

Retirement and Disability Policy Challenges for the 21st Century

One of the great American achievements of the 20th century was the development of a comprehensive national social insurance system. A core element of the system was a sturdy retirement component—with Social Security as a foundation, supplemented by a private pension system and individual savings arrangements—which sought to conquer the long-standing economic fear of poverty in old age. For the last half century, millions of American workers were able to look forward to their retirement as a time of dignity, respect, and security. The Congress later extended these social insurance protections to those workers who were unable to engage in gainful economic activity because of disability. Indeed, insuring workers and their families from the potentially devastating income loss caused by unexpected injury, illness, or death removed another great risk to their economic well-being.

The challenges facing retirement and disability programs are long-term, severe, and structural in nature. A successful policy response to these challenges will require a fundamental and comprehensive reassessment of each of the key components of our national retirement and disability system.

The following challenges and illustrative questions provide a framework for thinking about these issues in the future.

Social Security faces severe, long-term, structural financing challenges that if not addressed, could lead to the depletion of its trust funds. The unfunded obligation for the Old Age, Survivors, and Disability Insurance (OASDI) trust funds for the next 75 years is \$3.7 trillion in present value as of 2004. Projected tax income to the OASDI trust funds will begin to fall short of outlays in 2018 and, by 2042, trust fund balances will be insufficient to fully finance benefits promised under the current program. Social Security faces this long-term financing shortfall largely because of several concurrent demographic trends, namely that people are living longer, spending more time in retirement, and having fewer children. For example, average time in retirement grew from 11.5 years in 1950 to 18 years for the average male worker as of 2003. Women are also having fewer children. In the 1960s, the fertility rate was an average of 3 children per woman, but by 2030 it is expected to fall to 1.95—a rate that is below replacement. Taken

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together, these trends threaten the financial solvency and sustainability of Social Security as well as the federal budget as a whole. Social Security could be brought into balance over the next 75 years in various ways, including an immediate increase in payroll taxes of 15 percent or an immediate reduction in currently promised benefits of 13 percent (or some combination of the two). Ensuring the sustainability of the system beyond 75 years will require even larger changes. Encouraging older workers to extend their labor force participation can also improve program solvency while contributing to overall economic growth. Lastly, highlighting the need for early action, even greater adjustments in scheduled benefits and revenues will be required the longer Social Security's financial challenges remain unaddressed.

▶ *How should Social Security be reformed to provide for long-term program solvency and sustainability while also ensuring adequate benefits (for example, increase the retirement age, restructure benefits, increase taxes, and/or create individual accounts)?*

▶ *How can existing policies and programs be reformed to encourage older workers to work longer and to facilitate phased retirement approaches to employment (for example, more flexible work schedules or receiving partial pensions while continuing to work)?*

Serious weaknesses have become manifest in our nation's private pension system. Despite sustained large federal tax subsidies, total pension coverage continues to hover at about half of the total private sector labor force. The number of traditional defined benefit plans in which employers rather than employees bear the risk of investment has been contracting for decades, and recent plan terminations by bankrupt sponsors of large defined benefit plans have threatened the solvency of the Pension Benefit Guaranty Corporation (PBGC), the federal agency that insures certain benefits under such plans. Recognizing the long-term challenges facing PBGC, GAO has placed PBGC's single-employer pension program on its high-risk list of programs needing further attention and congressional action. As of the end of fiscal year 2004, the agency's single-employer pension program registered a net negative accumulated position of \$23.3 billion. While growth in the number

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and coverage of defined contribution plans—where each worker has an individual account that receives contributions—has somewhat mitigated the decline of more traditional defined benefit plans, these plans have also experienced problems. Many workers covered by defined contribution pension plans continue to choose not to participate, potentially leaving them with an inadequate retirement income. The risk burden of defined contribution plans requires individual employees to be knowledgeable about investment and other retirement decisions, yet information and education are not always available. Large holdings of company stock in such plans may add to employees' risk that their retirement savings will be inadequate to provide levels of income needed in retirement. Finally, workers receiving their retirement benefit in a lump sum and the ability to withdraw or borrow money from retirement saving plans prior to retirement to supplement current consumption can drain workers' accounts of needed benefits well before retirement. Policymakers will need to consider how to best encourage wider pension coverage and adequate and secure pension benefits that are preserved for retirement purposes for the current and the future labor force, and how such pensions might best interact with changes to the Social Security program.

▶ *What changes should be made to enhance the retirement income security of workers while protecting the fiscal integrity of the PBGC insurance program (for example, increasing transparency in connection with underfunded plans, modifying PBGC's premium structure and insurance guarantees, reforming plan funding rules, or restricting benefit increases and the distribution of lump sum benefits in connection with certain underfunded plans)?*

▶ *How can existing policies be reformed to encourage income preservation strategies so that retirement income lasts an individual's entire life (for example, benefit annuitization)?*

Meanwhile, federal disability programs, such as those at the Social Security Administration (SSA) and the Department of Veterans Affairs (VA), have experienced significant growth over the past decade and are expected to grow even more as increasing numbers of baby boomers reach their disability-prone years. Moreover, the composition of the disability rolls has changed significantly, with a

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larger proportion of beneficiaries with mental impairments receiving benefits today than in the past. At the same time, recent scientific advances as well as economic and social changes have redefined the relationship between impairments and work. Advances in medicine and technology have reduced the severity of some medical conditions and have allowed individuals to live with greater independence and function in work settings. Moreover, the nature of work has changed in recent decades as the national economy has moved away from manufacturing-based jobs to service- and knowledge-based employment. Given the projected slowdown in the growth of the nation's labor force, it is imperative that those who can work are supported in their efforts to do so. Yet federal disability programs remain mired in concepts from the past and are poorly positioned to provide meaningful and timely support for workers with disabilities. Further, in light of a congressionally established commission to study the appropriateness of veterans' benefits, VA may be faced with the need to reform its eligibility criteria. Over the last decade, GAO has built a body of work examining these issues and, more recently, has called for the fundamental transformation and modernization of federal disability programs, including SSA's Disability Insurance and Supplemental Security Income programs and VA's disability programs. In January 2003, GAO added modernizing federal disability programs to its high-risk list.

- ▶ *How can federal disability programs, and their eligibility criteria, be brought into line with the current state of science, medicine, technology, and labor market conditions (for example, which jobs are based on knowledge and skills rather than on strength and endurance)? How can such programs better facilitate the participation of people with disabilities in the workforce and society (for example, earlier intervention in providing vocational rehabilitation or assistive technology devices such as voice synthesizers or standing wheelchairs)?*

- ▶ *What options could be considered for reforming VA's current disability benefits structure for veterans (such as revisiting the definition of service-connected benefits) that would ensure appropriate and adequate benefits?*