Task Force, Nat'l Conference of State Leg.	State Senator, Co-Chair	State/local	IGA	Participant	Female		CO
A	James	Burton	California Public Employees' Retirement System	CEO	State/local	POL	Participant	Male	C	CA
A	Thomas	Carper	National Governors Association	Chair	State/local	IGA	Participant	Male	C	DE

WHCSS- A group by constituency

Priority	F. Name	L. Name	Organization	Title	Constituency Group	Ref. Dep.	Presenter or Participant	Gender	Race	State
[redacted]										
A	Nancy	Graham		Mayor	State/local	IGA	Participant	Female	C	FL
A	John	Hurson	SS Task Force, Nat'l Conference of State Leg.	Co-Chair	State/local	IGA	Participant	Male		MD
A	Ron	Kirk	US Conference of Mayors Lead on SS	Mayor - Dallas	State/local	IGA	Participant	Male	AA	TX
A	Michael	Leavitt	National Governers Association	Vice-Chairman	State/local	IGA	Participant	Male	C	UT
A	Don	Miller	National Council Teachers Retirement System	President	State/local	IGA	Participant	Male	C	
A	Kevin	Murray	California Legislative Black Caucus	Chairman	State/local	IGA	Participant	Male	AA	CA
A	Carolyn	Ratto	League Of California Cities	President	State/local	IGA	Participant	Female		CA
A	Yvonne	Richardson	Louisiana Association Of Public Employee Retirement Systems	President	State/local	POL	Participant	Female	C	LA
A	Arturo	Vargas	Nat'l Association of Latino Elected & Appointed Officials	Executive Director	State/local	IGA	Participant	Male	H	CA
A	Betty Lou	Ward	National Association Of Counties	President	State/local	IGA	Participant	Female	C	NC

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A	Joe	Carollo		Mayor	V P	VP	Participant	Male	H	FL
A	Marion	Copenhaver	N H State Rep From Etna		V P	VP	Participant	Female	C	
A	Preston	Daniels	City Of Des Moines	Mayor	V P	VP	Participant	Male	AA	IA
A	Joyce	Dugan	Eastern Band of Cherokee Indians (NC)	Principal Chief	V P	VP	Participant	Female	NA	NC
A	Martha	Fuller- Clark	New Hampshire State Rep From Portsmouth	State Representative	V P	VP	Participant	Female	C	NH
A	Herky	Harris	Ivesco Capital Management, Inc.		V P	VP	Participant	Male	C	
A	William	Lambert	United Teachers		V P	VP	Participant	Male	C	CA
A	Judy	Lichtman	National Partnership for Women & families	President	V P	VP	Participant	Female	C	DC
A	Harold	Schaitberger	International Assoc. Of Firefighters	Exec. Assistant to the Gen. Pres.	V P	VP	Participant	Male	C	DC
A	Larry	Seidman	University Of Delware		V P	VP	Participant	Male	C	DE
A	Susan	Bianchi-Sand	Council Of Women	President	Women	OPL	Participant	Female	C	DC

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A	Nancy	Campbell	National Women's Law Center	Co-President	Women	OPL	Participant	Female	C	DC
A	Cindy	Hounsell	Women's Institute For A Secure Retirement	Executive Director	Women	OPL	Participant	Female	C	DC
A	Karen	Nussbaum	A F L - C I O	Director, Working Women's Department	Women	OPL	Participant	Female	C	DC
A	Carole	Roberts	Secure Retirement Coalition	Chair	Women	OPL	Participant	Female	C	DC
A	Gail	Shaffer	Business & Professional Women	CEO	Women	OPL	Participant	Female	C	DC
A	Ellie	Smeal	Feminist Majority Foundation	President	Women	OPL	Participant	Female	C	VA
A	Jane	Smith	National Council Of Negro Women	President and CEO	Women	OPL	Participant	Female	AA	DC
A	Nancy	Zirkin	A A U W	Government Relations Director	Women	OPL	Participant	Female	C	DC
A	Michael	Beattie	National Council Of Students With Disabilities	Director	Youth	SSA/ NEC	Participant	Male	C	VA
A	Kristen	Konefal	U N I T E Political Dept.		Youth	OPL	Participant	Female		NY
A	Liz	Kramer	Campaign For America's Future	Deputy Director	Youth	OPL/ NEC	Participant	Female	C	DC

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A	Heather	Lamm	Third Mellinium	Chairperson	Youth	OPL	Participant	Female	C	CA
A	Kamal	Latham	Kennedy School Of Government/ Third Millenium	Graduate Student	Youth	OPL	Participant	Male	AA	NY
A	Adam	Luna	2030 Center	Program Director	Youth	NEC/ OPL	Participant	Male	C	DC
A	Hans	Riemer	2030 Center	Founder and Director	Youth	OPL		Male	C	DC
A	Eric	Rodriguez	National Council Of La Raza	Senior Policy Analyst	Youth	OPL	Participant	Male	H	
A	Dennis	Rogers	Black Youth Vote!	National Coordinator	Youth	OPL/ NEC	Participant	Male	AA	DC
A	Anthony	Samu	United States Student Association	President	Youth	OPL/ NEC	Participant	Male	A	
A	Eric	Seidel	U S Junior Chamber Of Commerce	President	Youth	OPL	Participant	Male	C	OK
A	Richard	Thau	Third Millenium	Exec. Director	Youth	OPL/ NEC	Participant	Male	C	NY

CENTER ON BUDGET AND POLICY PRIORITIES

Statement of Robert Reischauer at the White House Forum on Social Security

Albuquerque, New Mexico
July 27 1998[1]

Many workers, particularly younger ones, are worried that they may not get a very good return on the payroll taxes that they and their employers are sending in to the Social Security system. They wonder whether some other type of pension system might give them a better payback than Social Security promises.

The answer to their question, of course, is "yes." A reformed and strengthened version of the current system can give workers better returns than those of the current system or those of any of the alternative structures that have been proposed.

To see why this is the case we need to look at the three reasons why returns on Social Security payroll taxes are relatively low for today's workers. One of these reasons, no rational person should want to change; another we can do nothing about; and the third we can and should act to correct. If we take this corrective step, Social Security will be able to pay higher average benefits than any of the various privatization plans could pay for similar levels of contributions.

The first reason why today's workers will get a rather low return on the Social Security taxes they pay is that a portion of their contributions — about $1 out of every $4 — goes not for retirement purposes but rather to provide disability and survivors insurance. Just like the fire insurance we all have on our homes and the collision insurance we purchase for our cars and trucks, none of us should want to have a high return on this portion of our contributions because that would mean that we had suffered either a disability that kept us from working or the death of a breadwinner.

The second reason why future retirees can expect low returns arises because most payroll tax dollars we send in for retirement purposes — some $13 out of every $15 — are used immediately to pay benefits to current retirees, our parents and grandparents. This practice dates back to 1939

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[1] Robert D. Reischauer is a senior fellow at the Brookings Institution. He is the former director of the Congressional Budget Office and is co–author of a forthcoming Century Fund-Brookings guide to the debate on Social Security reform. He also is a member of the Board of Directors of the Center on Budget and Policy Priorities.

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Why Social Security Privatization Would Hurt Women

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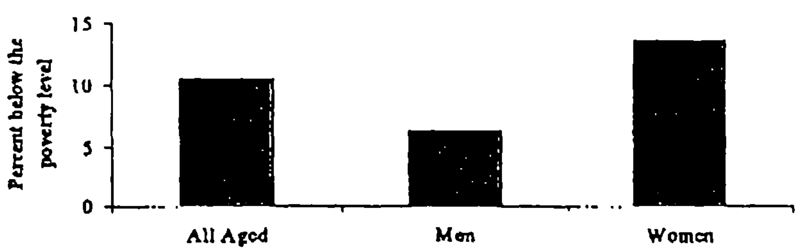
Proposals to replace some or all of the existing Social Security program with a new system of personal retirement accounts would undermine the financial security of older women. Poverty among women over 65 is already twice as severe as among men over 65 (Chart 1). The current Social Security program recognizes this problem, and its benefit structure compensates for two important characteristics of women: They are likely to have earned less than men, and they are likely to live longer. Privatization proposals currently being considered make no provision for these differences, and thus would make the poverty problem for women even worse.

Chart 1. Poverty Status of Persons 65 Years and Older by Sex, 1995

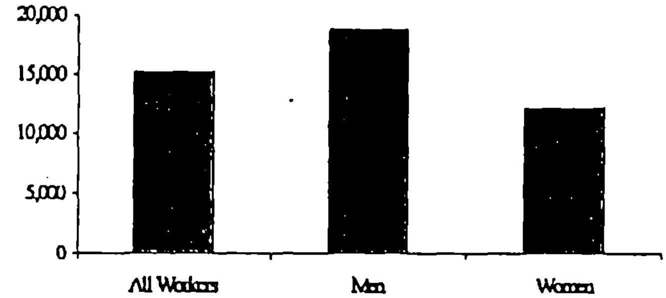


Source: U.S. House of Representatives, Committee on Ways and Means, *1998 Green Book*, May 19, 1998, Table A-6

Although the percentage of working-age women who hold jobs is much higher now than when Social Security was new (60 percent today versus 28 percent in 1940), their careers continue to be different. Women tend to spend fewer years in the workforce than men, since they interrupt their careers to care for young children or elderly parents. For the same reasons, women are also more likely to work at part-time rather than full-time jobs. And even when they work full time, women are likely to be paid less than men. As a result, median earnings for women are far below those for men (Chart 2).

A system relying even in part on personal savings accounts would perpetuate these differences into retirement. Unless special provisions were enacted, a woman's overall retirement benefit would depend on her contributions into her personal account and the earnings on those contributions. Because of lower earnings and less time in the labor force, these contributions and earnings would, on average, produce very low retirement benefits.

Chart 2. Median Earnings of Workers Covered by Social Security, 1994



Source: From the Social Security Administration website, online version of Social Security Bulletin, *Annual Statistical Supplement, 1997*, Table 4.B6, see: http://www.ssa.gov/statistics/supp97/pdf/t4b6.pdf (as of September 8, 1998).

Although Social Security's benefit rules are gender-neutral, they are particularly helpful for women. First, the progressive benefit formula provides proportionately higher benefits for low earners than for high earners. Second, for the woman who spends her career taking care of her family, Social Security provides a retirement benefit equal to 50 percent of her spouse's benefit. Third, for the homemaker who becomes divorced after at least 10 years of marriage, Social Security provides a retirement benefit based on her former spouse's benefits. Fourth, for the older woman whose husband dies, Social Security provides widow's benefits equal to 100 percent of her husband's benefits. Fifth, if a younger widow's children are getting survivors' benefits, she also receives benefits while she is caring for them and not working.

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

In addition to providing benefits to compensate for lower lifetime earnings, Social Security has two features that compensate for the fact that women live longer than men. Life expectancy at

age 65 is currently 19.2 years for women compared to 15.6 years for men (Table 1). Because Social Security pays benefits for life, it supports women who outlive their spouses. And because benefits are adjusted annually for changes in the cost of living, their buying power is protected against being eroded by inflation — a protection that increases in importance with every passing year. Without such protection, even a modest 3 percent inflation rate cuts the purchasing power of a $100 benefit to $74 after 10 years and to $55 after 20 years.

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	Life Expectancy (in Years)	
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With personal retirement accounts, on the other hand, benefits are not automatically converted to a lifetime annuity or protected against being diminished by inflation. If individuals receive their money in a lump sum, they risk exhausting their assets before they die — a risk that is compounded by the absence of inflation protection. In theory, annuity and inflation protection could be purchased separately, but private annuities are very expensive to purchase and inflation-adjusted annuities are nonexistent in the United States.

In short, the present Social Security system offers a range of protections — progressive benefits formula, dependents' benefits, lifetime benefits, and inflation adjustments — that are of great importance to women and are not duplicated by any of the proposals to privatize the system. These are established rights, promised by law. Women should be very reluctant to give them up for an untried system that relies on individual investments for even part of their basic retirement income.

ALICIA H. MUNNELL

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Social Security compensates for extra costs of women.

By contrast, personal retirement account benefits are not automatically converted to a lifetime annuity or protected against being diminished by inflation. If individuals receive their money in a lump sum, they risk exhausting their assets before they die – a risk that is compounded by the absence of inflation protection. In theory, annuity and inflation protection could be purchased separately, but private annuities are very expensive to purchase, and inflation-adjusted annuities are virtually nonexistent in the United States.

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Equities for Social Security: Does It Make Sense?
by Alicia H. Munnell*

Two proposals for expanding Social Security investments to include equities -- one through government-managed individual accounts and the other directly through the trust funds -- elicit very different responses. In fact, the two approaches are remarkably similar. They should raise the same issues. If one distrusts the government and fears that politics will affect investment decisions, neither option should be acceptable. If one trusts the government to set up appropriate mechanisms, then the choice should be direct trust fund investment since it will, by maintaining the commitment to a defined benefit plan, produce the best retirement system done the road.

Investing in equities is not necessary to restore long-run balance to the Social Security program; the projected deficit is small enough that conventional fixes could do the job. But the higher expected return on equity investment does reduce the need for tax increases or benefit cuts and improves the rate of return on Social Security contributions. Thus, many have gravitated towards equity investment as one component of a package to bring the Social Security system into long-term financial balance.

Early in the debate, three alternative approaches were on the table. The most extreme was individually managed private accounts similar to IRAs. The IRA approach has been all but eliminated from consideration because of the extremely high administrative costs associated with setting up 150 million individual accounts. These costs have exceed 20 percent of accumulations in Chile and the United Kingdom, countries that have introduced a system of individual accounts, and could be even higher in the U.S. given the small size of the average account.

The remaining candidates are government-managed individual accounts and direct trust fund investment. A system of government-managed individual accounts would work very much like the existing Thrift Saving Plan, which Congress set up a dozen years ago as part of the pension plan for federal employees. The federal government would deposit a worker's contributions in an individual account and, following the worker's preferences, allocate the money among a designated series of index equity funds, bond funds, and fixed-income investments. In the case of direct trust fund investment, the government would invest a portion of payroll tax receipts in an appropriate broad market index, such as the Russell 3000 or the Wilshire 5000.

Those who fundamentally do not trust the government should find neither option appealing. Opponents of investing in equities through the trust funds contend that the government might use its equity holdings to directly influence corporate decisions and might also invest on the basis of social rather than risk and return considerations. For example, the current controversy over tobacco litigation might create pressure to take tobacco holdings out of the index. But note that a system of government-administered

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* The author is the Peter F. Drucker Professor of Management Sciences at Boston College Carroll School of Management. Prior to that she was a Member of President Clinton's Council of Economic Advisers and Assistant Secretary of the Treasury for Economic Policy.

individual accounts also requires the government to designate a series of index equity funds for investment. Hence, questions about which stocks to include in the indexes, and how shares are to be voted are just as much issues for the government-administered individual accounts are as for the centrally managed approach. No one wants the government in the business of picking stocks and voting proxies. Anyone who believes that the government will not be able to structure arrangements to avoid this type of activity should oppose any equity investment for Social Security.

Those who do trust the government to design a structure to insulate investments from politics -- through establishing an independent advisory board, picking a broad-based index, and delegating voting rights to pension fund managers -- should favor the approach that will produce the best retirement system for future generations.

Using that criterion, the economics argue strongly for direct trust fund investment and against government-managed individual accounts. Individual accounts would more than double the cost of the current Social Security system, and they would make retirement income unpredictable. Another weakness of such plans is that, although proponents argue against early withdrawals, the law would be changed over time to allow individuals access to these funds before retirement, so that retirees and their families would end up with inadequate retirement income. Individual accounts also would undermine the provisions in the Social Security program that protect low-income workers and women.

In contrast, accumulating reserves in the Social Security trust funds and investing part of those reserves in equities offers many of the advantages of individual accounts without the risks and costs. It ensures predictable retirement incomes, and it keeps transaction and reporting costs to a minimum, producing higher net returns on equity investments than individual accounts. Those who oppose trust fund investing because they fear the government will not be able to insulate investment decisions from politics should question why they are sanguine about government-managed individual accounts.

Why Social Security Privatization Would Hurt Women

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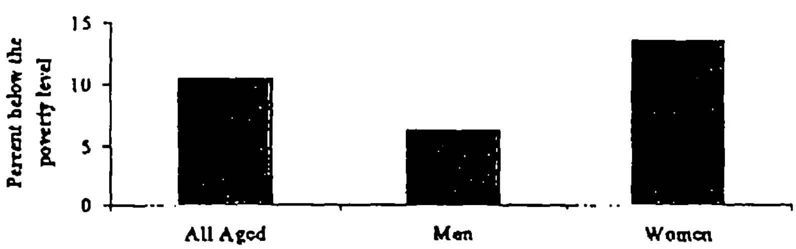

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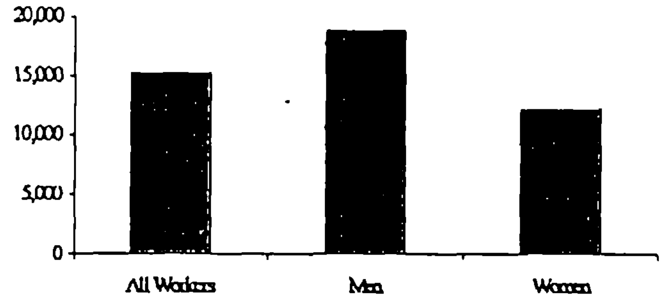

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In addition to providing benefits to compensate for lower lifetime earnings, Social Security has two features that compensate for the fact that women live longer than men. Life expectancy at age 65 is currently 19.2 years for women compared with 16.7 years for men. Because Social Security pays benefits for life, it supports women who outlive their spouses. And because benefits are adjusted annually for changes in the cost of living, their buying power is protected against being eroded by inflation – a protection that increases in importance with every passing year.

By contrast, personal retirement account benefits are not automatically converted to a lifetime annuity or protected against being diminished by inflation. If individuals receive their money in a lump sum, they risk exhausting their assets before they die – a risk that is compounded by the absence of inflation protection. In theory, annuity and inflation protection could be purchased separately, but private annuities are very expensive to purchase, and inflation-adjusted annuities are virtually nonexistent in the United States.

In short, the present Social Security system offers a range of protections – progressive benefits formula, dependents' benefits, lifetime benefits, and inflation adjustments – that are of great importance to women and are not duplicated by any of the proposals to privatize the system. These are established rights, promised by law. Women should be very reluctant to give them up for an untried system that relies on individual investments for even part of their basic retirement income.

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Equities for Social Security: Does It Make Sense?
by Alicia H. Munnell*

Two proposals for expanding Social Security investments to include equities -- one through government-managed individual accounts and the other directly through the trust funds -- elicit very different responses. In fact, the two approaches are remarkably similar. They should raise the same issues. If one distrusts the government and fears that politics will affect investment decisions, neither option should be acceptable. If one trusts the government to set up appropriate mechanisms, then the choice should be direct trust fund investment since it will, by maintaining the commitment to a defined benefit plan, produce the best retirement system done the road.

Investing in equities is not necessary to restore long-run balance to the Social Security program; the projected deficit is small enough that conventional fixes could do the job. But the higher expected return on equity investment does reduce the need for tax increases or benefit cuts and improves the rate of return on Social Security contributions. Thus, many have gravitated towards equity investment as one component of a package to bring the Social Security system into long-term financial balance.

Early in the debate, three alternative approaches were on the table. The most extreme was individually managed private accounts similar to IRAs. The IRA approach has been all but eliminated from consideration because of the extremely high administrative costs associated with setting up 150 million individual accounts. These costs have exceed 20 percent of accumulations in Chile and the United Kingdom, countries that have introduced a system of individual accounts, and could be even higher in the U.S. given the small size of the average account.

The remaining candidates are government-managed individual accounts and direct trust fund investment. A system of government-managed individual accounts would work very much like the existing Thrift Saving Plan, which Congress set up a dozen years ago as part of the pension plan for federal employees. The federal government would deposit a worker's contributions in an individual account and, following the worker's preferences, allocate the money among a designated series of index equity funds, bond funds, and fixed-income investments. In the case of direct trust fund investment, the government would invest a portion of payroll tax receipts in an appropriate broad market index, such as the Russell 3000 or the Wilshire 5000.

Those who fundamentally do not trust the government should find neither option appealing. Opponents of investing in equities through the trust funds contend that the government might use its equity holdings to directly influence corporate decisions and might also invest on the basis of social rather than risk and return considerations. For example, the current controversy over tobacco litigation might create pressure to take tobacco holdings out of the index. But note that a system of government-administered

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individual accounts also requires the government to designate a series of index equity funds for investment. Hence, questions about which stocks to include in the indexes, and how shares are to be voted are just as much issues for the government-administered individual accounts are as for the centrally managed approach. No one wants the government in the business of picking stocks and voting proxies. Anyone who believes that the government will not be able to structure arrangements to avoid this type of activity should oppose any equity investment for Social Security.

Those who do trust the government to design a structure to insulate investments from politics -- through establishing an independent advisory board, picking a broad-based index, and delegating voting rights to pension fund managers -- should favor the approach that will produce the best retirement system for future generations.

Using that criterion, the economics argue strongly for direct trust fund investment and against government-managed individual accounts. Individual accounts would more than double the cost of the current Social Security system, and they would make retirement income unpredictable. Another weakness of such plans is that, although proponents argue against early withdrawals, the law would be changed over time to allow individuals access to these funds before retirement, so that retirees and their families would end up with inadequate retirement income. Individual accounts also would undermine the provisions in the Social Security program that protect low-income workers and women.

In contrast, accumulating reserves in the Social Security trust funds and investing part of those reserves in equities offers many of the advantages of individual accounts without the risks and costs. It ensures predictable retirement incomes, and it keeps transaction and reporting costs to a minimum, producing higher net returns on equity investments than individual accounts. Those who oppose trust fund investing because they fear the government will not be able to insulate investment decisions from politics should question why they are sanguine about government-managed individual accounts.

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CENTER ON BUDGET AND POLICY PRIORITIES

Statement of Robert Reischauer at the White House Forum on Social Security

Albuquerque, New Mexico
July 27 1998[1]

Many workers, particularly younger ones, are worried that they may not get a very good return on the payroll taxes that they and their employers are sending in to the Social Security system. They wonder whether some other type of pension system might give them a better payback than Social Security promises.

The answer to their question, of course, is "yes." A reformed and strengthened version of the current system can give workers better returns than those of the current system or those of any of the alternative structures that have been proposed.

To see why this is the case we need to look at the three reasons why returns on Social Security payroll taxes are relatively low for today's workers. One of these reasons, no rational person should want to change; another we can do nothing about; and the third we can and should act to correct. If we take this corrective step, Social Security will be able to pay higher average benefits than any of the various privatization plans could pay for similar levels of contributions.

The first reason why today's workers will get a rather low return on the Social Security taxes they pay is that a portion of their contributions — about $1 out of every $4 — goes not for retirement purposes but rather to provide disability and survivors insurance. Just like the fire insurance we all have on our homes and the collision insurance we purchase for our cars and trucks, none of us should want to have a high return on this portion of our contributions because that would mean that we had suffered either a disability that kept us from working or the death of a breadwinner.

The second reason why future retirees can expect low returns arises because most payroll tax dollars we send in for retirement purposes — some $13 out of every $15 — are used immediately to pay benefits to current retirees, our parents and grandparents. This practice dates back to 1939

we need to look at the three reasons why returns on Social Security payroll taxes are relatively low for today's workers. One of these reasons, no rational person should want to change; another we can do nothing about; and the third we can and should act to correct. If we take this corrective step, Social Security will be able to pay higher average benefits than any of the various privatization plans could pay for similar levels of contributions.

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AFRICAN AMERICANS, HISPANIC AMERICANS, AND SOCIAL SECURITY: THE SHORTCOMINGS OF THE HERITAGE FOUNDATION REPORTS

Executive Summary

by Kilolo Kijakazi

The Heritage Foundation has released two reports on Social Security's rate of return for minorities. One report addresses African Americans; the second speaks to Hispanic Americans. Heritage argues that the African-American community will secure poor and even potentially negative rates of return from Social Security because African Americans have lower life expectancies. Heritage asserts that Social Security also is a bad deal for Hispanic Americans because they are a disproportionally young population and will bear a significant share of the cost of financing Social Security in the future. According to these reports, these communities would fare better under a retirement program of individual accounts invested in the private market.

The Heritage reports contain critical flaws, however, in their assumptions about both Social Security and individual accounts. The erroneous assumptions result in large errors in Heritage's analysis of rates of return for the population in general and for minorities in particular. As this paper explains, Heritage's rate-of-return calculations substantially understate the rate of return from Social Security and heavily overstate the rate of return from the individual accounts that Heritage favors. As a result, the Heritage calculations are inaccurate.

The Social Security actuaries concluded that Heritage "grossly underestimates the expected rates of return from Social Security benefits" for workers in general and African Americans in particular.

A major part of this paper is drawn from an assessment of the Heritage paper on African Americans that the Social Security Administration's highly respected Office of the Chief Actuary conducted. The Office of the Chief Actuary identified major errors in Heritage's work, including the fact that Heritage exaggerated the taxes that African Americans pay into Social Security while substantially understating the Social Security benefits that African Americans receive. The actuaries concluded that Heritage "grossly underestimates the expected rates of return from Social Security benefits" for the overall population and especially for African Americans. The actuaries also examined Heritage's subsequent work on Hispanic Americans and found it seriously flawed as well.

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CENTER ON BUDGET
AND POLICY PRIORITIES

September 9, 1998

HOW WOULD VARIOUS SOCIAL SECURITY REFORM PLANS AFFECT SOCIAL SECURITY BENEFITS?

An Analysis of the Congressional Research Service Report

by Kilolo Kijakazi and Robert Greenstein

Summary

In June of this year, Rep. Charles Rangel, ranking member of the House Ways and Means Committee, released a Congressional Research Service analysis he had requested on the extent to which three Social Security reform proposals would reduce defined Social Security benefits. The three plans include:

- the bill introduced by Senators Daniel Patrick Moynihan and Robert Kerrey (S. 1792);

- a proposal by the National Commission on Retirement Policy, a panel of Members of Congress and private citizens organized by the Center for Strategic and International Studies (legislation recently introduced in the Senate by Senators Judd Gregg, John Breaux and a few other senators — S. 2313 — and in the House by Reps. Jim Kolbe, Charles Stenholm, and others — H.R. 4256 — is based on the NCRP proposal); and

- a May 1998 proposal by Robert Ball, commissioner of the Social Security Administration under Presidents Kennedy, Johnson, and Nixon and a member of the 1994-1996 Social Security Advisory Council.

The CRS analysis was not designed to be a comprehensive analysis of all components of these three plans, but rather an assessment of an important issue — the degree to which the "defined," or guaranteed, benefits that beneficiaries would be assured of receiving through the Social Security system would change under the three plans. Accordingly, the study does not examine the retirement income that could be generated by individual accounts, which the three plans all contain in differing forms. [1]

The CRS analysis finds that the Social Security benefits guaranteed under the three plans vary greatly.

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[1] The analysis also does not examine changes in payroll taxes or the effects of a few features of the plans, such as proposals in some plans to eliminate the Social Security earnings test.

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- Over the next 75 years, average Social Security benefits would be 23 percent lower under the NCRP plan than under the current benefit structure, 16 percent lower under the Moynihan-Kerrey plan than under the current benefit structure, and six percent lower under the Ball plan. [2]

- In other words, the CRS analysis finds that the reduction in guaranteed Social Security benefits would be approximately four times larger under the NCRP plan than under the Ball plan and nearly three times greater under the Moynihan-Kerrey plan than under the Ball plan.

As noted, these figures are 75-year averages. The depth of the reductions in Social Security benefits, as well as the differences among the three plans in the size of the defined benefit reductions, would grow significantly as the years pass. The CRS study reports the results of analyses the Social Security actuaries have conducted of the three plans:

- In 2025, the Social Security benefits received by average wage-earners who retire at age 65 would be 33 percent lower under the NCRP plan than under the current Social Security benefit structure. They would be 11 percent lower under the Moynihan-Kerrey plan than under the current benefit structure and about one percent lower under the Ball plan.

- By 2070, the Social Security benefit reductions would be considerably deeper. The Social Security benefits of average wage-earners retiring that year at age 67 would be 48 percent lower under the NCRP plan than under the current benefit structure, meaning that the guaranteed benefit would be cut about in half. Under the Moynihan-Kerrey plan, the average benefit for an individual retiring in 2070 at age 65 would be

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[2] These estimates reflect the effects of provisions in the Ball and Moynihan/Kerrey plans to increase the taxation of Social Security benefits, since such measures are a benefit reduction from the beneficiary's perspective. The figures subsequently cited for the percentage benefit reductions for individuals retiring in 2025 and 2070, however, do *not* include the taxation-of-benefit provisions; the memorandum prepared by the Social Security actuaries that CRS used in conducting its analysis did not include the effects of those provisions when examining benefit reductions for individuals retiring in given years. This is the principal reason that while the Ball plan would reduce total Social Security benefits an estimated six percent over the next 75 years, the benefit reduction for an individual retiring in 2025 is estimated at one percent. (Ball subsequently presented a proposal to the House Ways and Means Committee in testimony on June 3, 1998 that dropped the taxation-of-benefits provision included in the Ball proposal analyzed here.)

Table 1

Estimates by the Social Security Actuaries of Benefit Reductions for Average-Wage Earners Under the Three Plans[1]

Year of Retirement	Moynihan-Kerrey	NCRP	Ball
2025	11%	33%	1-2%
2070	22%	48%	1-2%

Source: SSA actuaries estimates, as reported by CRS

[1] These estimates reflect benefit reductions in the year of retirement for beneficiaries retiring at age 65, except that the estimates for the NCRP plan in 2070 reflect benefit reductions for individuals retiring at age 67. The SSA actuaries did not prepare estimates of the effects of the NCRP plan in 2070 for individuals retiring at age 65. These estimates do not include the effects of certain features of these plans, including changes in the taxation of Social Security benefits and in the length of the earnings averaging period that is used to compute Social Security benefits. These estimates also do not reflect the effects on retirees as they grow older of provisions reducing cost-of-living adjustments.

reduced by 22 percent, or more than one-fifth.[3] The benefit reduction percentage would remain very small under the Ball plan. (See Table 1.)

(Note: Under the NCRP plan, reductions in Social Security benefits would be smaller for low-wage earners than to average-wage earners due to establishment of a new Social Security minimum benefit. According to the CRS study, the reduction in Social Security benefits for a low-wage earner retiring in 2025 at age 65 would be 13 percent under the NCRP plan. The reduction for a low-wage earner retiring at 67 in 2070 would be 31 percent. In conducting this analysis, CRS defined a low-wage earner as one who earned 45 percent of the average wage throughout his work career; currently, 45 percent of the average wage is $12,552.[4])

The CRS study also explains that under the three plans, there would be additional reductions in guaranteed benefits as beneficiaries grow older after retirement, due to changes the plans make in procedures either for computing annual Social Security cost-of-living adjustments or for measuring changes in the Consumer Price Index on which the cost-of-living adjustments depend. The additional reductions

[3] The memoranda prepared by the Social Security actuaries that CRS used in conducting its analysis do not provide data on the percentage reduction in benefits for workers retiring at age 67 under the Moynihan-Kerrey plan.

[4] Individuals with earnings lower than 45 percent of the average wage would face smaller Social Security benefit reductions in the NCRP plan if they worked a sufficient number of years. The minimum benefit for a very low-wage worker under the NCRP plan could exceed the benefit the worker would receive under current law.

are largest in the Moynihan-Kerrey plan, which sets annual cost-of-living adjustments below the Consumer Price Index. The additional reduction is much smaller in the other two plans and smallest in the Ball plan, which would result in the measured CPI being slightly lower but would maintain the cost-of-living adjustment at the CPI level.[5] CRS projects that as a result of these provisions, benefits would decline between age 65 and age 80 by an additional 13 percent under the Moynihan-Kerrey plan, an additional seven percent under the NCRP plan, and an additional four percent under the Ball plan. For those living into their early 90's, the additional benefit reductions would be nearly twice this size.

It should be noted that the figures shown in Table 1 reflect reductions in Social Security *retirement* benefits. Under the legislation embodying the NCRP and Moynihan-Kerrey proposals, there also would be substantial reductions in Social Security disability and survivors benefits, because the changes in the Social Security benefit formula and cost-of-living provisions would apply to disability and survivors benefits as well as to retirement benefits.[6]

Finally, the study finds that all three plans would fully restore long-term, or 75-year, actuarial balance to the Social Security system. The actuaries of the Social Security system project that the system faces a deficit over the next 75 years equal to 2.19 percent of taxable payroll. The NCRP plan results in a saving of 2.23 percent of taxable payroll over this period. The Moynihan-Kerrey plan saves 2.25 percent of taxable payroll. The Ball plan saves 2.33 percent.

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[5] Under the Moynihan-Kerrey plan, the annual cost-of-living adjustment would be set one percentage point below inflation as measured by the CPI. The Ball plan would keep the cost-of-living adjustment at the CPI, but directs the Bureau of Labor Statistics to update the market basket on which the CPI is based no less frequently than every five years instead of every 10. CRS estimates that would be equivalent to reducing the cost-of-living adjustment by three-tenths of one percentage point per year. The legislation on which the NCRP plan is based calls for development of a new Social Security CPI that would be lower than the regular CPI to the extent that the Bureau of Labor Statistics estimates the regular CPI contains "substitution bias." If BLS concluded that the measures it announced in April 1998 to reduce substitution bias in the CPI have addressed this matter and no such further bias remains or can be estimated, the Social Security CPI that the NCRP plan establishes would be set .33 percentage points below the regular CPI each year. This level of detail on how the cost-of-living adjustments would work under the NCRP plan was not available when the Social Security actuaries prepared the estimates on which the CRS analysis is based; as a result, the CRS analysis may somewhat overstate the degree to which this aspect of the NCRP plan would result in additional benefit reductions as retirees grow older.

[6] Some sponsors of the legislation embodying the NCRP plan have stated that it does not change disability benefits. Such statements are not correct and appear to reflect some misunderstanding on the part of these sponsors of the effect of their legislation on disability benefits. The NCRP plan changes the benefit formula for computing a beneficiary's primary insurance amount (or PIA), on which Social Security benefits are based for retirement benefits, disability benefits, and survivors benefits alike. A forthcoming Center on Budget and Policy Priorities analysis will explain this matter in more detail.

Why Does the Depth of the Benefit Reductions Differ So Much?

These findings raise an important question. What accounts for the CRS finding that the Ball plan would reduce defined Social Security benefits much less than the other two plans while doing as well in closing the 75-year imbalance? There are two principal reasons for this finding.

First, the other two plans reduce the revenue going into the Social Security trust fund and place greater reliance on individual accounts; they essentially divert payroll contributions from the trust fund to individual accounts. The Ball plan, by contrast, does not reduce the revenue going into the trust fund. It adds voluntary individual accounts on top of Social Security but does not divert money from the trust fund for them.

Under current law, the revenue the trust fund is projected to receive over the next 75 years is insufficient to pay the full benefits to which beneficiaries would be entitled during this period. This is what is meant by the statement that Social Security eventually becomes insolvent. Diverting payroll tax revenue from the Social Security trust fund makes the financing shortfall larger and consequently necessitates deeper benefit reductions (or larger payroll tax increases) to put the trust fund back into long-term balance. As the Congressional Research Service explained in an earlier report: "Obviously, if it is projected that the taxes that finance the [Social Security] system are insufficient to pay future promised benefits, earmarking some of them for the buildup of private accounts would make this problem worse. It would mean that to restore the system to solvency future tax increases would have to be larger or benefits cut deeper."[7]

Not surprisingly, CRS found that the NCRP plan, which diverts the most revenue from the Social Security trust fund, contains the deepest Social Security benefit reductions. Among the large benefit reductions in this plan is an across-the-board benefit cut resulting from an increase in the age at which individuals may retire and receive full benefits; the age at which individuals can retire and receive full Social Security benefits would be raised to 70 by 2029 and to approximately 72½ by 2075, a larger increase than any other major plan has proposed.[8] The plan also includes a reduction of one-third in Social Security spousal benefits. (These benefit reductions are described in more detail later in this paper.)

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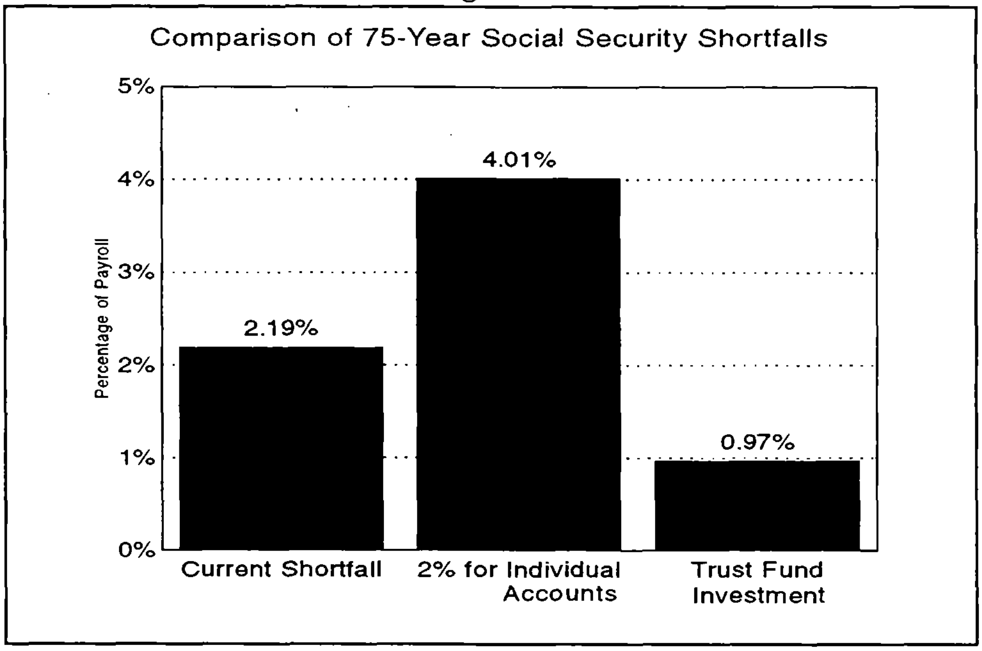
[7] "Ideas for Privatizing Social Security," Congressional Research Service, April 6, 1998.

[8] The age at which individuals may retire and receive full Social Security benefits is commonly referred to as the "normal retirement age." That term, however, is a misnomer; the majority of Social Security beneficiaries retire and begin drawing benefits before this age. What is commonly called the "normal retirement age" is simply the age at which full, rather than reduced, Social Security benefits are paid.

Figure 1



The second reason the Social Security benefit reductions are much more modest under the Ball plan than under the other plans is that the Ball plan invests a portion of the Social Security trust fund reserves in equities. This enables the trust fund to capture the stock market's higher rates of return. The actuaries estimate that the earnings the trust fund would receive from this investment would reduce the 75-year imbalance in the Social Security system by slightly more than half. That, in turn, reduces the benefit reductions or tax increases needed under the Ball plan to restore long-term balance.

Figure 1 illustrates that redirecting two percent of the payroll tax to individual accounts, as the NCRP plan would do, would enlarge the 75-year shortfall from 2.19 percent of taxable payroll to 4.01 percent, in the absence of other changes. The Figure also shows that investing up to 50 percent of the trust fund in equities, as the Ball plan would do, would reduce the 75-year deficit from 2.19 percent of taxable payroll to 0.97 percent, in the absence of other changes.

For these reasons, Rudolph Penner, a former CBO director now at the Urban Institute who supports the NCRP plan, recently observed that "plans that have the trust fund buying equities generally cut [Social Security] benefits less than plans establishing individual accounts."[9]

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[9] Testimony of Rudolph G. Penner before the Senate Budget Committee, July 23, 1998.

The CRS Analysis and Individual Accounts

Proponents of the NCRP plan and the Moynihan/Kerrey bill have criticized the CRS analysis. They fault it for not including the retirement income that would result from the individual accounts the plans contain. They also argue that it is not appropriate to compare benefits under these plans to benefits under the current Social Security system since the current system will not be solvent over the long term. They contend the proposed plans should be compared to a Social Security system revised in a manner that puts it in long-term actuarial balance.

Proposals to divert part of the payroll tax revenue from the Social Security trust fund to individual accounts entail moving partially from a "defined benefit" plan that specifies the payment of particular benefit amounts based on a retiree's earnings history (i.e., from Social Security) to a "defined contribution" plan in which the benefits available to retirees vary greatly. Under a defined contribution plan, benefits depend not only on a beneficiary's earnings history but also on individual investment decisions, the performance of the stock and bond markets (including the state of the markets in the year an individual retires), the real interest rate assumptions used when retirees convert their accounts to annuities, the extent to which funds in individual accounts are consumed by fees that firms charge for managing the accounts (and, where applicable, for converting accounts to annuities at retirement), and other factors.

In weighing options for reforming Social Security, policymakers need to understand the degree to which the defined benefits — that is, the benefits Social Security provides — would be reduced under various approaches, since it is only the defined benefits that retirees are assured of receiving at specified levels. This is the information the CRS study provides.

More comprehensive analyses that factor in the anticipated returns from individual accounts also are needed and should be undertaken. Such analyses are more difficult to conduct, however, than the type of analysis CRS has conducted on the extent to which these three plans would reduce Social Security benefits. Analyses attempting to factor in returns from individual accounts consequently will need to be undertaken with great care. In particular, such studies will need to consider several factors that may have a large impact on the retirement income that individual accounts generate:

> <u>Variation in returns from individual accounts</u>: Since individual accounts do not provide defined benefits, the levels of income they generate will differ considerably among beneficiaries and over time. The retirement income from such accounts is likely to offset the reductions in Social Security benefits for some retirees but not others. Retirees who are lucky or wise in their investments should be able to offset the full loss in their guaranteed benefits. Retirees who are unlucky or unwise in their investments — including those who retire and convert their account to a lifetime annuity in a year the market is down — would

likely face large reductions in the income they have to live on in their declining years.

A recent GAO report took note of these issues. "There is a much greater potential for significant deterioration of an individual's retirement 'nest egg' under a system of individual accounts," the GAO wrote. "Not only would individuals bear the risk that market returns would fall overall but also that their own investments would perform poorly even if the market, as a whole, did well"[10]

Of particular concern are the returns received by those who lack investment experience. Today, fewer than half of all U.S. households have any investments in the stock market; this lack of experience is likely to make it harder for many to earn solid returns. Moreover, even experienced investors pursuing sound investment strategies can have investments that turn sour and earn below-market returns. The fact that a substantial majority of mutual funds earn rates of return that are below the performance of the S&P 500, a broad measure of the major stocks in the market, is evidence of this fact. These concerns are greatest for plans that allow individuals a wide array of choices in how to invest the funds in their accounts, such as plans that establish accounts similar to IRAs or 401(k) accounts.

Another group likely to face substantial reductions in retirement income under individual accounts are those who must retire early for health reasons but are not sufficiently infirm to meet the stringent Social Security disability criteria, as well as those who have been employed in physically strenuous occupations that are not suitable for someone past their early or mid-60s. Individuals who must retire early would tend to have smaller individual accounts because they would have fewer years of contributing to these accounts. At the same time, they also are likely to have lower Social Security benefits because most of the reform plans that divert revenue from the Social Security trust fund to individual accounts — such as the NCRP plan — raise the normal Social Security retirement age substantially. These plans take this step to shrink Social Security benefit costs enough to help compensate for the large Social Security revenue losses that the diversion of payroll tax revenue to individual accounts entails.

Analyses of the retirement income generated by individual accounts should reflect the range of outcomes these accounts are likely to produce. Simply estimating the average anticipated rate of return for such accounts would obscure the fact that substantial numbers of people would likely receive significantly less income than that from their individual accounts, while others would receive more. Stated another way, such an approach would be

[10] General Accounting Office, *Social Security: Different Approaches for Addressing Program Solutions*, July 1998, p. 6.

problematic because it would fail to reflect the increased risk to beneficiaries that individual accounts carry.

Administrative and Other Costs: Analyses of the retirement income that individual accounts would provide also need to factor in the costs associated with such accounts. Since such costs are paid out of the funds in the accounts, they affect the amount of money available in the accounts to pay retirement benefits.

Private accounts necessarily incur administrative and management fees. Some private account systems also incur costs when account-holders retire and convert the funds in their accounts to lifetime annuities. The individual retirement accounts — or IRAs — and the 401(k) accounts that many Americans possess incur all of these costs. Estimates from two eminent economists, Peter Diamond of M.I.T and Henry Aaron of the Brookings Institution, indicate that between 7.5 percent and 30 percent or more of the amounts saved or earned under the individual account systems that would be established under various Social Security privatization proposals would be consumed by administrative, management, and (where applicable) annuitization costs and fees.

Plans that invest Social Security trust fund revenues in equities, rather than diverting trust fund revenue to individual accounts, avoid almost all of these costs. The General Accounting Office recently reported: "Most of the cost of managing an index fund is incurred maintaining thousands of individual accounts. In contrast, the government, as a single investor, would incur negligible costs as a percentage of its assets. Therefore, investing collectively through the government would result in significant administrative savings compared to investing through individual accounts."[11]

This is one of the reasons some Social Security experts, such as Brookings Institution senior fellows Henry Aaron and Robert Reischauer, the former CBO director, favor investing a portion of trust fund reserves in equities as an alternative to individual accounts. Aaron and Reischauer observe that because investing trust fund reserves in equities would avoid such costs, it would generate a higher average net rate of return than individual accounts while exposing beneficiaries to much less individual investment risk.

The Social Security "Baseline"

The other criticism lodged against the CRS analysis by proponents of the NCRP plan and the Moynihan/Kerrey bill is that comparing benefits under reform plans to

[11] General Accounting Office, "Social Security Financing: Implications of Stock Investing for the Trust Fund, the Federal Budget, and Economy," statement of Barbara D. Bovbjerg before the Senate Special Committee on Aging, April 22, 1998.

benefits under the current Social Security benefit structure is inappropriate since the current Social Security system will not be solvent over the long term. They contend that the appropriate standard against which reform proposals should be measured is an altered model of Social Security that includes measures bringing the system into long-term balance.

This criticism of the CRS study is unconvincing. Use of a baseline, or a point of reference where no change has taken place, is common in research. The benefit levels the current benefit structure pays provide an appropriate baseline measure against which to compare the Social Security benefits that various reform plans would provide. To use these benefit levels as a baseline in no way suggests that changes are not needed to restore long-term solvency to the system; it simply provides a readily understandable measure of comparison.

Nor does use of this baseline alter comparisons to each other of the plans CRS examined. The comparative standing of these plans would remain unchanged if CRS had used a different standard. For example, if CRS had used the Moynihan-Kerrey bill as its standard, the NCRP plan would be shown to reduce Social Security benefits relative to the standard while the Ball plan would be shown to raise them.

More important, there is no widely accepted way of altering Social Security to achieve long-term balance that can serve as a baseline. In particular, to compare alternative plans to a policy of restoring balance solely by cutting Social Security benefits may be misleading; that is an option no one is suggesting. Not a single member of the 1994-1996 Social Security Advisory Council recommended such an approach. No proponent of Social Security reform has proposed it.

Furthermore, use of a standard which assumes that balance will be restored solely by cutting benefits could lead to some misunderstanding among the public. Some plans that reduce retirement income below the levels the current benefit structure provides could be shown to *increase* benefits relative to such a standard; some of the public could mistakenly think this means that such plans would raise benefits relative to the standard-of-living that the current benefit structure provides. If many Americans mistakenly believed such a plan would raise retirement income above the levels the current system provides, they could conclude that no sacrifice would be involved and no increase needed in saving by individuals.

A number of these issues are discussed in more detail below.

Why Do Plans that Reduce or Divert Payroll Tax Revenue Result in Large Reductions in Social Security Benefits?

The principal reason the NCRP and Moynihan-Kerrey plans reduce Social Security benefits much more deeply than the Ball plan does is that they reduce the revenue going into the Social Security trust fund. This deepens the trust fund's financing shortfall and necessitates deeper benefit reductions to eliminate the shortfall. The NCRP plan reduces the revenue going into the trust fund on a permanent basis, while the Moynihan-Kerrey plan reduces trust fund revenue for the next 30 years (and, on average, over the 75-year period used in Social Security projections).

The NCRP plan mandates the permanent diversion of two percentage points of the payroll tax from the Social Security trust fund to individual accounts. The Moynihan-Kerrey bill reduces the payroll tax by two percentage points through 2024 (and by less than two percentage points from 2025 through 2029).[12] The Moynihan-Kerrey plan provides for voluntary individual accounts funded with its one percentage point reduction in the *employee* share of the payroll tax, along with a mandatory employer matching contribution for any employee establishing such an account, financed by the one percentage point reduction in the *employer's* share of the payroll tax.

Reducing the revenue going into the Social Security trust fund necessitates deeper reductions in Social Security benefits to restore long-term balance. For example, an analysis by the Social Security actuaries shows that the NCRP plan's diversion of two percentage points of payroll tax revenue to individual accounts increases the deficit in the Social Security trust fund by an amount equal to 1.82 percent of taxable payroll over the next 75 years. The Social Security actuaries project that the current shortfall equals 2.19 percent of taxable payroll over the next 75 years. By deepening the shortfall by 1.82 percent of taxable payroll, the NCRP plan's diversion of two percent of the payroll tax enlarges the size of the Social Security deficit approximately 80 percent. That, in turn, necessitates Social Security benefit reductions about 80 percent larger than otherwise would be needed to restore Social Security to long-term balance.[13]

The NCRP plan achieves these deeper benefit reductions in a number of ways, including the following.

- The NCRP plan raises the age at which individuals can retire and receive full, rather than reduced, Social Security benefits to a higher age level than any of the other major plans that have been offered. For example,

[12] The Moynihan-Kerrey plan begins to raise the payroll tax in 2025 and restores the tax rate to its current level by 2030. The plan also would begin to raise the payroll tax rate slightly *above* the current level in 2045 and continue raising it until 2060. At that time, the combined employee and employer shares of the payroll tax would be one percentage point above the current level.

[13] The NCRP plan offsets a modest portion of the revenue loss by shifting from the Medicare trust fund to the Social Security trust fund the share of the revenue from partial taxation of Social Security benefits that currently is deposited in the Medicare Hospital Insurance Trust. Shifting this revenue would deepen the long-term fiscal imbalance in the Medicare trust fund, however, which is more serious than the long-term imbalance in the Social Security trust funds. When all of its changes in trust fund revenue are considered, the NCRP plan deepens the trust fund shortfall by 1.39 percentage points of payroll, or 50 percent.

the plan advanced by the 1994-1996 Social Security Advisory Council that went the farthest in raising the age at which workers can retire and draw full benefits would raise this age from 65 today (and eventually 67 under current law) to 70 by 2083. By contrast, the NCRP plan would increase this age to 70 by 2029 and to approximately 72½ by 2075. The NCRP plan also would raise the *early* retirement age, the age at which retired individuals can retire and begin to draw reduced Social Security benefits, from 62 to 65 by 2029 and to approximately 67½ by 2075.

Raising the age at which individuals can retire and receive full benefits essentially constitutes an across-the-board reduction in Social Security benefits because it reduces benefits not only for those who retire earlier but also for those who remain at work until this age, a point that is not widely understood.[14] Each one-year increase in the age at which full benefits are paid results in a reduction of approximately seven percent in the Social Security benefits that an average worker receives over his or her retirement years.[15]

In addition, increasing from 62 to 65 the age at which individuals can retire and begin to draw *reduced* Social Security benefits would be particularly burdensome for those who are unable to work until 65 either because they are in poor health during their early 60s (but are not sufficiently infirm to meet the stringent Social Security disability criteria) or because they have been employed in physically strenuous occupations in which they cannot remain employed until 65.

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[14] Under current law, with the age at which full benefits are paid set at 65 and scheduled to rise to 67 by 2022, workers who retire at 62 (or 63 or 64) receive lower monthly benefits for the rest of their lives in recognition of the fact that their benefits will be spread over more years. Conversely, those who do not retire until age 70 receive *higher* monthly benefits for the rest of their lives because they will draw benefits for fewer years. Under proposals to raise to 70 the age at which full benefits are paid, however, those who retire at 70 would receive the standard benefit that now goes to those retiring at 65; they would no longer receive an enhanced benefit for workers who do not retire and begin drawing benefits after the age at which full benefits are paid. Raising the age at which full benefits are paid thus essentially constitutes an across-the-board cut; if the age is raised to 70, those retiring at 70 lose benefits along with those who retire in their 60s.

[15] "Increasing the Eligibility Age for Social Security Pensions," Testimony of Gary Burtless, senior fellow, The Brookings Institution, before the Senate Special Committee on Aging, July 15, 1998. When the age at which individuals can retire and draw full benefits is raised to 70 under the NCRP plan, individuals would be able to retire at 65 and begin drawing reduced Social Security benefits, just as individuals today can retire and begin receiving reduced benefits at 62. Those electing the early retirement option would receive reduced Social Security benefits for the rest of their lives. Under the NCRP plan, individuals could retire and begin to make withdrawals from their individual accounts before age 65 if there were enough funds in the accounts to provide monthly payments at least equal to the poverty line.

- The NCRP plan also makes major changes in the Social Security benefit computation formula. Under the current, progressive formula, Social Security benefits equal 90 percent of the first $477 of a worker's average monthly wage over his or her work-years, 32 percent of the next $2,875 of a worker's average monthly wage over his or her work years, and 15 percent of the remainder of a former worker's average monthly wage.[16] The NCRP plan would, over time, lower these 32 percent and 15 percent "replacement rates" to 21.36 percent and 10.01 percent, respectively, which would constitute a large benefit reduction. A significantly smaller percentage of the wages and salaries many workers earned would be replaced by Social Security benefits when they retired. This formula change alone reduces benefits for a worker whose average wages are $40,000 in 1998, and whose wages rise in subsequent years at the same rate as average wages in the economy, by 22 percent.

- In addition, the NCRP plan proposes to reduce the benefit Social Security provides to spouses of primary wage-earners; the spousal benefit would be lowered from 50 percent of the primary wage-earner's benefit, as under current law, to 33 percent of that benefit. Many spouses thus would experience a benefit reduction of up to one-third, on top of the NCRP plan's other benefit reductions. (Some members of the 1994-1996 Social Security Advisory Council also proposed to reduce the spousal benefit, but they used the savings from this proposal to help finance an *increase* in the benefits that Social Security pays to widows and widowers so as to provide more adequately for widows, who face poverty at very high rates.[17] In 1996, some 39 percent of elderly widows — about two in every five — had incomes below 150 percent of the poverty line.[18] Reducing spousal benefits without raising widows' benefits would reduce benefits principally among women.)

Since the Ball plan does not divert trust fund revenue to fund individual accounts, it does not need Social Security benefit reductions of this magnitude. As noted above, the Ball plan further shrinks the size of the benefit reductions or tax

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[16] In computing these average monthly wage figures, the Social Security Administration indexes wages earned in years before a worker's retirement by changes in average wages in the U.S. economy in the intervening years.

[17] Under the recommendation these Advisory Council members made, the widow or widower of a deceased worker would receive 75 percent of what the couple's *combined* benefit would have been, rather than receiving only the worker's benefit (or only the widow or widower's own benefit, if larger), as under current law. *Report of the 1994-1996 Advisory Council on Social Security, Volume I: Findings and Recommendations*, January 1997

[18] Bureau of the Census, Current Population Survey, 1996, March 1997.

increases needed to restore Social Security to long-term balance by investing a portion of Social Security reserves in the equities markets and thereby capturing the higher rates of return these markets provide. This is essentially the same strategy that state and private pension funds use.

Estimating the Effects of Various Plans When Income From Individual Accounts is Added

The CRS analysis does not purport to be a comprehensive analysis of all components of the three plans it examines, but rather an assessment of the changes made in the defined, or guaranteed, benefits that retirees would be assured of receiving through Social Security. Analyses also are needed that include projected returns from individual accounts. Undertaking such analyses is not easy or straightforward.

To factor in benefits from individual accounts one must make assumptions regarding investment behavior, stock market performance, the expectations that firms selling annuities have concerning what inflation and interest rates will be in coming years, and other factors. Since future earnings are unlikely to mirror past earnings exactly, all such projections are subject to a wide range of error. More important, projected rates of return from individual accounts generally are averages; the actual benefits that individuals would derive from such accounts would vary substantially from the estimated average figures, with some beneficiaries garnering higher rates of return and others receiving lower rates of return.

Many low-income earners may receive relatively low rates of returns from their investments. Low-income families tend to have little experience with retirement accounts or with investing in stocks, bonds, and mutual funds. They would be more likely than experienced investors to make poor investment choices. Experience with 401(k) accounts suggests they also would be likely to invest quite conservatively, probably out of fear of losing the limited resources they have. In a June 17, 1998 House Ways and Means Committee hearing on individual accounts, several witnesses testified that much of the public lacks sufficient knowledge about investing to manage such accounts well.[19]

When estimating the retirement income that individual accounts would generate, there is no easy way to factor in the potential for a substantial segment of the public — and in particular, those with below-average earnings — to invest unwisely or too conservatively. One possible approach is to show ranges for the levels of retirement income and rates of return that individual accounts would generate. Estimates that simply show projected average rates of return on individual accounts, rather than

[19] Testimony of Teresa Tritch, senior editor of *Money* magazine, and Ric Edelman, head of Edelman Financial Services, before the U.S. House of Representatives Subcommittee on Social Security of the Committee on Ways and Means, June 18, 1998.

The Year of Retirement Can Greatly Affect a Beneficiary's Level of Retirement Income Under A System of Individual Accounts

There also are a number of other ways in which investment risk would affect the retirement income an individual would receive under a system of individual accounts. For example, Gary Burtless, a senior fellow at the Brookings Institution, has shown that under such a system, the amount of the monthly annuity for an individual who converts his or her individual account to an annuity at retirement could vary greatly not only as a result of the investment choices a worker has made but also as a result of the state of the stock market in the year the individual retired.

If an individual retires and converts his or her account to an annuity in a year in which the stock market is very high, the individual is likely to receive a more ample annuity check. But if the individual has the misfortune to retire and annuitize when the market is down, the individual can be faced with a meager income for the rest of his or her life. Burtless' research shows that if workers retiring in the 1960s and 1970s had deposited funds in individual accounts throughout their careers, with the money invested in stock index funds, an average male worker who retired and converted an individual account to an annuity in 1976 would have received a monthly benefit for the rest of his life that was *only a little more than half as large* as the monthly benefit an average male worker who retired and annuitized seven years earlier, in 1969, would have received.

ranges, tend to oversimplify this matter. Another possible approach is to attempt to estimate the percentage of individuals likely to secure rates of return lower (or higher) than the average rate of return. Such variations are particularly important in light of the fundamental purpose of social insurance, which is to *assure* the retired, the disabled, and survivors a certain basic income.

Even more difficult is the task of estimating how the stock market will perform in coming decades. Given the dizzying increases in the market in recent years, using market performance for a period that includes these years to predict future performance may generate estimates of rates of return for individual accounts that prove to be too high. The ratio of stock prices to corporate earnings has climbed will above its traditional range, which raises questions about how much further the equities markets will rise. No one knows the answer to this question. In recent congressional testimony, Rudolph Penner, who backs the NCRP plan, acknowledged that for this reason, "considerable uncertainty surrounds the assumption regarding what can be earned" through investment in equities.[20] (It may be recalled that only three decades ago, in the 1970s, the market preformed poorly and lost a large share of its value.)

[20] Testimony of Rudolph G. Penner, senior fellow, the Urban Institute, before the Senate Budget Committee, July 23, 1998.

Administrative Costs

One set of factors that can more readily be taken into account in estimating the retirement income that individual accounts may generate involves the costs associated with these accounts, including administrative and management fees, costs under some plans of converting funds in these accounts to annuities that pay a monthly benefit until death, and costs under some plans of the transition from Social Security to private accounts. All private account plans entail some or all of these costs. Since the costs are generally paid from the accounts, they reduce the retirement income the accounts generate. Estimates that do not reflect such costs are not valid.

The administrative costs that must be paid from the funds in individual accounts are the expenses that investment firms incur in handling the accounts, conducting marketing efforts to attract investors, communicating with their investors, record-keeping, and corporate overhead. The fees these firms charge to account-holders also include a profit margin; no one can expect private firms to handle such accounts for free or at a loss. The administrative costs for IRAs currently range from $35 to $45 per account per year.[21] For private defined contribution pension plans, administrative costs vary by the number of participants in the plan and have been estimated to range from approximately $50 per year per participant for a plan with 10,000 or more participants to nearly $290 for a plan with 15 or fewer participants.[22] Flat-rate costs of this nature are most disadvantageous to low-wage workers, since these charges consume a larger percentage of the investments in small accounts than of the investments in larger accounts. In addition to these administrative costs are investment management fees that firms charge for investing the funds in these accounts and shifting the funds as account-holders direct.

Two eminent economists, Peter Diamond of MIT and Henry Aaron of the Brookings Institution, have studied administrative and management fees associated with IRAs and 401(k) plans.[23] They estimate that by retirement, costs for individual accounts established on an IRA or a 401(k) model would consume, on average, about 20 percent of the funds otherwise deposited in or earned by the accounts. As Diamond

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[21] Remarks by Philip Lussier, State Street Global Advisors, before the National Commission on Retirement Policy, Social Security Working Group, February 25, 1998.

[22] Edwin C. Hustead, "Trends in Retirement Income Plan Administrative Expenses," *Pension Research Council Working Paper*, 96-13, Philadelphia: University of Pennsylvania, 1996.

[23] Statement by Peter Diamond, AARP-Concord Coalition Debate on Social Security, Albuquerque, July 27, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; testimony of Henry J. Aaron before the Senate Committee on the Budget, July 23, 1998.

Financial Securities Analyst Explains That Administrative Costs Can Substantially Reduce Returns From Accounts

In testimony July 24 before the Subcommittee on Finance and Hazardous Materials of the House Commerce Committee, Joel M. Dickson, Senior Investment Analyst with the Vanguard Group, explained the large role that administrative costs can play in lowering rates of return that individual accounts can provide, especially for the smaller-than-average accounts of workers with below-average earnings. Dickson stated:

"Much of the recent debate on individual accounts has centered around how Social Security participants can earn higher rates of return — like those experienced in the private financial markets. Unfortunately, there is often a large gap between the assumed market return on an investment and the actual return realized by investors. The reason? Cost... What may seem to be a relatively small cost difference over a short period of time can become an enormous difference over a long investment horizon....

"Consider a $1,000 investment in two equity funds; one earns a market return of 10%; the second earns only 8%, which represents the market's return reduced by an all-too-realistic total cost of 2% (arising from charged expenses and portfolio transaction costs). After the first year, the difference in account values between the two options is only $20. Of course, a participant investing over the course of their working lifetime must consider much longer time horizons. Over 40 years, the first fund soars to $45,000. The second fund, earning 2% less per year, grows to $22,000 — less than half what the market earned....

"The key pricing variable for private accounts is the average account size. To the extent that costs of servicing the accounts could not be covered by asset-based management fees, other charges — like account maintenance fees — are likely. One of the criticisms often made about privately-managed, individual accounts is that lower-income workers may not be as financially savvy, resulting in lower average returns. I think a bigger issue is that lower-income and part-time workers will have small account balances, potentially subjecting them to higher fees because asset-based revenue cannot begin to cover the costs of maintaining these accounts. Thus, they are likely to earn lower returns than higher-income workers that make the same investment choices for reasons unrelated to financial market sophistication."

explains, a one percent annual average charge on funds in such an account consumes, over a 40-year work career, 20 percent of the funds in the account.[24] Based on the most recent financial data on mutual funds, a one percent annual charge is a conservative

[24] Diamond explains that with a one-percent annual charge on holdings in accounts, a dollar deposited in an individual account in the first year of a 40-year work career will be subject to the one percent fee 40 times, while a dollar deposited in the final year before retirement will be subject to the fee once. On average, dollars in the account will be subject to the one percent annual charge 20 times, so approximately 20 percent of the amounts deposited or earned by the account will be consumed by these charges. Diamond also notes that in Chile, costs consume approximately 20 percent of the amounts in individual accounts, with the percentage being *higher* in Great Britain and Argentina.

estimate. Lipper Analytical Services reports that in 1997, the average charge on no-load stock funds equaled 1.21 percent of amounts invested in the funds, while the average charge on front-load stock funds equaled 1.25 percent.[25] Moreover, the 1994-1996 Advisory Council on Social Security estimated an annual charge of one percent on assets in privately managed individual accounts.[26]

The amounts consumed would generally be larger than 20 percent for smaller-than-average accounts and smaller than 20 percent for large accounts. This means the retirement income that individual accounts modeled on IRAs or 401(k) plans would generate would be about 20 percent smaller on average than the income would be without these fees and costs. It also means that estimates of the retirement income that IRA-type or 401(k)-type accounts would generate will overstate this income by approximately 20 percent on average if the estimates do not reflect these fees and costs.

Costs of Converting Accounts to Annuities

A sizable additional cost also would be incurred under plans that feature private accounts modeled on IRAs or 401(k) plans — the cost of converting the funds in a worker's account to a lifetime annuity when the worker retires. These costs cover a company's marketing expenses, commissions to agents, investment costs, overhead, and profits.

The leading study on this issue indicates that the fees charged for converting an account to an annuity at retirement consume, on average, approximately five to ten percent of the retirement savings of an individual purchasing a $100,000 annuity.[27] In other words, the insurance company would take five to 10 percent of the amount in the retiree's account to cover its costs and profits, with the amount of the monthly annuity check being based on the remaining 90 percent to 95 percent of the funds in the account. (These annuitization costs can vary by as much as 15 percent across insurance firms. A retiree would need to be fairly astute in selecting the best company from

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[25] See Robert McGough, "Robust Fund Industry Isn't Lowering Fees," *Wall Street Journal,* May 14, 1998.

[26] The Advisory Council assumed an annual change of one percent on accounts established under the Personal Security Accounts proposal, a proposal that diverted *five* percentage points of the payroll tax to individual accounts. Since many of the administrative costs involved in managing private accounts are fixed costs that do not vary with the size of the account, this suggests that the average charge could be larger than one percent per year on the smaller individual accounts that would be established under plans using IRA-type or 401(k)-type accounts that divert two or three percentage points of the payroll tax into these accounts rather than five percent.

[27] Olivia S. Mitchell, James M Porterba, and Mark J. Washawsky, *New Evidence on the Money's Worth of Individual Annuities,*"Cambridge, National Bureau of Economic Research, April 1997. Also see Aaron, *op. cit.*

which to purchase an annuity. Many people do not have sufficient investment expertise to make the wisest choices in purchasing annuities.)

In addition, prices for annuities are generally raised to cover the company's risk of incurring added costs due to "adverse selection." Adverse selection refers to the probability that people with longer-than-average life expectancies will be more likely to purchase lifetime annuities than people with shorter-than-average life expectancies. Insurance companies cover themselves for the costs of paying lifetime annuities to people who may live to very old ages. The resulting increase in the price of annuities has been estimated to reduce the value of retirement savings being converted to an annuity by an additional 10 percent.

Totaling all of these costs and charges, Henry Aaron concludes that the administrative and management costs *plus* the costs of converting funds in these accounts to annuities would consume *between 30 percent and 50 percent* of the amounts saved in IRA-type or 401(k)-type individual accounts. These are very large amounts and indicate why analyses of plans that include individual accounts need to reflect estimates of these costs in their computations. (Estimates of rates of return from individual accounts issued by privatization proponents such as the Heritage Foundation tend to ignore such costs and are not valid as a result.)

Costs Under the Thrift Savings Plan Model

Diamond also has examined likely administrative costs for individual accounts modeled on the Thrift Savings Plan. The individual accounts the NCRP plan would create are based on this model. The costs for this type of account would be considerably lower but would still be significant. Diamond estimates that the costs of administering this type of account would consume approximately 7.5 percent of the funds in an average worker's account (as distinguished from the 20 percent cost Diamond and Aaron estimate for plans with IRA or 401(k) type accounts), reducing the retirement benefits these accounts would pay by that percentage.[28] Under the NCRP

[28] Administrative costs for TSP equaled approximately $20 per participant in 1997, which equaled about 3.75 percent of what would be the average worker's deposit into a private account under the NCRP plan. As Aaron, Diamond, and former Thrift Savings Plan head Francis Cavanaugh have testified, using this model for the accounts of 140 million to 150 million workers employed by millions of employers would entail significantly higher costs in percentage terms than the cost of operating the Thrift Savings Plan for employees of a single employer, the U.S. Government. The TSP's economies-of-scale would not be available due to the existence of millions of separate employers. In addition, many costs associated with operating the Thrift Savings Plan are borne by the federal agencies in their role as employer rather than by TSP itself (e.g., responding to employees' questions); such costs would almost certainly not be imposed upon private employers under an individual accounts plan based on the TSP model. These costs would have to be borne by the entity operating the accounts system and defrayed through charges on the accounts. In addition, federal agencies transmit the relevant data to TSP electronically, while many private employers submit data on paper; that would further increase the costs for the entity administering the accounts (as well as the risk of errors in maintaining accounts (continued...)

Investment of Trust Fund Reserves in Equities Likely to Yield Higher Rates of Return by Reducing Costs

Both the Ball plan and a separate plan designed by former Congressional Budget Office director (and now Brookings senior fellow) Robert Reischauer and Brookings senior fellow Henry Aaron would invest a portion of Social Security trust fund assets in broadly indexed funds. Such approaches would tend to generate higher rates of return than plans that divert a portion of payroll tax revenue to individual accounts, because investing a portion of the trust funds in the equities markets does not entail the administrative costs, management fees, and (in some cases) annuitization costs involved in systems with nearly 150 million individual accounts.

If individual accounts and trust fund reserves invested in index equity funds were both to earn the average market rate of return — but the retirement benefits the individual accounts paid had to reflect the administrative costs, management fees, and, where applicable, annuitization costs these accounts must pay — the investment of trust fund reserves in the market would necessarily generate a higher net rate of return. Investing a portion of trust fund reserves in the market also pools the risk of investing in the market so no single individual has to face the threat of large investment losses.

For these reasons, Reischauer, Aaron[25] and a number of other economists have concluded that this approach is likely to yield higher rates of return at lower risk to beneficiaries than a system of individual accounts.

[28] Henry J. Aaron and Robert D. Reischauer, "Tune It Up, Don't Trade It In,"*The Washington Post*, Outlook section, April 19, 1998. In addition, Francis Cavanaugh, former head of the Thrift Savings Plan, recently testified that "The only feasible way for the Social Security system to benefit from the higher returns offered by the stock market is to invest a portion of the trust fund in stocks, which is what virtually all large public and private pension and retirement funds have already done." Statement of Francis X. Cavanaugh before the Subcommittee on Social Security of the House Ways and Means Committee, June 18, 1998.

plan, the percentage by which accounts would be reduced to cover administrative costs would be the same for all accounts without regard to their size.

Annuitization costs under a plan such as the NCRP proposal are less clear. The NCRP plan requires a minority of retirees to annuitize. Others *could* annuitize but would not have to do so; those who did would have several options regarding how to annuitize. Some individuals who annuitized would likely incur large annuitization costs. Some others likely would not convert their accounts to annuities. Those who did not annuitize would not be able to withdraw all their funds at once; there would be limits on the amounts they could withdraw. The annual amount an individual would be allowed to withdraw would be based on his or her life expectancy. As the individual grows older, the maximum withdrawal allowed would decrease to stretch

[28] (...continued)
records).

the savings left in the account over the years expected to remain in the individual's life. If an individual with a modest account lived to a very old age, the withdrawals could eventually become very small. This stands in contrast to Social Security benefits, which do not decline in amount as an individual grows older but rather increase to keep pace with inflation.

(There also is some question as to the feasibility of using the Thrift Savings Plan model for a system of 140 million or 150 million individual accounts held by workers of millions of employers. Francis X. Cavanaugh, the former head of the Thrift Savings Plan and a former Reagan Administration Treasury official, recently testified that managing such a system would require 10,000 highly trained federal employees and stated that in his view, "... it would be impossible to establish cost-effective TSP-type PSAs [personal savings accounts] for the Social Security system."[29])

Conclusion

The CRS study provides a useful analysis of the effects of the three plans on the defined benefits that Social Security provides. The data in the study demonstrate that plans that reduce or divert Social Security payroll tax revenue from the trust fund to individual accounts entail deeper reductions in Social Security benefits than plans that do not reduce trust fund revenue. The data also illustrate the fact that plans that invest a portion of Social Security trust fund assets in equities can restore Social Security to long-term balance with smaller Social Security benefit reductions than other plans because such an approach boosts trust fund revenues.

Subsequent studies should attempt to incorporate the effects of the individual accounts that various plans establish on the income that retired workers would receive. Such analyses will need to take into account the average amounts the individual accounts are projected to earn, the risk that account-holders would face and the wide variation in retirement income that consequently could result, and the costs and fees that would affect the benefit payments these accounts can make.

[29] "Statement of Francis X. Cavanaugh before the Subcommittee on Social Security of the House Ways and Means Committee, June 18, 1998.

Elderly Poverty Rate in U.S.
Before and After Receipt of Social Security, 1996

Poverty rate before benefits	50.1%
Poverty rate after benefits	12.3%

Source: Census Data

Elderly Lifted out of Poverty by Social Security as Percentage of All Elderly Lifted Out of Poverty by Safety Net Programs, 1996

	Number (millions)	As Percentage of All Elderly Who Are Lifted Out of Poverty
Elderly lifted out of poverty by:		
Social Security	11.7	89.3%
Other social insurance	0.4	3.1%
Means-tested cash	0.5	3.7%
Means-tested non-cash	0.5	3.8%
All safety net programs	13.0	100.0%

People Lifted out of Poverty by Safety Net Programs, by Age, 1996

	All Persons (millions)
Number poor lifted out of poverty by:	
Social insurance (primarily Social Security)	17.9
Means-tested cash programs	3.0
Means-tested non-cash programs	4.3
Federal taxes and the EITC	1.7
All safety net programs	27.0

NATIONAL WOMEN'S LAW CENTER

December 3, 1998

Shirley Sagawa
Deputy Assistant to the President
Office of the First Lady
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Shirley:

As we discussed, I enclose some materials on Social Security that might be useful to you:

1. The statement we submitted for the White House Conference, which focuses on individual retirement accounts and the concerns they pose for women.

2. A report on earnings sharing that I co-authored several years ago that is a good summary of the effect of the current system on women as well as the modifications that need to be made to any earnings sharing proposal to improve the system for women.

3. An excerpt from a 1992 report of a task force of the House Select Committee on Aging, on which I served, which suggested some incremental Social Security reforms that would help women.

4. An analysis by the Center on Budget of the shortcomings of the Heritage Foundation reports on African Americans and Hispanic Americans and Social Security.

Hope this is helpful. Look forward to seeing you soon.

Best,

Duff

Nancy Duff Campbell
Co-President

Enclosures

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INDIVIDUAL ACCOUNT PROPOSALS THREATEN SOCIAL SECURITY'S ESSENTIAL PROTECTIONS FOR WOMEN AND THEIR FAMILIES

For over 60 years, Social Security has increased the economic security of all Americans -- but its guaranteed benefits and family protections are especially important to women. Women represent 60% of elderly Social Security recipients, and women depend more on Social Security benefits than do men. Social Security provides more than half of the income of elderly women living alone, and is the only source of income for 25% of such women. Elderly women still have a poverty rate that is nearly twice as high as that of elderly men (13.1% versus 7%). But without Social Security, more than half of all elderly women would be poor.

The Social Security system is not in crisis now. It can pay benefits at current levels for more than 30 years. However, by 2032 the surplus in the Trust Fund is expected to be gone, and payroll taxes will be insufficient to maintain benefits. To ensure adequate benefits for future generations of women, Social Security needs to be strengthened by reforms that close the financing gap and improve the economic security of women and their families. Unfortunately, the debate over ways to reform Social Security seems to be focusing on proposals to replace Social Security, in whole or part, with individual accounts which pose serious risks for women. For that reason, this brief statement focuses on the problems inherent in individual accounts.

- **Individual accounts, which lack Social Security's progressive benefit structure and spousal benefits, would disadvantage women who work for lower pay and take time out of the labor force to care for children and family.**

Social Security is a social insurance program designed to provide meaningful retirement benefits to all workers and their families. Social Security's benefit formula is progressive: those who have worked for low wages throughout their lifetime receive retirement benefits that are a larger percentage of their lifetime earnings. And Social Security guarantees benefits to spouses, divorced spouses, and surviving spouses: a vital protection for women who spend time out of the labor force to care for children and other family members.

Although women are working more and earning more than in the past, their lower earnings relative to men's will persist. The wage gap has narrowed, but not disappeared. And women are still more likely than men to spend time out of the labor force or working part-time. Today, 63% of women receive benefits based on their husbands' earning history, because the spousal benefit (50% of the husbands' benefit) exceeds the worker benefit based on their own earnings history. The percentage of women relying on spousal benefits is expected to decline, but will remain high well into the 21st century; in 2060, 40% of women are projected to receive benefits as spouses rather than workers.

In contrast to Social Security, benefits from individual accounts are directly related to the size of the individual's contribution and the return on investment. Protections for low earners could be devised; however, they would be more politically vulnerable than Social Security's integrated, progressive, social insurance approach. And it is unclear in several of the proposals for individual accounts whether protections for spouses, divorced spouses, and surviving spouses would be required -- and if so, how substantial they would be. About 20% of elderly widowed and divorced women are currently poor; they cannot afford a loss of benefits.

- **Protection equal to Social Security's guaranteed, inflation-protected, lifetime retirement benefits would be difficult, if not impossible, for women to secure through individual accounts.**

Social Security provides workers and their surviving spouses with benefits that are guaranteed for life and adjusted for inflation. These protections are especially important to women. Women live longer than men; over 70% of Americans age 85 and older are women. Women are thus at greater risk of outliving their savings, and of seeing other sources of income decline in value due to inflation. And women generally have lower savings than men, and are less likely to have pension income.

Individual savings and investments are an important supplement to Social Security. But to the extent individual accounts substitute for guaranteed Social Security benefits, they put women's economic security at risk. To minimize the risk of losing their investments, women may choose to invest their smaller individual accounts conservatively; studies indicate that women currently invest more conservatively than men. But women then run the risk that their assets will not grow sufficiently to last through their lifetime, or even keep up with inflation.

Women will be especially hard pressed to obtain through the market the lifetime protection that Social Security provides. Lifetime annuities can be purchased. But converting to to an annuity--which is done all at once -- makes a woman's lifetime retirement benefits extremely sensitive to the state of the stock market at the time of the conversion. In addition, the costs of converting savings to an annuity are high. Economist Henry Aaron estimates that overall, 30 to 50% of the savings in an IRA or 401(k) individual account converted to an annuity are lost to administrative and management fees and the cost of conversion. Few private annuities are indexed for inflation. And most private annuities -- unlike Social Security -- base monthly payments on gender, providing women with lower lifetime benefits for the same investment.

- **Replacing Social Security with private accounts jeopardizes disability and survivors' benefits for workers and their families.**

Social Security is not just a retirement program. It provides benefits for disabled workers, 40% of whom are women. And Social Security provides for the families of workers who become disabled or die. Nearly 4 million children receive Social Security survivors or disability benefits -- and 98% of the parents who receive benefits for caring for them are women. Individual accounts are designed to provide for retirement only. The savings in individual accounts will not protect families that must cope with a wage earner's disability or early death.

Clinton Presidential Records
Digital Records Marker

Earnings Sharing In Social Security:

A Model for Reform

Center for Women Policy Studies