Statement of Hal Daub
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at the
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I want to thank Mark Thresher and Greg Lashutka for inviting me to be here with you today to participate in this forum on Retirement Security in the 21st Century.

Today, you will hear that we face some very large and difficult challenges in meeting the retirement security needs of those who will be reaching old age during this new century. I will be among those who will be telling you that. But first let me point out that—in many ways—we are fortunate to be facing those challenges. A forum like this would have been totally incomprehensible at the start of the last century. In 1900, life expectancy at birth was about 47 years. There were only 3 million Americans—about 4% of the population aged 65 or over. Those who did make it to age 65 could look forward to far fewer remaining years than is the case today. And they did not typically feel they had reached the age of "retirement." Most worked either until they died or, at least, until they were well beyond today's common retirement ages. There was no Social Security, no Medicare, and very little in the way of private pensions.

So, we are not starting from scratch. We have a broad array of institutions that have developed over the past century to address the retirement security needs of our population. In the public sector, we have the social insurance programs of retirement, survivors, and disability insurance to provide a basic level of income support. We have Medicare to address the health care needs of retirees and the disabled. Supplementing these major public social insurance systems, we have employer-based pensions and health insurance, individual savings, and private life and health insurance – all private sector institutions subject to governmental regulation and, at least ideally, encouragement. And, importantly, we have public safety-net programs such as Supplemental Security Income and Medicaid.

These are and will continue to be important institutions in the overall picture of retirement security in the coming century. But the challenges they face are monumental. We have—particularly since World War II—enjoyed generally quite favorable economic circumstances. The baby boom generation provided the nation with a large supply of workers. That was augmented by the increasing labor force participation of women. The abilities of both men and women were further enhanced by rising levels of education. We have also benefited from great technological advances during the past century.

Of course, we hope and expect that we will continue to see productivity gains and technological advances. But, demographically, the party is over. In 1965, there were 4 workers for every Social Security beneficiary. Today that ratio has dropped to 3.3 to 1. Over the next 20 years, we will see it decline to 2.3 to 1 and ultimately to less than 2 to 1.

What I would like to do this morning is to have you join me in looking at our national social insurance programs: the role they play now in the overall picture of economic security, what they accomplish, the challenges they face in the future, and what we need to do to meet those challenges.

First of all, let's talk a little bit about the basic concept of social insurance. Over the course of a lifetime, most individuals in society will go through a period of childhood in which they are cared for by their parents. In young adulthood, they embark upon careers and begin earning the wherewithal to support themselves and their own children and to begin building up reserves of savings, private insurance, and investments ultimately to enjoy a comfortable retirement in old age. A portion of these individuals through some combination of talent, hard work, and education will do very, very well in life and will find themselves well able to manage all of this from their own earnings and wealth. At the other end of the spectrum, there will be others who through lack of capacity, misfortune, or other causes find themselves on the very lower fringes of society barely able, if at all, to support themselves through early and middle adulthood, let alone put anything aside for their old-age. But the large bulk of society falls between these two extremes. And the role of social insurance is to provide a core level of economic stability and security for that great middle group of Americans as a base to build on.

The term "social insurance" covers more than retirement protection, of course. The Federal-State unemployment insurance program is social insurance designed to meet the reality that there will be some degree of displacement from time to time as we go through business cycles and other changes in the economic circumstances of society and of individual businesses. Workers' compensation programs provide social insurance against the effect of workplace injuries. As Chairman of the Social Security Advisory Board, I have the particular duty of studying and talking with you about the programs supported by the Social Security payroll tax which provide retirement, disability, and survivorship benefits. The Medicare program is not in our primary area of focus but there are very substantial interrelationships that we cannot ignore.

The Social Security program provides this basic core of income security for essentially the entire population. A small proportion of public employees in the State and local sector are outside the program and there is, of course, some underground economy work that does not contribute, but, all told, some 156 million individuals will work this year in jobs that are covered by Social Security. Somewhat more than 47 million people are drawing monthly Social Security benefits. This includes 32 million retired workers and their dependents. Six million disabled workers get benefits as do nearly 5 million widows. Three and one-half million children of deceased or disabled workers are also receiving Social Security each month.

It is clear that the Social Security programs are a part of the basic fabric of our society's systems of economic security. For about 20 percent of the aged, Social Security benefits are the only source of income and for 2 out of 3 of the aged Social Security accounts for more than half of their income. And for about one-third of the aged, Social Security accounts for 90 percent or more of their income.

Now, you can look at these numbers and find that they have a lot of messages to think about—some good and some not so good. But the first and most important message is that these numbers are facts, like them or not. Our social insurance programs of Old-age, Survivors, and Disability Insurance cover essentially our entire population and they form the centerpiece—and, for some, nearly the whole table—of retirement security for our older citizens. The Social Security program is not going to go away and it should not.

But if the existing Social Security system as a core element of economic security is a fact, it is equally a fact that the system is not now soundly financed. Social Security is a long-range proposition. As a society, we ask working men and women to pay a significant part of their earnings into the program, with matching contributions from their employers. We tell them to do this in the expectation that the program will provide them a base of economic security in retirement. We owe them a system that, insofar as we can foretell the future, is designed to deliver on those promises. We do not have such a system today.

You may have seen some recent news articles about differing estimates. Earlier this month, the Congressional Budget Office released a new and different way of projecting the financial status of the Social Security funds. That CBO report looks a little rosier than the official Trustees' projections in March, but only a little. The trend line may move up and down a bit, but its underlying direction does not change. The lack of balance between the baby boom generation now moving into their retirement years and the baby bust generation that followed them is not a projection. It is a fact.

In just about 4 years the Social Security disability program will start paying out more in benefits than the taxes it takes in. About 10 years after that, the same thing will happen with the Social Security retirement program. Over the next few decades, the baby boom retirees will be drawing down all of the reserves we have been building up over the past 20 years. At that point it would take an increase in the Social Security tax rate from its current level of 12.4 percent of earnings to something like 17 percent in order to keep paying benefits in full. And things are going to continue getting worse from that point even after the baby boom bulge has moved through the system. One major reason for that is the happy but costly fact that the experts believe we are going to have modest but continuing increases in how long we all live. It's great but it's not free.

So we do have a serious problem on our hands in the Social Security program, and the next question is what can we do about it? There are a lot of different answers that can be given to that question. But the basic answer is very simple. "We can deal with it." This is not a huge asteroid that is on a collision course with Earth. It is a program and a very important program. It is out of balance, and it is seriously out of balance. But that is the kind of problem that can be solved.

Six years ago, in July of 1998, the bi-partisan Social Security Advisory Board unanimously issued what we on the Board like to call our "sooner rather than later" report. Three years ago we issued it again. It is just 33 pages long. It identifies about 2 dozen proposals that have been kicking around for quite a while. In some combination, these proposals—or others like them—can restore the Social Security program to a sustainable level of solvency. I do not suggest that these proposals are easy. Ultimately, a solution involves some combination of benefit constraints and revenue increases. And that choice is not fun. But, again, it is a fact. Delay is not going to change it. What delay will do is to foreclose some of the less painful and more gradual options. If we wait until the year before insolvency, we will pretty much have reduced our choices to sudden large benefit cuts or tax increases.

So the answer is to tackle the problem sooner rather than later. The Board has talked about reissuing the report later this year for the third time. I think we will do that, and I sincerely hope that this time it gets the attention of policymakers.

The financial imbalance of Social Security is a problem that can be solved, and should be solved, and—one way or the other—will be solved. But it is only one part of a complex of interrelated retirement security issues that we face as we move into this new century.

Our society and our law-making institutions tend to deal with these different parts of these issues separately. That is not necessarily unfortunate. The various different public and private programs that contribute to retirement security each serve a set of needs and purposes some of which they share in common and others of which are distinct. It would, I think, turn out to be a very bad idea to try to come up with a grand plan to achieve perfect coordination of all aspects of retirement security.

On the other hand, it is important for us to be aware of the interrelationships of the various elements of retirement security. We need to learn where one element can—without undermining its own objectives—contribute to strengthening the objectives of other elements. Particularly, in view of the major challenges we are going to face, we need to think about whether there should be some rearrangement of the tasks that the various programs bear.

In looking at the challenges ahead, I think it is reasonably obvious that health care programs are the biggest area of concern. As the Social Security Advisory Board has been talking with experts on various aspects of retirement security over the past couple of years, we have more than once been cautioned against even thinking about Medicare and other health programs. The experts' advice has been to stick with Social Security because its problems are manageable.

But, of course, we don't really live in a world where you can isolate health and income security. At any given point in time, governments and individuals and businesses and, indeed, all of society have a finite amount of resources that they have to allocate among all the objectives they need to meet. If one area of expenditure begins to explode, it is going to constrain the ability to meet other needs. Recently the Board held a forum on Social Security Disability. We invited the Comptroller General, David Walker, to make a presentation. One of his charts showed the currently anticipated spending for Social Security, Medicaid, and Medicare between now and the year 2080 measured as a proportion of our country's total economic production. Right now these three programs consume about 8 percent of our economy's output. By 2080, under current trends, that would triple to about a quarter of the economy. That includes some increase in Social Security spending, but the big growth is in the health programs.

Health is, of course, a very important priority, and as our population ages we are going to face increasing expenditures simply because we have more and older people to serve. However, much of the increased spending is unrelated to population growth but just reflects continuing high rates of inflation in the cost of providing medical care. Much of that inflation is not provably related to better and more effective treatment. If we do not find ways to address the problem of growing health care costs, they threaten our whole complex of income security. At a governmental level, if Medicare and Medicaid are allowed to continue their present trajectory, they grow to the point of consuming some 20% of economic production. That translates into about 100% of what the country has historically spent on all governmental programs—that is not only health and income security, but also national defense, agriculture, education and all other priorities including payment of interest on the debt.

At a business level—and I think you will hear more about this later—rising health care costs are making it more difficult for employers to continue to provide health care coverage for employees and retirees. And at an individual level, growing costs of health care will cause very substantial dislocations. For example, the Social Security and Medicare Trustees' report issued in March points out that today the typical beneficiary faces out-of-pocket costs for Medicare deductibles and coinsurance equal to about 15 percent of the average Social Security benefit. By the end of this decade, that will have more than doubled to 35 percent. Twenty years later it will hit 50 percent. By 2078, 80 cents of each dollar of the average Social Security benefit is projected to be needed for those out-of-pocket medical costs, leaving 20 cents for food, shelter, and other needs. Any sort of a hope for a reasonable retirement income security future has got to include finding a way to get a handle on the costs of providing health care.

I know we are going to hear later today about private sector employer-sponsored retirement security programs, and I look forward to learning a great deal in those sessions. But I would like to briefly point out a few important considerations as we think about social insurance programs on the one hand and private sector efforts on the other. Social insurance operates as a core element that the employer and individually based efforts can supplement. That is an additional reason why it is important that our policymakers act soon to get Social Security back on a sound basis. How can employers and individuals make appropriate adjustments in their systems and plans if we have a large question mark as to what the core social insurance benefits will be?

At a recent Board hearing that we held in Boston, the Vice-President of a small manufacturing firm told us about his efforts to get the employees in his firm to think about their future—to do some degree of financial planning to understand what they will need in retirement and what they can expect to have. He was appalled at how difficult a task that is proving to be. I know that Jack VanDerhei and his colleagues at EBRI have been doing monumental work in trying to advance this same objective. But, how realistic is it for us to expect individuals to plan for the future when we are telling them that the system that they depend on for the base of that planning is not soundly financed? The Social Security program projects a certain level of benefits. But it doesn't look like it will have enough revenue to support that level. And we aren't ready to reveal whether we will lower the benefits, increase the revenues, or do something in between.

We do need to improve—greatly improve—the level of individuals' understanding of and planning for their financial future. The reason we need to do that is because they are not saving enough for themselves. And they are also not saving enough for our society—which is, of course, also their society. The somewhat scary numbers that I cited earlier about the proportion of domestic production that will be consumed by Social Security, Medicare, and Medicaid all are based on the assumption that we will continue to enjoy a healthy, growing economy. If we do not have the national savings to provide the means for investment and productivity growth, those proportions could be much worse. As we look for ways to improve our public and private instruments of retirement security, we need to keep in mind that we should be changing them in ways that enhance the level of savings.

Another interrelationship that we must think about—and do a better job with—is how private sector programs of income security supplement the public programs. A little while I go, I said that some of the statistical measures of income of the aged can be viewed as good or bad from different perspectives. Let's look at how many of the aged get almost all of their income from Social Security. A report issued last year by the Social Security Administration says that 20 percent—1 out of every 5—of aged households has no other income except Social Security. Another 13 percent of them get 90 percent or more of their income from Social Security. So one-third of the aged are nearly totally dependent for income on Social Security payments.

On the one hand, there is some good about this story. Our system is providing a core of income security protection for many older people who, for whatever reason, reached old age without other sources of income to support them. Many of these individuals would be in far worse circumstances without Social Security. We would have a far greater aged population in poverty and on welfare. On the other hand, Social Security is intended to be a base of income security. It does not and cannot provide sufficient income for a comfortable retirement. We need to find ways to broaden participation in employer-sponsored pensions and other private sector programs so that we will not have a third of the aged who live out their retirement years almost entirely dependent on Social Security.

The income security picture for older Americans also includes an element that we sometime overlook, but we should not, and that is employment. Perhaps we should begin to get away from the term “retirement”. Much of the challenge we face in dealing with income security issues in the coming century comes down to the changing ratio of the working to non-working population. And that, in significant part, is driven by the fact that we are living longer and healthier. At least a part of the answer to meeting that challenge is to see if we cannot find ways to encourage more labor force participation. Our mindset from the 20th century was an abundant and growing workforce of individuals who would spend the central part of their lifetimes in as full employment as they could get—more often than not in physically demanding jobs—and then they would retire and live off their Social Security, pensions, and saving for their remaining years. We are facing a century with a much less abundant workforce. Much of the work that is available today is less physical and more interesting. And we have a pool of better trained, better educated, healthier, and longer-lived older citizens. What we have to do is to change that mindset so as to marry the coming workforce needs of our economy and the growing pool of available older workers. How do we do this? Well, employers, for example, need to think about how they can structure employment in ways that meets their workforce requirements and yet remains attractive to older workers. For purposes of today’s forum, we need to make sure that the changes we make in public and private retirement security programs encourage—and do not discourage—the employment of older workers. In the case of Social Security specifically, a major improvement along these lines has already been made by eliminating the penalty provision that used to take away the benefits of older workers who stayed in employment past age 65. But certainly there is room, both in the public and private sector, for finding additional ways to encourage continuing employment for those older citizens who are able and willing to remain productively employed at least on a part-time or part-year basis.

In thinking about the concept of simultaneously trying to meet both our economy’s coming workforce needs and the challenges facing our public and private income security programs, we need to think not only about the potential of older workers but also about our disability programs. People think of Social Security as a retirement program, but it also includes a very significant disability component. Because disability often limits the ability of individuals to earn Social Security credits, we also have many Americans getting general-fund financed assistance on the basis of disability. Between the two programs, there are about 9 million disability recipients with costs running roughly $100 billion per year for income support. There are also substantial costs in Medicare and Medicaid benefits for the disabled. Here again, however, we have a 20th Century mindset that needs to be changed to meet 21st Century realities. The program had it origins in the 1950s as a kind of early retirement program for older workers with disabilities. In fact, the legislative history explicitly indicated that it was designed to relieve the pressure for lowering the Social Security retirement age. To qualify, you were required to prove that you couldn’t work, and the rules “rewarded” any protracted attempt to work by cutting off benefits. The program still pretty much operates that way, but we are beginning to seriously question whether that is appropriate. Many individuals with impairments are able and eager to lead independent productive lives. If we can structure our programs to help them do that instead of giving them incentives not to work, we can accomplish several objectives. The individual can lead a more fulfilling and economically rewarding life. The costs of our income support programs can be reduced. And we will not be wasting productive workforce capacity.

We begin a new century with many foreseeable challenges to our public and private retirement security programs. We are certain to encounter some unforeseeable ones also. While we may be tempted to throw up our hands, we must instead roll up our sleeves and begin to tackle these challenges. The challenges are not going to go away, but neither are we. What you all are doing today by coming together in this very timely forum is an important step in recognizing that social insurance, private pensions, individual savings and investment, and health programs—public and private—all have a part to play in this effort. There is no one magic answer, and there will be no one master plan to solve all the problems. But what we can do is to think about our overall collection of retirement security programs and how they can be changed in the coming Century to meet their own objectives and also to supplement each other to meet the challenges and needs of our changing population.