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WOMEN AND SOCIAL SECURITY REFORM: ARE INDIVIDUAL ACCOUNTS THE ANSWER?

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BEFORE THE

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UNITED STATES SENATE

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WOMEN AND SOCIAL SECURITY REFORM: ARE INDIVIDUAL ACCOUNTS THE ANSWER?

MONDAY, FEBRUARY 22, 1999

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The committee met, pursuant to notice, at 1:07 p.m., in room SD–628, Dirksen Senate Office Building, Hon. Charles Grassley, (chairman of the committee) presiding.

Present: Senators Grassley, Burns, Hagel, Breaux, Bryan, Bayh, and Reed.

OPENING STATEMENT SENATOR CHARLES GRASSLEY, CHAIRMAN

The CHAIRMAN. I would call the hearing to order. This is our first hearing of the Aging Committee during the 106th Congress.

When I became Chairman 2 years ago, and that was at the beginning of the 105th Congress, my primary goal, and I think it is one shared by my ranking Democrat, Senator Breaux, was to review the likely future financial status of the Social Security and Medicare programs and to promote those initiatives that will ensure baby boomers and future generations enjoy health and income security as they grow older.

I believe that we made considerable strides in this debate. However, we are now 2 years closer to the retirement of the baby boom generation and, of course, as time marches on, it means more emphasis upon enacting those policies which will provide the tools to sustain our retirement programs for the 21st Century.

We dedicated last year to a great debate about our Social Security program. In public and private forums across the country, workers and retirees discussed their concerns, their hopes and their desires for this program that has been part of the social fabric of America now for 60 years.

After those discussions, which have been led by the President, and have been led by Members of Congress, have been led by private organizations, I think it emphasizes that we must forge ahead from that background. The clock is ticking, and we need to advance to the next step toward preserving Social Security.

As the debate progressed over the last several months, many of the plans to save Social Security included the concept of individual accounts, as part of the Social Security system. Possibly because of this, one of the themes which seemed to be echoed time and again during last year's debate was the concern that, as policymakers work toward preserving Social Security, that women's unique needs for the programs might be overlooked.

And, of course, there does not need to be that sort of concern because policymakers ought to consider that issue. It is a very important issue because I certainly believe that important issues facing women have not, to this point, been satisfactorily addressed. Women will have longer life spans and depend on Social Security for more years in retirement than men do. And, of course, women are more likely to move in and out of the workforce, raising children and caring for elderly parents, and they are more likely to have custody of children after a divorce. Women tend to earn less than men because of years out of the workforce and the shrinking, but still prevalent pay gap.

Today's hearing will examine the benefits women derive from the current Social Security program and the benefits women would realize under a system which would include an individual account component. We will hear from two panels of distinguished experts who will address these issues, but more importantly will offer possible solutions to problems that women face in regard to this issue.

On our first panel, we will hear from Dr. Olivia Mitchell and Dr. Alicia Munnell. I would like to point out that Dr. Mitchell also testified at our first hearing of the Aging Committee in the last Congress. Dr. Mitchell and, indeed, most of our panelists may be more eager than anyone to help save Social Security, so that they will not have to come here and testify all of the time.

On our second panel we will hear from Dr. Robert Clark, Dr. Gene Steuerle and Dr. Mark Warshawsky. This panel will examine specific concerns that arise under individual accounts; things like investment behavior, the impact of divorce and longevity for everybody, but particularly for the longer life span of women.

Each panelist will offer recommendations to address these issues in the design of an individual account component.

I will introduce the first panel. However, I would like to have Senator Breaux speak at this point and thank him once again for not only his cooperation on this hearing, but we had 2 years of outstanding cooperation during the last Congress, and I look forward to that sort of relationship this time.

STATEMENT OF SENATOR JOHN BREAUX

Senator BREAUX. And here we go again.

The CHAIRMAN. Here we go again.

Senator BREAUX. Thank you very much, Mr. Chairman, and thank you for once again laying out an agenda for this Aging Committee which I think will have great impact on the future dealings of the rest of this Congress.

I think that what we are able to do in the last Congress was significant in pointing out numerous, very serious problems with programs that particularly affect elderly in this country, and I am certain that the rest of this Congress, with regard to this committee, we will continue that record of really paying attention to the things that need to be improved and things that need to be done that are, in fact, not now being done.

I would hope that the 106th Congress may go down in History as a Congress that really seriously addressed two of the most significant problems that we have as a Nation. And that is, obviously, the Social Security system for this country and for the 44 million Americans who are on that program, as well as a Congress that addressed serious reform in the Medicare program, again, affecting millions of seniors.

I will not go into great detail about the problems of both programs, but are very evident. Thank goodness people live a lot longer than they used to, and there are a significantly larger number of those people who are living longer. There will be a gradual bringing in to the systems of the 77 million baby boomers who become eligible starting in the year 2008 for the benefits of both programs.

While both programs offer great benefits, they have great challenges because of the insolvency that is just around the corner in both of the programs. I would hope that this committee will be able to contribute to a greater understanding of what the problems are and also to discuss realistic solutions.

Today, with regard to Social Security, it is clear that we are focusing on a particular problem with Social Security and that is the inequitable treatment of women who become eligible for Social Security. Women live longer than men, on average, women who work less than men, on average, because of other obligations such as raising children or caring for adult parents which takes them out of the workforce and make them less able to earn as much as their male spouses.

It is interesting, I think, for most people to learn, perhaps for the first time, that women who, in fact, work must choose the higher of their own benefit or their husband's Social Security benefit when the time comes for them to make that decision. Thereby, if she picks her husband's benefit, she gets really no credit for all of the years that she may have worked under the system, which is something that I dare say many people do not realize.

So the bottom line is that I think this committee can play a major role, Mr. Chairman, in looking for real solutions to two of this Nation's most serious problems that we are going to be facing and, hopefully, we can do it in the 106th Congress before we get into the election cycle.

[The prepared statement of Senator Breaux along with prepared statements from Senator Hagel and Senator Enzi follows:]

PREPARED STATEMENT OF SENATOR JOHN BREAUX

Women are among the vulnerable populations that must be protected during Social Security reform. We need only think of our mothers, wives, and daughters to bring home the importance of ensuring that women can retire with dignity and security.

Congress should start with our common goals—we all want to prevent women from living in poverty in retirement. There are things we can do within the current system and in a reformed system to make Social Security a true bedrock of security for women who disproportionately rely on the system.

However, I have an additional goal in mind. The impending insolvency of Social Security certainly isn't good news. However, the silver lining is that Social Security reform will present us with a rare opportunities—such as tackling head on the difficulties facing women as they look towards financial security in retirement.

Lets face it, many of the very reasons that women depend heavily on Social Security, Social Security reform will never "fix". They are broader societal factors—women live longer, women leave the workforce to have children, women are often underpaid. In fact, many we don't want to fix. They are good things.

While we should design the traditional Social Security system as best we can to benefit women, we have an opportunity to use Social Security as an effective tool in helping women achieve financial independence.

Many women struggle to access equity investment, they struggle to create their own economic assets. Women can't always be last in line in creating wealth for themselves and their families. I believe that individual accounts can help elevate the financial security of women.

But they, must be done right. My plan with Senator Gregg introduces individual accounts only as a supplement to Social Security. The traditional social system is left in tact and improved. The individual accounts are limited and regulated.

Individual accounts can offer women the best of both worlds—if done right. That is why I am open to hearing from the witnesses. I hope to learn things that I may not have thought of and that will help me as I continue to strive to improve upon my bill.

PREPARED STATEMENT OF SENATOR CHUCK HAGEL

Good afternoon, Mr. Chairman. Thank you for calling this timely and important hearing.

The debate over Social Security reform is one of most vital that our nation faces. There is no one in America, or in this room, that will not be touched by this debate.

This is a spectacular opportunity. Not since Social Security was created have we had a chance to look at this program in total and ask some very basic questions. What do we want this program to do for us and at what cost? What should the role of government be in providing retirement security?

I believe Social Security reform that incorporates personal retirement accounts would harness the power of private markets and compound interest, giving individuals ownership of their retirement savings. Americans want more power, more choice, more responsibility in deciding their own future and economic well-being.

However, as we strengthen this important program, we need to take into account ways in which these changes will affect all Americans.

Today's hearing will address some important issues in this debate relating to women. Women, on average, live longer than men. In 1998, a man age 65 could expect to live to an age of 81. A woman at age 65 could expect to live to age 84. Additionally, there is a lifetime earnings differential between men and women that needs to be accounted for in any efforts to strengthen Social Security. These facts alone mean that any changes we make to Social Security will disproportionately affect women.

I look forward to hearing from our distinguished panel as they discuss benefits women derive from the current Social Security system and how these benefits could be affected by adding a personal accounts component to the system. As I stated before, I believe that the idea of adding personal accounts to the Social Security System must be examined as we proceed to strengthen Social Security.

How we engage the challenges before us will determine the future of our nation. Failure is not an option. Strong, dynamic, imaginative leadership will be required. We are up to the task.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR MICHAEL ENZI

Thank you, Mr. Chairman, for holding this hearing regarding the impacts of Social Security reform on women. This Committee will play a key role identifying the issues in the Social Security debate during this Congress. I look forward to being an active participant.

I have been hearing some disturbing concerns from my constituents about Social Security reform. Many seniors—especially women—fear that any changes to the system would cut their benefits and leave them without an income safety net in their golden years. Certain reform proposals do carry increased risk. Others call for a reduction in benefits or an increase in taxes. However, I believe we need to forego the scare tactics and politics in this important debate and instead provide people with the facts. Clearly, it is not in our interest to reform Social Security in a manner that would undermine its ability to provide a reliable safety net to retirees.

As we have seen in actuarial reports from the Social Security Administration, the system will have a negative cash flow in 2013, and it will be bankrupt in 2030. If we do nothing to avoid the pending solvency crisis, we'll all face the possibility of entering retirement without a safety net. Therefore, Congress must act in a timely manner to ensure the long term stability and solvency of Social Security.

I strongly support examining the merits of diversifying the individual investments made with Social Security payroll taxes. I am hopeful that today's testimony will demonstrate the financial, as well as personal, pros and cons of giving Social Security beneficiaries more control over their individual contributions for retirement. It is time to give Social Security beneficiaries some of the same options and returns on their hard-earned dollars that they have with their other retirement accounts.

This hearing should give us all a better perspective on the unique issues of the Social Security debate faced by women. I look forward to reviewing the witness' testimony.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

I will take care of a couple of administrative things before I call the first panel. First of all, for members that are not here, and we have one coming in now, but for staff of other members who are not here, if your member wants to give an opening statement after they arrive or under some sort of time constraints, I hope you will feel free to tell me because I try to accommodate members on both sides of the aisle in regard to dividing their time between this committee and other committees.

And, also, for each of our witnesses, as well as members, particularly for new members of the committee who cannot come, you are welcome to have questions submitted to our panelists in writing. And if you do that, we would like to have responses in about 2 weeks. I hope that would be convenient for panelists if you get written responses from both people that are absent, as well as people who—those of us who are here might have some questions we will submit in writing.

Senator Burns.

Senator BURNS. Thank you very much, Senator Grassley. I have no opening statement. I would rather listen to the witnesses.

The CHAIRMAN. OK. Thank you.

We will go to——

Senator BURNS. You robbed me of my lunch. [Laughter.]

I have not missed very many lunches.

The CHAIRMAN. Dr. Olivia Mitchell is of the Wharton School of Business at the University of Pennsylvania. She is our first witness. Dr. Mitchell was a member of the Technical Panel for Income and Retirement Savings of the Social Security Advisory Council. She is an expert in the area of public finance and has published extensively on social insurance.

She will discuss ways in which a Social Security system with an individual account component could benefit women and if there are potential problems women face, how these problems can be addressed. Also, she will discuss ways to design a minimum benefit to compliment an individual account component.

And Dr. Alicia Munnell is the Peter F. Drucker professor of Management Sciences at Boston College's Carroll School of Management. Also, she is the director of the new Center for Retirement Research at Boston College. She has participated on numerous advisory boards and panels on social insurance, and she will discuss features of the current Social Security system which help women and concerns that she has and will discuss with us about creating an individual account component. Furthermore, she will discuss ways in which her concerns can be addressed.

We will start with Dr. Mitchell and then Dr. Munnell, and we will let the panel finish before we ask questions.

Go ahead.

STATEMENT OF OLIVIA S. MITCHELL, PROFESSOR, DEPARTMENT OF INSURANCE AND RISK MANAGEMENT, WHARTON SCHOOL OF BUSINESS, THE UNIVERSITY OF PENNSYLVANIA, PA

Dr. MITCHELL. Thank you. It is a pleasure to be here, Mr. Chairman and other members of the committee. I am grateful to be asked to testify before your committee on issues regarding individual accounts.

In my testimony, you asked me to focus on three topics. First, what I will do is examine briefly some of the strengths and weaknesses of our current old-age system that are specifically relevant to how women fair in retirement. Second, I will discuss some of the objections that are frequently raised in connection with individual accounts in a reformed Social Security system. And, third, what I would like to do is outline how one might construct a reform system that would include individual accounts that would meet some of these objections raised.

If I might preview my conclusions—we always have to preview them in business school. That way you catch their attention—I do argue that it is possible to add an individual saving account pillar to our national retirement system in such a way that addresses many of the objections that have been raised previously.

So let me start by focusing on some of the strengths as well as the weaknesses of our retirement income system. We know that Social Security, employer pensions and individual saving combine to make a strong and flexible diversified set of mechanisms protecting the elderly. Quite frankly, I would rather grow old in the America of today than in the America of 50 years ago.

But despite this positive assessment, there are deep and growing problems that confront our system. Social Security, as we know, faces a downstream cash-flow problem, and many older persons still live either at poverty or close to the poverty line. Others face insecurity associated with the death of a spouse, the onset of poor health and the simple reality of living too long and running out of money.

So against this backdrop, policymakers, such as yourselves, are focusing on the particular situation of women. Now most provisions of our pensions, our Social Security and our tax laws are, in fact, gender neutral. But it is frequently argued that these programs do not play out that way in practice. And it is for this reason, I believe, that women have become the focus of attention in the retirement arena.

Now, there are two explanations that I have for this. First, as Senator Grassley noted, women do tend to live longer than men, on average. Many women will become widows and spend down their assets around the time that their husbands pass away. Nonmarried women tend to start retirement with relatively lower levels of assets to begin with, and that combined with a longer life expectancy, means they might do less well in old age.

Women's longer life span also makes them a little more vulnerable to inflation and health care problems than their male counterparts, as Senator Breaux noted. A second point, of course, is that older women are more likely to be poor than are older men. If an ideal retirement system were one that guaranteed some minimum safety net or minimum consumption level, I think it is fair to conclude our current old-age system falls short on that account.

As I show in my written statement submitted earlier, our national retirement income system has both positive and negative effects on women. Our mothers and our grandmothers who are, today, retired, benefited a great deal from a traditional family benefit philosophy that is embedded in Social Security. But the situation, I would argue, is somewhat different looking forward.

Virtually all cohorts working today anticipate receiving less in Social Security benefits than they paid in in taxes. Furthermore, economic and demographic changes mean that the retirement system imposes some of the heaviest marginal tax rates, as Senator Breaux pointed out, on working women, many of whom are finding that the system does not meet their needs.

In addition, the serious financial challenges confronting Social Security undermine many Americans' confidence in the ability of the system to sustain us in the years ahead. Those of us anticipating being here in 50 years, and I hope I am among that group—perhaps not in this room, though—have a deep interest in seeing this system reformed as soon as possible so we can look forward with security.

I now turn to the question of how individual accounts might remedy some of these shortcomings. There are several common objections you hear—some associated with the accumulation phase; that is, saving for retirement, and some associated with the decumulation phase. I will list them and give a brief comment.

During the accumulation phase, some people argue that low-wage workers, among them some women, could contribute relatively little to individual accounts which might produce a low accumulation by retirement age. My response is that women's earnings and their years in the labor force do tend to be lower than men's so, on average, they might receive lower benefits than men. But these gaps are narrowing, so the concerns would be lessened over time.

In addition, people with very low accumulations would be better covered by a minimum benefit provision embodied in an overall Social Security reform. By contrast, under the current system, there is no minimum benefit in Social Security.

A second objection you sometimes hear is that participants might make poor investment choices. Other speakers in the second panel today will talk to that point. I would simply say I do not think women are particularly less likely to be good investors.

Some people argue that homemaker spouses that never hold a paying job would end up with no contributions to their individual accounts, and that might be a strike against the individual account approach. My comment is that the fraction of spouses that have never had a paying job is falling over time, so this is less of a problem, looking ahead. Also, and this is very important, individual account balances have the virtue of continuing to grow during periods out of the labor force, unlike the current Social Security rules which do not give you a benefit if you are not working.

Furthermore, individual accounts could be bequeathed in the event of a husband's death and, of course, in the event of divorce, they could be allocated across the parties that are splitting.

Some people argue that individual accounts might end the Social Security Administration's current commitment to disability and survivor's insurance. I would say, to the contrary, most personal account plans assume that the Social Security Administration continues to offer a program of survivor and disability benefits or, alternatively, some other method of privately managed plans could be included.

Let me turn briefly to the decumulation phase. Some people say that workers might retire too early, even if their individual account balances are too small to produce a minimum benefit. My reaction is that, in fact, most of the realistic individual account plans preclude access to the money too early, holding it until some nationally agreed on retirement age.

Some people say that participants might try to get their money as a lump sum rather than annuitize it, so they are protected until they die. Now, this does present the problem of adverse selection, and one of our other speakers today will touch on that. I would simply say that there are personal individual account plans that require that a portion of the money be annuitized, and that seems to be a reasonable compromise.

I have also heard that since women, as a group, live longer than men, on average, their annual annuitized benefit will be less than men, but this can be remedied—it has been remedied, for example, in Britain, with unisex mortality tables.

So, as we see, several of the objections enunciated by opponents of the individual account approach can, I think, be dealt with by careful program design.

Let me just point out that personal account plans cannot be assessed in a vacuum. Rather, they should be seen as a useful element of an overall retirement system that needs reform, one that would benefit women as well as men. Some positive outcomes could result:

For example, individual accounts with earnings sharing between spouses would protect the retirement accumulation of couples who end up divorcing prior to the current system's 10-year minimum that you need in order to get a benefit.

Instituting accounts could afford participants access to capital remarks that they previously lacked, potentially increasing many Americans' well-being.

Careful structuring of investment options could improve investment performance and could put pressure on investment managers.

And, finally, low-wage workers' individual accounts could be boosted with a Government match, perhaps at a rate that falls with income. This would help buildup the small accounts and would diminish concerns about administrative expenses.

So to the extent that some women and, indeed, some men will still reach retirement age with low benefits, our old-age system will be asked to provide a minimum floor of income. Regrettably, one factor I find missing in the current public debate is the real question of how a safety net should be constructed, including, by the way, SSI and disability insurance.

I would simply put before the committee the notion that the Health and Retirement Study is an excellent data source that could and should be used to address some of these issues. And I commend the Congress and the National Institute on Aging for its support of this valuable data collection endeavor.

So, to close, I thank the committee for its effort to explore how women might fare under alternative Social Security reform plans. We must acknowledge that women, like men, have varied work earnings and marital patterns, and these are very different from what was in place 60 years ago when the Social Security system was founded. These changes must be met by a flexibly adapting retirement income system.

Mr. Chairman, this concludes my prepared statement. At this time, or after Dr. Munnell speaks, I will be happy to answer any questions.

[The prepared statement of Ms. Mitchell follows:]

Statement of Olivia S. Mitchell[1]
Professor of Insurance and Risk Management and
Executive Director of the Pension Research Council
The Wharton School • University of Pennsylvania

Testimony before the Senate Special Committee on Aging
Hearing regarding Social Security Individual Accounts and Women

February 22, 1999

Mr. Chairman and Members of the Committee:

Thank you for inviting me to testify before your Committee on issues regarding individual accounts under a reformed Social Security system and ways to resolve these issues.

In my testimony today you have asked me to focus on three topics. First I examine strengths and weaknesses of our current retirement income system that are pertinent to discussions of how women fare in retirement. Second I discuss some of the objections raised in connection with adding an individual account component to our old-age income system. And third, I outline how one might construct a reformed system that includes individual accounts, one that would meet some of the objections raised. To preview my conclusion, I argue that it is possible to add an individual saving account pillar to our national retirement system, in a way that addresses many of the problems inherent in the current system.

OUR NATION'S RETIREMENT INCOME SYSTEM HAS BOTH STRENGTHS AND WEAKNESSES

The US retirement income system has strengths but it also has many important weaknesses. There is no doubt that Social Security, employer pensions, and individual provision for old age combine to make a strong, flexible, and diversified set of mechanisms protecting the elderly. Optimists argue that our system is working well, pointing to the drop in elderly poverty rates since the 1960's, the fact that more Americans can afford to retire earlier than ever before in our history, and the impressive accumulation of employer-provided pension wealth. This positive picture of the nation's retirement system is complemented by the efforts to boost retirement saving in recent years including 401(k), IRA, and Roth retirement plans, rules requiring faster vesting and joint/survivor options under private pensions, and measures taken to strengthen the nation's defined benefit pension system. Most agree that the prospect of growing old in America today is more appealing than it was in the 1930's.

Despite this positive assessment of the retirement landscape, pessimists emphasize the deep and growing problems confronting our national retirement system. The Social Security system faces critical solvency problems over the next few decades. Concerns abound regarding employer pensions as well: there has been little growth in private coverage for over a decade, and many people offered pensions turn them down, for reasons only poorly understood. And as far as individual saving goes, Americans have done a poor job of building individual assets, despite the fact that the period of time we anticipate spending in retirement is growing longer. Moreover, many older persons still live at or below the poverty line, and still others face insecure economic circumstances associated with the death of a spouse, the onset of poor health, or the simple reality of living too long and spending down their assets.

It is against this backdrop that policymakers seeking to revamp the nation's retirement system are asked to focus on the particular situation of women. While most of the key provisions of our pensions, social security, and tax laws are explicitly gender-neutral, it is frequently argued that they do not "play out that way" in practice. For this reason, women have become a focus of attention in the retirement arena. There are two explanations given for this. First, women tend to live longer than men on average. Many married

[1] Opinions expressed in this testimony are my own and not necessarily those of the institutions with which I am affiliated; comments should be addressed to mitchelo@wharton.upenn.edu

women will become widows and spend down their assets around the time their husbands pass away. Nonmarried women tend to have relatively low levels of assets to begin with, which combined with a long life expectancy places them at risk for economic insecurity in old age. Women's longer lifespan means that they are more vulnerable to inflation and health care problems than their male counterparts. As a result, and the second reason people focus on how the retirement income system affects women differentially, is that older women are more likely to be poor than are older men. If an "ideal" retirement income system were one that guaranteed some "safety net" or minimum consumption level, many older women as well as many men fall below this level in America today.

In my view, our old-age system has contributed to these problems because the philosophical perspectives structuring the system are outmoded and incoherent. To remedy these problems, it is essential to develop a comprehensive and updated framework for a national retirement income policy. In doing so we need to take a look at the underlying philosophies that have shaped what we have, along with the inherent conflicts between them.

The Earnings Replacement Approach
Much of our old-age system is structured around **earnings replacement**. This philosophy emphasizes that people earning more must save more, to ensure that retirement income does not drop too far below what they lived on while working. This was encouraged by the tax code which provides a greater tax break for higher earning people via company-sponsored pensions and IRA's. (Of course, nondiscrimination laws curb tax deferred saving for very high earners). Hence, too, the Social Security benefit formula was structured using an earnings replacement philosophy, to replace part of the worker's lifelong pay. Underlining the earnings-related focus of Social Security was the requirement that people could only receive benefits if they contributed a fixed number of years to the system (roughly 10).

Not surprisingly, the earnings replacement approach has produced a positive relationship between saving and earnings. That is, people with lower lifetime earnings – including lower skilled and part-time/part-year employees – save less, since they have less to replace. People with higher lifelong earnings have more in retirement. Also, anyone with a short time in the paid labor market – less than 10 years – is often ineligible for retirement benefits on his or her own record. The result of this approach is that many women retiring today are eligible for low, or no, benefits on their own account. Since today's older women as a rule spent few years in the paid labor market, and many of those who did earned low pay, they are less likely to have company pensions and individual retirement assets than older male retirees. [They are also less likely to be covered for disability benefits under SSDI as a result]. In the future, pension coverage and asset accumulations are expected to grow as women's earnings and years of paid employment increase.

Another result of the earnings replacement philosophy is that retirees are not guaranteed a minimum retirement income in our current system. In other words, people who experience low or erratic labor market earnings and employment over their lifetimes end up with low or no pension and social security at all. An alternative approach would be to guarantee all Americans some affordable minimum benefit, such as the poverty line, and then to construct the retirement income system so that this was achieved. Of course, this would require a change in the underlying philosophy of the retirement income system, one we describe below in more detail.

Redistribution and the Traditional Family Subsidy
Another philosophy underlying our national retirement income system is a **redistributive** one. One way this is seen is in the redistributive benefit formula that returns higher proportional benefits to low lifetime earners. Another example of this is that the system builds in a subsidy to one particular household type, namely the "traditional" family, which 60 years ago consisted of a husband-earner and a wife-homemaker who reared the children. At that time, marriages lasted longer than they do now – generally until one spouse died – and the husband usually predeceased his wife. The designers of the Social Security system structured benefit rules to subsidize this traditional family by allocating a benefit to the nonworking wife worth half her husband's benefit. If she were widowed, she and her dependent children also received a survivor benefit. (Under Social Security benefit rules are gender-neutral, but most surviving spouses have been widows.)

Subsidizing traditional families under Social Security produces income redistribution toward households of one type – married couples where only one partner works for pay and the other raises children – and away from households of many other types. These others include households where both partners work for pay and households with nonmarried persons. In addition, under current rules, the system has a "length-of-marriage" requirement such that families with single parents cannot get dependent or widow benefits unless the marriage lasts for 10 years or more.

These rules appear quite arbitrary and unfavorable toward many women, in the current environment. Families today do not readily fit the traditional mold embedded in the Social Security benefit structure designed 60 years ago. Dramatic changes in marriage and divorce patterns, along with women's rising labor force attachment, have shrunk the group eligible for the traditional family subsidy under Social Security. For instance, divorce rates tend to peak at around seven years of marriage, leaving a large and growing fraction of the population uncovered by the traditional family subsidy. Some population groups have experienced dramatic declines in marriage rates, rendering them ineligible for spouse, dependent, and survivor coverage. Many working wives also receive no net benefit from paying the Social Security payroll tax their entire working lives, since their benefit as wives exceeds their benefit as retired workers. Though technically they are "dually entitled" (their own retiree benefits are topped up to the level they would receive as nonworking spouses), the reality is that no net retirement benefit at the margin results from their payroll tax payments. Hence the result is that in many households the system discourages rather than encourages work and saving. This is particularly troubling for lower-paid dual-earner households where holding a job is a necessity rather than an option; conversely, the traditional family subsidy tends to reward higher-income households where one spouse does not hold a paying job.

The Current System Faces Insolvency

Another problem confronting all older workers is that the current retirement income system faces insolvency. That is, under current rules, Social Security revenues are insufficient to maintain benefit promises into the future. Since women live longer in retirement than men, and a larger portion of their promised retirement benefits comes from Social Security than from other sources, many will feel particularly vulnerable to the shadow of uncertainty cast by the political and economic uncertainty created by not knowing how this insolvency problem will be resolved. Hence reforms instituted soon, even if they are phased in over time, will benefit women and their families.

The Current System Has Mixed Effects on Women

In sum, our national retirement income system has both positive and negative effects on women. Our mothers and grandmothers, who are today retired, benefited a great deal from the traditional family benefit philosophy guiding benefit rules. But the situation is different looking forward. Virtually all cohorts working today anticipate receiving less in benefits than taxes paid into the system. Furthermore, demographic and economic changes have meant that the retirement system imposes some of the heaviest marginal tax rates on working women, many who are finding that that the system does not meet their needs. In addition, the serious financial challenges confronting our Social Security system are undermining many Americans' confidence in the ability of the system to sustain promises made. Those of us anticipating being here over the next 50 years –many of us women – have a deep interest in seeing the system reformed soon, in a way that will put to rest much of this uncertainty.

IMPACTS OF A PERSONAL RETIREMENT ACCOUNT REFORM

Next we examine whether and how a personal retirement account approach could remedy some of these shortcomings in our national approach to retirement policy. I shall show that individual accounts are at worst neutral toward women, and they could even improve women's retirement income security.

There are many specific individual account plans in the works, including some under construction by key members of this Committee. Rather than exploring the specifics of any particular plan, I draw on my observations gleaned from serving as co-chair of the Technical Panel on Income and Retirement Saving for the last Social Security Advisory Council. There it was argued that a viable individual account approach would involve mandatory payroll contributions to a funded, individually-directed, defined contribution pension plan. Some choice of investment options would be permitted, initially probably limited to a handful of broad index funds, with government regulatory oversight and reporting.

In the course of that work we explored the pros and cons of personal saving accounts from many angles. I organize the most commonly hear objections to individual accounts into two groups, those associated with the accumulation phase (prior to retirement) and those associated with the decumulation phase (after retirement).

Issues in the Accumulation Phase
Taking these in order, during the *accumulation* phase, concerns are sometimes expressed about the following. I attach my observations immediately following each point:

1. Low-wage workers, and people with modest attachment to jobs covered by Social Security, would contribute relatively little to their personal saving accounts. This could produce a low accumulation by retirement.

Comment: Women's average earnings and years in the labor force are lower than men's, so women on average would receive lower benefits than men from these accounts, a result in keeping with the earnings replacement philosophy outlined above. Of course, gaps in earnings and labor force attachment are narrowing by sex, so these concerns will be mitigated in the future. In addition, people with very low accumulations would be covered by the minimum benefit alluded to above; by contrast, there is no minimum guaranteed benefit provided under the current system.

2. Participants might make poor investment choices, take out loans against their accounts, or cash out the lump-sums in their accounts, potentially undermining the purpose of the individual accounts.

Comment: Today's women are not more likely to cash out, take loans from, or misinvest, their pension assets, judging from available evidence. Pension participants can also be educated about the benefits of pension saving and financial issues, and women should be as likely as men to be educable in an individual accounts context. Again, those who did so would be covered by the minimum benefit provision, providing a safety net not available under the current system.

3. Homemaker spouses who never held a paying job would have no contributions to their personal accounts.

Comment: The number of homemaker spouses without a paying job is falling over time, and individual account balances have the virtue of continuing to grow during periods out of the labor force, unlike the current Social Security rules that reduce benefits for nonworking years. Further, individual accounts could be bequeathed in the event of the husband's death. Some personal account plans also guarantee a minimum benefit ("demogrant") to all older Americans, a feature lacking under the current system.

4. In the event of divorce, individual account balances might not be equitably split between the two parties.

Comment: Just as private pension balances are considered in the allocation of assets at divorce, so too could personal saving account balances.

5. Individual accounts might end the Social Security Administration's current commitment to disability and survivors insurance.

Comment: Most personal saving account plans assume that the SSA continues to offer a program of disability and survivor benefits. Alternatively, privately managed disability and life insurance plans could be included in the reform plan.

Issues in the Decumulation Phase
During the *decumulation* or retirement phase, concerns are sometimes expressed regarding the following:

1. Some workers may want to retire early, even if their individual account balance is too small to produce a minimally adequate benefit level.

Comment: Most personal saving account plans preclude access to the accounts until some nationally agreed-on retirement age.

2. Some participants would ask for their benefit as a lump sum, rather than an annuity. This produces adverse selection in the annuity pool, and exposes those taking the lump sum to the risk of running out of money.

Comment: Some personal account proposals require that all or a portion of the account must be annuitized.

3. Insurers selling annuities pay a lower annual benefit to those with longer life expectancies. Since women as a group live longer than do men on average, a woman's annual benefit will be smaller than a man's with the same accumulation amount in the pension.

Comment: Some personal account proposals require insurers to use unisex mortality tables in setting the annuity benefits, at least for the minimum guaranteed benefit.

4. Participants might not elect payout plans from their individual accounts that are inflation protected, exposing retirees to a benefit that fell in real terms.

Comment: With the advent of government-issued inflation-linked bonds, insurers can construct a real annuity that would offer protection against inflation.

Clearly some of the objections enunciated by opponents of a personal saving approach are worthy of attention. On the other hand, as we have shown, responses are available to many of them, and most can be dealt with by careful program design.

MEASURES SUPPORTIVE OF AN INDIVIDUAL ACCOUNT SYSTEM

My earlier discussion emphasized that our current system has many problems, some of which are of particular concern to women. These include the fact that Social Security faces insolvency, benefit rules do not guarantee minimum retirement benefits to all, and many working women face extremely high marginal tax rates under the program. Could a well-designed individual account plan solve these problems? I believe so, and I will offer suggestions as to how an individual account plan could be beneficial in an overhauled retirement income system.

In undertaking such an overhaul, I believe that two assumptions are likely to guide policy. First, any reform of the US old-age system – including one with a personal retirement account plan – will have a minimum retirement income promise, payable to retirees whose benefits fall below some poverty threshold. Second, any reformed old-age system in the US will provide some protection against the risks of disability and premature death.

Individual Accounts In a Reformed Old-Age System

My point is that personal account plans cannot be assessed in a vacuum. Rather, if carefully fashioned, they could be a useful element of a reformed retirement income system, one that would benefit women as well as men. Several positive outcomes could result:

- Instituting individual accounts with earnings sharing between spouses would protect retirement accumulations for couples who divorce prior to the current system's 10-year cutoff, helping homemakers and low-earners.
- Instituting funded accounts could afford participants access to capital markets that they previously lacked, potentially increasing many Americans' wellbeing and incentives to learn about financial matters.
- Careful structuring of investment options, along with transparent reporting and disclosure of administrative expenses, would improve investment performance and put competitive pressure on investment managers.
- Low-wage workers' individual account contributions could be boosted with a government match, perhaps at a rate that falls with income. This match would help build up small accounts quickly and also would diminish concerns about administrative expenses on small accounts.
- Retirees could be required to take at least one portion of the benefits as an inflation-indexed annuity priced with unisex mortality tables. This would protect both the plan participant against running out

of money, and future taxpayers against the chance that some retirees would later demand that benefits be paid to those who had take a lump sum and lost it.

- Individual accounts could permit future Social Security benefit and tax schedules to be brought into alignment, thus reducing uncertainty regarding future benefit and tax rules for the retirement system.

To the extent that some women – and indeed some men – will still reach retirement age with low benefits, it must be anticipated that our old-age system will still be asked to provide indigent people a minimum level of support. Regrettably, many Social Security reformers have avoided the question of how a safety net would work in a revamped system. Time constraints prohibited the Technical Panel and the Advisory Council from taking a hard look at how old-age benefits, SSI, and DI interact. What is needed is a thorough and integrated analysis of these closely allied programs, and I hope that your Committee can press for this in moving forward on Social Security reform plans. The Health and Retirement Study is an excellent datasource that could and should be used to address these issues, and I commend the Congress and the National Institute on Aging for its support of this valuable data collection endeavor. Yet many reformers are reluctant to address the key role of a guaranteed minimum benefit under the nation's old-age system, perhaps because doing so spotlights some of the failings of the current program.

One place to begin would be to take a hard look at how well – or how poorly – the safety net is working for older people today. Having assessed this, it would then be necessary to determine what would happen under any particular reform of just the retirement benefit piece, and how the moving parts would mesh. To their credit, personal saving account advocates on the last Advisory Council built a minimum benefit into their individual account approach. In so doing, they show that it is possible to balance an earnings-replacement approach with the redistributive considerations so important to our retirement income system.

Conclusion

In closing, I commend this Committee on its effort to explore how women would fare under alternative Social Security reform plans. We must acknowledge that women, like men, have varied work and marital patterns, and today's patterns differ dramatically from those of 60 years ago. These changes – and ones we will see in the future – must be met by a flexibly adapting retirement income system. Individual saving accounts can help meet the challenges of the new millenium.

Mr. Chairman, this concludes my prepared statement. At this time I will be happy to answer any questions you or the other Committee Members may have.

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The CHAIRMAN. Dr. Munnell.

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

Dr. MUNNELL. Chairman Grassley, Senator Breaux, members of the committee, I am delighted to have the opportunity to appear before you today to discuss the important topic of the potential impact of Social Security reform on women.

My view, unlike that of Senator Breaux and Dr. Mitchell, is that women do very well under the current Social Security program and that cutting back the current Social Security program and replacing it with individual accounts would hurt the retirement security of older women.

At the same time, everything is not perfect in Social Security. Single older women continue to experience very high rates of poverty. So some targeted change within the current system should be made to help this group. Let me just briefly summarize these views in five points.

First, as Senator Grassley indicated, in the context of a retirement program, women differ from men in two important ways: They earn less and they live longer. They earn less because they tend to work part-time more often than men. They tend to spend time outside of the labor force more often than men. And even women working full-time only earn 74 percent of what a male full-time worker earns.

The second point is, although Social Security is technically gender neutral, as Dr. Mitchell said, the present Social Security system compensates for these two aspects of women, longer life and lower earnings, in several ways.

First of all, the progressive benefit formula provides proportionately higher benefits for low-income workers than for high-income workers and women workers, on average, tend to be lower income workers.

Second, for women who spend their careers taking care of their families, Social Security provides spouse's benefits. Divorced homemakers married at least 10 years can also get these benefits.

For older women whose husbands die, Social Security provides survivors' benefits equal to 100 percent of the husband's benefit.

If children are getting survivors' benefits, younger widows who stay at home to care for them also receive benefits. So it is important because it has a progressive benefit formula, and it is important because it provides family benefits.

There are two other aspects that particularly compensate for the fact that women live longer than men:

One, Social Security pays benefits as an annuity. That means you get benefits every month, no matter how long you live, and women, on average, live 3 years longer than men.

Second, Social Security benefits are adjusted annually for changes in the cost of living, and inflation protection matters more the longer you live, and women live longer than men.

So women live longer, they have lower earnings. The current system compensates for these two characteristics. In my view, moving toward a system of individual accounts would endanger these protections, and we are talking about a proposal to cut back on Social Security and replace them with some individual accounts. We are not talking about just adding on some individual accounts.

But to the extent that you cut back Social Security and replace them with individual accounts, women would do worse. A woman's overall retirement benefits would depend, at least in part, on how much money she put into her personal account and how much she earned on those accounts. Because her earnings are low, her contributions would be low, and her benefits from that component of her retirement benefit would also be low.

Second, some of the family benefits associated with Social Security would be cut back on. To the extent that you take 2 percent and divert it toward individual accounts, you will not have the family benefits associated with that component.

As Dr. Mitchell mentioned, with individual accounts, it is not automatic that money is transformed into an annuity. To the extent that people get money in lump sums, they can spend it early and not leave anything for their survivors, so that widows could be hurt by this component.

And this risk of lack of annuitization is compounded by the fact that inflation protection is very difficult to duplicate and impossible to duplicate, actually, in the private market, since inflation-adjusted annuities are not existent in the United States.

Finally, proposals that purport to introduce individual accounts and guarantee all benefits under the current system, the so-called Feldstein plans, or sons of Feldstein, should be viewed very skeptically. These proposals are based on very optimistic economic assumptions, and my sense are inherently unstable and would undermine Social Security's defined benefit structure.

So women differ from men; current system helps women; moving to individual accounts could hurt women. And women have very little to gain from individual accounts. Simply shifting your payroll taxes to individual accounts will not increase the rate of return on Social Security contributions defined very broadly. Yes, the accounts that you set up at Fidelity will look better than your Social Security system account, but you also have to adjust for the fact that you have to continue to pay benefits to current retirees. So you have got to take into account the cost of financing the existent unfunded liability.

When you add it all up, you do not get higher returns just by diverting some of your payroll tax monies away from the program.

So women are different than men; current system helps women; moving to individual accounts could hurt women; and they have little to gain.

The final point is that, despite the protections of Social Security, nonmarried older women have poverty rates around 20 percent. Now, part of this problem is unrelated to Social Security. It has to do with the fact that those with private pensions see their benefits eroded by inflation, and others see their benefits either terminated when their husband dies or cut in half.

Similarly, as women age or people age, they tend to draw down their assets, and so the interest that they get from the assets that are drawn down declines. So part of it has nothing to do with Social Security, but part of it does. The problem is that the benefit for the widow is inadequate once the husband dies. And so that a targeted change within the current system would be increasing the benefit paid to elderly widows, the common proposal is to 75 percent of the couple's benefit, and that would alleviate some of the problem for older single women.

But the main point I want to leave you with is that Social Security's current defined benefit structure with a progressive benefit formula, with dependents' benefits, with annuitization and with inflation protection, serve women well. They, and other low-paid people, should be very cautious about moving to an untried system of individual accounts.

Since the light is still green, I just want to add one point. I think economists have really blurred this issue of how well women do under Social Security because they focus constantly on this so-called second-earner's problem, and that is that wives are eligible for 50 percent of the husband's benefits, even if they pay no taxes, and so a lot of people have said, "Oh, look, they pay taxes, but they do not get any benefits until their own earned benefit exceeds 50 percent of their husband's benefit." That is true, but that is a minor problem, and it is certainly not a negative for women because the way you can get rid of that problem entirely is just eliminate the spouse's benefit. No one is advocating that. It would hurt women a lot, but it is an indication that the system it does not discriminate against women. It helps women because of the various provisions in the program.

Thank you.

[The prepared statement of Dr. Munnell follows:]

THE POTENTIAL IMPACT OF SOCIAL SECURITY REFORM ON WOMEN

Testimony before
the Senate Special Committee on Aging
February 22, 1999

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Chairman Grassley, Senator Breaux, members of the Committee, I am delighted to have the opportunity to appear before you today to discuss the important topic of how Social Security reform could affect women. My view is that women do very well under the current Social Security system. Therefore, replacing 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. At the same time, single older women continue to experience high poverty rates, so some targeted change within the current system should be made to help this group. Let me briefly summarize my views.

I. In the context of a retirement program, women differ from men in two important ways:
- They have lower lifetime earnings than men.
  - Women who work are more likely to work part-time.
  - Full-time women workers earn less than full-time men workers.
  - Women take more time out of the labor force than men do.
- They live longer.

II. Although gender neutral, the present Social Security system compensates for these differences.
- The progressive benefit formula provides proportionately higher benefits for low earners than for high earners.
- For women who spend their careers taking care of their families, Social Security provides spouse's benefits. Divorced homemakers (married least 10 years) can also get these benefits.
- For older women whose husbands die, Social Security provides survivors' benefits equal to 100 percent of their husbands' benefits.
- If children are getting survivors' benefits, younger widows who stay home to care for them also receive benefits.
- Social Security pays monthly benefits for life, which is particularly valuable to women who on average live longer than men.
- Social Security adjusts benefits annually for changes in the cost of living. Inflation protection matters more for women than for men because women live longer after retirement.

III. Moving toward a system of individual accounts would endanger these protections.
- A woman's overall retirement benefit would depend, at least in part, on her contributions into her personal account and the earnings on those contributions. Low earnings and less time in the labor force would produce low contributions and low retirement benefits.
- Many of the family benefits currently provided by Social Security would likely be cut back.
- With individual accounts the money is not automatically converted to a lifetime annuity; retirees could use it up before they die and leave nothing for their widows.
- This risk 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 non-existent in the United States.
- Proposals that purport to introduce individual accounts and guarantee all benefits under the current system should be viewed skeptically. These proposals are inherently unstable and would undermine Social Security's defined benefit structure.

IV. Women have little to gain from individual accounts.
- Shifting payroll taxes to individual accounts will not increase the rate of return on Social Security contributions, defined broadly.
- Returns on individual accounts may appear higher initially, but not after adjusting for the cost of paying benefits to current Social Security retirees.

V. Despite the protections of Social Security non-married older women have poverty rates around 20 percent.
- Part of the problem stems from non-Social Security factors.
  - Private pension benefits erode due to inflation, and are either cut in half or terminated when the husband dies.
  - Interest income declines as assets are drawn down.
- Part of the problem is due to the cutback in Social Security benefits when husband dies.
- Raising survivor benefits would alleviate some of the problem.

In summary, Social Security's current defined benefit system with a progressive benefit formula, dependents' benefits, annuitization, and inflation protection serve women well. They and other lower paid people should be cautious about moving away from the existing system.

I. Women Earn Less and Live Longer

Poverty among women over 65 is already twice as severe as among men over 65; without Social Security the discrepancy would be even greater. The reason is that in the context of a retirement program women differ from men in two important ways: they are likely to have earned less than men and they are likely to live longer.

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), women continue to have lower lifetime earnings than men for three reasons. First, women who work are more likely to work part-time. At the end of 1998, roughly 26 percent of women worked part-time, compared with 11 percent of men. Women account for 68 percent of all part-time workers. Second, women working full-time earned less than men working full-time. The median earnings of full-time year-round women workers in 1997 was $24, 973, compared to $33,674 for men. That is, among full-time workers, women earn 74 percent of men's earnings. Third, women take more years out of the labor force, since they interrupt their careers to care for young children or elderly parents. Of workers retiring in 1996, at the median a woman had worked 27 years over her lifetime compared to 39 years for a man.

Women also live longer than men do. A 65-year-old woman today can expect to live to 85, compared to 81 for a man. This gap has increased since 1940 and is expected to persist in the future. Because women live longer, they rely on Social Security for more years. They also become increasingly dependent on Social Security as they age. Among unmarried women, those aged 65 to 74 get 43 percent of their income from Social Security, whereas those 75 and over get 55 percent of their income from Social Security.

II. Women Do Very Well Under Social Security

The current Social Security program recognizes the special characteristics of women and compensates through its benefit structure for the fact that they earn less and live longer. It is useful to tick off the ways in which Social Security's benefit rules are particularly helpful for women. First, the progressive benefit formula provides proportionately higher benefits for low earners than for high earners, and women are more likely to be low earners.

Second, for women who spend their careers taking care of their families, Social Security provides retirement benefits equal to 50 percent of their husbands' benefits. Divorced homemakers (married least 10 years) can also get these benefits.

Third, for older women whose husbands die, Social Security provides widows' benefits equal to 100 percent of their husbands' benefits. This is important because women tend to outlive their husbands.

Fourth, if children are getting survivors' benefits, younger widows who stay home to care for them also receive benefits.

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

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

Economists have somewhat obscured how well women fare under Social Security by focusing on the so-called "second-earner" problem. From the beginning, Social Security has treated men and women earners the same; each receives a benefit based on his or her own earnings. In addition, if a spouse has low or no earnings, Social Security provides a spouse's benefit equal to 50 percent of the primary earner's. This benefit reflects the fact that in 1939, when the benefit was introduced, most married women stayed home to care for children.

As more women entered the labor force over time, the existence of this benefit has created the so-called "second-earner" problem. Working wives pay payroll taxes from the first dollar of earnings, but increase their benefit only after the benefit based on their own earnings exceeds half of the primary worker's benefit. That is, since women are entitled to 50 percent of their husband's benefit even if they do not contribute to Social Security, critics charge that the system discriminates against women because they get nothing back for much of their payroll taxes. Some also worry that payroll tax payments without corresponding benefits will discourage women from working.

The clearest way to see that the spouse's benefit does not discriminate against the second earner is to consider the easiest way to solve the alleged inequity -- simply eliminate the spouse's benefit completely. Such a move would solve the problem, but it would also certainly make women worse off. Social Security does not discriminate against second earners, who usually tend to be women; it discriminates in favor of couples by paying a spouse's benefit even if the wife's earnings are small or non-existent, and thereby helps women.

In short, the current Social Security program offers a range of protections — progressive benefit formula; family benefits, lifetime benefits, and inflation adjustments. These are of great importance to women and are not duplicated by many of the proposals to privatize the system.

III. Moving Toward Individual Accounts Endangers Women's Protections

All the protections of the current program would be put at risk if reform moved toward individual accounts. 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 low earnings and less time in the labor force, these contributions and earnings would, on average, produce low retirement benefits. Thus, individual accounts would perpetuate the earnings differences between men and women into retirement.

Second, many of the family benefits currently provided by Social Security would likely be cut back.

Third, with individual accounts the money is not automatically converted to a lifetime annuity or protected against inflation. If people get their money back in a lump sum, they could use it up before they die and leave nothing for their widow. This risk is compounded by the absence of inflation protection.

Some proponents of individual accounts argue that these concerns can be addressed. It is possible, they say, to introduce individual accounts and guarantee everyone the full benefits they would receive under the current system – the so-called Feldstein plan. The best of both worlds; women would do fine. This is a false promise, because Feldstein-type plans are inherently unstable. Consider two scenarios.

Although various versions of the Feldstein plan are floating around, they all have more or less the same structure. Workers would deposit 2 percent of their earnings up to the taxable maximum in an individual account. They would be reimbursed dollar-for-dollar for these deposits through a refundable income tax credit, financed in the short-run by the budget surpluses. The individual accounts would be invested in regulated stock and bond funds. When workers reach retirement age and begin to draw their pensions from their personal savings account, their Social Security benefits would be reduced by $3 for every $4 withdrawn. Overall workers would receive 60 percent of their benefits from Social Security and 40 percent from their personal accounts. The reductions in Social Security would eventually close the long-term financing gap.

- Start/Stop Scenario. One scenario is to start the Feldstein plan during this period of budget surpluses, but discontinue it once the surpluses disappear. The Feldstein plan appears painless in the short-term because contributions to personal savings accounts would in essence be financed by the surpluses. Once the surpluses disappear as the baby boom retires, continuing to provide tax credits for contributions to personal accounts would require more taxes, cutbacks in other programs, or increased borrowing. (Feldstein claims that the plan would be self-financing by 2030, but the Congressional Budget Office rejected this claim and the Social Security actuaries found that the Feldstein plan would have a negative effect on the federal budget in each of the next 75 years.[1]) If the plan is abandoned once the surpluses disappear:
    - Social Security's financing gap will have grown because no steps will have been taken to solve the problem.
    - The pressure to cut benefits will be great because people will have accumulated funds in their personal accounts. The personal accounts will be temporary, but the benefit cuts will be permanent.
- Long-run scenario. If the Feldstein plan continues, it would involve an enormous increase in government-mandated retirement pensions that would favor middle and high earners, who are disproportionately men, and it would eventually undermine support for a defined benefit guarantee like Social Security.

[1] Congressional Budget Office, "Analysis of a Proposal by Professor Martin Feldstein to Set Up Personal Retirement Accounts Financed by Tax Credits." August 4, 1998 and "Social Security Actuaries Analysis of the Feldstein Plan," Memorandum from Stephen C. Goss, December 3, 1998.

- The premise of the Feldstein plan does not make sense. It raises, not lowers, the level of mandated government pensions. Given the great concern about financing projected retirement and health cost for an aging population, mandating increased benefits for this group puts an unreasonable burden on the rest of society. Moreover, the bulk of the increased mandatory spending on retirement income would go to higher earners, who tend to be men, not women.

- The Feldstein plan would eventually undermine support for a defined benefit guarantee like Social Security. High and moderate earners would pay substantial payroll taxes to Social Security over their lifetimes, but would lose a large percentage of their Social Security benefits under the offset provision. When these earners compared their returns from Social Security with their returns from their personal savings account, they would conclude that Social Security was an unacceptably bad deal.

In short, the Feldstein plan is likely to lead to the unraveling of the current Social Security system. If a proposal sounds too good to be true, it probably is. There is no way to get around the fact that women have a lot to lose by moving to a system of individual accounts.

IV. Women Have Little to Gain from Individual Accounts

Women not only have a lot to lose from substituting individual accounts for traditional Social Security benefits, but also have little to gain. Shifting payroll taxes to individual accounts will not increase the rate of return on Social Security contributions, defined broadly.[2] Yes, the returns on individual accounts may appear higher, but that's not the whole story. It is necessary to subtract from those higher returns the cost of paying benefits to current retirees under the existing Social Security system.

When Social Security first started, the President and the Congress decided to pay benefits to the first generation of retirees whose lives had been disrupted by the Great Depression. Because the taxes of today's retirees went to support these early beneficiaries, someone must pay benefits for today's elderly. If current payroll taxes are diverted to individual accounts, then the government will have to raise other money or borrow to pay off this obligation. Subtracting the cost of higher taxes or borrowing reduces the return on individual accounts to the level of the Social Security fund.

[2] See John Geanakoplos, Olivia Mitchell, and Stephen P. Zeldes, "Would a Privatized Social Security System Really Pay a Higher Rate of Return," in R. Douglas Arnold, Michael J. Graetz, and Alicia H. Munnell, *Framing the Social Security Debate: Values, Politics, and Economics*, Brookings Institution Press for the National Academy of Social Insurance, 1998. The authors conclude: " ...Privatization without prefunding would not increase Social Security returns, when properly measured. Privatization with prefunding would eventually raise the rate of return to future generations of participants, but at the cost of a lower rate of return to early generations (p. 138)."

There is no disagreement on this point among professional economists: simply diverting payroll taxes to individual accounts will not raise the rate of return on Social Security contributions. Therefore, women have a lot to lose and little to gain.

V. Some Reforms Would Improve the Current System

Retaining the current defined benefit structure will serve women the best in the long run. That does not mean, however, that the current benefit structure cannot be improved. Specifically, some change is needed to help elderly widows and divorcees.

Although poverty rates among the elderly have fallen dramatically, poverty among widowed, divorced, and never married women remains high. While poverty among married women averaged 4.6 percent in 1997, poverty rates for unmarried women hovered around 20 percent (divorcees 22.2 percent, widows 18.0 percent, never married women 20.0 percent). For elderly black and Hispanic women the poverty rate was closer to 30 percent.

Some of the reason for the higher poverty among widows than among married women rests outside the Social Security system. In some cases, private pension benefits end when the husband dies; in most cases the benefit is cut in half. In addition, since, unlike Social Security, most private pensions are not indexed for inflation, their purchasing power erodes over time. Furthermore, the amount of interest income tends to decline during retirement as people spend down their assets. But Social Security also contributes to the problem by providing an inadequate benefit for widows. Under current law, when the husband dies the widow gets a benefit equal to the higher of her own or her spouse's benefit. If the husband and wife were receiving equal benefits, the widow would end up with 50 percent of the couple's benefit. If the wife had not worked and was entitled only to the spouses benefit of 50 percent, then the widow would receive the husband's benefit, which would equal 67 percent of the couples benefit.

Liberalizing the survivor benefit would improve the economic well being of widows and elderly divorcees significantly. Most proposals suggest raising the survivor benefit to three-quarters of the combined couple's benefit. Such a change is of increasing importance given the projected increases in life expectancy.

VI. Conclusion

Let me conclude. Women have a large stake in the current Social Security debate. They can be hurt if Social Security payroll taxes are diverted to individual accounts. At the same time, a shift to individual accounts will not increase the returns on their Social Security contributions. Women should be very reluctant to give up current Social Security protections for an untried system that relies on individual accounts for even part of their basic retirement income. Reforming the treatment of widows, however, could help alleviate the serious problems that still exist among this segment of the population.

The CHAIRMAN. Thank you both, and we have differing points of view, so we ought to have a very good discussion now as we go into our questions. Would you set 5 minutes for questions, please, for each of us.

You mentioned, Dr. Mitchell, in your testimony that one of the assumptions that you feel should guide reform policy is that a minimum retirement income promise should be put in place for retirees who would fall below the poverty threshold. Where would you set the minimum benefit? For example, would it be set at the poverty line? Should the benefit be indexed to inflation? In other words, how would you structure the minimum benefit?

Dr. MITCHELL. It is a very difficult question and probably the most important question in looking at how we might structure the retirement system going forward. I know that some of the proposals that emerged out of the Social Security Advisory Council had the minimum benefit which was actually below the poverty line. In that case, I remember the plan that was proposed by the Shieber-Weaver Group. They proposed something like $410 a month, which was a relatively low benefit.

There is always a tradeoff between trying to set that benefit high enough to sustain at least poverty-line consumption versus having enough money left over to put into an individual account.

In Britain, they followed the same sort of process that the Schieber-Weaver plan adopted, which was to target around $400/ $500 a month. But obviously it is a question of how generous you are able to be, while still leaving enough in the individual account to make it politically sustainable.

My view is that at least setting a poverty-line target would be better than what we have now, which is no target, no minimum at all.

The CHAIRMAN. From that point of view, as you probably know, we have few plans to save Social Security on the table now that have included a provision for minimum benefit. One reason for this is that, in the context of closing the funding gap, setting a minimum benefit is a very costly provision that has to be offset by either tax cuts, benefit cuts in other areas, or increased borrowing. So would you pay for or how would you pay for the minimum guaranteed benefit provision?

Dr. MITCHELL. To me?

The CHAIRMAN. Yes.

Dr. MITCHELL. There are a number of ways to do it. Perhaps one of the most interesting is to link what is in the individual account and the minimum benefit. So that, for example, if you have managed to save enough in your individual account, then you might no longer be eligible for the minimum benefit. So the notion is that they dovetail each other, that they integrate with each other.

A different approach is simply to make everybody eligible to get the minimum, but that does become a lot more expensive. So the integrated approach, I think, is more appealing, and that would also structure the individual accounts so that people would have an incentive to save more at the margin to be able to overcome and get over that minimum benefit level.

The CHAIRMAN. Dr. Munnell, you suggest increasing survivor benefits to keep elderly widows out of poverty. Some plans suggest a decrease in the spousal benefit in order to offset an increase in the widow's benefit. So I am interested in knowing if you would support this provision and then, if not, then how you would offset the benefit increase.

Dr. MUNNELL. Yes, Senator Grassley. I think that is a good tradeoff. Reduce the amount of money that the wife gets when her husband is alive and is getting a large benefit, and increase it after her husband dies when she needs it more or she is on her own and grows old with little other sources of income. So I would go for the tradeoff.

The CHAIRMAN. Then following up with you Dr. Munnell, there has been a long-time concern about the way that the retirement program affects working women because a woman can work and pay taxes for many years and yet generate no extra benefits over and above what she would have received had she not worked.

Most women, even women with children, are working women today, unlike when Social Security started. In fact, labor force participation for women born since 1960 is around 70 percent. As an economist, how do you think this affects women and their willingness to work, and do you not think that a savings-based system, which gives women a return on every dollar earned, would be more favorable to working women? You see my bias.

Dr. MUNNELL. No. No, I do not. I think that this is what economists have focused on over the years, this fact that women contribute, but they really do not earn anything in addition until they get a benefit equal to 50 percent of their husband's.

The Social Security system is gender neutral. It treats women workers just like it treats men workers. They both get benefits based on their earnings history. In addition, it does this very nice thing because, when the system first started, most women stayed home and did not have an earning's record of their own, and that is it provides an additional benefit for the spouse. And economists have focused on this sort of incentive effect for this first 50-percent-of-benefit phenomenon for working women, and I think we just lost sight of all of the important attributes of the system that help women so much; the progressive benefit formula, dependents' benefits, annuitization, indexation. All of those things are so important to women, and this sort of incentive effect is really relatively minor and probably has a minor effect on the labor force participation of women.

The CHAIRMAN. Dr. Mitchell, I would like to hear your response to what was just stated by Dr. Munnell.

Dr. MITCHELL. In my testimony I noted that there are a number of things that could effectively be replaced by the private market, and actually I would take some disagreement with Dr. Munnell on the inflation indexation point. The Government, as you know, has made available inflation-indexed bonds, and it is now feasible for private insurers to offer inflation-indexed annuities. So it seems to me that that's another objection that could well be met by a private alternative.

Dr. [continuing]. not Dr. Senator Breaux. [Laughter.]

Senator BREAUX. I have been dealing with Medicare for so long, I feel like I am a doctor. [Laughter.]

Thank you both for your presentations. I think they have been very helpful.

I think that, Dr. Munnell, you had said that Social Security, the current system, helps women. I think it helps some women, and I think it does not particularly help women who work all of their lives, and I think that, as the Chairman pointed out, when we first passed Social Security, most women did not work. Most women did not work outside the home. They worked very hard in the home, but they did not work outside of the home and, therefore, I think Congress, at that time, probably wanted to take more and better care for women who were predominantly people who stayed at home and worked in the home. And I can understand that. I would have been very enthusiastic about supporting that.

But, today, the statistics tell us about over 70 percent of the women today, who are 39 and below, work outside of the home with full-time careers, and they are not getting any credit for the Social Security that they pay into the system. Now, that is not good for them, but it is good for those who do not work. So I think there is a very strong bias in the system for women who are not working outside of the home, and I am not sure we can say that it helps all women. I think it helps some more than others.

But be that as it may, the real problem we have is that the system is going broke, and while we have to worry about the inequities in it, we also have to worry about how do we make it solvent into the future.

One of the things that a number of us have suggested, and I would like both of your comments on this, Senator Gregg and I have introduced a bill in the last Congress and are reintroducing in this Congress, along with two members from the House, in a bipartisan fashion, which is a proposal that has been scored as restoring the solvency to Social Security, and you all both know it. I am just trying to lay this out for the record.

One of the ingredients in that proposal is to establish a tax cut of 2 percent for Social Security payments and require that that 2 percent be set aside and invested by the individual in individual savings accounts patterned after what all of us here and all of these people behind me do every month and contribute to the Thrift Savings Plan for the Federal employees in a high-risk, medium-risk and low-risk account which gives them a substantially better return than we get investing it now in Government securities at a 2.3 percent return.

So I would like to ask both of you to comment on how women would particularly perhaps be affected by that type of a proposal. Dr. Mitchell.

Dr. MITCHELL. I think it has some very promising elements. As I said before, individual accounts which allow people's income and investments to continue growing, even in years that they are out of the labor force for a period of time, have to be seen as quite a favorable outcome, especially compared to the current system, where if you have years in which you are not paying into the system, those are counted as zero years in your earning history.

If I might be so bold, I might suggest that 2 percent might be too small and that bigger accounts would be better, but that is a subject which needs to be scored on its own merits.

It seems to me that you still have the issue of trying to do earnings sharing. Are you, in fact, going to be getting credit for a period of time when you are not at work? Are you getting credit for the earnings of your spouse? How are you going to handle that in the case of a divorce or in the case of a death, should they be bequeathed?

But it seems to me that it is going in the right direction. The one question that sometimes people raise is 2 percent of a very low income amount is a very small accrual. And so, therefore, some folks have suggested that maybe there should be a Government match or some sort of increased contribution for lower income people, which I believe would preserve some of the redistributive elements that Dr. Munnell has pointed to.

But, in principle, I think it is a very positive step.

Senator BREAUX. On that point, before Dr. Munnell comments, our plan does have a minimum benefit plan, so that no one working 20 years would live in poverty under the Social Security retirement plan, and the individual accounts would be owned by the individual and would be inheritable if one of them die.

Dr. Munnell.

Dr. MUNNELL. Senator Breaux, your plan involves a significant cutback in benefit promises compared to what is under the current Social Security system. So what you do is you cut back Social Security a lot, and put these individual accounts in place.

Senator BREAUX. Explain to me how I cut back because I do not think I do that.

Dr. MUNNELL. You end up with lower Social Security benefits—under the defined benefit portion of the Social Security plan, the benefits are lower than they would be, and they are supposed to be made up, on average, with the income that you get from your individual account. So you say overall you end up——

Senator BREAUX. Oh, sure. OK.

Dr. MUNNELL. But it is very important that you are cutting back on the defined benefit program. Because your point is right, for high-income people, Social Security does not do all of that much. So a woman who has a well-paying job and works her entire life, she is a relatively high-income person. She is not benefiting particularly from Social Security.

What Social Security does is help middle- and lower paid people, particularly, and women tend to fall into that group. And to the extent that you move away from that program to a program where benefits are based on your own contributions, lower income people are not going to do as well.

Senator BREAUX. Well, I do not want to be argumentative, but just to point out the other side of the thing, there is not a minimum benefit package for low-income workers under Social Security now. Our plan, for the first time, establishes that in the Social Security plan. They do not have that now.

Dr. MUNNELL. It used to be——

Senator BREAUX. It used to be, but they do not today, and our plan puts that into place. In addition to that, if the program goes broke, nobody is going to be helped, middle income, lower income or wealthy retirees if we do not have a plan.

But, anyway, I wanted to get some discussion on that, and I appreciate it. Thank you.

The CHAIRMAN. Senator Burns and then Senator Bayh after Senator Burns.

Senator BURNS. Thank you very much.

We are just now starting to talk about, and I think the President has legitimized the debate on, Social Security reform. I see it as a very, very positive thing in the approach that Senator Breaux and several of them have been talking about because I think for the first time we will allow lower income and middle-income earners to start developing an estate and also wealth, creating wealth, if given the right tools and the right options in order to do that.

And, granted, the system that we are trying to deal with and try to move toward, is we have all looked at the model that was done in Chile, enjoying a great deal of success, allowing lower income people—and when I say "people," I mean both men and women—and they are very happy with it. Now, granted, that was a brand new system of which they did not have any kind of a Social Security system before this was initiated.

We are trying to reform an old system. And when we do that, we tend to run into walls sometimes that are built—sort of artificial walls. And I am just wondering do we make the system so favorable that we tend to, the people of the United States, tend to expect it without any kind of responsibility to themselves, and taking care of themselves for old age, or building estates, that they become more reliant on Government. And I am one that says, once you become reliant on Government, then Government sort of infringes on freedoms, even when you are old, and I am approaching that age.

Do you want to comment on that?

Dr. MUNNELL. Yes. I mean, the idea that we keep looking to Chile as our model I find——.

Senator BURNS. No, it is not a model, but it is an idea that has been, so far, has been very successful.

Dr. MUNNELL. But as you pointed out, they had a crumbling Social Security system and no capital markets. It was the right thing for them to do. It is not the right thing for us to do.

Our system works. Social Security works. It has a long-run financing problem. We should fix that long-run financing problem. It is very hurtful to people's——

Senator BURNS. How would you do it?

Dr. MUNNELL. You can do it a lot of ways. I would be happy to talk about some. The President has done it by closing half the gap by putting in general revenues, something that I would support. You can increase the taxable wage base a little. You can bring in State and local workers a little.

Senator BURNS. Do you know how many taxes we are paying now? We are paying more in payroll taxes than we are in income taxes. Now, you may be back here on this East Coast, but I am telling you, we are out there in the hinterland, and I will tell you it is tough. And you think you have got a booming economy, you have got another book to read.

The CHAIRMAN. She is not an enemy. You asked her for——

Senator BURNS. I know. I know. But I——

The CHAIRMAN. You asked her for a——

Dr. MUNNELL. That is all right.

Dr. MITCHELL. Let me just add to this debate, which I find fascinating.

You can make a series of comments and statements about what the system has done in the past, and certainly my mother and perhaps many of the other older women in the room and in the rest of the country would say, "It is a great system for what has happened in the past."

But as you correctly point out, we have a new world ahead of us. We face insolvency problems. And I think you cannot have it both ways. You cannot say, on the one hand, "The current system is great, and we ought to go back to that," and on the other hand say, "Oh, well, we need to fix it. There is a cost associated with moving forward." We are at a crossroads. We need to take advantage of it. One of the very clear lessons from the Advisory Council work, the panel that I chaired, was that people really want to have this phased in. They want a reform, and they want some lead time. Because when you are talking about old-age systems, they want to be able to prepare so that they know "X" years in advance what will be happening. So the lead time is essential.

Senator BURNS. Now you can continue.

Dr. MUNNELL. I did not mean to be argumentative.

Senator BURNS. No, no. And I am not either, but I went home and spent all week in my State, and I will tell you where I am coming from is that we are in a world of hurt, and it is really pinching us in the heartland of this country. This good economy has not worn off on us.

Dr. MUNNELL. I actually went out with Congressman Ed Markey and did some town hall meetings with him. So I feel like I have a little taste of what people think out there. I do not feel like they are clamoring for individual accounts. I do not feel like they are clamoring for taking control of their own investment decisions. I think most people want to preserve the current system. As Dr. Mitchell said, we all agree we need to fix it. I do not think we should wait to fix it. Because the sooner you take an action, the smaller the action has to be. So we all want it fixed.

I just think that we have a lot to lose by cutting back on the current defined benefit structure, where your benefit is based on your earnings' history and moving to an individual account, I think that the low- and middle-income people in this country will be hurt.

Senator BURNS. I have got a follow-up question, but I do not want to infringe on my time.

Senator BREAUX. Mr. Chairman, may I just make an observation before you recognize somebody on my side?

The CHAIRMAN. Sure.

Senator BREAUX. We are all a bunch of guys up here talking about——

Senator BURNS. Yes, I know it.

Senator BREAUX [continuing]. Social Security and women——

Senator BURNS. That makes a lot of sense. [Laughter.]

Senator BREAUX. That is not to say our women colleagues, and I have a strong interest. I talked to Senator Blanche Lincoln yesterday, and she had a function, a public meeting scheduled in Arkansas and she could not be with us, but has a real strong interest and tends to be very active in this area, and I am sure Senator Collins on your side is in the same position. It is not just a bunch of guys talking about this.

The CHAIRMAN. Yes. And in the case of——

Senator BURNS. In other words, we are not qualified.

The CHAIRMAN [continuing]. Senator Bayh, and Reed, and Bryan, and Hagel, if you want time for any opening comments, beyond your questioning, I always give every member of the committee a chance for comment.

Senator Bayh, welcome to our first meeting of this committee.

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. Thank you, Senator. I would like to express my appreciation to you and our ranking member for your leadership on this important issue. We are having the first hearing about the changes possibly coming up in the Social Security system and how they affect women.

I am particularly interested in this, considering that 60 percent of the elderly beneficiaries in my State happen to be women, and so how we go about looking at these reforms and understanding all of the consequences I think is very, very important.

Let me get to my questions. I have four very brief ones. I am new to the Senate, so I do not filibuster quite as much, given my limited tenure.

Senator BREAUX. You will learn. [Laughter.]

Senator BAYH. I will learn, John Breaux, at the knee of the master.

First, to Dr. Mitchell. You alluded to, in your statement, the phenomena of relatively small accounts by low-income earners, and you mentioned the potential problem of transaction costs. How would you propose to deal with that?

Dr. MITCHELL. Well, there are a number of different models, but I think that there are some important functions that are worth keeping in mind, and we already have some things in place that other countries have not been able to do. So, for example, collecting the taxes, we do a relatively good job on that front. It's relatively streamlined, and cost-effective.

The second phase has to do with the recordkeeping and the accounting. I think it is fair to say that under the current Social Security system there is really no need to get that money in quickly and get it deposited in the account quickly because that is not the way the system works.

However, if we were going to have individual accounts, we would probably need to restructure the whole administration, so that there is a very short time lag between the time the money comes out of your pocket as a worker and it gets invested. That will take some new structural investments in the Social Security system. I would argue, however, that those investments may need to be done anyway, whether or not the money is actually invested in the capital market or in any other format.

And then you have the benefit payout phase. And at that point, you need to establish who is eligible, you need to figure out how much money they get, and annuitize it. There are insurers, there are other groups in the economy that are fairly good at figuring out how to collect money and pay the money.

So I think we have some strong financial institutions that could do that in a relatively cost-effective way.

Senator BAYH. Certainly. Well, we want to make sure that the administrative expenses do not eat up a disproportionately high percentage of the——

Dr. MITCHELL. Absolutely.

Senator BAYH [continuing]. the savings of the individuals.

Dr. Munnell, if I could ask you next, if I understand your position on this, your objection is to the individual accounts, not to investments in equities per se.

Dr. MUNNELL. Right.

Senator BAYH. Do you have an opinion on some of the proposals that have been made to invest in the equity markets to generate a higher rate of return, but to have some quasi-governmental organization, like State pension funds currently use, overseeing those investments?

And if you do not have an objection to that, would you at all be concerned about the role of even a quasi-governmental body taking large ownership stakes in the private economy?

Dr. MUNNELL. Let me start, the key thing that I want to preserve is having people's benefits based on their earnings history because I think it is very important that the Social Security benefit—it is a modest benefit; average person got $780 a month last year—that that amount be predictable, that it not be subject to market fluctuations. So I do not want to have part of it from a defined benefit plan and part of it from an individual account.

I have no objection, in fact, I support the President's proposal to investment a small part of the Social Security trust fund in equities. The investments would not be done by the Government. They would be done by private-sector managers, by Merrill Lynch, by State Street, by Fidelity. There would be an independent investment board. All of the stuff would be done at arm's length.

You could model it after the Fed monetary policy. Without being unduly influenced, they can invest something that would amount to 4 percent of the total value of equities in this country without——

Senator BAYH. You are not worried about jawboning whatever this independent entity might——

Dr. MUNNELL. No. I think jawboning will occur. I saw Jesse Jackson testify, and he would say, you know, we ought to invest in companies that have good employment policies. I think that you will have health people saying we should not invest in tobacco companies. I think you will have labor people saying we should not invest in companies that are anti-labor. That is their job. All of those people are supposed to be jawboning.

The job of Congress would be to set up a board that keeps its eyes on the prize and invests for maximum profit. And a lot of people jawbone the Fed, saying it should have lower interest rates or should tighten now or do whatever, but those people are appointed for long and staggered terms, and they keep their eye on what the economy is doing and do the best thing for the economy.

So I think there will be advocacy, but I do not think it will affect the investment decisions in the long run.

Senator BAYH. Building upon Dr. Munnell's defined benefit point, Dr. Mitchell, I would like to ask you about what most financial advisers believe that for a well-balanced portfolio, in the long run, there needs to be some fixed-income component of that. If we do cut back on the defined benefit, might that not risk skewing the investment patterns of many Americans toward riskier portions of their portfolio as opposed to the defined fixed-income portion of the portfolio?

Dr. MITCHELL. The overall prescription that many financial advisers give often focuses on a narrow piece of people's overall assets; for example, just their 401(k) plan. A much more complete story would be to say, let us look at whatever assets you have as an entire package. Maybe you have a house. Maybe you have human capital; that is, all of the training and education you have invested in yourself, and then look at what you have in the retirement portfolio, be it Social Security, be it employer pensions and so forth.

The general question, then, would be, going forward, are people constrained somehow so that they cannot get in the market right now, and would some sort of investment in equities improve their well-being? And the sense is probably there are people who do not currently have access to the capital market who would be better off by being able to get into that.

Now, again, you wanted to restrict the question to the trust fund investment. I would say allowing this to happen in an individual account format gives people more choice over their asset portfolio; do they want more risk or do they want less risk? So, in that sense, it would be, I think, even better to allow the individual choice.

Senator BAYH. I see I have run out of time. I have many more questions and look forward to pursuing them at another time.

Thank you both very much.

The CHAIRMAN. You can submit questions for answer in writing, if you want to.

Senator Hagel and then Senator Reed.

Senator HAGEL. Mr. Chairman, thank you, and welcome to both of our witnesses. I apologize for missing your statements. I will read your statements.

I have one general question that I would ask that each of you answer, and it is this: Should creating wealth be a long-term objective for maintaining Social Security?

Dr. Mitchell.

Dr. MITCHELL. The way that this question is often phrased by economists is: Do we need more saving; that is, does the economy undersave? Would we do better if we had more capital stock?

In the course of my work with the Technical Panel for the Advisory Council, the group of people that we talked to pretty much concluded that we do need to increase national saving. Americans typically save less than all of the rest of the developed world. There are many questions about why we do not do better.

A recent study I did looking at the preparedness of older Americans for retirement suggests they are quite under prepared. So I would say yes.

One of the goals of a retirement income system should be to increase national saving. It is not the only goal, but it is one goal.

Senator HAGEL. And to amplify on that just for a moment before we go to Dr. Munnell, how would you propose to do that in the most direct, simple form of what we are dealing with today as we project out into the next century?

Dr. MITCHELL. Well, the problem is if it were easy, they we would all be able to go home early. My sense is that one of the best ways to try to increase wealth, to try to increase national saving is to reduce deficit spending, and not only current annual deficit spending, but to try to draw down the long-term implicit debt of the Social Security system.

I just put out a book on Social Security, and there Steve Goss, the Chief Actuary, estimated what the Social Security debt was, and it is on the order of $9 trillion. So that is not current deficit spending. That is not on current account. That is what needs to be, in some sense, set aside out of GNP to be able to fund the system. So some pre-funding would increase our overall GNP down the road quite a bit.

Senator HAGEL. Any suggestions on how you would do that?

Dr. MITCHELL. Well, there are lots of suggestions. Dr. Munnell has talked about raising taxes.

Senator HAGEL. What is achievable and realistic?

Dr. MITCHELL. Well, gee, that is your job, I thought. [Laughter.]

Senator HAGEL. That is why you are here, Doctor.

Dr. MITCHELL. Right. It seems to me that you ultimately have a Hobson's choice of raising taxes or cutting benefits, and then it is just a question of who you do it on. Do you do a little bit now and a lot later, or do you do a little bit later and a lot now?

But the ultimate point is that we are going to have to reassess what the country can promise in the nature of retirement benefits from the Government; i.e, from taxpayers, and what we ourselves are going to have to take responsibility for, and that is the nature of the balance.

Senator HAGEL. Dr. Munnell. Thank you.

Dr. MUNNELL. I agree with Dr. Mitchell that we should have increased national saving, and I think the President's proposal to save the surpluses is the best way to do that. I mean, you actually put them in a lock box, and you prevent them from being spent otherwise, and that will increase national saving and will actually make it easier to support an older population in the future.

I do not understand the arguments for some that we should be building up inheritances for low- and middle-income people. If low- and middle-income people want to leave inheritances now, they could take their meager retirement incomes and buy life insurance with them and leave stuff for their family. They are poor, and they need all of their lifetime income that they have while they are alive. So I do not think that is a feasible option. But increasing national saving in the aggregate, through the saving of the surpluses, I think is a good idea.

Senator HAGEL. You do not see creating wealth and taking 2 percent, 4 percent or any other dynamic or part of this equation that has been discussed over the last 2 years and will continue to be discussed, as an important dynamic for the future of maintaining Social Security.

Dr. MUNNELL. If you take 2 percent from this current—we have a 2 percent hole in Social Security. It is roughly 2 percentage of payroll short. If you say I am going to divert another 2 percent from the current Social Security program, then you have got a 4 percent hole, and the only thing you can do then is cut back on your Social Security-defined benefit. And I am against that. I think we should keep the defined benefit that we have and find ways to raise more money or to cut the level a little bit, but to close the gap without moving toward an individual account.

Senator HAGEL. What do you think of Senator Bob Kerry's idea about—did this come up?—about everybody getting a thousand dollars when they are born, and we set that account up, and that is the beginning, and it grows, creates wealth and so on?

Dr. MUNNELL. That sounds lovely, but we have budget constraints, and the question is what are we not going to do because we do that? I think it is very hard. Low- and middle-income people have very low incomes, and the idea that we should be worrying about them leaving an estate to their children just does not seem the most important problem.

Senator HAGEL. But are you not really saying let us just keep that low- and middle-income group down and never give them a chance to be able to move up? Is that not the grand theory of Government knows best and let the Government control it?

Dr. MUNNELL. No. I think that low- and moderate-income people need to do everything they can to improve their human capital, get good education, so they can go out in the job market, compete and get higher income. So I think people should move ahead.

The question is should we make it a priority of leaving an estate, and that does not seem like a priority to me for people whose incomes are stretched over both their working lives and in retirement.

Senator HAGEL. Thank you.

The CHAIRMAN. Senator Reed.

Senator REED. Thank you, Mr. Chairman.

Dr. Mitchell, in your testimony you raised a concern that with these individual accounts there might be the temptation, the strong temptation to either cash them out or to borrow against them. It would seem to me in the context particularly of women in the workforce, many of whom are the heads of households, many of whom have very low-income jobs, that would be a very difficult temptation to avoid, in many cases, leaving them with nothing to show for it when they really needed it, when they reached their retirement age.

And I guess when we design the system, we have to worry not only about the economics, but also about the human dimension of what people will do given these incentives or disincentives.

To what extent could this be a major flaw in these proposed individual accounts?

Dr. MITCHELL. It is a valid point. You need to look at the history of 401(k) plans, where people are taking their lessons. Some employers, not all, by any means, permit employees to take a loan against their accumulations as they go forward.

Of course, people in the retirement business acknowledge this is a bad idea because if you take a loan out against your 401(k) count, you are losing the opportunity costs. You are losing the earnings you could be making on that account, and it would be important to try to protect that.

Now, you might be able to do it, if you wanted to, after a point. You could say, once you have accumulated enough in your account to pay out a minimum benefit, then after that point we would give you access to a lump sum above that or perhaps a loan above that.

But the point is, if you are still going to give a minimum benefit guarantee, I think the Government needs to protect itself against people dissipating their individual accounts. So the strongest argument would be one where you would say you cannot get the money until you have enough accumulated to make a viable retirement annuity. That seems to me to be a reasonable argument.

Senator REED. Thank you. Dr. Munnell, do you have thoughts on this issue?

Dr. MUNNELL. It is something I am concerned about. Once you tell people it is their money, they are going to feel like they are going to want to have access to it, particularly if they get or have some family catastrophe. I think it would inevitably start out with people would not be allowed to touch it until retirement. But over time, I think that you would see that erode, as you do with IRAs and with 401(k)s.

And so I am very concerned that people end up at retirement and do not have this supplementary pile they are supposed to have.

Senator REED. I guess, just thinking out loud, to what extent would the system be much different if you say, "OK, we've got this new great individual retirement account, but you cannot touch it until you accumulate enough money to pay the benefit, which might be 20 years from now." We might be going through a lot of fancy maneuvering for something that the public, at least, will see to be just about the same as Social Security.

Dr. MITCHELL. But currently we cannot borrow against our Social Security accounts.

Senator REED. Exactly.

Dr. MITCHELL. You cannot get your money when you are 45 if you want it. We have other programs. We have a disability program that helps insure you if you suffer a disability and you need the money and so on. So it seems to me that it is reasonable to keep those plans in sight.

Senator REED. I agree with you, Dr. Mitchell, but I think, when you pursue that path, to the public, this does not look a lot different than what they have enjoyed or not enjoyed all of these years, and so what the heck are you guys doing down there with all of this fanfare. Just a thought, perhaps.

Dr. Munnell, the President recently proposed that he make—or the Government, rather, not he. He is not that generous yet—that the Government make a contribution to these savings plans complementing individual contributions. Would that make it better, in your mind, or easier to accept if there was a complementary Government contribution along with the private contribution?

Dr. MUNNELL. The key differentiation that I would like to emphasize is whether you are talking about a proposal that cuts back on the current defined benefit plan and replaces part of that with an individual account or whether you are talking about a proposal, such as the President's, where you keep the current defined benefit plan, and you add on.

I like it that the President has not proposed to cut back on the Social Security plan and has instead addressed the broader issue that no one was expected ever to live on Social Security, and a lot of people do not have enough additional supplementary savings, and that is what he is trying to address through the USA accounts, but it is an add-on. It is not a carve-out.

Senator REED. Can I try to, again, sort of sketch out the differences between your colloquy with Senator Breaux where you are suggesting that these plans, if they cut benefits, should be rejected. And I think the contrary response is, well, we are going to establish a minimum benefit. We'll guarantee that and then anything above that, through the private account mechanism, is just, if you will, gravy.

But you seem to be innately suspicious that either the gravy will never materialize or the benefit level will be so low that it will be unlivable. Is that fair?

Dr. MUNNELL. Senator Reed, I have strong confidence in social insurance programs, programs where everybody in this country participates, and everybody takes an interest in how good they are. They are kept up-to-date with prices. They are structured correctly.

I have no confidence in programs that are designed for low-income people. They are here one year. They are gone the next year. And they are not well designed; their benefits erode by inflation; they are allowed to vary haphazardly. So it is a very big philosophical point whether you are talking about social insurance or means testing.

Senator REED. Thank you. Well said. Thank you.

The CHAIRMAN. Thank you, Senator Reed.

Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman, to you, and to the ranking member, and to the witnesses for sharing their thoughts.

Dr. Mitchell, you remind us of the reality that there is no easy way to go here. I believe you characterized it as a Hobson's choice; raise taxes or reduce benefits. Those are not words that the Congress likes to hear. I suspect it is a reality.

Dr. MITCHELL. Sorry.

Senator BRYAN. We appreciate your candor.

If that is indeed your premise, what you are telling us implicitly then is, even if we adopt the individual-account approach that you are suggesting, that does not get us all of the way home. Am I correct in that?

Dr. MITCHELL. The question is which home are you trying to get all of the way back to? And I am not trying to be devious.

Senator BRYAN. No, and let me be more specific. When I say it does not get us all of the way home, we all recognize the financial sword of Damocles that hangs over the Social Security system in 2032. What we are talking about is at least extending the solvency for some period of time—25, 50 years—but more than just a year or two or three, depending upon how the economy performs.

In that context, I think what you are telling us is that we could adopt the approach that you favor, but that still would not do enough in terms of establishing an extended solvency for the program.

Dr. MITCHELL. Well, it is an interesting question because we, in the U.S., under Congress's guidance, have always taken a 75-year time horizon. I have done a lot of work in other parts of the world where they think 3 years is a long time. So I think we are to be commended to take the long——

Senator BRYAN. In politics, three months is a lifetime. [Laughter.]

Dr. MITCHELL. Right. Right. One news cycle.

But it seems to me that we do currently take the 75-year perspective. That is not an unreasonable one. Though, of course, many of our children and grandchildren will still be around after that. I think that the relevant goal is the goal of ensuring some sort of minimum retirement income and security around that income level; that is, I do not want to be 85 or 95 or, Heaven help me, 105 years old and not know whether or not I am going to be getting a benefit check and how big that benefit check will be.

So we need to try to think about what sort of system will restore solvency, but also will reduce uncertainty. And in that sense, I think it is fair to say that having a minimum benefit that will put a floor, a safety-net floor, under a program we do not have right now.

And the other notion is what about individual accounts that puts more burden on the individual, but by the same token, it reduces the exposure of the individual retirement package to tax changes and benefit changes down the road. So it is that balance that I think we are trying to seek.

Senator BRYAN. Dr. Mitchell, let me a bit more persistent in what I am trying to establish. Let us assume that we accept your proposal, as you have discussed it and do nothing else. In the context of the 2032 date, does that move us to the year 2050, or 2040? Where does it get us? All other aspects of the system remaining the same, and no new taxes.

Dr. MITCHELL. I am not quite sure what proposal you are outlining. But let us say——

Senator BRYAN. You have testified regarding the individual retirement account system that you have favored. What I am trying to ascertain in the context of your statement, is whether or not we are not going to get there from here without increasing taxes or reducing benefits.

Dr. MITCHELL. Under the proposal that Senator Breaux has laid out, there would be a maintenance of the overall tax burden, but a portion of the payroll tax would go to individual accounts. The defined benefit amount that would be paid out would thereby lower, and the individual account would be higher. So I guess the question is, is that a long enough perspective? Is 2050 long enough? And I think economists would be the first to admit that we have a hard time forecasting interest rates next month, next year, much less 75 years down the road.

But the notion is that we want to try to establish a viable long-term commitment on the Government's part that will, in fact, make the retirement picture more secure. And maybe 75 years is a reasonable period of time, especially because the window moved forward every year that time passes.

Senator BREAUX. Would the Senator yield just for a point?

Senator BRYAN. I would be happy to yield.

Senator BREAUX. Just as a point of observation, the plan that we had introduced was scored by the Social Security Administration as restoring solvency out past the 75 years. But there were more things to it other than just a 2 percent savings account. We did a CPI adjustment, and we did another increase in the retirement age over 25 years plus the 2 percent, and they scored that as restoring solvency outside the 75-year window. But there are a lot of things in there that are tough.

Senator BRYAN. And I thank the Senator for his observation.

Dr. Munnell, obviously you are not greatly enthralled by this approach. The question that I would ask of you is could we do what Dr. Mitchell has recommended, that we at least look to still protect the survivor and the dependent children benefits? What happens to those benefits if we pursue this individual account approach, and divert some of the revenue that would go into the system for those accounts?

Dr. MUNNELL. It is possible. I mean, if you are only having a small account, then you will have survivor and dependent children benefits and the rest of the program. I think we keep needing to ask why are we going to change the system so dramatically when most people are satisfied with how it is now.

The notion of this financial sword of Damocles just does not seem correct to me. Yes, the trust fund is exhausted in the Year 2032 if we do nothing under current law. But even then, we have payroll taxes in place to pay 75 percent of benefits. So, basically, we are arguing about where do we want to be between this 75 percent and 100, and whether you do it by individual accounts or you do it by the current program, that is the decision you have to make, and I think that is the point that Dr. Mitchell is making that you have got to close that gap and disguising it is sort of—individual accounts is not a solution.

Senator BRYAN. But you do agree that the responsible course of action is not to defer that decision?

Dr. MUNNELL. No, I agree.

Senator BRYAN [continuing]. until 2032. We ought to be doing it now.

Dr. MUNNELL. I could not agree more.

Senator BRYAN. I thank the witness, and I thank the chair.

The CHAIRMAN. If it is OK with my committee, I think we will dismiss this panel and not have a second round of questions.

I thank each of you very much, and keep in touch with us. We will be talking about this for, hopefully, just a few months, but it could be a few years if we do not get a political bipartisan agreement. Thank you very much.

Dr. MITCHELL. Thank you, Senator Grassley.

Dr. MUNNELL. Thank you.

The CHAIRMAN. I now call the second panel. We are going to hear from Dr. Robert Clark. He is a professor of economics, business management, North Carolina State. He has co-authored a study examining participation rates and asset allocations by gender in 401(k) plans. He will outline the conclusions he has drawn from his research regarding women's investment behavior compared to men in these 401(k) plans.

He will discuss how these conclusions can give policymakers insight into how women may fare if an individual account component were part of the Social Security system, and if there are potential problems women face regarding investment of how these concerns can be addressed.

Dr. Gene Steuerle is a senior fellow at the Urban Institute, and he was a member of the National Committee on Retirement Policy. Dr. Steuerle will contrast the impact of divorce on women under the current Social Security system and under a system with an individual account components. He will discuss the goals that should be kept in mind when providing benefits to divorced spouses.

Finally, he will discuss what options are available for splitting the assets in an individual account among divorced spouses and how any concerns regarding splitting the assets can be addressed by us policymakers.

And, last, Dr. Mark Warshawsky is director of Strategic Policy at the Teachers Insurance and Annuity Association-College Retirement Equities Fund, and we know that as TIAA-CREF.

He will discuss options for designing a distribution structure which could address women's needs and also will discuss the life expectancy of women and how annuities can alleviate the concern that women will outlive their retirement assets specifically. He will focus his testimony on issues relating to pricing of annuities, mandating joint survivor benefits, and indexing and inflation, whether annuitization should be mandatory and the possible administrative costs of purchasing an annuity and how annuities can provide inflation protection.

Each of you will have your entire statement printed in the record. We will ask Dr. Clark, then Dr. Steuerle, and then Dr. Warshawsky, and we will have questions after the presentation of all three. Proceed.

STATEMENT OF ROBERT L. CLARK, PROFESSOR, COLLEGE OF MANAGEMENT, NORTH CAROLINA STATE UNIVERSITY, RALEIGH, NC

Mr. CLARK. Mr. Chairman, Senator Breaux, and committee members, thank you for inviting me to testify on these important issues before you today.

As you requested, my testimony will focus on, first, empirical evidence concerning gender differences in participation rates——

The CHAIRMAN. You might need to draw closer. Somebody was there ahead of me.

Mr. CLARK [continuing]. in participation rates in 401(k) plans and the management of plan assets.

I have prepared several charts indicating gender differences in the probability of making any contribution to a 401(k) plan, the magnitude of annual contributions as a percentage of annual earnings and how 401(k) funds are invested.

Next, I will examine how changing the Social Security system into a system of mandatory individual accounts would affect women and whether policies could be instituted to eliminate potential adverse effects on women from the modification of Social Security.

First, how will women behave under a system of mandatory individual accounts? The best available evidence that we have today is to examine how women currently make investment decisions when they are covered by a voluntary 401(k) plan. The evidence that I am going to discuss is based on a study of 87 401(k) plans, including 150,000 workers. The details of this study are described in my written testimony. This research was done in conjunction with Gordon Goodfellow who is here today with me and several of his colleagues at Watson & Wyatt Worldwide.

Recently, some analysts have speculated that women, in comparison to men, are less likely to participate in 401(k) plans, contribute a smaller share of their earnings to their retirement plans and invest pension funds more conservatively yielding a lower retirement benefit. These hypotheses have received considerable public attention. However, they have not been verified by broad-based research studies.

To aid the committee in its deliberations, I would like to address two fundamental questions concerning gender differences in 401(k) plans.

First, are women less likely to make contributions to 401(k) plans and do they make smaller annual contributions? The short answer to this is no. Almost 80 percent of all workers in these firms made a contribution to 401(k) plans in 1995. The proportion of workers making contributions increases with their age and with their annual earnings. Women of the same age, tenure and earnings in these firms actually are more likely to have made a contribution to the plan than were men. This relationship is shown first in Figure 1, which shows how the proportion of women and men making a contribution to a 401(k) plan increases with their annual earnings.

Figure 2 shows the same relationship by age and, again, shows that women are more likely to be making contributions, holding constant their age and work history. So we can see that, on the basis of this information, at least the probability of participating in a 401(k) plan, women are not less likely to contribute than men.

Given participation in the plan, the typical worker contributed about 7 percent of annual earnings to the plan. Standardizing for age, job tenure, and earnings, women contributed a higher proportion of annual earnings to the 401(k) plan than did men. These differences are shown in Figure 3. So, we observe that women are providing a higher proportion of their salary into the 401(k) plan than men.

The second question then that we would like to look at is, once the money gets into the pension plan, are women more conservative investors in their 401(k) plans than men? Again, the answer is no, with a caveat. In 401(k) plans that do not offer company stock as an investment option, women and men invest approximately the same proportion of their retirement funds to fixed income assets. This is shown in Figure 4. This means that when they have a plan that does not require or encourage the individual investor to put their money into the company's own stock, that women and men are investing in approximately the same manner. There are some differences with age and income as these things change, but the difference on gender is quite negligible.

In plans that provide a company stock option; that is, the company requires you to put some money into the company's own stock to get the company match or the company matches are made in company stock, then we do observe some differences.

First, in Figure 5, we are shown that women tend to allocate a higher proportion of their contributions into fixed income assets than do men. And, again, you see the relationship with earnings, how investments would change as earnings go up.

Now then, women and men still invest approximately the same proportion of their remaining funds in other equities, not including the company's own stock. And this is shown in Figure 6. From the figure, we can see that the proportion of the assets devoted to broad-based mutual funds or other equities is about the same for men and women.

Finally, the difference then has to be that men are more likely to put the money into the company's own stock. And that, of course, could be a very risky investment. The company stock is likely to have more fluctuation than the broad-base market and, of course, it's also putting your retirement investments in the same place that your current earnings are tied to. Whether that's a good investment or not, I would leave to those individuals that are making them. But that's the main difference in the 401(k) investment behavior of men and women.

So when we observe 401(k) plans that do not have company stock options, women and men are making similar investments. When they do have these company stock options, women put more in fixed-income assets, men put more in the company stock, they both put about the same amount into broad-based mutual funds.

Now, the previous panel had a considerable debate about the role of shifting to mandatory accounts and how that would affect women. Replacing current Social Security benefits with mandatory individual accounts would mean that future Social Security retirement benefits for each person would depend more directly on the amount contributed. Professor Munnell indicated that she was currently interested in maintaining that link between lifetime earnings histories, and certainly that's even more direct in the case of individual accounts.

Of course, the ultimate benefit would also depend on how the funds are invested and the distribution choices chosen. Potential gender differences in the shift to individual accounts are possible in each of these areas, but what does the evidence show?

First, will women receive a lower benefit under a system of mandatory individual accounts because of their work histories? Evidence presented above indicates that, in general, men and women with comparable job tenure and earnings make similar investment choices. Thus, we should not expect gender differences among those with comparable work histories. However, on average, women have lower incomes and fewer years of service.

Under the present Social Security system, women receive the greater share of the subsidy associated with the progressive benefit formula. This potential adverse effect could be reduced or eliminated by providing a matching Government contribution. So if you are worried about that particular issue and if you decide to go adopt individual accounts, here is a way that you might be able to modify that effect.

Will women have lower benefits due to bad investment choices? Again, the evidence shows there that that is unlikely. Will women receive lower annual benefits when they convert their retirement funds into annuities? First, we know women will live longer than men. If annuities are purchased in the open market and annuity sellers are allowed to use gender-specific life tables, the answer is, yes, they would receive lower benefits. However, Congress could mandate the use of unisex life tables by private sellers or the Government could itself be the seller of the annuity. So there ways, if that is your concern, to avoid this problem.

Will divorced or widow women be left with no retirement benefits? If a retired worker converts his retirement funds into annuity that ends with his death, widows would be facing a bleak future. To address this issue, Congress could require the use of joint life annuities as the primary method of accessing funds. This concern could also be eliminated by the use of earnings sharing. So all of the family earnings would be credited equally to the two spouses. Again, there is a way that you could address that issue.

Will divorced women have access to retirement benefits? Individual retirement accounts should be considered as part of family wealth. It could be divided at the time of the divorce. You could do that by legislation or by judicial review.

In summary, my testimony has two major conclusions. First, women should not be considered unable or unwilling to save for retirement, nor should they be considered less sophisticated investors. My research shows that investment decisions of women in 401(k) plans are similar to those of men with similar work histories. As such, shifting Social Security to a system of individual accounts should not be rejected because of concerns about the quality of women's investments.

Second, in making a decision whether to adopt mandatory individual accounts as a central component of Social Security in the 21st Century, Congress must consider how such a fundamental change in social policy will affect various economic and demographic groups. It is important to recognize that most gender-related concerns associated with individual retirement accounts can be addressed by various Government restrictions or requirements concerning the distribution subsidies and investment options.

If mandatory individual accounts are adopted, Congress must decide whether the advantages of such restrictions outweigh the distortions that they may introduce into a system of individual retirement accounts.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Clark follows:]

GENDER DIFFERENCES IN THE MANAGEMENT OF INDIVIDUAL RETIREMENT ACCOUNTS

Testimony Before the Senate Special Committee On Aging

by

Robert L. Clark
Professor
College of Management
North Carolina State University

February 22, 1999

INTRODUCTION

The well known financial problem facing Social Security in the twenty-first century requires the immediate attention of Congress. In order to restore the financial integrity of this very important retirement program, Congress and the Administration are now considering a series of options to reform Social Security ranging from modifying the current system to the adoption of mandatory individual accounts as a major source of retirement benefits.

My testimony today examines the economic effects on women of eliminating the present Social Security benefit structure and replacing it with system of mandatory individual retirement accounts. My presentation focuses on three areas of emphasis identified in Chairman Grassley and Senator Breaux's letter of invitation to me. First, I will discuss the findings of my research concerning gender differences in the management of 401(k) plans. Second, I will extend these results to examine how women might fare under a Social Security system dominated by individual retirement accounts as well as examining other potential problems for women associated with shifting to individual accounts. Third, I will identify possible restrictions on the management of these accounts that could moderate or eliminate potential adverse effects of individual accounts on women.

GENDER DIFFERENCES IN 401(k) PLANS

Understanding the financial decisions of men and women currently covered by 401(k) plans provides the best evidence of how workers might be affected by the adoption of mandatory individual retirement accounts as part of a new Social Security system. Recently, some analysts have speculated that women, in comparison to men, are less likely to participate in 401(k) plans, contribute a smaller share of their earnings to their retirement plans, and invest their pension funds more conservatively yielding a lower retirement benefit. These hypotheses have received considerable public attention; however, they have not been verified by broad-based research studies. Despite the lack of evidence, these assertions have made there way into the policy debates concerning the adoption of mandatory individual retirement accounts as a component of Social Security.

To test the validity of these assertions, Gordon Goodfellow, Sylvester Schieber, Drew Warwick, all of Watson Wyatt Worldwide, and I examined the employment records of 87 companies with 401(k) plans.[1] Using these data, we were able to examine gender differences in the participation rate in 401(k) plans along with the proportion of annual earnings that workers contributed to their plan in 1995. In addition, we examined the allocation of 1995 contributions and plan assets between fixed income assets and equities. The results of this study are highlighted in Figures 1-7 and Tables 1-4.[2] While the research findings presented in the first part of my testimony are the result of joint work with Goodfellow, Schieber, and Warwick, the conclusions expressed in the second part of the testimony are my own and should not be attributed to my research colleagues.

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[1] Our complete research study is published in Robert Clark, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick, "Making the Most of 401(k) Plans: Who's Choosing What and Why?" in Olivia Mitchell, Brett Hammond, and Anna Rappaport (eds.), Forecasting Retirement Needs and Retirement Wealth, Philadelphia: University of Pennsylvania Press, forthcoming.

[2] I want to thank Gordon Goodfellow for constructing these figures. The figures are based on the statistical findings reported in Clark, et al.

The relationships shown in the figures are based on a statistical analysis of approximately 150,000 workers in the 87 companies.[3] Female employees represented 46 percent of the sample. The women tended to be somewhat younger than the male workers and on average, had lower earnings. The following conclusions are based on statistical estimates of the probability that worker participated in a 401(k) plan and given participation, the proportion of salary allocated to the plan during 1995. Finally, I report findings on how contributions to the 401(k) plans along with account balances were invested. The statistical analysis shows how the decisions of men and women of the same age, tenure, and earnings differ in their decisions concerning retirement savings. Tables 1-4 report mean values of the various relationships by gender, age, and annual earnings while Figures 1-7 are based on statistical estimates that hold constant the worker's age, earnings, job tenure, and the employer.

Key findings of this analysis are:

1. **Are women less likely to make contributions to 401(k) plans and do they make smaller annual contributions to these plans? No, research findings indicate the women of similar age, job tenure, and earnings are actually more likely to participate in voluntary 401(k) plans and they tend to contribute a larger percentage of their annual earnings.**

    - Almost 80 percent of all workers in these firms made a contribution to the 401(k) plan in 1995. The proportion of workers who made a contribution to the 401(k) plan in 1995 increased with age and with annual earnings up to $75,000 (Table 1).

3 The research reported in this testimony was based on the analysis of contribution and investment decisions in the 401(k) plans of 87 plans. All the information was for the 1995 calendar year. The data were compiled by Watson Wyatt Worldwide. Forty-one of the plans were administrative record keeping clients of Watson Wyatt and 46 were not. The smallest plan in the group had slightly less than 25 participants and the largest plan had approximately 15,000 participants. A total of 234,573 workers were employed by these firms in 1995. The sample of employees in these companies used in the analysis was limited to full-time workers aged 20 to 64 with at least one year of service and annual earnings of at least $10,000. After deleting workers who did not meet these criteria, there were 156,376 workers in the sample.

- Women of the same age, tenure, and earnings in these firms were actually more likely to have participated in the 401(k) plan in 1995 than men (Figures 1 and 2). In total 80 percent of the women and 78 percent of the men made a 1995 contribution to their 401(k) plan (Table 1).

- Given participation, the typical worker, both male and female, contributed about 7 percent of their 1995 earnings to the 401(k) plan (Table 2). Standardizing for age, job tenure, and earnings, women contributed a higher proportion of annual earnings to the 401(k) plan than men and the difference increased with annual earnings (Figure 3).

2. **Are women more conservative investors than men with their 401(k) contributions and account balances in plans that do not offer or require investment in company stock? No, in these plans, women tend to hold approximately the same percent of their retirement funds in fixed income assets as do men.[4]**

   - In plans with no company stock requirements, the proportion of contributions and asset balances allocated to equities by both men and women declines with age reflecting the expected lifecycle pattern of saving decisions (Table 3).

   - In plans with no company stock requirements, the proportion of contributions and asset balances allocated to equities by both men and women increases with annual earnings (Table 3).

   - In plans with no company stock requirements, men and women invested approximately the same proportion of their 1995 contributions to fixed income assets (Figure 4).

3. **Are women more conservative investors in 401(k) plans that offer or require an investment in company stock? Yes, in these plans, men tend to hold a larger proportion of their retirement funds in company stock than do women while women hold a larger proportion in fixed income assets.**

   - In companies that provided company stock as an investment option, women allocated a higher proportion of their contributions and account balances to fixed income assets than men (Table 4 and Figure 5).

   - In these companies, men invested a higher proportion of contributions and account balances to company stock than women at all levels of earnings (Table 4 and Figure 7).

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[4] Fifty-eight companies with approximately 45 percent of the participants did not offer company stock as an investment option while 29 companies with 55 percent of the participants either offered company stock as an investment choice or provided the company match be taken in company stock.

On the basis of these findings, I reject the hypothesis that women are less concerned about saving for their retirement. Instead, the data show that women of comparable age and earnings are somewhat more likely to contribute to their 401(k) plans and contribute a higher percent of annual earnings if they do decide to make a contribution. Also rejected is the hypothesis that women are less able or more conservative investors. The evidence shows that in general, women and men make similar investment decisions with their retirement funds except when the plans include company stock as a part of the investment options. Men do tend to be more willing to accept the greater risk associated with investing in the stock of their employers than are women.

Several caveats should be attached to these conclusions. First, these results are based on an analysis of working women who already are covered by a 401(k) plan and have some experience with these investment options. Second, the analysis compares women to men with comparable job tenure and earnings. In general, this comparison will mean that the overall household income for women is higher than that for men and this may lead to the finding of increased retirement saving and a willingness of women to bear more risk men with the same earnings. Third, as a group, women have fewer years of job tenure and lower earnings than men. Thus, differences in retirement savings may occur if one compares all women to all men without considering employment characteristics. However, I would reiterate that on the basis of available evidence, we must conclude that there is relatively little difference in the behavior of men and women with similar work characteristics in their approach to managing their individual accounts in 401(k) plans.

INDIVIDUAL RETIREMENT ACCOUNTS AND THEIR IMPACT ON WOMEN

Replacing the current Social Security benefit structure with mandatory individual retirement accounts would mean that future Social Security retirement benefits for each person would depend more directly on the amount contributed into their individual accounts. The realized benefit in retirement will depend on contributions while working, investment decisions by the worker, and distribution choices. Potential gender differences in the shift to individual accounts are possible in each of these areas. First, in a pure individual account plan, all contributions of each person would be credited to their own account. There would be no subsidy to the individuals and no tax on these funds to redistribute to others in the manner that the current Social Security system does. Thus, men and women of comparable earnings and years of work would make the same contributions into their own account.

The evidence presented above indicates that, in general, men and women with comparable job tenure and earnings make similar investment choices. If they have the same investment results, they would have the same total in their fund at retirement. However, on average, women have lower incomes and fewer years of service. Under the present Social Security system, women receive a greater share of the subsidy associated with the progressive benefit formula. Under a pure individual accounts plan they would not receive the same subsidy.[5]

This potential adverse effect on women from a shift to individual accounts could be moderated (or eliminated) by the use of subsidies to the contributions of low income workers from either the general fund as the President has proposed for his voluntary individual accounts plan or by a tax on the contributions of higher income workers. Such plans would benefit all low income workers relative to high income workers and would not simply provide additional benefits to all women.

The evidence presented above indicates that women are at least as likely as men to make voluntary contributions to their retirement accounts and tend to contribute at least as high a percent of their salary to these accounts. Virtually all proposals for the shift to individual accounts would require mandatory contributions so that potential gender differences in participation and contributions need not be examined further in regard to evaluating these plans. However, some proposals for maintaining the basic benefit structure of the current system would permit voluntary additional contributions to individual accounts or voluntary contributions on top of a mandatory component. My research would indicate women would be equally as likely as men to take advantage of these voluntary retirement plans.

Given similar contributions, will investment decisions by women lead to smaller funds at retirement? Again, the evidence indicates that gender differences in investment

[5] Of all workers beginning Social Security benefits in 1996, the median woman had worked 27 years, while the median man had worked 39 years. Because of the progressive benefit structure, women with fewer years of credited earnings and lower annual earnings during their working years received a higher replacement rate from Social Security. At present, Social Security would replace 54 percent of average lifetime earnings for the median female retiree and only 41 percent for the median male retiree. National Economic Council, Interagency Working Group on Social Security, "Women and Social Security," unpublished paper, Washington, 1998.

patterns should not be a cause of concern. The key point concerning investment patterns in a system of mandatory individual accounts is the range of investment options permitted to all participants. Congress could allow unrestricted choice of investments or could limit investments to few basic options. Policies could be adopted that would mandate some minimum allocation of assets to both fixed income and equities. For example, each investor could be required to devote a minimum of 25 percent of their account balance to fixed income assets and 25 percent to equities with the remainder being invested at the participant's discretion and these minimum investment limits could change with the age of the worker. My research indicates that the decision on whether such restrictions should be placed on Social Security participants need not be based on gender differences in risk aversion or investment ability.

Converting individual accounts into retirement income can be done through lump sum distributions or through converting the funds into a life annuity. At present, Social Security benefits provide a life annuity to both the retired worker and his/her spouse. The benefit formula is gender neutral so that men and women with comparable earnings receive comparable annual benefits. However, women have a longer life expectancy than men so that the current system provides an implicit subsidy to women in the form of a greater present value of lifetime benefits. At age 65, life expectancy for women is almost 20 years while that of men is just over 16 years.

Converting the individual accounts of the future into life annuities raises several issues. First, if left to the private market that considers gender in the determination of life expectancy, similar individual retirement accounts would yield smaller annual benefits for women.[6] This issue could be dealt with by requiring annuitization and having the government provide gender neutral annuities. Second, since wives tend to outlive their husbands, consideration must be given to whether an individual accounts plan will provide adequate protection for widows. Currently, Social Security provides a widow's benefit equal to the retired worker's benefit. Similar protection could be provide under an individual accounts plan by requiring that retirement funds be converted to joint life annuities. In such a case, family income would be unaffected by the death of the retired worker. Currently, household Social Security benefits decline by one-third when the retired worker dies.

The current system provides two other types of benefits that provide disproportionate benefits to women. These are the spouse benefit and the benefit to divorced spouses. While gender neutral in principle, virtually all of these benefits are paid to women.[7]

Currently, a married women who had never made contributions into Social Security can receive a benefit equal to 50 percent of her husband's benefit. Obviously, this benefit subsidizes certain types of households and this subsidy would be eliminated in most proposals for individual accounts.

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[6] Using gender specific life tables, a $100,000 annuity would provide a monthly benefit of $772 for a 65 year old man, but only $700 for a 65 year old women. At age 70, the differences are even larger, $880 for a man and $781 for a women. U.S. General Accounting Office, "Social Security Reform: Implications for Women's Retirement Income," GAO/HEMS Report 98-42, Washington: USGPO.

[7] Approximately 98 percent of those receiving spouses benefits and those dually-entitled (receiving their own retired worker benefit and a spousal supplement to bring the combined benefit up to 50 percent of their spouse's benefit) are women. U.S. Social Security Administration, Annual Statistical Supplement to the Social Security Bulletin, Washington: USGPO. Currently, about 37 percent of women receive Social Security benefits based solely on their own earnings histories. This is forecasted to increase to approximately 60 percent by 2060. National Economic Council, Interagency Working Group on Social Security, "Women and Social Security," unpublished paper, Washington, 1998.

For divorced women, Social Security currently provides a spouse benefit if the marriage lasted at least 10 years. This benefit structure provides some basic retirement income protection for divorced women and an implicit subsidy to men who have multiple wives. With individual accounts, there is a measurable retirement fund that could be considered as part of household wealth in divorce settlements. Thus, the retirement benefits generated by a worker's contribution could be allocated to himself, current spouse, and all past spouses. The distribution of these funds could be specified by law or could be left to the judicial process. An alternative would be to adopt a system of earnings sharing within the household so that half of all family earnings are deposited into the individual account of the husband and half to the wife's account.

GENDER CONSIDERATIONS IN DECIDING WHETHER TO ADOPT INDIVIDUAL RETIREMENT ACCOUNTS

In summary, my testimony has two major conclusions:

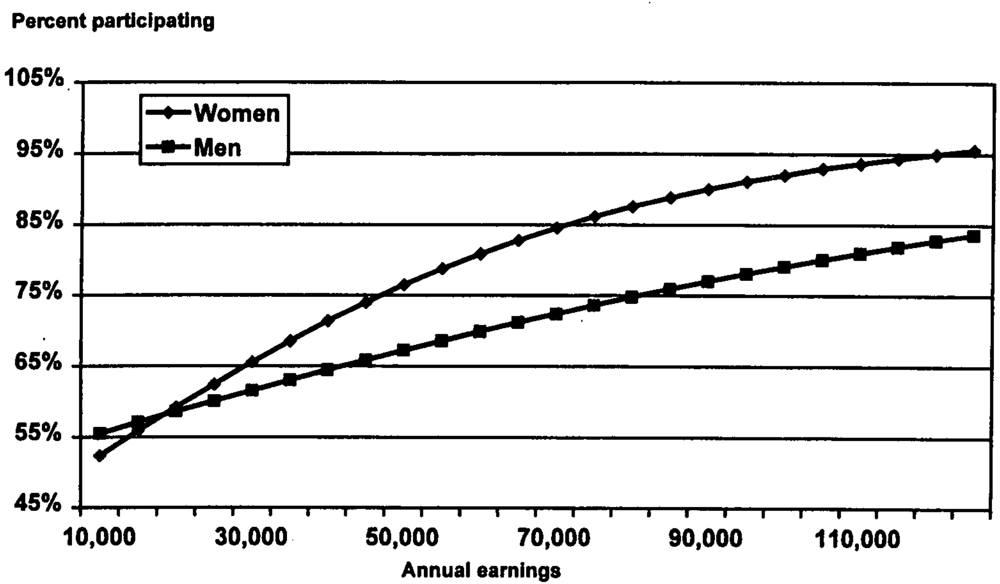
1. Women should not be considered unable or unwilling to save for retirement. Nor should they be considered less sophisticated investors. My research shows that the investment decisions of women in 401(k) plans are similar to those of men with similar work histories. As such, shifting Social Security to a system of individual accounts should not be rejected because of concerns about the quality of women's investment decisions.

2. In making the decision whether to adopt mandatory individual accounts as a central component of Social Security in the twenty-first century, Congress must consider how such a fundamental change in social policy will affect various economic and

demographic groups. It is important to recognize that most gender-related concerns associated with individual retirement accounts can be addressed by various government restrictions or requirements concerning distributions, subsidies, and investment options. If mandatory individual accounts are adopted, Congress must decide whether the advantages of such restrictions outweigh the distortions that they may introduce into the new system of retirement income provisions.

Figure 1

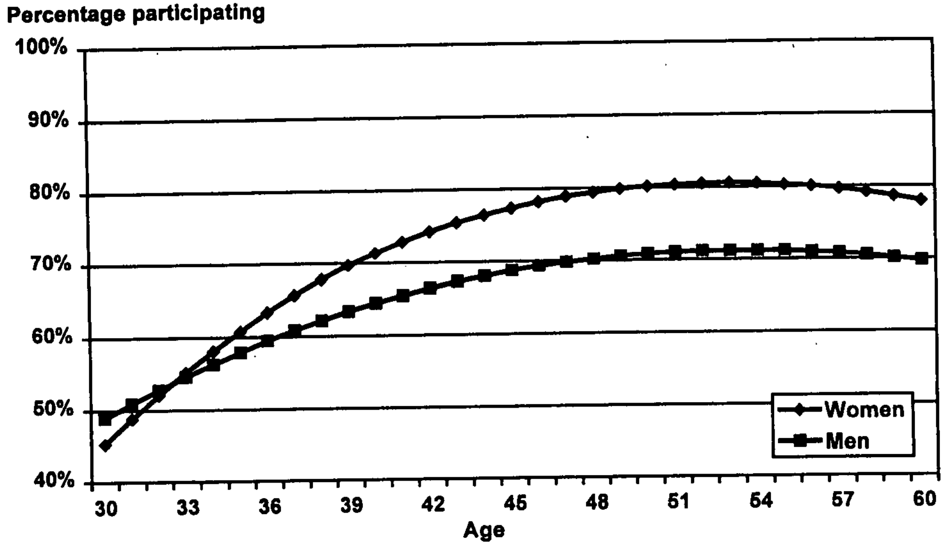
401(k) Participation Rate by Sex and Earnings



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Figure 2

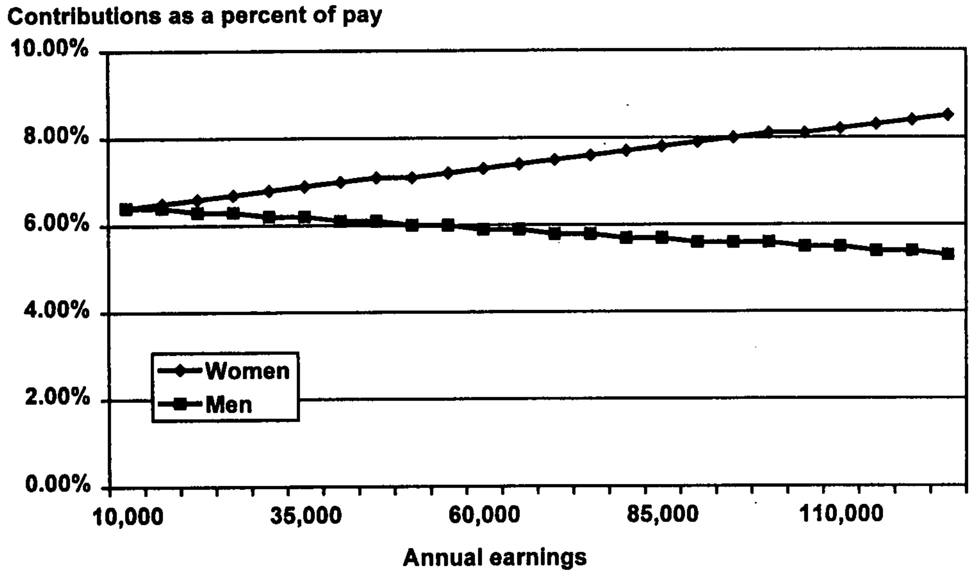
401(k) Participation Rates by Sex and Age



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Figure 3

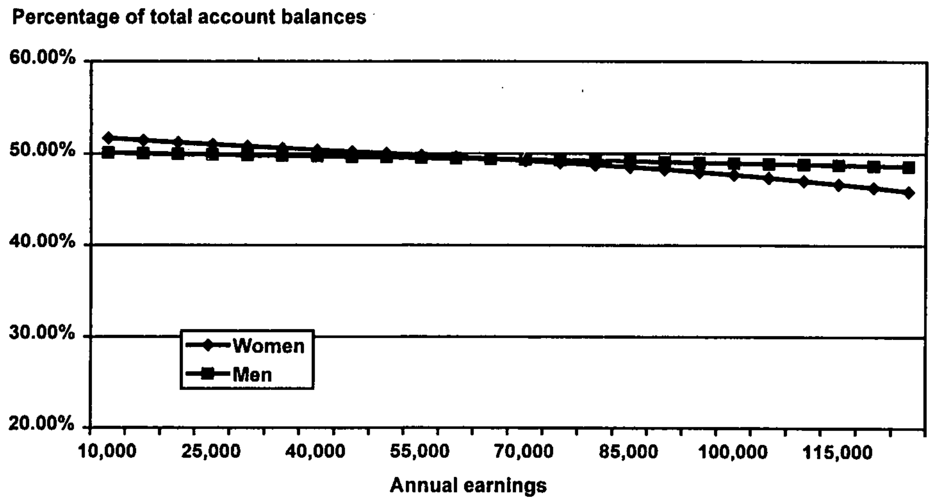
401(k) Contribution Rates by Sex and Earnings



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Figure 4

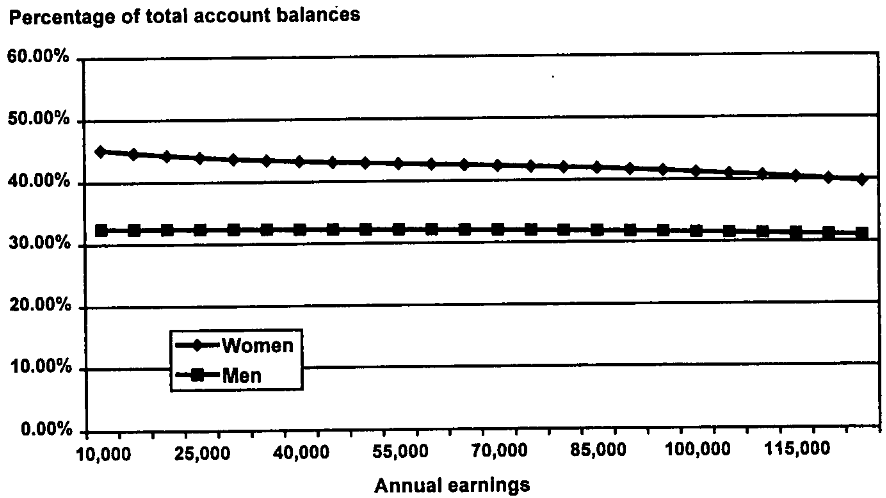
**Allocation of 401(k) Contributions to Fixed-Income Assets
By Sex and in Plans that Do Not Offer Company Stock
As an Investment Option**



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Figure 5

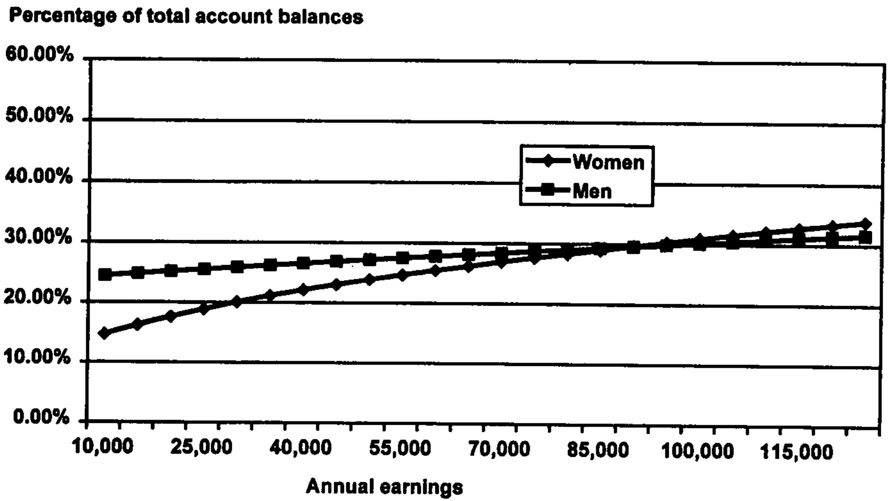
Allocation of 401(k) Contributions to Fixed-Income Assets
By Sex for Plans that Offer Company Stock
As an Investment Option



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Figure 6

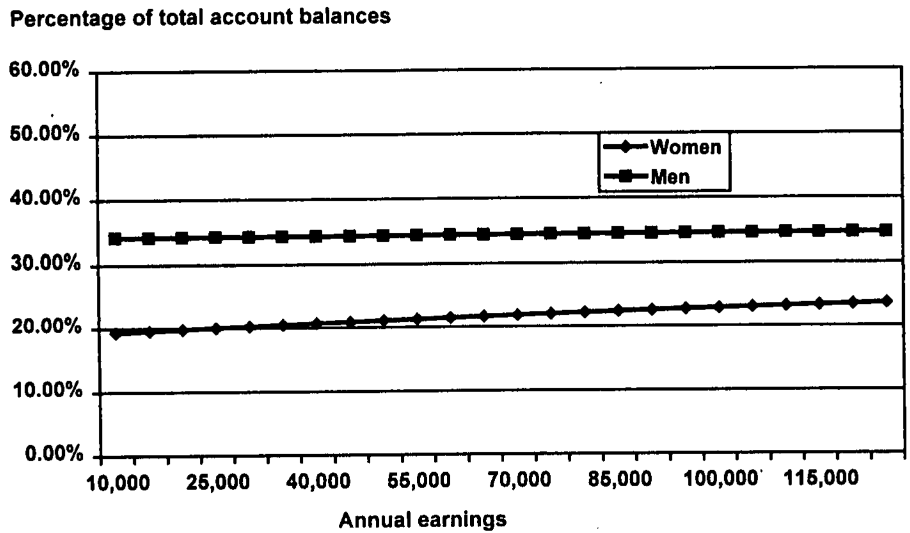
Allocation of 401(k) Contributions to Other Equity Investments by Sex and Earnings: Plans with Company Stock as an Investment Option



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Figure 7

Allocation of 401(k) Contributions to Company Stock by Sex and Earnings: Plans with Company Stock as an Investment Option



Source: Pension Research Council Working Paper #98-12 , Clark, Robert, Gordon Goodfellow, Sylvester Schieber, and Drew Warwick. "Making the most of 401(k) Plans: Who's Choosing What and Why?"

Table 1

Participation Rates by Sex, Age, and Earnings (Percent)

Age group	Annual Earnings in $1,000s: 10.0-14.9	15.0-24.9	25.0-34.9	35.0-44.9	45.0-59.9	60.0-74.9	75.0-99.9	100.0 +	All Earnings
					Women				
20-29	47.8	65.2	77.9	87.5	90.9	90.0	86.7	100.0	68.7
30-39	63.8	74.7	82.0	88.4	91.7	94.3	93.3	78.9	80.1
40-49	68.0	79.5	83.5	88.1	91.9	94.9	94.0	82.0	82.4
50-59	78.0	84.6	87.8	92.8	93.8	97.6	97.7	87.8	88.5
60-65	79.8	87.7	88.9	93.3	92.2	91.7	100.0	78.6	87.6
All Ages	64.3	76.0	82.7	89.0	92.0	94.8	94.1	81.8	79.9
					Men				
20-29	34.1	56.1	64.6	76.4	85.3	**92.4**	**93.6**	84.6	63.8
30-39	49.3	65.9	72.1	77.8	86.2	90.7	**93.8**	**91.4**	77.7
40-49	53.4	67.1	73.4	78.2	84.5	89.3	91.5	**90.1**	80.2
50-59	62.1	73.8	75.8	81.1	86.0	92.2	94.6	**92.5**	83.4
60-65	69.2	70.2	71.3	82.0	89.9	**97.0**	92.2	**93.3**	82.3
All Ages	48.8	64.6	71.4	78.3	85.6	90.7	92.9	91.2	77.7

Source: Authors' calculations of the proportion of employees participating in 401(k) plans by sex , age, and earnings from a file containing data on 87 401(k) plans and 156,376 persons employed by plan sponsors and eligible to participate in the plans in 1995.

Entries for men in boldface type show age and earnings cells where men's participation rate is greater than women's.

Table 2

401(k) Contribution Rates by Sex, Age, and Earnings (Percentage of Annual Earnings)

Age group	Annual Earnings in $1,000s: 10.0-14.9	15.0-24.9	25.0-34.9	35.0-44.9	45.0-59.9	60.0-74.9	75.0-99.9	100.0 +	All Earnings
	Women – Contributions as a percentage of earnings								
20-29	4.2	4.2	4.5	5.6	6.8	6.0	5.3	2.9	4.5
30-39	6.0	6.1	6.1	6.6	7.6	7.5	6.9	5.3	6.4
40-49	6.8	7.0	6.8	7.4	8.1	8.2	8.1	5.9	7.1
50-59	7.7	8.9	8.3	9.2	9.0	9.5	7.8	6.8	8.6
60-65	8.9	10.6	9.0	10.4	8.8	10.1	10.7	4.8	9.8
All Ages	6.5	6.7	6.4	7.3	8.0	8.0	7.5	5.7	6.8
	Men – Contributions as a percentage of earnings								
20-29	**4.7**	**5.1**	**5.4**	**6.3**	**7.0**	**7.3**	**5.4**	**4.8**	**5.7**
30-39	**7.7**	**6.9**	6.1	6.4	7.1	7.4	**7.2**	**5.4**	**6.7**
40-49	**10.3**	**8.3**	6.4	6.5	7.0	7.4	7.2	5.8	6.9
50-59	**10.8**	**9.8**	7.7	7.5	8.1	8.3	7.6	6.0	7.9
60-65	**11.6**	10.2	9.0	8.4	9.1	8.7	7.6	**5.7**	8.7
All Ages	**8.6**	**7.3**	6.3	6.6	7.3	7.6	7.3	**5.8**	6.9

Source: Authors' calculations of the proportion of annual earnings contributed to the 401(k) plan by sex, age, and earnings. Contribution rates are calculated only for employees making a contribution in 1995. Plan information is from a file containing data on 87 401(k) plans and 156,376 persons employed by plan sponsors and eligible to participate in the plans in 1995.

Entries for men in boldface type show age and earnings cells where men's average contribution rate is greater than women's.

Table 3

401(k) Account Balances Held in Equities by Sex, Age, and Earnings: Plans without Company Stock as an Investment Option (Percent)

	Annual Earnings in $1,000s								
Age group	10.0-14.9	15.0-24.9	25.0-34.9	35.0-44.9	45.0-59.9	60.0-74.9	75.0-99.9	100.0 +	All Earnings
				Women – Percentage of balances in equities					
20-29	55	57	60	67	67	75	72	30	58
30-39	48	52	56	63	66	67	74	77	55
40-49	49	51	51	60	59	60	68	70	52
50-59	42	46	48	56	58	61	60	69	46
60-65	40	37	43	48	61	49	50	87	39
All Ages	47	51	53	61	62	63	69	72	52
				Men – Percentage of balances in equities					
20-29	**58**	46	57	64	**70**	72	**83**	**84**	57
30-39	**50**	45	51	59	63	**68**	72	**78**	59
40-49	47	39	39	53	57	60	63	**71**	54
50-59	39	31	32	44	49	54	57	64	46
60-65	32	23	28	41	40	**56**	50	61	40
All Ages	**48**	40	46	55	59	62	64	71	54

Source: Authors' calculations of the allocation of 1995 401(k) balances in equities by sex, age, and earnings. Allocations are calculated only for employees with a positive account balance at the end of 1995. Plan information is from a file containing data on 58 401(k) plans that did not provide the option of investing in company stock.

Entries for men in boldface type show age and earnings cells where men's average allocation of account balances to equities is greater than women's

Table 4

Allocation of 401(k) Contributions and Balances By Sex and Earnings: Plans with Company Stock as an Investment Option (Percent)

	Annual Earnings in $1,000s								
Sex Group	10.0-14.9	15.0-24.9	25.0-34.9	35.0-44.9	45.0-59.9	60.0-74.9	75.0-99.9	100.0 +	All Earnings
	Percentage of employee contributions in company stock								
Women	25	25	26	30	32	29	28	27	27
Men	60	35	37	42	43	43	41	39	41
	Percentage of employee contributions in other equities								
Women	38	30	32	37	40	45	47	51	34
Men	25	31	28	28	33	35	40	45	32
	Percentage of employee contributions in fixed-income assets								
Women	36	45	42	32	27	26	25	22	39
Men	15	33	35	30	25	22	19	16	27
	Percentage of employee-financed 401(k) balances in company stock								
Women	26	26	28	34	36	30	31	27	29
Men	65	37	42	48	47	47	44	40	45
	Percentage of employee-financed 401(k) balances in other equities								
Women	39	30	31	35	37	44	44	49	33
Men	24	33	29	28	30	33	37	42	31
	Percentage of employee-financed 401(k) balances in fixed-income assets								
Women	36	44	41	31	27	26	25	24	38
Men	12	30	29	25	22	21	19	18	24

Source: Source: Authors' calculations of the allocation of 1995 401(k) contributions to and balances in company stock, equities, and fixed-income assets by age and earnings. Allocations are calculated only for employees making a contribution in 1995, or for employees with a positive balance at the end of 1995. Plan information is from a file containing data on 29 401(k) plans that did provide the option of investing in company stock.

The CHAIRMAN. Thank you, Dr. Clark.
Dr. Steuerle.

STATEMENT OF C. GENE STEUERLE, SENIOR FELLOW, URBAN INSTITUTE, WASHINGTON, DC

Mr. STEUERLE. Mr. Chairman and members of the committee, I would like to congratulate you on delving into these issues of how the family is treated under Social Security and particular reforms of that system.

These family issues derive from adjustments related to spouses, survivors and divorced former partners of workers. You have asked me, in particular, to concentrate on the difficult issue of divorce.

There are two equity principles that I believe should apply to Social Security and its treatment of the family. The first is equal justice or what is sometimes called horizontal equity. Individuals in equal circumstances should be treated the same. In the case of divorce, this generally means that married couples should share equally in any accrual of assets during their time of marriage together.

A second principle is that benefits should be related to need—or vertical equity. Social Security exists primarily to protect the truly old against poverty. This leads to such proposals as the one adopted by the National Commission on Retirement Policy, a wage indexed minimum benefit that tries to ensure that almost all of the elderly are kept out of both absolute and relative poverty.

Now, family policy in Social Security today does not follow cleanly from a set of principles and can be likened to the following: Think of a part of a major metropolitan city in which many people on the street are poor. The Government responds to this poverty situation by taking a basket of money, climbing to the top of a skyscraper and then throwing the money off the roof.

Now, much of the money, indeed, does reach the poor. But some lands on penthouses occupied by rich people, some is acquired by middle-income people on other floors or on the ground, and much of it is distributed fairly arbitrarily, although much does reach the poor.

Now, here are some examples from how Social Security treats divorce today.

If a spouse divorces a worker after 9 years, 11 months, and 27 days of marriage, that spouse gets absolutely nothing from Social Security in auxiliary benefits and is entitled to no share of the worker's benefit.

On the other hand, if a worker gathers five spouses over the course of a life, each for 10 years and 1 day of marriage, each of those spouses can be entitled to hundreds of thousands of dollars of Social Security benefits because of the marriage.

As a third example, if a spouse divorces a worker after 40 years of marriage, as long as the worker is alive, the spouse is entitled to a benefit that is much lower than when the worker dies. Thus, the divorced spouse's well-being is inversely related to the remaining life span of the worker, thus, creating an interesting set of incentives for a P.D. James mystery novel, but incentives I will not examine further in my testimony.

Fourth, if a single head of household raises children and works for 40 years at $10,000 a year, she will be entitled to substantially fewer Social Security benefits than a divorced or married person who never works, never raises children and never contributes to Social Security, as long as the latter person happens to be married to a rich worker for 10 years or more.

Finally, a middle-class divorced person of a rich person can face a substantial marriage penalty and forfeit some survivors benefits if she marries another middle-class worker.

In my testimony, I provide you with a number of details on the increasing prevalence of divorce in today's society. Here are two examples. The percentage of women currently divorced has risen from about 2.5 percent in 1970 to over 8 percent in 1997. When we look among old men and women below the poverty line, we find that over 10 percent of them now are divorced. However, 53 percent of them are widowed, 2 to 3 percent are separated and about 9.5 percent are never married.

Women comprise about 73 percent of this poverty group. In general, poverty is concentrated or related to living alone in old age. Now, because of the substantial increase in divorce rates, especially among individuals with less than 10 years of marriage, and a corresponding decrease in remarriage rates by those who are divorced, and an increase in the number of individuals who remain unmarried, the protection provided to some lower-income individual women and some men is partially eroded.

If one redesigns Social Security according to a set of principles, I believe that it would incorporate the following elements:

We would have a minimum benefit along the lines of the National Commission on Retirement Policy that would remove most of the elderly from absolute, as well as relative poverty. It would have a system of earnings sharing or benefit sharing for couples. Such a system would approximately prorate benefits of either spouse according to the share of a normal working life that they spend together.

A third element of a reform system would cap the spousal survivor's rule that provides the largest windfall welfare benefits to the spouses of the richest workers, regardless of whether they raise children and inversely to their own work efforts and contributions to Social Security.

And, finally, the system should no longer provide greater benefits to couples simply because their ages are further apart than if their ages are close together.

How does individual accounts and USA accounts fit into this world? In my view, they can be designed easily to be shared more or less equally—thus, helping to meet the principle of equal justice or horizontal equity that I outlined.

However, individual accounts and USA accounts are not really designed or intended to deal with the issue of ensuring against poverty in old age. For this reason, it is hard to set them up to replace the Social Security system that inevitably has a significant element of redistribution to it.

By the same token, individual accounts and USA accounts do not necessarily reduce progressivity any more than do private pensions. What I believe confuses matters and confused some of the debate with the last panel is that many people look at reforms one at a time. For example, if all that happened were that individual accounts were to replace part of the existing system, there could be a decrease in progressivity.

On net, however, progressivity could be enhanced if the benefit formula itself were made more progressive, either by changing the rate schedule or by providing a minimum benefit.

In conclusion, the treatment of the family in Social Security does not take into account the circumstances of families today. Many inequities can only be addressed by adherence to a set of principles. Such principles could help ensure both that more of the elderly are kept out of poverty and that spouses share more equally in the retirement benefits accruing from and attributable to the years spent together.

Finally, let me make a plea that Congress try to ensure that a much more thorough and systematic examination of these family issues be undertaken. I would be glad to try to help you to find experts who could help perform such an examination in a nonpartisan manner.

Thank you.

[The prepared statement of Mr. Steuerle follows:]

THE TREATMENT OF THE FAMILY AND DIVORCE IN THE SOCIAL SECURITY PROGRAM

Special Committee on Aging
United States Senate

February 22, 1999

C. EUGENE STEUERLE
Senior Fellow

Any opinions expressed herein are solely the author's and should not be attributed to the Urban Institute, its officers or funders.

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Mr. Chairman and Members of the Committee:

This Committee is to be congratulated for delving into issues of how the family is treated under Social Security and potential reforms of that system. Despite the vital importance for almost all families and the hundreds of billions of dollars in annual spending involved, family issues for the most part have remained on the sidelines in the Social Security debate. These family issues derive from the adjustments that Social Security makes to benefits in cases where there are spouses, survivors, and divorced former partners of workers.

My comments can be summarized as follows:

- (1) The treatment of the family should follow from a set of basic principles.
- (2) The treatment of the family in today's Social Security program has a number of clear-cut inequities and distortions precisely because it does not follow cleanly from a set of principles.
- (3) Any reform creates winners and losers, but the fear of creating sympathetic losers locks Social Security into a mid-20th century structure and continues to keep on the back burner real reform in its treatment of the family.
- (4) In the case of divorce -- the issue to which you asked me to pay special attention in my testimony -- conditions in society itself have changed dramatically over the past several decades.
- (5) For divorced persons, a reformed Social Security should attempt to achieve the goal of meeting needs by using minimum benefits and adjusting its rate structure. Its equal justice or horizontal equity goals should try to insure that couples share more or less equally in Social Security benefits that *accrue* from their years together. Some of this can be done by formula, but some may involve further adjustments in divorce decrees.
- (6) In the case of individual accounts and USA accounts, they can easily be split at time of divorce to try to meet the equal justice criteria, but they generally are not designed to meet goals of redistribution according to need. Nonetheless, they should not be assessed in isolation but only as part of an entire package of retirement programs and government subsidies. The package itself can be made more progressive or less progressive with or without an individual account or USA account component.

Two Equity Principles for Social Security

There are two equity principles that should apply to Social Security and its treatment of the family:

(1) *Equal justice (or horizontal equity)*. Individuals in equal circumstances should be treated the same. In the case of divorce, this generally means that married couples should share equally in any accrual of assets during their time of marriage together, just as most of them usually shared equally in consumption during that same period of time. In some cases, however, the measure of accrual requires taking into account how future income will be related to sharing of resources, saving, and investment in education during years together.

(2) *Benefits related to need (or vertical equity).* Social Security exists primarily to protect the truly old against poverty. This leads to such features as a progressive benefit formula and to such proposals as the one I recommended and that was adopted by the National Commission on Retirement Policy (NCRP): a wage-indexed minimum benefit that tried to insure that almost all the elderly were kept out of absolute and relative poverty.

It is important that these principles not be confused. For example, guaranteeing that a rich divorced person shares fairly in the assets that derive from his or her former marriage may have nothing to do with need or progressivity, but it may still be fair. Similarly, there are many poor elderly whose condition has nothing to do with divorce, so granting extra benefits to someone simply because he or she is divorced could turn out to be progressive, but not fair nor well targeted.

Today's Social Security Approach

Family policy in Social Security can be likened to the following. Think of a part of a major metropolitan city in which many people on the street are poor. The government responds to this poverty situation by taking a basket of money and climbing to the top of a skyscraper and then throwing the money off the roof. Much of the money indeed reaches some of the poor. But some lands on penthouses occupied by rich people and some is acquired by middle-income people on other floors or on the ground. However, any time that reform is suggested, opponents point out that it would cut back on at least some of the money garnered by some of the sympathetic poor people on the ground.

Here are some examples of how Social Security treats divorce today. Many of these results follow from the rule that a divorced person married for 10 years or more is entitled to full spousal and survivor benefits, one married less than 10 years is entitled to none.

(1) If a spouse divorces a worker after 9 years, 11 months, and 27 days of marriage, the spouse gets absolutely nothing from Social Security is auxiliary benefits and is entitled to no share of the worker's benefit (spouses can still get benefits on their own earnings records)..

(2) If a worker gathers five spouses over the course of a life, each for 10 years and 1 day of marriage, each of those spouses is entitled to hundreds of thousands of dollars of Social Security benefits because of the marriage. Correspondingly, a worker paying the same amount of taxes, but having only one spouse, generates hundreds of thousands of dollars less in potential auxiliary benefits.

(3) If a spouse divorces a worker after 40 years of marriage, as long as the worker is alive the spouse is entitled as a spousal benefit of only one-half of the benefit garnered by the worker. However, should the worker die, the divorced spouse is entitled to a survivor's benefit equal to the worker's full benefit itself. Thus, the divorced spouse's well-being is inversely related to the remaining lifespan of the worker (thus creating an interesting set of incentives for an P.D. James

mystery novel but which I will not explore further here). Put another way, the benefits to the divorced spouse are not prorated according to her or his own need and, given the separation of spouses, are too dependent upon the life span of the worker.

(4) If a single head of household raises children and works for 40 years at $10,000 a year (wage-indexed) and contributes every year to Social Security, she will be entitled to substantially fewer Social Security benefits than a divorced (or married) person who never works, never raises children, and never contributes to Social Security, as long as she happened to be married to a rich worker for 10 years or more.

(5) A divorced person who was married to a much older worker on average will get substantially more benefits than a divorced person who was married to a worker of the same age. (In effect, those who marry older workers are more likely to get survivors' benefits, which are more generous than spousal benefits, than are those who marry younger workers.)

(6) A middle class divorced person of a rich worker could face a significant marriage penalty and forfeit some survivors benefits if she marries another middle-class worker.

Why do these inequities and anomalies arise? They are the consequence of formulas for both spousal benefits and benefits for divorced persons that are poorly targeted at either of the two issues that should be at stake: the well-being of spouses or divorced persons or anyone else, for that matter, based upon need; and the right of each spouse to share in the fruit of the household during years of marriage.

The Reform Dilemma: Winners and Losers

What typically stymies reform is that it inevitably would involve winners and losers. By practice, past Congresses have patched on new benefits for spouses and divorced persons in ways that pretended only to create winners. A new sympathetic case leads to the demand for some new patch -- but without regard to whether the patch is well placed or whether some of the old patches should be removed. Today, however, the current level of promises in Social Security probably cannot be sustained, so it is no longer possible to pretend that legislation can create only winners. An opportunity is present to engage in reforms that, whatever the total to be spent, address better the needs of the older population, as well as provide more equal justice or horizontal equity.

Still, any reform will still face obstacles. Somewhere there will be a divorced person with low wages who was married for 11 years to a higher income worker. Following a set of principles, it would be hard to set up a system where this divorced person was entitled, as is the case today, to significantly more benefits than many other low-income workers who were married for less than 10 years or the lifetime spouses of many middle-income workers. While a reformed system as a whole can easily direct a greater portion of resources to those with greater needs, it cannot hold everyone harmless. Thus, reducing the poverty rate among older divorced individuals may still lead to some future retirees who are divorced to receive lower benefits than under current law.

How the World of Divorce Has Changed

The following data provides you with many details on the increasing prevalence of divorce in today's society. Formerly, whatever the inequities of the Social Security treatment of divorce, it affected only a modest number of retirees because of the smaller frequency of divorce and the higher frequency of remarriage in the case of divorce.

As compared to 1970, we can note the following trends:

- The percentage of women currently divorced has risen from 2.54 in 1970 to 8.16 in 1997.
- This increase in the percentage of women currently divorced has occurred for all age groups, and it has been most dramatic for middle-aged women (see Figures 1 and 2 in the Appendix).
- Among middle-aged women (aged 45-49), the percentage currently married has dropped sharply (from 81.36 to 67.89), the percentage currently divorced has increased sharply (from 5.25 to 17.69), and the percentage who never married has also risen sharply (from 3.90 to 8.00). (See Table 1 in the Appendix).
- Older men and women (aged 65 and over) who are currently divorced are more likely to fall below the poverty line than those who are married. The probability of falling below the poverty line is even greater for men and women who are widowed, separated, or were never married. Finally, the probability of falling below the poverty line is much higher for women than for men. (See Table 2 in the Appendix.)
- Among older men and women (aged 65 and over) below the poverty line, 24.79 percent are married, 10.41 percent are divorced, 52.81 percent are widowed, 2.57 percent are separated, and 9.42 percent never married. Women comprise 73.40 percent of this poverty group, and men 26.60 percent. (See Table 3 in the Appendix.)

Because of the substantial increase in divorce with less than 10 years of marriage, the decrease in remarriage rates, and the increasing prevalence of unmarried individuals, the protection provided to some lower-income individual women has partially eroded. As in the case when women entered the workforce in increasing numbers, the system as a whole may be saving money, but at the cost of greater inequity

How a Reformed Type of System Might Work

If one redesigns Social Security according to a set of principles, I believe that it would incorporate the following elements:

(1) A minimum benefit, along the lines of the National Commission on Retirement Policy, that would remove most elderly from absolute and relative poverty. That particular minimum benefit required years of coverage, but they are fairly easy to obtain; in any case, it is possible to design such a minimum so almost all women and men in future decades could be made to quality a minimum benefit.

(2) A system of earnings sharing or benefit sharing for couples. Such a system would approximately prorate benefits of either spouse according to the share of a normal working life that they spent together. Congress ought to consider whether further adjustments could be provided in divorce decrees if it was felt that the accumulation of future earnings (e.g., returns to education) would only show up in later earnings. Today, however, Social Security cannot handle that type of adjustment. Note that private plans are going through a similar turmoil over how to handle rights to pension assets in the case of divorce.

(3) Capping of a spousal and survivor's rule that provides the largest windfall welfare benefits to the spouses of the richest workers regardless of whether they raise children and inversely to their own work efforts and contributions to Social Security. Thus, the system would no longer provide substantially more benefits to a couple with $50,000 in combined earnings split $45,000/$5,000 than to an equal income couple with earnings split $25,000/$25,000.

(4) The creation of an actuarial balance to which individuals would be entitled, with spousal and survivors benefits calculated off of that actuarial balance according to the age of the partners. Thus, the system would no longer provide greater benefits to couples simply because their ages were far apart rather than close together.

Individual Accounts and USA Accounts

Individual accounts and USA accounts can be designed easily to be shared more or less equally, thus helping to meet the principle of equal justice or horizontal equity in the case of divorce. Essentially each member can be entitled to one-half of the moneys in those accounts due to years of marriage -- again, with further adjustments sometimes made in divorce courts. Some favor splitting deposits up front on an individual basis; some employers instead prefer that these divisions be made in divorce court. Either way, however, the equal justice principle can be approximated.

On the other hand, individual accounts and USA accounts are not designed or intended to deal with the issue of insuring against poverty in old age. For this reason, it is hard to set them up to replace a Social Security system that inevitably has a significant element of redistribution to it. By the same token, individual accounts and USA accounts do not necessarily reduce progressivity, any more than do private pensions.

The battle over individual accounts and USA accounts, therefore, is often misdirected. On the extreme of one side will come the proclamation that no transfer system is necessary (or hint that somehow there will be a costless welfare system that backs up a completely privatized Social Security system). On the extreme of the other side will come the proclamation that every element of the system must have significant redistribution attached to it. In truth, there is a lot of middle ground.

What also confuses matters is that many people look at reforms one at a time. For example, if all that happened were that individual accounts were to replace part of the existing system, there could be a decrease in progressivity. On net, however, progressivity might be enhanced -- whether or not individual accounts of USA accounts replaced part of the existing system or were added on top of it -- if the benefit formula itself was made more progressive, either by changing its rate schedule or by providing for a minimum benefit.

Conclusion

The treatment of the family in Social Security, unfortunately, does not take into account the circumstances of families today. We may soon undertake a significant reform of Social Security, one that could shift around trillions of dollars in future benefits, yet these family issues have been given little consideration in the debate to date. Many inequities can only be addressed by adherence to a set of principles. Such principles could help insure both that more of the elderly are kept out of poverty and that spouses share more equally in the retirement benefits accruing from and attributable to years spent together.

Finally, let me make a plea that Congress try to insure that a much more thorough and systematic examination of these family issues be undertaken. I would be glad to try to help you find experts who could help perform such an examination in a nonpartisan manner.

APPENDIX

Table 1. Change in Marital Status Among Women Aged 45-49, 1970-1997.

	1970	1997
Married	81.36	67.89
Divorced	5.25	17.69
Widowed	6.18	2.94
Separated	3.31	3.49
Never Married	3.90	8.00

Source: The Urban Institute, 1999. Based on the Current Population Survey.

Table 2. Probability That People Aged 65 and Over Will Be Below the Poverty Level, Given Their Marital Status or Sex (1997).

Married	4.88
Divorced	16.45
Widowed	16.99
Separated	28.74
Never Married	24.00
All Men	6.80
All Women	13.62

Source: The Urban Institute, 1999. Based on the Current Population Survey.

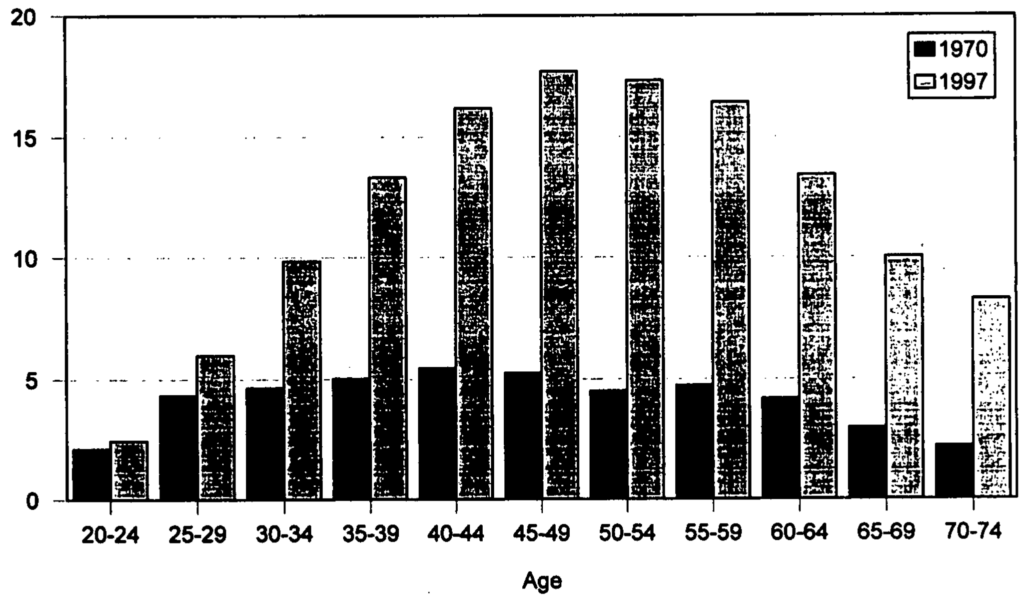
Table 3. Percentage of People Aged 65 and Over and Below the Poverty Level, By Marital Status and Sex (1997).

Married	24.79		
Divorced	10.41		
Widowed	52.81		
Separated	2.57	All Men	26.60
Never Married	9.42	All Women	73.40
Total	100.00	Total	100.00

Source: The Urban Institute, 1999. Based on the Current Population Survey.

Percentage of Women Currently Divorced, 1970-1997

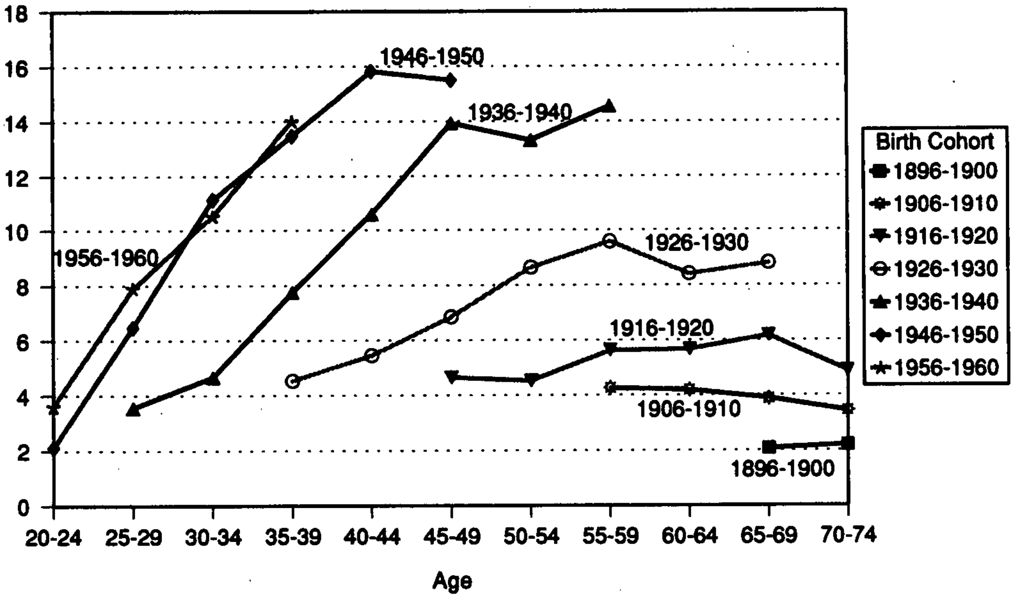
By Age Group



Source: The Urban Institute, 1999. Based on the Current Population Survey.

Percentage of Women Currently Divorced

By Age and Cohort



Source: The Urban Institute, 1999. Based on the Current Population Survey.

STATEMENT OF MARK J. WARSHAWSKY, DIRECTOR OF RESEARCH, TEACHERS INSURANCE AND ANNUITY ASSOCIATION-COLLEGE RETIREMENT EQUITIES FUND, NEW YORK, NY

Mr. WARSHAWSKY. Good afternoon, Chairman Grassley and members of the committee. I am director of Research at the TIAA-CREF Institute, the financial and economic research and education arm of TIAA-CREF. Founded in 1918, TIAA-CREF is a nonprofit financial services company and the Nation's largest private pension system, providing defined contribution pension plans to almost two million workers in the nonprofit, education and research sectors and making retirement income payments to almost 300,000 annuitants.

I am pleased to testify at this hearing, which provides a good opportunity to review research and information relevant to understanding some of the implications for women of setting up individual accounts under various Social Security reform proposals.

I have a chart. As we all know, women live longer than men. According to the Social Security Administration Office of the Actuary, in 1998, a woman age 62 could expect to live to age 84, while a 62-year-old man could expect to live to only age 80. According to the projection of the Social Security actuary, by the year 2020, at the height of the retirement of the baby boom generation, women age 62 are expected to live to age 85½.

The life expectancy statistics I have just cited are expectations; that is, averages. If you knew your exact date of death, you could schedule a draw-down of pension and personal assets at retirement, so that the flow depleted those assets just at the moment of death. In reality, however, almost everyone is uncertain about how long they will live. This is true for people at the time of retirement, and it is especially so for women.

According to the Social Security actuary, a woman age 62 currently has a 25-percent chance that she will live to age 92, and a 10 percent chance that she will live until age 97.

Is there a way of ensuring that people will have a sufficient income in these extra years? There is. It is called the life annuity. In its most basic form, an annuity, whether issued by a life insurance company, an employer pension plan or a Government program, pools people together and pays out a higher flow of income to each participant for his or her entire lifetime than if each individual were left to his or her own devices.

The risk-sharing features implicit in the life annuity are especially critical to women. Women have longer life expectancies, greater uncertainty about length of life, and according to some studies, higher aversion to risk. These considerations argue strongly that the life annuities should be an important or even mandated component of any individual accounts established under Social Security reform.

Because women, as a class, are longer alive than men, insurance companies, absent any legal impediments, will price $1 of annuity income issued to women at a higher premium than $1 of annuity income issued to men. Indeed, in the market for a single-premium, immediate life annuities issued to individuals, women are currently charged about 10 percent more for a single-life annuity than men.

This extra charge is more than justified by differences in mortality experience.

Since the Norris case was decided by the Supreme Court in 1983, life annuities for employer-sponsored retirement plans, defined benefit plans, as well as defined contribution plans, such as the Thrift Saving Plan for Federal Government workers and TIAA-CREF plans for workers in education and research, must be provided on the same rate basis to women as to men.

It seems fair to apply the same unisex pricing principles currently in force for employer-sponsored pension plans as in the current Social Security defined benefit plan, for life annuities purchased with accumulations from Social Security individual accounts. The same principles of equality and social justice should apply to all retirement accounts.

Another area in which rules should be uniform is spousal consent. To combat the problem that some pension plan participants were selecting the single-life annuity option, not notifying their spouses of their choice and leaving their spouses, usually wives, with no benefit if the participant predeceased the spouse, Congress enacted the Retirement Equity Act, REA, of 1984. REA contains the requirement that a plan participant who elected any form of payment other than a joint-and-survivor annuity must obtain the spouse's written, notarized consent. A joint-and- survivor annuity qualified under this law must provide income to the surviving spouse in an amount equal to at least one-half of the income payable when the participant and spouse are both alive.

The reasons that compelled Congress to enact REA for pension plans should probably lead to some type of joint-and-survivor annuity requirement for individual accounts established under Social Security reform. Moreover, in the context of individual accounts, serious consideration should be given to increasing the required level of income payable to the survivor from 50 percent to two-thirds. Such a rule would mimic the Social Security benefit formula, which recognizes the partial, but incomplete, economies of scale in the cost-of-living for a couple.

The central purpose of a retirement plan, whether publicly or privately sponsored, whether a defined benefit or a defined contribution, is to provide the plan participant and his or her spouse with income in retirement to finance their living expenses. A logical corollary of this purpose is that the flow of income in retirement should increase over time to reflect, at least in part and approximately, increases in the cost of living. Although price inflation is currently low, in the past inflation has ravaged the purchasing power of fixed-income-flows of pensioners. There is always a risk that inflation could again rise to high rates.

Because of their longer life expectancies, women are especially exposed to the risk of inflation during retirement. Therefore, in any system of individual accounts established under Social Security Reform, women, in particular, would benefit from gradual increases in annuity benefits over their lifetime.

As I explain in my written statement, providers of individual annuities, and I highlight the very successful experience of TIAA-CREF in this regard, have devised several types of annuities that provide for increases in income as the annuitant ages.

Thank you for your kind attention, and I will be glad to answer questions.

[The prepared statement of Mr. Warshawsky follows:]

STATEMENT OF

MARK J. WARSHAWSKY
Director of Research, TIAA-CREF Institute

TEACHERS INSURANCE AND ANNUITY ASSOCIATION
and
COLLEGE RETIREMENT EQUITIES FUND

BEFORE THE

SPECIAL COMMITTEE ON AGING

SENATOR CHARLES E. GRASSLEY, CHAIRMAN

of

UNITED STATES SENATE

on

SOCIAL SECURITY REFORM

Monday, February 22, 1999

I. Introduction

Good afternoon, Chairman Grassley and Members of the Committee. I am Mark Warshawsky, Director of Research at the TIAA-CREF Institute, the financial and economic research and education arm of TIAA-CREF. Founded in 1918, TIAA-CREF is a nonprofit financial services company and the nation's largest private retirement system, providing defined contribution pension plans to almost 2 million workers in the nonprofit education and research sectors and making retirement income payments to almost 300,000 annuitants.

I am pleased to testify at this hearing, which provides a good opportunity to review research and information relevant to understanding some of the implications for women of setting up individual accounts under various Social Security reform proposals. Because Social Security currently serves as the foundation of Americans' retirement plans, it is in everyone's best interest to take on the crucial task of fashioning an efficient and fair Social Security program as soon as possible. Understanding the operational details of individual accounts and the impact that they can have on groups such as women is an essential step in evaluating proposals to add individual accounts to Social Security. Your leadership in conducting this hearing should be commended.

There are a number of features in the current Social Security system that address the special retirement security needs facing women. Similar types of benefit features are available in employer-sponsored retirement plans. As you requested, I will focus my remarks on the life expectancy of women and how life annuities can alleviate the concern that women will outlive their retirement assets. I will also address design features such as unisex pricing of annuities, joint-and-survivor benefits, and indexing and inflation, and how these concepts might be carried over to individual accounts under Social Security reform. I base my testimony on the results of several research studies, including some I have helped conduct over the years, as well as the experience of TIAA-CREF.

II. The Advantages of Life Annuities, especially for Women

As we all know, women live longer than men. According to the Social Security Administration, Office of the Actuary, in 1998, a woman age 62 could expect to live to age 84, while a 62-year-old man could expect to live to only age 80. According to the projection of the Social Security Actuary, by the year 2020, at the height of the retirement of the baby boom generation, women age 62 are expected to live to age 85.

The life expectancy statistics I have just cited are expectations, that is, averages. If you knew your exact date of death, you could schedule a draw down of pension and personal assets at retirement so that the flow depleted those assets just at the moment of death. In reality, however, almost everyone has considerable uncertainty about length of life. This is true for people at the time of retirement, and it is especially so for longer-lived women. According to the Social Security Actuary, a woman age 62 currently has a 25 percent chance that she will live until age 92, and a 10 percent chance that she will live until age 97.

To avoid the problem of poverty at the end of life, one might conserve one's assets, and draw only small amounts so as to self-insure against the risk of longevity. But this tactic only spreads poverty over one's lifetime rather than postponing it to the end of life. There must be a better way of solving the problem of using one's assets to finance consumption over an uncertain lifetime.

And there is. It is called the life annuity. In its most basic form, an annuity, whether issued by a life insurance company, an employer pension plan, or a government program, pools people together, and pays out a higher flow of income to each participant for his or her entire lifetime than if each individual were left to his or her own devices. The risk-sharing features implicit in the life annuity are especially critical to women, with their longer life expectancies, their greater uncertainty about length of life, and, according to some studies, their higher aversion to risk. These considerations argue strongly that the life annuity should be an important or even mandated component of any individual accounts established under Social Security reform.

How does the annuity issuer accomplish this magic of maximizing income, while eliminating risk, for the plan participants? By pooling the resources of the population and paying more, in total, to the longer-lived than to the shorter-lived. It is important to note that the system can only work with some element of mandatory participation or pre-commitment. That is, if an individual knew his or her life expectancy to be shorter than the population average, that individual would be less likely to participate voluntarily in the life annuity program or would want to be excused from the arrangement after entering. If there were enough individuals with this knowledge who were able to act by refusing to participate or withdrawing, the remaining individuals in the pool would be longer-lived than the general population, and the annuity issuer would be forced to raise prices or cut income flows. This process, called adverse selection by actuaries and economists, in the extreme can destroy the viability of the life annuity principle.

Mandatory annuitization can help out with another potential problem, called moral hazard by economists and other social scientists, which can be particularly severe in public programs. More specifically, allowing individuals to take lump-sum withdrawals from their accounts upon retirement creates the risk that some individuals would deplete these assets early. In the worse case, they might become impoverished and be forced to rely on public welfare programs. If the public welfare program was generous enough, some otherwise prudent individuals might be tempted to take greater risks or spend larger sums, knowing the welfare program was there as a safety net. Mandatory annuitization helps avoid this unfortunate scenario and relieves pressure on the social safety net.

An annuitization requirement would be like the current Social Security system, in which lump-sum withdrawals are not available and retirement benefits are uniformly computed at a certain age. Yet among the advantages of individual accounts are their abilities to reflect individual preferences and their allowance for the accumulation of wealth for various purposes. These purposes include extraordinary expenditures, such as uninsured health and long-term care needs, or transfers to children and grandchildren.

Women are particularly exposed to the risk of long-term care. They typically survive their husbands and therefore have no spousal assistance available as the need for home health care or nursing care arises in later life. If individual accounts are set up, thought should be given to allowing some flexibility in withdrawing assets from the accounts in specific circumstances. Ideas might include an option to postpone the age of mandatory annuitization to age 70. Another might be an exemption from mandatory annuitization if the account size is sufficient to produce retirement income flows above certain minimum poverty levels. Widespread coverage of the population by private long-term care and Medigap insurance would lessen the need for cash withdrawal flexibility.

III. Annuity pricing and women

It is important to explain at the outset of our technical discussion that annuities provided from defined benefit plans (such as Social Security) and annuities purchased with funds accumulated in defined contribution or individual account plans generally operate quite differently. In a defined benefit plan, most extra annuity benefits provided, such as disability benefits or indexation for inflation, are *added* at the cost of the provider to the base level of benefits and do not reduce them. By contrast, in individual account plans, extra features such as inflation indexation or joint-and-survivor benefits must be paid for by the annuitant and therefore *reduce* annuity benefits otherwise payable, given a fixed accumulation of assets. Of course, economically the two modes of operation are equivalent, particularly if the sponsor of the defined benefit plan calculates what it can afford, including the extra benefits likely to be paid, and sets the base benefit level accordingly. But in the perception of plan participants, the two modes of operation may appear quite different, particularly when the context is converting part of Social Security's currently defined benefits to an individual account set-up.

Because women are, on average, longer-lived than men, insurance companies, absent any legal impediments, will price single life annuities issued to women at a higher premium than single life annuities issued to men. Indeed, in the market for single-premium immediate life annuities issued to individuals, women are currently charged about 10 percent more for a single life annuity than men. This extra charge is more than justified by differences in life expectancies. Since the Norris case was decided by the Supreme Court in 1983, life annuities from defined benefit plans as well as from defined contribution plans such as the Thrift Saving Plan for federal government employees and TIAA-CREF plans for workers in education and research must be provided on the same rate basis to women as to men.

Because the Social Security defined benefit formula uses the same unisex pricing principles currently in force for employer-sponsored pension plans, it seems fair to require that life annuities paid out from accumulations in individual accounts which may be established under Social Security reform be paid on a unisex basis. The same principles of equality and social justice should apply to all retirement accounts. When a male plan participant , who takes a distribution from his retirement plan, rolls it over to an IRA and then purchases a tax-qualified individual single life annuity priced on a sex-distinct basis, he circumvents the intent of the law and the Supreme Court's decision. This practice creates the theoretical possibility that adverse selection will occur. The remaining group of (largely female) plan participants will therefore receive lower income flows. Of course, if annuitization were mandatory for individual accounts, the possibility of adverse selection arising from unisex pricing would be largely eliminated.

A final consideration on annuity pricing and women's concerns: Administrative expenses are largely fixed costs, that is, the same costs are incurred in establishing and servicing an individual account whether the account size is large or small. Women, who typically earn less than men and whose attachment to the labor force is more intermittent, will likely build up smaller account balances. *If* the providers of the individual accounts (including the issuers of life annuities when account balances are converted at retirement) were allowed to charge fixed dollar fees, women would be adversely affected. If, however, the plan providers covered their expenses as a certain percentage of assets, as most providers currently do in the retirement plan business, and the same percentage were applied to accounts of all sizes, then women would fare as well as men.

IV. Joint-and-survivor benefits

Under a joint-and-survivor annuity, monthly benefits are paid to the annuitant over his or her lifetime *and* the lifetime of the beneficiary, usually a spouse. The monthly benefit is smaller than the monthly amount from a single-life annuity because payments are being paid over two lifetimes rather than one. Originally under ERISA, a retiring worker was not required to elect a joint-and-survivor option from a pension plan nor even to tell his or her spouse what benefit payment method was selected. Because the joint-and-survivor payment appeared smaller, some plan participants were selecting the single-life annuity option, leaving their spouses (usually wives) with no benefit if the participant predeceased the spouse.

To combat this problem, Congress enacted in the Retirement Equity Act (REA) of 1984 a requirement that a plan participant who elected any form of payment other than a joint-and-survivor annuity must obtain the spouse's written, notarized consent. [IRAs, simplified employer pensions, and state and local government retirement plans, however, are not covered by this requirement.] A joint-and-survivor annuity "qualified" under this law must provide income to the surviving spouse in an amount equal to at least one-half of the income payable when the participant and spouse are both alive.

The reasons that compelled Congress to enact REA for pension plans should probably lead to some type of joint-and-survivor annuity requirement for individual accounts established under Social Security reform. Moreover, in the context of individual accounts, serious consideration should be given to increasing the required level of income payable to the survivor to two-thirds so as to mimic the Social Security benefit formula, which recognizes some partial but incomplete economies of scale in the cost of living for a couple.

It is less clear whether an election, with consent, to opt out of the joint-and-survivor form should be made available in a system of individual Social Security accounts. Arguments favoring a strict joint-and-survivor requirement with no opt-out election include the following considerations. Spousal consent is a burdensome and sometimes confusing process, and if it were desired to lower administrative costs and reduce the need for participant decisions, the joint-and-survivor payment method could be made the only allowable method. It is also possible that even though some spouses give their consent to the selection of a single-life annuity, they do not understand what they are giving up. Finally, a strict joint-and-survivor requirement would also reduce the scope for adverse selection which might possibly occur under unisex pricing of annuities. With unisex pricing of annuities and the election allowed to opt out of the joint-and-survivor payment method, it is likely that married women will choose a single life annuity and married men will choose a joint-and-survivor annuity. This behavior could thereby lead to an equilibrium situation where the mortality of longer-lived women is more pronounced in the remaining population pool causing benefit levels to be reduced.

There are other considerations, however, which argue for allowing the holders of the individual accounts to choose whether or not to take a joint-and-survivor payment method, provided, of course, spousal consent is obtained. Variables such as the relative health of the account holders, the relative account sizes among the couple, the availability of other retirement assets, and other needs such as supporting special children, all argue for some flexibility in this choice. These same needs for flexibility also argue for the allowance of guaranteed periods whereby a designated beneficiary (even other than the spouse) will continue to receive monthly payments after the death of the annuitant[s] until the period (typically ten or twenty years) ends. Allowing guarantee periods of payments also reduces the scope for adverse selection.

Now I would like to share with you TIAA-CREF's successful experience with life annuities as the primary form of distribution from retirement plans. All TIAA-CREF plans provide for a variety of annuity income options. The plan sponsor-determined rules in about 85 percent of TIAA-CREF plans also allow participants to choose whether to take retirement benefits in lump sums for cash or transfers, either fully or partially. In addition, most TIAA-CREF plans allow for distributions as systematic withdrawals, interest only, or, after the later of retirement or age 70-1/2, the minimum required to avoid the imposition of an Internal Revenue Code-imposed 50 percent excise tax. Even with this wide array of distribution options, when TIAA-CREF participants settle their account at retirement, almost two-thirds -- 60 percent of males and almost 70 percent of females -- choose a life annuity of some type.

Among TIAA-CREF participants selecting a life annuity, men were much more likely to choose a joint-and-survivor annuity than were women. Half of the male annuitants selected a full benefit to a survivor and about a quarter chose a two-third or half benefit to a survivor. By contrast, more than two-thirds of the female annuitants chose a single-life annuity, with the remainder selecting the joint-and-survivor form. There has been a strong trend since 1984 for all annuitants, but especially men, to select the joint-and-survivor payment form. About 80 percent of male annuitants and 75 percent of female annuitants chose some type of guaranteed period.

V. Inflation-indexation

The central purpose of a retirement plan, whether publicly or privately sponsored, whether defined benefit or defined contribution, is to provide the plan participant and his or her spouse with income in retirement to finance their consumption needs. A logical corollary of this purpose is that the flow of income in retirement should increase over time to reflect, at least in part and approximately, increases in the cost of living. Although price inflation is currently low, in the past inflation has ravaged the purchasing power of the fixed income flows of pensioners, and there is always a risk that inflation could again rise to high rates. Again because of their longer life expectancies, women are especially exposed to the risk of inflation during retirement. Therefore, in any system of individual accounts established under Social

Security reform, women would particularly desire and need gradual increases in annuity benefits over their lifetime.

Social Security benefits are now automatically adjusted to reflect changes in the cost of living and many pension plans and individual annuities also provide adjustments increasing income flows over the lifetime of the plan participant. In fact, TIAA-CREF invented the variable life annuity in 1952 precisely for the purpose of allowing its annuitants to receive income increases during retirement resulting from (anticipated) stock price appreciation. Although there is little evidence that stock prices reflect inflation, at least in the short-run, and stocks are certainly volatile, annuitants in equity-based variable accounts, over most historical time periods, have received impressive increases in incomes. These annuitants, although retired from the labor force, are able to participate in the general performance of the economy, by maintaining equity investments which have performed well in the United States and other developed countries over most recent historical periods.

Another more stable payment method intended to increase benefits over the annuitant's lifetime, implemented at TIAA-CREF in 1982, is called the graded method. Under this approach, instead of being entirely paid out, dividends are reinvested and used to buy additional future income. Although income under this method is not able to reflect unexpected sharp spikes in inflation, studies have shown that purchasing power is preserved, indeed enhanced, over most historical periods through 1995. Both variable annuities and the graded payment method are widely utilized by TIAA-CREF participants settling their accounts.

There are still other ways that individual annuities in the United States provide income flows reflective of inflation. TIAA-CREF offers an Inflation-Linked Bond Account that variable annuitants can use as an underlying investment. Because this Account invests almost exclusively in U.S. Treasury Inflation-Protected Securities, if inflation were to spike, the value of the account would increase, and variable annuitants would receive increases in income reflective of the increased inflation rate. The federal or not. Required distributions may continue periodically over the lives or life expectancies of the plan participant and his or her designated beneficiary. These payments must be included in the plan participant's taxable income; if they are not, the participant is subject to a confiscatory 50 percent penalty tax. If payments are made over life expectancy, the Code and regulations require that the life expectancy must be calculated using an IRS-determined unisex mortality table.

These requirements were put into place in 1962 to prevent Keogh plans from becoming vehicles for income and estate tax avoidance. At that time, age 70-1/2 was the life expectancy of men who were much more likely than women to utilize Keogh plans in the social and labor market conditions extant in 1962. While the original intent for, and structure of, the requirements may have been valid, the rules have become increasingly outmoded in today's labor market and social conditions. Life expectancies, especially for women, have increased dramatically, and women are now as likely to be covered by retirement plans as men.

The following changes to the minimum distribution requirements would treat women, as well as men, more fairly. Their cost, in terms of lost tax revenues to the federal government, is likely to be small.

- Change the required start date to the later of age 76 or retirement. The increased participation of women in the labor force, and increasing life expectancies for both men and women argue for the first change in the start age for minimum distributions in almost 40 years.
- Update the mortality table used by the IRS. The Annuity 2000 table, recently put out by the Society of Actuaries, is the more accurate mortality table to use instead of the 1983 table now used by the IRS.
- For spousal survivors, allow minimum distributions to begin when the surviving spouse turns 76 rather than when the deceased participant would have turned age 76 (70-1/2 in current law). The current set of rules is particularly unfair to female survivors, who are usually younger than their husbands.

We thank you for your leadership on both Social Security and pension reform.

The CHAIRMAN. Thank you very much.

I will start with Dr. Clark. You mentioned in your testimony that women of a similar age, similar job tenure and earnings are more likely to participate in voluntary 401(k) plans. Did your research give any indication as to why women are more likely to participate?

Mr. CLARK. The short answer is, no, sir. What we did was look at what they did, not try to determine exactly why they did it. These data were from employment records, and so the amount of information that we had on them was fairly limited. We knew their age, and their earnings, how long they had been on the job, what type of pension plan they had in addition to the 401(k) plan, their 401(k) contributions and how they invested.

The CHAIRMAN. You looked at 87 different 401(k) plans in operation during 1995. Was there ever any question by anybody critiquing your study about whether or not it was a fair sample?

Mr. CLARK. A question raised by anyone else, no; questions raised by ourselves, yes. The data were put together by Watson & Wyatt Worldwide. Some of these companies were their clients, some of them were not. They ranged in size from roughly 25 participants up to I think 15,000 participants. So it was not the really big companies. It was a broad cross section of the others. So I think in terms of representativeness, they are certainly an example of a multitude of case studies that, by and large, I believe, should reflect the general market.

The other studies that have addressed this issue have typically had only one plan. And so, in that sense, this study is much broader based than those.

The CHAIRMAN. In conducting your study, did you gather occupational data on the subjects such as whether they were executives or secretaries or laborers? In other words, did the study subjects reflect a range of occupations? And, also, did your research give any indication as to the level of financial education the participants in 401(k) plans might have had?

Mr. CLARK. We did not have occupational, per se, but we did have earnings, and so we have a full range of earnings, as you could see from the charts, from people earning $10– to $15,000 all of the way up to earning over $100,000. So while I could not identify executives and secretaries, I can guess where they would fall in the range of earnings. So, I think we do have the full occupational range covered, and we could make statements about what types of workers we are looking at.

The CHAIRMAN. The other part was on whether or not there was a financial sophistication of participants.

Mr. CLARK. On these particular data, we did not. In another paper with Watson & Wyatt as well, we did look at educational, in conjunction with offering 401(k) plans, and we found that companies that provided education to their workers had a significant increase in the proportion of people participating in the plan and the amount that they were contributing. And so our conclusion in that study that has been cited in some of the GAO papers as well, was that education does matter, and it can have a significant influence on people's behavior.

The CHAIRMAN. Thank you.

Dr. Steuerle, you mentioned in your testimony that earnings sharing could be incorporated into a redesigned Social Security system. Would such a provision be adequate for homemaker spouses who are out of the workforce to raise children or to care for elderly parents?

Mr. STEUERLE. Senator, what I tried to do was distinguish between the two goals of trying to provide equal rights to the assets or the earnings in a marriage and to provide provision to people because of need, and I argued that we need to separate them.

Earnings sharing, it seems to me, addresses the first of those issues, that it tries to establish horizontal equity the same way that Congress has required, essentially, the equivalent of earnings sharing or what is called benefits sharing in private pension plans. But it is not required, if you think of it in its own Social Security system.

In terms of meeting needs of individuals, however, I think you have to turn to provisions such as that promoted by the National Commission on Retirement Policy, of which Senator Breaux was a co-chair, which looks to items like minimum benefits and the progressivity of the benefit formula.

One reason you want to look to those types of adjustments, by the way, is that divorced individuals are not the only people in society who are needy. I tried to point out we have widows who are needy, we have individual workers who were never married who are needy. And if you want to adjust for need, you want to do it on an even basis. You do not want to just favor one group over another because they happen to be divorced or they may not happen to be divorced.

The CHAIRMAN. Earnings sharing has been around for a couple of decades. Would you elaborate for me, Dr. Steuerle, why you think earnings sharing is a worthwhile provision to include in a redesigned Social Security system and, specifically, how it would help women.

Mr. STEUERLE. Again, Senator, I believe earnings sharing addresses the first of the issues, which is the issue of how to treat equally people in a marriage, so that they share equally in the benefits from that marriage. And I distinguish that from whether women would be helped, in general. The people we want to help are people who are needy, whether they are women or they are men.

It is true that women bear a much higher percentage of poverty, for instance, in old age. We want to address poverty in old age, and we want to help people who are poor, regardless of their particular sex. Just as one wants to address progressivity through progressivity formulas, one wants to address equal sharing through equal sharing formulas.

Earnings sharing is not necessarily the only way one can do this. One can think of other forms of benefit sharing. But there are ways to make sure that whatever is contributed to the system, a couple shares equally in those benefits. I mentioned one group, for instance, which is very much hurt by the current system: those people—and there are many of them now who—divorce from a marriage of less than 10 years. They receive absolutely no share of the benefits of a worker for that marriage of less than 10 years. This is something, again, the Congress would not allow the private pension system to do, but does it within its own system.

The CHAIRMAN. Dr. Warshawsky, you laid out in your testimony a number of options for designing a distribution structure which would benefit women. In Great Britain, beneficiaries have the option of purchasing an annuity with 75 percent of their account balance, which leaves the remaining 25 percent as a lump sum. Another distribution option would be to require a beneficiary to purchase an annuity which would assure above-poverty-level payments and the remainder of the account balance could be used however the beneficiary would like.

I am interested in hearing your views on these two options or maybe any other options you want to bring up, but specifically those two and whether either would create particularly negative effects on women.

Mr. WARSHAWSKY. In fact, in my written statement, I mentioned those two options as, in fact, something that can be considered. I think, to some extent, just relating to a priori panel's discussion, it depends whether these accounts, in fact, are replacing part of Social Security, the defined benefit formula, or whether they are in addition to it. If they are replacing part of a defined benefit formula, I think we really have to be very careful, in terms of allowing significant leakage from an annuity, which ensures income throughout one's lifetime.

By contrast, if it is an add-on, then the minimum-required income is covered, and then there may be more scope for other distribution choices.

The CHAIRMAN. Have you conducted any research examining the cost of mandatory annuities if unisex pricing were used to calculate the benefits? And, if so, could you tell us what the cost burden would be and if either gender would bear more of the cost.

Mr. WARSHAWSKY. Maybe I do not quite understand your question, but I will say that I have conducted a number of studies looking at pricing in the individual market for annuities, and there is, as I mentioned in my testimony, there is allowance for sex-distinct pricing. Currently, for women those annuities are about 10 percent more than for men, and this is more than explained by the differences in life expectancies.

The CHAIRMAN. Thank you.

Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. Thank the panel for their testimony.

Gene, thank you for your presentation. It was really interesting having you point out all of those different dichotomies that could result depending on whether you were married 9 years and 11 months and 27 days or 10 years and 1 day, and all of the various scenarios, and also the point about the mystery novels that could be written as a result of trying to maximize your Social Security benefits.

But it really points out all of the problems, I guess, we have created in trying to be fair to everybody. We just created a whole basketful of problems and inequities about what people get out of the system.

Dr. Munnell had talked about something I really did not understand about how the National Commission's recommendation on the 2 percent tax cut and require people to invest it into a thrift savings type of plan will result in benefit cuts. I mean, you were very involved in that commission and really writing the minimum benefit plan for us, which would be a major change in the current law.

Could you maybe elaborate what she was trying to tell me. Is there an answer to that? Because I do not think I totally understood it.

Mr. STEUERLE. Well, Senator, one thing I object to, to start with, is that we unfortunately are trapped by a language about "cutting benefits." Congress makes a law that promises continued increases in benefits over time, and when we talk about cutting back on that rate of increase, we call that a cut. It is not clear at all, under most of these proposals, that beneficiaries in the future are going to be worse off than current beneficiaries. In fact, the lifetime benefits in today's dollars are probably larger for future beneficiaries.

However, the growth rate promised in the system is so high, that if we decide we are going to reform the system by cutting back on the growth rate, then there are reduced benefits relative to the promises in the current system.

What Dr. Munnell was arguing was, well, if you also reduce the amount of revenues into the defined benefit part of the system because you are putting money into individual accounts, then that defined benefit part of the system will necessarily, just by the math or the arithmetic, have fewer benefits in aggregate. But that does not answer the issue——

Senator BREAUX. That does not mean the beneficiary will end up with less benefits. If you combine the two individual savings plus your defined benefit under the existing system, it may well add up to be more.

Mr. STEUERLE. Let us dodge the issue of the individual account just for the moment. The system is now currently overpromised by about a third; that is, benefits are about one-third in excess of the taxes that are available. Suppose you simply cut benefits across the board. Well, then everybody's benefit would be one-third lower relative to what it would have been because of that growth rate.

And Dr. Munnell is arguing two things. I think, one, she is worried if you cut back that you are going to hit some middle-income people in ways she does not like. She is also worried, I think, and this is an argument that many people have argued in the past; that if you try to solve that problem by bumping up minimum benefits, you are going to flatten the benefit structure, and she believes that you would reduce political support for the system.

I have some problem with that argument on political support, though, because it implies that an individual like myself and my wife, who are promised in excess of a third of a million dollars in Social Security benefits and about an equal amount of Medicare benefits, are not going to support the system unless we get our two-thirds of a million dollars. And I am using current dollars. I am not using inflation, Mr. Chairman.

Unless we get our two-thirds of a million dollars, we are not going to politically support the system. To me, that is a very expensive "buying out" of my political support. I do not deserve that level of benefits. I do not have that level of need. I can work that much longer in society and to argue that you have to give so much to me to get my political support to get something to everybody else is a stance on which I would disagree with Dr. Munnell.

Senator BREAUX. Can you explain for the benefit of the committee how we had structured the minimum benefit plan, what it would do under the commission recommendation?

Mr. STEUERLE. The commission recommendation was to try to set up a minimum benefit that within a few years would approximate the poverty level. After the establishment of that minimum benefit, which I think was established about 2008, it would then be wage-indexed so that not only would people be kept out of absolute poverty, but they would be kept out of relative poverty. That is, this minimum benefit would rise at the same rate as wages in the economy.

In that sense, it ends up to be much more generous than our projections of the supplemental security income which is the means-tested system that we now have. It would start replacing a means-tested system partly because most people do not believe that the elderly should be put on a means-tested system. Means testing does not work very well, as Dr. Munnell also argued, and the proposal would replace that SSI system over time. That was one of the costs we ended up bearing in our proposal, which meant we had to cut back on benefits or generate other savings elsewhere.

Let me say, also, with respect to the issue of women versus men, that the deputy chief actuary of Social Security ran the minimum benefit proposal. My understanding is he only has rough estimates, so I do not want to say these are final numbers. But he indicated to me, and he gave me permission to use these numbers, that as a result of that minimum benefit, we probably increased what is called the primary insurance amount—that is, the benefit one is entitled to under one's own work record—for about 10 percent of men, but about 50 percent of women. So we gave women a substantial increase in benefits on their own work record. Now, it usually did not increase the benefit for women or men who might get a benefit as a spouse. So that 50 percent figure would exaggerate the number people would have in actual increase.

But, in general, the poverty-level proposal that we made with this minimum benefit did much more to reduce poverty for women, I believe, than it did for men.

Senator BREAUX. I appreciate it, Mr. Warshawsky and Mr. Clark. Thank you very much for your presentation. It has been helpful. Thank you.

The CHAIRMAN. We are going to dismiss the panel now, except to remind you that maybe some members will have some questions for you to answer in writing.

Thank you very much for your participation. And, again, we will probably be calling upon you, to some extent, as we look into this. It is a part of the major Social Security issue that we have to deal with.

Thank you very much.

[Whereupon, at 3:02 p.m., the committee was adjourned.]

APPENDIX

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March 12, 1999

Senator Charles E. Grassley
Chairman, Special Committee on Aging
United States Senate
Washington, D.C. 20510-6400

Dear Senator Grassley:

I am pleased to respond to your follow-up question on my testimony at the February 22 hearing of the Aging Committee. You asked how much the cost of providing annuities would "eat up" as a portion of the assets in individual Social Security accounts. Over the past 15 years, I have conducted, jointly with several academic economists, many research projects on the pricing of, and the demand for, individual single-premium immediate annuities and annuities provided through defined contribution pension plans. Furthermore, I am familiar with the research of other economists and actuaries on the subject. In our own research, we found that the "load factor," that is, the percentage difference from fair actuarial value, on individual single-premium immediate annuities sold in the United States is about 20 percent for the retired person or couple with average life expectancy who desire a fairly certain investment return. This factor does vary somewhat from insurance company to insurance company, by age and gender of the annuitant, and over time. I am quite sure that this research is the source of Dr. Henry Aaron's comments on the subject.

I think that this estimate of the load factor can serve as an *upper bound* on what to expect for the portion of assets that will be "consumed" in individual Social Security accounts through the purchase of life annuities. Our research showed that about half of the load factor, that is, 10 percentage points, was attributable to "adverse selection," that is, the predilection of longer-lived individuals to purchase annuities and the avoidance of annuities by individuals with shorter life expectancies. The other half of the load factor was attributable to "administration," that is, sales costs (including commissions to insurance agents and general marketing), taxes, record keeping and communications, investment expenses, corporate overhead and profits. In the context of individual Social Security accounts, both sources of cost can be constrained, perhaps severely.

Most importantly, structural elements can be designed to assure that costs arising from adverse selection and administration will be significantly reduced. If life annuities are the mandatory payout form for individual Social Security accounts, adverse selection will be substantially contained. If life annuities are provided through some group purchasing mechanism managed by an oversight board or a federal agency, then administration costs, particularly sales costs, will be significantly reduced. For example, there could be Requests for Proposals to insurance companies to offer a somewhat limited and specific menu of types of annuities to a large population, as currently occurs in the federal government employees' Thrift Savings Plan (TSP). Marketing expenses, including agent commissions, would thereby be almost entirely eliminated. In fact, the insurance company offering life annuities through the

TSP currently pays out almost 15 percent more in monthly income to new TSP annuitants than it pays to purchasers of individual single-premium immediate annuities. Finally, even absent any special structures or mandates, the introduction of individual Social Security accounts will likely produce a large source of new demand for annuities; competitive pressures therefore would increase, leading to a reduction in costs.

Let me conclude with a suggestion. As you explore the practical questions of the design of individual accounts, you might consult with expert groups from the life insurance and mutual fund industries. These groups can advise you on the feasibility and costs of the various options you are considering.

Sincerely,

Mark Warshawsky

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