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PRESERVING AMERICA'S FUTURE TODAY

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

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PRESERVING AMERICA'S FUTURE TODAY

TUESDAY, JUNE 30, 1998

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Bala Cynwyd, PA

The committee met, pursuant to notice, at 9:48 a.m., at St. Joseph's University, The Haub Center, Bala Cynwyd, PA, Hon. Rick Santorum, presiding.

Present: Senator Santorum.

OPENING STATEMENT OF SENATOR RICK SANTORUM

Senator SANTORUM. I will call the meeting to order. Let me first apologize for the Schuylkill Expressway. There was a disabled vehicle and so we got caught behind a little bit of traffic, so I apologize for being late getting here this morning. As is the case when I am the cause for the delay, I will shorten the agenda by taking time out of my time, not anybody else's time. I had scheduled a few minutes for some opening comments. I will abbreviate them.

First, let me thank Chairman Chuck Grassley of the Aging Committee for agreeing to hold a field hearing, an Aging Committee field hearing here in Philadelphia, and giving me the opportunity to listen to people here in Southeastern Pennsylvania and their concerns about Social Security and the future of Social Security.

The Aging Committee is a committee that does not have any official legislative jurisdiction over the issue of Social Security, but as the Aging Committee, we obviously are very concerned and want to gather as much information as we can to be able to make sure that Congress makes an informed decision on the issue of Social Security, probably the most popular social program that we have in Washington and certainly the most popular among senior citizens.

So it is an important obligation for us to gather that information and I thought it was important for the public to be able to hear different sides of the story as to what is wrong with Social Security, what we can do to fix it, and the various proposals that are out there to do that.

We believe, on the Aging Committee and in the Senate, that this is a good time right now to discuss the issue of Social Security. The President has made this the year of discussion. Both leaders in Congress, Trent Lott and Newt Gingrich, have said that we want to have a discussion this year and have agreed that next year, we need to look at how we are going to solve this problem, and the President has also said that next year is the year for action.

So the more we can have these kinds of public dialogs, the better. It is important for the American public to tune in on this issue, and that is why bringing this committee here to Philadelphia, and we hope to do other hearings in other venues across the country, to bring the American public up to speed as to what the problems are and what the potential solutions to those problems are and to get their feedback, to get their input, and also to educate them as to what the different points of view are on the issue.

That is the general reason for the hearing. I will pass over all of my introductory comments. I will try to weave them into my questions, if you will, and I will turn it over to our panel here.

The first panelist is Patty DeMarco. Patty is 26. She has—is that right? That is what it says here. It says here, Patty is, at 26——

Ms. DeMarco. Very flattering, but——[Laughter.]

Senator SANTORUM. You have a good publicist, because they are giving you some good things. She is a young person, let us just put it that way, who has parents on Social Security, and so we just thought that would be an interesting mix, from someone who is younger who also has parents on Social Security.

We also have Meredith Keiser from the Foundation for Individual Responsibility and Social Trust, Carl Helstrom from Third Millennium, and we have Joe Sirbak. Joe is a St. Joseph's graduate and is on his way to law school.

So we thought we would hear from the younger folks. Patty, why don't you start off, and we will just go down the line. That would be fine. By the way, we are under very tight time constraints and we have asked everyone to hold their remarks to 5 minutes. If you can keep to that, we would appreciate it.

STATEMENT OF PATRICIA "PATTY" DEMARCO, WEST CHESTER, PA

Ms. DEMARCO. Good morning, Senator Santorum. I want to first thank you for allowing me the opportunity to appear before this committee and give you my thoughts and opinions about Social Security. I also want to commend you for holding these hearings on this hot button, very much politicized issue.

I know the reason we are all here today is to begin the process of meaningful positive reforms which will protect current retirees and ensure retirement security for future generations like mine.

I am 33 years old and born in 1964. It puts me on the line, right at the end of the baby boom generation and Generation X. I am living the American dream. I am the second generation of Italian immigrants who came to the United States through Ellis Island for a better life. My parents grew up modestly in New York City and were able to earn college degrees through free education. My father became an engineer, working in the field of government defense for his entire career, which included working on the Patriot missile project.

My mother was able to stay home and raise their six children, of which I am their third. Five out of six of us have attended college, and I am now the first in my family to earn a professional degree, just earning my Juris Doctor last month.

This dream turns into a nightmare, however, because for me, personally, somewhere around 2029 or 2030, the Social Security trust funds will be exhausted. This is the time when I am ready to retire after 47 years of work and paying into the system. But what will I have to show for it? Will I be able to receive anything back from all those payroll taxes for all those years? My generation can expect to face the financial responsibilities of any generation, with living expenses, higher payroll tax to support the baby boomers, and all with the expectation that I should have been saving and investing because I will not have Social Security.

Last year, I made $60,000 and I paid $7,500 toward Social Security. I have worked for 12 years and I have paid approximately $70,000 to the government for Social Security. Again, I ask myself, what do I have to show for it?

Last year, I was fortunate enough to attend a Social Security educational seminar held in Washington and I am now quite aware of some of the reasons why this situation exists. I perceive myself as a well-informed citizen, but I was quite surprised by the cold hard facts about Social Security. I was uninformed, to say the least, and misinformed, at best, facts such as, in 1945, 20 workers supported each retiree and now just two workers will be supporting every one retiree, or that the initial payroll tax was 2 percent, and now, just Social Security is 12.4 percent.

We must remember, however, Social Security is not a dirty word. It is actually one of the most successful Federal programs of the century. However, the original intent was to end poverty among the elderly. It has been very successful in doing this, taking the poverty level to just 13 percent, the lowest among any group. But at some point in time, we lost our way. Sixty-some years later, we are now in quite a bind.

My recommended reforms include preserving the system. I believe the government does need to keep its promise to people like my father, who worked for 45 years and paid into the system. That generation was promised, and I beg to differ with people that say they were not promised.

I think we should cut out our current fraud, waste, and abuse, but not create a bureaucracy like the IRS. We should also consider possible means testing for retirees and their families. At least make this voluntary. From what I understand, even the wealthiest of Americans are sent Social Security checks and some of them would like to give the money back. Let us give them a chance to do that.

I fully support the idea of personal savings accounts and believe that Congress can easily pass this with our generation's support. We have a lot more confidence in the stock market and there are a lot more smaller investors now than there used to be.

The next and most important reform, and maybe this is where the beginning is, is education and a type of psychological reform. The Generation X-ers think they are more likely to see a UFO than their Social Security benefits. The American public needs to be weaned off their dependency on Social Security as their sole means of income when they retire.

Other reforms Congress should consider, in addition to passing a Social Security reform bill, would be some tax incentives and relief for self-employed people and corporate America. Give them tax incentives, to employers who offer more substantial retirement benefits. Make it so people realize that Social Security is meant for its original intent of relieving poverty, not to support us all when we retire.

I do not know what the solutions are, but once again, I want to commend you for speaking with us today and gaining our ideas. Thank you.

Senator SANTORUM. Thank you, Patty.

Joe.

STATEMENT OF JOSEPH P. SIRBAK II, MACUNGIE, PA

Mr. SIRBAK. Well, again, first, thank you to Senator Santorum for inviting me here today. Thank you to St. Joseph's University for hosting this event. And thank you to all of those who came to this to participate in this vital discussion.

We all know there is a problem with Social Security. That is why we are here. Demographers tell us that in 20 years, there will be a lower ratio of working-age adults to Social Security recipients than ever. Under the current pay-as-you-go system, my generation would be burdened with the retirement costs of the baby boom generation, an unacceptable answer to the problem. It is essential that the cost of the impending Social Security crisis be shared among the generations.

Now, before I explain how I believe this can be done, let me share with you my vision of Social Security. Ironically, the looming insolvency of Social Security provides a unique opportunity to break out of old paradigms, to reevaluate the system from the bottom up. Social Security is now finally on the table. It is no longer the third rail. In living rooms across the country, Americans of all ages have begun debating how Social Security ought to be reformed and many have begun to question the very desirability of the program's existence.

I count myself among the latter, wishing that Americans would decide it is now finally time to retire Social Security. I, and I believe the majority of young adults, would prefer to save for retirement ourselves instead of depending upon the government to do it for us. A surprisingly high percentage of my friends and I, myself, have already begun to invest in IRAs, 401(k) plans, et cetera.

Of course, any plan for privatizing Social Security should include a minimum annual contribution into a retirement account so that our senior-most members of society are able to support themselves in their old age, and other parts of Social Security, such as disability benefits, can be spun off into independent agencies. Still, by privatizing the largest share of Social Security, the primary retirement fund, we could unleash enormous economic potential.

Currently, income we save for retirement through Social Security is transferred to Social Security recipients and spent. It is current consumption. However, if we began saving for our own retirement, that money would become market-driven investment. Investment creates jobs. Investment creates innovation and economic growth. These benefits would be multiplied for retirement savings, which would seek long-term growth, sustainable growth, rather than merely maximizing quarterly profits.

Now, privatizing Social Security will not solve the nearing crisis. In fact, it will worsen the projected shortfall because people will cease to pay into the system. So, how will these costs be shared?

First of all, as a nation, we should all follow the lead of President Clinton, pledging to devote the entire budget surplus for as long as it lasts to Social Security. Now, senior citizens, and primarily those of higher incomes, can contribute to the solution by sending back some of their benefits or accepting reduced benefits flat out.

Baby boomers can contribute by permitting any combination of slightly higher retirement ages, increased payroll reductions, and reduced future benefits. I leave that up to the baby boomers, how they want to make their contribution, but they have contributed in good faith into the system and are entitled to be cared for in their retirement. But this does not preclude a buy-out system, which is what I would ideally like to see, in which workers would accept their benefits reduced by a certain percentage and in exchange they would be allowed to invest their Social Security reductions for the remainder of their working years as they wished.

What this would do is it would allow us to begin to pay off the Social Security debt now instead of waiting until the baby boomers retire, and young adults, such as myself, would contribute to the solution by foregoing retirement Social Security benefits ever, you know, just write off as a loss the thousands I have already contributed into the system. I and my children would never receive benefits. In return, we would never pay into the Social Security per se but would instead pay higher taxes which would be specifically earmarked for a Social Security closeout fund from which the baby boomers would draw their retirement benefits.

So to sum up, a large bill is coming due and there is no way to avoid paying it. We could choose to save Social Security this time with superficial adjustments in retirement ages, benefits, payroll deductions, et cetera. If this is the solution that is chosen, we must guarantee that the costs are borne equally by all and not placed entirely on my generation, as the logic of the pay-as-you-go system would imply. However, I hope that we could take this opportunity to totally reinvent the way Americans save for retirement. With a little long-term thinking, we can not only address the nearing Social Security crisis, but we can ensure the economic health of the United States for years to come. Thank you.

[The prepared statement of Mr. Sirbak follows:]

Written Statement by Joseph P. Sirbak II
For the U.S. Senate Special Committee on Aging
Delivered June 30, 1998
St. Joseph's University

I would like to begin by thanking Senator Rick Santorum and members of the Senate Special Committee on Aging for inviting me here to speak with you today. I also want to thank St. Joseph's University, my alma mater, for hosting this event, and especially those of you who took time out of your schedules to participate in this vital discussion.

We all know there is a problem with Social Security. That is why we are here. Although numbers vary slightly, demographers can assure us that in 20 years, the ratio of working adults to Social Security recipients will be lower than at any time in the past.

Under the current pay-as-you-go system, the retirement costs of the baby-boomers will be placed almost entirely on my generation - an unacceptable answer to the problem, for us, and also for our parents and grandparents, who do not wish to disproportionately burden their children and grandchildren.

It is essential that the costs of the impending and unavoidable Social Security crisis be shared among the generations. Before explaining how this can be accomplished, let me share with you my vision of the future of Social Security.

Ironically, the looming insolvency of the Social Security fund provides a unique opportunity to break out of old paradigms - to re-evaluate the system from the bottom-up. Ten years ago, no one, and especially no politician, would have even considered tampering with Social Security. Today, however, in living rooms across the county, Americans of all ages have begun debating how Social Security ought to be reformed and many have begun to question the desirability of the program's very existence.

I count myself among the latter, wishing that Americans will decide it is now finally time to retire Social Security. I, and I believe the majority of young adults, would prefer to save for retirement ourselves, instead of depending upon the government. A surprisingly high percentage of my friends and I myself have already begun to invest in Individual Retirement Accounts.

But should we really retire Social Security? Does not society have a legitimate interest in preventing its most senior members from starving on the streets? Of course it does, and any plan for privatizing Social Security should include mandatory minimum annual contributions into retirement accounts. Disability benefits and other peripheral yet extremely important components of our Social Security system can be spun off into independent agencies.

Still, privatization of the largest share of Social Security could unleash enormous economic potential. Currently, income we save for retirement through the Social Security system is transferred to those collecting benefits and presumably spent; it can quite reasonably be classified as current consumption. If, on the other hand, people began saving for their own retirements, that consumption would become market-driven investment. Investment creates jobs, technological innovation, economic growth: benefits which are multiplied, when, as would be the case for retirement savings, that investment is long-term capital, preferring steady and sustainable growth to merely maximizing quarterly profits.

Privatizing Social Security, however, will not solve the nearing emergency. In fact, it will increase the projected deficit of the Social Security fund because people will cease to pay into the system. So how will these costs be shared? First, as a nation, we can all contribute by following the lead of President Clinton, who proclaimed during this year's State of the Union Address and on several occasions since, that the entire federal budget surplus, for as long as it lasts, go towards Social Security. Senior citizens, primarily those with higher incomes, can contribute to the solution by accepting reduced benefits. Baby-boomers can contribute by permitting any combination of slightly higher retirement ages, increased payroll deductions, and reduced future benefits. They have, however, contributed, in good faith, into the Social Security system all their lives, and are therefore entitled to reasonable benefits as they enter their golden years. This does not preclude a "buy-out" system, whereby workers would voluntarily accept a reduction in their future benefits in exchange for the freedom to begin investing their payroll deductions as they wish. Obviously, a forty-year-old would accept a higher cut in benefits than would a fifty-five-year-old, and the amount of the reduction in benefits would need to be tied to expected remaining working life. Through "buy-outs" we could begin to pay off the Social Security debt today, thereby lessening the severity of the shortfall as the baby-boomers reach retirement age. Finally, young adults such as myself, and perhaps even our children, would contribute by foregoing any future Social Security benefits. In return, we would never pay into Social Security per se, but would instead pay modestly higher taxes, specifically earmarked for a Social Security Close-Out Fund, from which the baby-boomers would collect benefits. If we had the will to privatize Social Security, the actuaries could develop formulas to ensure that people of all ages would contribute equally to the solution.

To sum up, a large bill is coming due, and there is no way to avoid paying it. We could choose to "save" Social Security with superficial adjustments in payroll deductions, retirement benefits, retirement ages, etc. If this is the solution that is chosen, then we must guarantee that the costs are borne equally by all, and not laid solely at the feet of my generation, as the logic of the pay-as-you-go system would imply. Hopefully, though, we will have the courage to totally re-invent the way Americans save for retirement. While we would begin to see some of the benefits of privatization immediately, the primary beneficiaries would be my children and their children. With a little long-term thinking, we can not only address the nearing Social Security crisis but also ensure the economic health of the United States throughout the twenty-first century.

Thank you for your time and attention. I will be happy to answer any questions.

Short Biography of Joseph P. Sirbak II
For the U.S. Senate Special Committee on Aging

I was born on December 6, 1976 in Allentown, Pennsylvania. I have lived my entire life in the Lehigh Valley with my parents, Joseph and Susan, and my three brothers, John (age 19), Thorne (age 17), and Todd (age 15). In 1994, I graduated from Emmaus High School and began my studies at St. Joseph's University. At SJU, I double-majored in Political Science and Economics. During summer and winter breaks, I interned with my municipal government, Lower Macungie Township and during the second semester of my Junior year, was honored to intern with the U.S. Department of State, Bureau of European and Canadian Affairs in Washington, DC. I graduated summa cum laude from St. Joseph's University in May, the recipient of awards conferred by the Political Science Department, the Economics Department, and the Law Alumni Association. I am currently temping with a Center City Philadelphia law firm and plan on heading off to Harvard Law School in the fall. In my free time, I enjoy reading, computers, hiking, and travel.

I am also attaching a current resume for your reference.

Senator SANTORUM. Thank you very much, Joe.
Meredith.

STATEMENT OF MEREDITH KEISER, FOUNDATION FOR INDIVIDUAL RESPONSIBILITY AND SOCIAL TRUST, PHILADELPHIA, PA

Ms. KEISER. Mr. Chairman, thank you for inviting me to participate in this dialog on Social Security. My name is Meredith Keiser and I am the executive director of the Foundation for Individual Responsibility and Social Trust, or FIRST, a national, non-partisan, non-profit organization that is seeking to engage young adults born between 1961 and 1981, a group often referred to as Generation X, in the political process.

What is my experience with Social Security? I am 23 years old and I know I will become eligible for full Social Security benefits at age 67 in the year 2042. I have three primary concerns about the future of Social Security: First, that young adults are now not being included in the decisionmaking process; second, that there is little education on Social Security, individual savings, and retirement; and third, that the information we do get is often misleading, inaccurate, and confusing.

Any reforms Congress enacts will have a large impact on my and future generations. My generation should have the opportunity to be heard by the policymakers who are responsible for resolving this issue. We should have the opportunity to debate the various options for reform, to study the tradeoffs in an educated manner, and to pass our recommendations for the future to you.

From my experience, we are a generation that is completely capable of evaluating the risks we are willing to take and making the choices that need to be made if, as citizens, we are provided a forum to do so. Education will enable young adults to engage in informed discussion about the future of Social Security.

The place for such an education is in college or high school. Groups like FIRST, Americans Discuss Social Security, the Concord Coalition, and Third Millennium are developing formats and curricula to educate students about Social Security. The challenge is to convince teachers and administrators that civic issues like this should be part of a standard curriculum and that, in a democracy, the tools of citizenship are as valuable as the skills of reading, writing, and arithmetic.

In order to get more members of my generation involved, we need to receive more credible information about the problems that our country faces. Unfortunately, members of the media, political leaders, and special interest groups have a tendency to sensationalize the issue and distort the facts, thereby misinforming the public. We need to know why the problem exists, what the reform options are, what the ramifications of the various solutions are, and how we can incorporate our voice in the decisionmaking progress. When we see misinformation on the problem, it reinforces the mistaken belief that there is nothing my generation can do.

How do people of my generation experience the Social Security debate? We see it on television in short sound bytes which do not provide us with the information we need to make informed decisions. We need to conduct community forums, where citizens come together to deliberate the issues our country faces. Thanks to the efforts of many organizations, more and more young people are joining the discussion. I urge you to encourage these efforts by attending as many of these meetings as you can.

Most people assume that members of Generation X, as its name suggests, are apathetic and lazy. Worse, most people believe that if a young person has an opinion, it could not possibly be based on a sound foundation. We must have taken it from something we heard last week on "Melrose Place".

My work with FIRST shows that this is an unfair stereotype. I have found that Generation X can have an important and a vital voice in the political process and we have the ability to help solve the long-term financing problem Social Security faces. Many members of my generation do not believe that you will listen to us. Our challenge and yours is to prove this assumption wrong. Thank you.

[The prepared statement of Ms. Keiser follows:]

Testimony of Meredith Keiser
Foundation for Individual Responsibility and Social Trust (FIRST) Executive Director
Senate Special Committee on Aging
Tuesday, June 30, 1998, St. Joseph's University

Mr. Chairman, thank you, , for inviting me to participate in this dialogue on Social Security.

My name is Meredith Keiser, and I am the Executive Director of The Foundation for Individual Responsibility and Social Trust, or FIRST, a national, non-partisan, non-profit organization that is seeking to engage young adults born between 1961 and 1981, a group often referred to as Generation X, in the political process.

FIRST does this by coordinating nonpartisan conversations across the country and by hosting a national convention each year. At our first annual National Deliberation Day, at 24 sites in 15 states, participants identified eight general themes that our generation needs to address if we are to improve our country during the next century. At our second "We the Future" Convention held last October here in Philadelphia, our delegates identified 39 critical questions under each theme to answer over the next two years. We will incorporate the answers to these questions into a Generational Action Plan, an outline of individual responsibilities and social trusts needed for the 21st century.

You have asked me to relate my personal thoughts and concerns, as a younger citizen of our nation, regarding one of the most recognized programs in the history of this country, Social Security. What I have to say to you today is the product of my personal experiences with this issue and with the many voices of my generation which I have been fortunate to encounter as a result of my work as Executive Director of FIRST.

What is my experience with Social Security? I am 23 years old. Due to the 1983 Amendments to the Social Security Act, I know I will become eligible for full Social Security at age 67 in 2042. I also know that there is general agreement today that Social Security needs to be reformed sooner, rather than later to accommodate the retirement of the baby boom generation and the subsequent aging of America.

I have three primary concerns about the future of Social Security. First, that young adults are not involved in the decision-making process, second, that there is little education on Social Security issues, individual savings and retirement, and third that the information we do get is often misleading and inaccurate.

Any reforms that congress enacts will have a large impact on my and future generations. My generation should have the opportunity to be heard by the policymakers who are responsible for resolving this issue. We should have the opportunity to debate the various options for reform, study the trade-offs in an educated manner, and pass our recommendations for the future to you. From my experience, we are a generation that is completely capable of evaluating the risks we are willing to take and making the choices that need to be made, if, as citizens, we are provided a forum to do so.

Education will enable young adults to engage in an informed discussion about the future of Social Security. Unlike many of my peers, I am fairly educated about Social Security and its problems. My education did not come from high school or college courses. Instead, it has come recently from examining Social Security analyses, and serving as an Executive Committee member of the Social Security Challenge. The challenge is funded by Americans Discuss Social Security, a project of the Pew Charitable Trusts. Students from all over the country were asked to create a plan to make Social Security a hot issue on America's campuses. The best plan will be implemented with a $100,000 budget, and each member of the winning team will receive a $10,000 scholarship. I am pleased to report that 155 teams applied and 7 regional winners have been announced. I urge you to acknowledge these efforts.

However, my education should have come earlier, in college or high school, and students could be learning right now if important civic issues such as Social Security were included as part of our schools curricula. Groups like FIRST, ADSS, The Concord Coalition and Third Millenium are developing formats and curricula to educate students about Social Security. The challenge is to convince teachers and administrators that civic issues like this should be a part of a standard curriculum and that, in a democracy, the tools of citizenship are as valuable as the skills of reading, writing and arithmetic.

In order to get more members of my generation involved, we need to receive more credible information about the problems our country faces. Unfortunately, members of the media, political leaders, and special interest groups have a tendency to sensationalize the issue and distort the facts thereby misinforming the public. Social Security is not in crisis, but it does face long-term financing problems of which young adults need to be aware. We need to know why the problem exists, what the reform options are, what the ramifications of the various solutions are, and how we can incorporate our voice in the decision making process. When we see this misinformation on the problem, it reinforces the mistaken belief that there is nothing my generation can do.

How do people of my generation experience the social security debate? We see it on television. What we see is short sound bytes, thoroughly unable to provide us with the information necessary to make informed decisions. How then will our generation receive the information we need about the reform proposals so we can examine the trade-offs between reform options? Many groups, large and small, conduct community forums where citizens come together to deliberate the issues our country faces. Thanks to the efforts of many organizations, more and more young adults and students are joining the discussion. I urge you to encourage the efforts by attending as many of these meetings as you can.

It is our experience at FIRST that the deliberative method can and should be used in addressing many of the other important problems that this nation faces. FIRST will continue to add more young people to the discussion. Social Security is one of the major issues we are discussing. Over the next two years, we will assemble the results of our deliberations into the Generational Action Plan. We will present this plan to all candidates, both local and national, for political office in 2000 inviting their response.

Most people assume that members of Generation X, as its name suggests, are apathetic and lazy. Worse, most people believe that if a young person has an opinion, it could not possibly be based on a sound foundation. We must have taken it from something we heard last week on Melrose Place.

My work with FIRST shows that this is an unfair stereotype. I have found that Generation X can have an important and vital voice in the political process, and we have the ability to help solve the long-term financing problems Social Security faces. Many members of my generation do not believe you will listen to us. Our challenge, and yours, is to prove this assumption wrong. Thank you.

Meredith Keiser
Executive Director, The Foundation for Individual Responsibility and Social Trust

Ms. Keiser, age 23, has been the Associate Director of the Foundation for Individual Responsibility and Social Trust since August 1996 before assuming the Executive Director position in January of 1998. She graduated from Colgate University in May of 1996 with a B.A. in Psychology. Ms. Keiser studied psychology, aboriginal studies and women authors in Australia in 1995.

Since joining FIRST, she has organized and coordinated both the original We the Future Convention and We the Future 2, as well as National Deliberation Days, 1997 and 1998. She serves on the Executive Committee for the Social Security Challenge, funded by Americans Discuss Social Security, a project of the Pew Charitable Trusts.

In her spare time, she teaches swimming lessons to young children and leads an aerobics and nutrition class for senior citizens.

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Senator SANTORUM. Thank you, Meredith.
Carl.

STATEMENT OF CARL HELSTROM, THIRD MILLENNIUM, NEW YORK, NY

Mr. HELSTROM. Mr. Chairman, I appreciate the opportunity to testify before the Special Committee on behalf of Third Millennium, a national organization for Americans born after 1960 who are concerned about the future of our country. Third Millennium's efforts to create a national dialog on fiscal issues are well known. My colleagues and I have testified before Congress 16 times on the need to reform Social Security and Medicare, and the findings of our studies and surveys have been the impetus for some of the most important advancements in the debate about Social Security.

It was a 1994 Third Millennium study that produced the finding that Patty quoted that says that more young Americans believe UFOs exist than those who believe Social Security will exist by the time they retire.

I first became acquainted with Third Millennium because I was involved in the Social Security reform movement. I worked for several private grant-making foundations in the New York City area that have strong philanthropic interests in the Social Security debate. One of them in particular decided in 1994 to develop a special project on Social Security reform with a goal of strategically investing some philanthropic dollars to instigate a broad public discussion of the issue. Little did we know how well those investments would pay off back then.

At the time, you could count on your fingers the people in Washington who were willing to talk officially about Social Security reform. No one dared to use what we call the P words, privatization and personal accounts, which we all use so daringly today. And if you mentioned the infamous third rail of American politics anywhere around Capitol Hill, it was usually in the back room of Bullfeathers, which is a popular Capitol Hill watering hole, with frequent furtive glances over your shoulder. Of course, there were remarkable exceptions like the CATO Institute and their staunch advocacy of the concept that retirement security ought to be a private affair.

There are important political lessons to be learned by realizing how much things have changed in four short years. It is very important to remember that much of the original hard work and ingenuity that launched Social Security reform to the top of the political heap, enabling us to be here today to discuss the previously undiscussable, originated outside the Beltway.

Sam Beard, who is here today, the founder of Economic Security 2000, realized that early on and it motivated him to develop an extensive grassroots initiative that is spreading the Social Security reform message throughout towns and cities throughout the country. We have come very far very fast, and to me, it is incredibly exciting to consider where we might be in another year or two.

I have spent a great deal of time researching pension systems and working with the Social Security reform movement, but I only really began to understand the enormous inequalities of the system through personal experience. About 2 years ago, I left a good job near Washington, DC, to pursue better opportunities in New York City. The move was excellent for my career and my income increased by 60 percent. The downside was that my tax liability increased by a substantially higher rate. I am in a higher tax bracket now and working primarily as an independent contractor, so I have to pay twice as much FICA tax.

What has that meant to my family? Every quarter, I am forced to send thousands of dollars to the government that could have been saved for a down payment on a house or for my children's education. Frankly, I do not like it, because I believe I am being forced to pay more than my fair share.

But the person who is really upset about this is my wife, Jane, who is an extremely talented 30-year-old woman, a mother of three, with a graduate degree in government from Lehigh University, just up the road from here in Bethlehem. She stays home with our three young sons because we believe it is the right thing for her to do. But even if she did work outside the home, we would realize only a marginal increase in our real income because of the additional child care costs and taxes that she would have to pay. Essentially, we feel that she is stuck in a catch–22 created by the Federal Government.

The point I am trying to make is that the opportunity costs imposed on my family by the tax system, especially FICA, are too high. What does that have to do with Social Security reform? Well, I believe this discontent about taxation and the future of the Social Security system that I feel is increasing among young Americans. More and more people like my wife and I are asking ourselves tough questions, like, why should I pay thousands of dollars into a public system that benefits people I do not even know and will never benefit me and my family, especially when I could be putting the money into private investments that will?

Let me read a letter to the editor that appeared in the June 14 edition of the Los Angeles Times from a young woman named Marni Anderson. She describes herself as, "a 30-year-old college-educated worker who may or may not see a penny of all the money I am being forced to pay over my entire career into the Social Security system." She wrote, "I was incensed by the article, 'Working Together,' in which President Clinton and Republican Congressional leaders 'joined in a rare show of amity to scold Americans for not saving more for their own retirement.' The fact that close to half of our total paychecks are going toward taxes makes it very difficult to make ends meet, much less save for the future. The politicians are failing in their responsibilities and yet they have the gall to shift the blame to the American people." I think that is a pretty clear indication that Social Security reform is important to Marni Anderson, and I know she is not alone.

The message I would like to leave you with is this. There are thousands of Jane Helstroms and Marni Andersons out there realizing how important Social Security reform is to their future and the future of their families and they have already decided that they will not be victims of the system.

Mr. Chairman, I believe Social Security reform is already in the works and the question you should be asking yourself is, how much will be enough? Thank you.

millennium

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Testimony of Carl Helstrom
Member, Board of Directors of Third Millennium
Special Senate Committee on Aging
Tuesday, June 30, 1998, St. Joseph's University, Philadelphia, PA

Mr. Chairman, I appreciate the opportunity to testify before this Special Committee on behalf of Third Millennium, a national organization for Americans born after 1960 who are concerned about the future of our country. Third Millennium's efforts to create a national dialogue on fiscal issues is well known. My colleagues and I have testified before Congress 16 times on the need to reform Social Security and Medicare, and the findings of our studies and surveys have been the impetus for some of the most important advancements in the debate about Social Security. It was a Third Millennium survey in 1994 that produced the new famous finding that more young Americans believe UFOs exist than believe Social Security will exist by the time they retire.

I first became acquainted with Third Millennium because I was involved in the Social Security reform movement. I work for several private foundations in the New York City area that have strong philanthropic interests in the Social Security debate. One of them in particular decided in 1994 to develop a special project on Social Security reform with the goal of strategically investing philanthropic dollars in the instigation of a broad public discussion of the issue. Little did we know how well those investments would pay off.

Back then, you could count on your fingers the folks in Washington who were willing to talk officially about Social Security reform. No one there dared to use the "p" word. If you mentioned the infamous "third rail of American politics" anywhere around Capitol Hill at all, it was in hushed whispers over a beer in the back room of Bullfeathers with frequent furtive glances over one's shoulder. Of course, there were remarkable exceptions, such as the Cato Institute and their staunch advocacy of the concept that retirement security ought to be a private affair.

There are important political lessons to be learned by realizing how much things have changed in four short years. And it is very important to remember that much of the original hard work and ingenuity that launched Social Security reform to the top of the political agenda, enabling us to be here today to discuss the previously undiscussable, originated outside the Beltway. Sam Beard, the founder of Economic Security 2000 who will participate in the second panel today, realized that early on. It motivated him to develop an extensive grassroots initiative that is spreading the Social Security reform message in towns and cities across the country. We've come so far so fast, it's incredibly exciting to consider where we might be in a year or two.

I've spent a great deal of time researching pension systems and working with the Social Security reform movement, but I really only began to understand the enormous inequalities of the system through personal experience.

About two years ago, I left a good job near Washington, D.C., to pursue better opportunities in New York City. From a career standpoint, the move was excellent. However, while my income increased by 60%, my tax liability has increased by a substantially higher rate. I'm in a higher tax bracket now, and, working primarily as an independent contractor, I have had to pay twice as much FICA tax. What has that meant to my family? Every quarter, I am forced to send thousands of dollars to the government that could have been saved for a down payment on a house or for our children's education. Frankly, I don't like it, because I believe I am being forced to pay more than my fair share.

But, the person who is really upset about it is my wife Jane, an extremely talented 30-year-old mother of three with a graduate degree in government from Lehigh University, just up the road from here in Bethlehem, Pennsylvania. She stays home with our three young sons because we believe it is the right thing for her to do. But, even if she did work outside the home, we would realize only a marginal increase in real income because of the additional taxes she would have to pay. So, she is stuck in a Catch- 22 created by the Federal government.

The point I'm trying to make is that the opportunity costs imposed on my family by the tax system, especially FICA, are too high. What does that have to do with Social Security reform? More and more young people my wife and I meet are asking themselves some tough questions, such as: "Why should I pay thousands of dollars into a public system that benefits people I don't even know, but will never benefit me and my family, especially when I could be putting the money into private investments that will?"

The discontent among young people is increasing. Let me read to you a letter to the editor that appeared in the June 14 edition of *The Los Angeles Times*. It's from a young woman named Marni Anderson, a self-described "30-year-old college-educated worker who may or may not see a penny of all the money [she is] being forced to pay over [her] entire career into the Social Security system."

"I was incensed by the article 'Working Together,' in which President Clinton and Republican Congressional leaders joined in a rare show of amity to scold Americans for not saving more for their own retirement," Marni wrote. "The fact that close to half of our total paychecks are going toward taxes makes it very difficult to make ends meet, much less save for the future. The politicians are failing in their responsibilities and yet they have the gall to shift the blame to the American people."

That's a pretty clear indication that Social Security reform is important to Marni Anderson, and I am here to tell you that she is not alone.

Mr. Chairman and members of the Committee, the current Social Security system has survived as long as it has only because the Depression generation and their children bought into the collectivist ethic that supports it, because demographics allowed successful fiscal manipulation, and because the public had very little knowledge about how the system actually works.

Today's young people are more self-reliant, there are more of us, and we know that the system is likely to fall apart. The message I'd like to leave you with is this: thousands of Jane Helstroms and Marni Andersons out there are realizing how important Social Security reform is to their future and the future of their families, and they have already decided that they will not be the system's victims. Social Security reform is already in the works, and the question you should be asking yourselves is, "How much will be enough?"

Thank you.

Senator SANTORUM. Thank you very much, Carl.

As I think you were informed earlier, if there are any questions from the audience, we will be happy to, if you will write them down and they will pass them up here, I will be happy to share them with the panelists.

Meredith, your point was that we need to listen to the younger people. Obviously, we have four young people up here to testify in the first panel and we appreciate your feedback. I would ask one sort of general question to the young folks out there on the panel and that is, how much of a topic of discussion is this?

One of the real concerns I have is that if Social Security is going to be reformed, it is going to have to address both the folks who are currently engaged in Social Security who, when you talk about Social Security, immediately become engaged, and that is people at or near retirement. It is no problem getting people who are at or near retirement engaged in the discussion of Social Security.

The question I have is, how can we engage young people in this debate, because I agree with you. I think that they do need to be heard from, but as you also know, it is very difficult to get them to participate in that kind of dialog. I appreciate St. Joseph's hosting this forum and being here on a campus, but if you look throughout the audience—I know they are not in school right now, but if you look throughout the audience, there are not a lot of young people here, and when I held my forums, and I have had several of them throughout Pennsylvania and we have had them across the country, it is very difficult to get young people to show up and to participate.

So are there any thoughts as to how this can be, in fact, a broad dialog, not just among policymakers and people at or near retirement but among the whole population? Anybody can respond. It is a free-for-all.

Ms. DEMARCO. Part of what I said in my comments was when I went to the Social Security seminar down in Washington, I was really surprised about what I learned. I came back from that very informed and very excited to share it with my coworkers and friends.

I found that when you give them those facts that are really quite stunning, some of them, and really educate people, that they start to think about the issue. But I think government needs to maybe go a little further, and I do not know if the answer is through some of the suggestions that Meredith had with corporate America's help. I know my employer issues a statement every year that shows how much you will expect to receive in Social Security and their pension fund and your 401(k) and they hold seminars. I do not know, public television, sponsorship from Hollywood, people seem to listen to those public service announcements.

I think when people start to find out facts, that they really start to be more interested. Everyone is really wrapped up in their daily lives, but I agree with you that it is an issue that we need to bring to the forefront, and it is through groups like Third Millennium and the Concord Coalition, things like that, that this discussion is starting.

I do not know if any of my panel members have a comment.

Ms. KEISER. I do. I think that the problem is more underlying than that, and it is that people, young people, do not think that showing up matters and that is really the problem that needs to be tackled before you figure out how to market to them and how to get them involved. It is really a much deeper problem that needs to be addressed. How do you address it? That is why we are here. Nobody has found the perfect solution for that yet because people are not participating.

What FIRST is doing is trying to bring these young people together and invite politicians and members of the community to come and listen, and I think that is a very good first step to take.

Senator SANTORUM. Anybody else?

Mr. HELSTROM. I agree with Meredith. I think it is a deeper and more underlying problem. I think what is going on in the press is very impressive. There is a lot of press about Social Security reform all over the United States. I mentioned Sam Beard's project, which he will probably talk about in the next panel, but they are going to many, many, many cities and towns in every State and getting the message out.

With young people, I think the important thing is for those of us who are interested in the issue to talk to every young person we know. Today is Tuesday. Two days ago, my son was christened and we had a christening party and that was the topic of discussion. We talked about Social Security reform. I have two brothers-in-law who are just out of college, in their first jobs, and they have the attitude that they are not going to see any Social Security benefits, but they believe they will be able to earn enough money, accumulate enough wealth to take care of themselves despite that. They think they will have some sort of collateral source of wealth.

But I think, with due respect to the rest of the folks on the panel, I think, unfortunately, I have seen their future and I am it. I am 36 and I have three kids, and once those costs start adding up, people start to think a lot more about taxes and Social Security reform and that sort of thing because you are not just out of college. You are not just taking care of yourself. So I think that over the next 2 years, with the public discussion in the press and with everything that Third Millennium and the other groups are doing and just all of us trying our best to get the message across, we are going to see a lot more young people involved.

Senator SANTORUM. Thank you very much for your testimony. I appreciate it, and we will now have the second panel. Thank you.

VOICE. What about questions for this panel?

Senator SANTORUM. My staff informed me that most of the questions that have been asked really are more appropriate for the second panel than this one. They showed me the ones that had been handed in today. If you have one——

VOICE. We do have one.

Senator SANTORUM. OK. Would you and your colleagues support the efforts of parents like myself, whose children have no Social Security number, to persuade Federal and State Governments to make an exception for them to be able to contribute? I do not——

VOICE. To live as ordinary Americans without a Social Security number. Are you panel members going to lock all of us into having a Social Security number? None of our children have one. We do not want them to have one. We are opposed to it on principle both as Americans and as citizens.

Senator SANTORUM. I think that is a separate issue that——

VOICE. I still would like to know, because this is an issue involving the revamping of this thing. Are they going to be part of the scheme which the Department of Transportation in Washington has already issued proposed rule changes that will require a Federal I.D. with everyone's Social Security number on that I.D.? If you do not have a Social Security number, will you be able to continue to function as an American citizen? This is of great concern. What will you all do as you are working to reform Social Security?

Mr. HELSTROM. This is not an issue that Third Millennium has dealt with, so I would have to speak personally. I personally would not do that.

VOICE. Would not what?

Mr. HELSTROM. Would not force you to have a number——

VOICE. Thank you.

Mr. HELSTROM. [continuing]. But I am not king, so I cannot——

Senator SANTORUM. OK. Thank you very much.

Could we have our next group of panelists come up? I see Mr. Tanner coming up and I saw Sam Beard up in front. Hi, Sam. It is good to see you. Thank you for being here. We also have Marshall Blume and David Langer. Please come on up.

Carl has already given Sam quite an introduction, so I think I can pass on much of it. But Sam Beard is the president of Economic Security 2000, which is a grassroots organization trying to energize a debate on Social Security and suggest a solution to Social Security which will benefit particularly lower- and moderate-income Americans.

Next is going to be Michael Tanner, who is the director of Health and Welfare Studies at the CATO Institute. As was mentioned also before, CATO has been one of the leading advocates for 20 years of dramatically revising and reforming the Social Security system.

Third is Marshall Blume, who is with the Wharton School of Business at the University of Pennsylvania. His expertise is in the area of financial markets and has spoken extensively on the issue of Social Security.

Finally is David Langer, and Mr. Langer is an actuary who, I believe, is here to—are you speaking for the AARP, is that my understanding, or——

Mr. LANGER. No. I am not affiliated with them. I am speaking on my own.

Senator SANTORUM. OK, speaking as a private actuary.

We will start off with Sam Beard. Sam, thank you so much for being here.

STATEMENT OF SAM BEARD, ECONOMIC SECURITY 2000, WASHINGTON, DC

Mr. BEARD. I very much appreciate being asked. What I want to say, Senator, is that you bring rare talents to the table because you start from the premise that Social Security is essential, the safety net is essential, it is essential to save the benefits for existing seniors and near-seniors, and yet, just with the changing demographics, that there are problems for the next generation. That is what I would like to address my remarks today, which is how do we do the balance.

As we go around the country and debate this, this is a panel on aging, so I want to talk about people who represent seniors groups and the aging. I just returned from speaking down in Mississippi in front of about 600 low-income seniors, all on Social Security, and I had the privilege of discussing that with the National Committee to Preserve Social Security. Their point was, the imbalances in Social Security are minor and it is all OK. A nip and a tuck will work.

Now, part of what the National Committee says is, we have the trust fund. We have $3 trillion in the trust fund, and that, so, OK, more money starts going out in 2013 than comes in, but we are safe until 2032 and it is just minor.

So I retorted. I said, all we have here is a missing $3 trillion, and I said, let us talk about what that means to the seniors in this group. All the money in the trust fund has been spent. There is not a penny there. So what the government reports tell you is, yes, let us find the $3 trillion, and here are your choices.

First, cut government spending by $3 trillion. Now, at this senior center in Mississippi, I had been to their annual planning meeting and they were talking about a waiting list of, in four counties, 5,000 people for home delivered meals, 1,100 people for different home care, and then they went down a $25 million budget which related to delivery of services to seniors. So if you cut government spending by $3 trillion, you are taking off the table all the seniors' home delivery programs or making big cuts into those exact programs which are essential. So I happen to be against those massive cuts, so I do not think cutting the Federal spending is right and I do not think it is a minor thing.

Second, the government reports tell you is you can borrow the $3 trillion. Now, if you borrow the $3 trillion, the interest charge which you have to actually pay is $180 billion a year. So that is the same thing. You then lose all the senior programs.

Third, is you can raise taxes. Now, the reality is, if you are missing $3 trillion, you need to raise taxes $43,000 a family, and then you say, well, shucks, it is only $2,100 a year for 17 years, and then the first day of the next year, Social Security is $240 billion a year in arrears.

So the point I was making is, I do not think taxing everybody, every family—I ought to ask this group. I do not think taxing every family in this room $43,000 is minor. I do not think it is modest.

So the point I was trying to make was, when you get to the bottom line of these Social Security numbers, once the baby boomers retire, it is all driven by demographics. You can either raise Social Security—you have two choices the old way. You raise Social Security taxes 50 percent. It goes from 12 percent of payroll, half by the employer, half by the employee, and you raise that to 18 percent of payroll just for Social Security. Now, I do not think the young generation wants that. So that is not good for the young generation, and no senior wants that for their grandchildren.

At the same time, the other option, the old way, is to cut benefits 32 percent. I am sitting here in a group of Mississippi seniors in a poor area and they are getting $400 a month, $300 a month, and certainly the answer is not to cut that 32 percent. It is disgraceful.

So now it starts to define the problem better, which is how do we have young people and old people, how do we save Social Security, save every part of the Roosevelt contract, Social Security is the best program, at the same time, not double taxes for the kids? So I thought that was a better definition of the problem.

Now, the next issue in this is a broader issue, retirement security. It is not just Social Security. Roosevelt said retirement security is supposed to be a three-legged stool. Sixty percent of the country has no savings. Leg one was supposed to be savings. Leg two was supposed to be a pension. Sixty percent has no pension or really minimum pension. Then Social Security is $8 trillion underfunded. So you have got a problem.

Then I get to it from a different way, which is I am scared we are becoming two separate societies. Down in Mississippi, we were told, do not at night walk around the streets. It is not safe. I was in Baltimore, had a panel like this. The chief of police came up to me afterwards and he says, "I know exactly what it means when you are talking about two separate societies. As chief of police, we fight this 24 hours a day. In lower-income Baltimore, there are not the jobs, there are not the opportunities. Hope is disappearing." In his words, "We are a thin piece of paper heading off massive civil disobedience." I live in Wilmington, DE, 75 shootings on the streets in Wilmington, DE, which is a pussycat of a town.

So there are a series of problems. Social Security faces imbalances, retirement insecurity, we are becoming two separate societies. Now, one thing that suggests itself goes right back to Einstein. The greatest force on earth is compound interest. Ben Franklin, a penny earned is a penny saved. So you start when you are young. We should redesign it, allow everybody to put $1,000 a year into an account which they own, totally save Social Security, save every part of the Roosevelt contract.

So I think there is a new way, and thank you for having me.

[The prepared statement of Mr. Beard follows:]

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U.S. Senate Special Committee on Aging

Philadelphia, PA – Field Hearing

Tuesday, June 30, 1998

<u>TESTIMONY BY SAM BEARD</u>

<u>FOUNDER, ECONOMIC SECURITY 2000</u>

- **Save Social Security.**
- **Save Every Dollar of the Roosevelt Contract.**
- **Broaden the Debate to:**
  - **Address Retirement Insecurity.**
  - **Add Progressive Savings and Wealth Accumulation.**

U.S. Senate Special Committee on Aging
Philadelphia, PA – Field Hearing

Tuesday, June 30, 1998

TESTIMONY BY SAM BEARD
FOUNDER, ECONOMIC SECURITY 2000

The Social Security dialogue currently misses two key issues: retirement insecurity and an increasing gap between rich and poor. Instead, we are discussing whether or not there is a Social Security problem – whether we can tinker with the system or whether we need to make structural changes.

In defining the problem, Social Security does face real problems: Changing demographics require meaningful reform. Seventy-six million Baby Boomers will begin retiring in a decade. Coupled with increased life expectancy, less than two workers will be asked to support each Social Security beneficiary. The Social Security Trustees Report clearly states that, by 2033, we will need to raise payroll taxes from 12.4% to 18% of payroll or cut benefits 25%.

Connect this to individuals: I was brought to a church in Denver by two young men who introduced me to their grandmother – Mrs. Drain. She wanted to know what all my talk meant to her. I told her that at retirement, Social Security promised me $16,000 each year, that the demographics required her two grandsons to each pay me half, and that I expected to live many years into retirement. I explained that if I got sick, I would go back to her two grandsons for my medical expenses – an additional $10,000 per year.

Let's try a different perspective. Social Security cannot and does not exist in a vacuum. It is inextricably related to retirement security. Most Americans have neither savings nor a pension and rely on Social Security for the majority of retirement income. The 60th percentile family has less than $1,300 in total savings. At age 65, the median family has $14,000 in total savings. Pension coverage in the United States never has extended beyond 49% of the workforce. And the AARP asserts that 40% of those covered receive seriously inadequate pension income. For a $20,000 a year worker, Social Security currently promises just $11,967 a year. With tinkers to the system, this promised benefit will be cut, and it already is not enough. We can and must do better.

I come to the Social Security debate from an entirely different perspective. The gap between rich and poor in America is worse than in any other industrialized nation. The United States in the 21st century will be defined by our ability to close this gap.

The opportunity lies in savings and compound interest. In America, there are two potential sources of income. Most understand the first income source: I get a job and I get paid. The second – income from wealth – is more difficult. Anybody who has invested savings understands that money at work means additional income. If I own and invest $50,000, I can reasonably expect to receive an additional $4,000 to $5,000 of income. Yet, after a lifetime of work, most African-Americans and Hispanic-Americans do not own a dime. The top 10% of Americans own 4,653 times the wealth of the bottom 20 %. This is disgraceful.

Through Social Security, we have an unprecedented opportunity to open this second source of income to all working Americans. Related to Social Security, there are currently 25 to 30 plans adding individually owned savings accounts. Almost all divert 2% of wage. But, 2% of wage for an $8,000 worker is $160 as a savings set aside. This is tiny and does not accomplish meaningful savings or ownership of wealth.

To achieve a major wealth accumulation impact, let's set a minimum standard – $500 a year or $1,000 a year for every worker who earns it (an $8,000 a year worker already pays $1,000 a year to Social Security). After a lifetime of work, a $500 per year set aside accumulates $75,000, a $1,000 per year set aside accumulates $150,000, and a $2,000 per year set aside accumulates $300,000.

If we establish goals related to a meaningful wealth accumulation impact, then we can look to creative financing and actuarial alternatives. The experts are doing all their thinking within traditional Social Security actuarial analysis – raise normal retirement age and adjust CPI, among others. They can show how to find 2% of payroll for savings.

To find 4 % of payroll without raising taxes, let's explore selling government land, using the tax code and savings matches, Liberty Bonds (see explanation), and zero coupon bonds as a tradeoff. Let's create a progressive protective floor and a progressive savings set aside plan.

This is easily understood as a percent of payroll. 1% of payroll requires $30 to $35 billion a year.

Let's take just two examples of creative out-of-the-box numbers analyses:

The first example, which I call the Ownership Agenda, can save $35 to $70 billion a year (1% to 2% of payroll). Let's give all Americans the choice to either remain in the current system or choose a new "Ownership Agenda."

The Ownership Agenda allows individuals to set aside money into individually owned savings accounts invested in the private sector by forfeiting a percentage of what Social Security currently promises. Instead of the $16,000 Social Security currently promises, ask for just $9,000 per year. In return, they get to invest a percentage of payroll. This minimizes what Social Security needs to pay out.

This does not relate to low-income Americans. Their floor of protection is already too low. (The $10,000 worker receives $510 per month. Millions receive $200 or $300 per month for life, and they have neither savings nor a pension.) Do not lower this.

A second option, which I call Liberty Bonds could save the system $35 to $70 billion per year or 1% to 2 % of payroll.

Affluent Americans have paid into Social Security and currently expect to receive $16,000 per year in retirement. Means testing makes Social Security a poverty program and breaks the national and communal umbrella which President Roosevelt created.

Let's use the tax code so affluent Americans say, "Please don't send me my Social Security checks." If many middle-income, upper-middle income, and high-income individuals defer Social Security benefits for 20 to 30 years, $35 to $70 billion per year can be saved.

These are just two examples. The point is that through out-of-the-box creativity, we can afford to open savings and wealth to all Americans.

To give a brief summary: Based on changing demographics, Social Security is in trouble. Retirement security is at risk. And we are in danger of becoming two separate societies with all the benefits of our economic system flowing to the top 25%.

Through Social Security, we have the opportunity to address all three issues: Save Social Security. Add savings to retirement security. And open a second source of income – income from money at work – to every working American.

There are no easy answers. But, if we put all the options on the table, and if we are creative, we can find the money to reopen economic opportunity to all Americans.

Senator SANTORUM. Thank you.
Michael.

STATEMENT OF MICHAEL TANNER, DIRECTOR OF HEALTH AND WELFARE STUDIES, CATO INSTITUTE, WASHINGTON, DC

Mr. TANNER. Thanks, Senator. I want to add my thanks to you for having this hearing. It is no small measure in Washington that has distinctly lacked political courage for someone to be willing to grasp the third rail of politics and to be willing to tackle this issue. We can be very grateful as a State and as a society that you have had the courage to take a leadership role on this, not just to grasp it but to sort of firmly hold it in both hands.

One of the earlier panelists talked about the need for facts, so let me give a few of the facts here that we can start with. The first is that Social Security is facing a severe financial problem and that problem is coming much sooner than most of us believe. In just 15 years, in the year 2013, Social Security will begin to run a deficit. That is, it will begin to spend more on benefits than it is taking in revenue.

Now, this number comes not from any cabal of right-wing Wall Street types but from the Social Security Administration's own Board of Trustees, including the Clinton administration's Secretary of HHS, Secretary of Labor, Secretary of Treasury are members of that panel.

Now, the theory, of course, is that once you hit 2013, you then go back to the Social Security trust fund and you use the money in the trust fund to continue to pay benefits until about 2032. Well, the only unfortunate part of that, as you have heard, is that there is really no money in the Social Security trust fund. What is in the Social Security trust fund is a series of government bonds which are, in essence, an IOU or a promise to tax individuals in the future, plus interest that has been attributed on paper to those bonds, but they do not represent real assets in the way that a trust fund traditionally represents assets. In fact, they represent a liability to the government.

There are two ways to look at this. One is, assume we never had a trust fund. What would happen in the year 2013 when Social Security goes into deficit? Well, if you are going to continue to pay your benefits, the government will have to raise taxes, borrow money from somewhere, or cut government spending in some other area.

The second opportunity, if we have a trust fund, what happens in 2013? You go back to the trust fund and you have to redeem the bonds. Where do you get the money to redeem the bonds? You have to raise taxes, borrow it, or find it somewhere else in the budget, exactly the same two options.

Another way to look at it is for people who are sort of sanguine about the trust fund is to consider that around 2029, which is right in the middle of the trust fund, and everyone says, well, we do not have a problem with Social Security, Social Security has to redeem somewhere around $760 billion worth of bonds that year in order to pay its benefits. Where is the Federal Government going to find $760 billion? That is equal to about half of our entire Federal budget right now.

But even if you could find a way to keep Social Security solvent, that does not solve the other problem with Social Security, and that is that Social Security is increasingly a bad deal for young workers. Someone who retired 20 years ago got back everything they paid into Social Security with interest and a lot more besides. It was a very good deal.

Someone who retires this morning will receive back a real rate of return on their Social Security taxes of about 2.2 percent. Now, that is positive, but you could do about as well if you put the money in a bank.

For young people, for most people under the age of 50, they will receive back a negative rate of return from Social Security. They will actually lose money, get back less in benefits over the course of their life than they pay in taxes over the course of their life, and if you raise taxes or you cut benefits in order to keep the system solvent, you will actually make that problem worse.

The third fact to bear in mind is that Social Security contains numerous inequities. It discriminates against working women because of the dual entitlement rule. It penalizes poor people and African Americans because they start work earlier and they die earlier. Therefore, they pay into more taxes but they receive fewer lifetime benefits.

Social Security also penalizes the country by decreasing economic growth by decreasing net domestic savings and by operating as a huge tax on labor. It is one of the most regressive taxes there is. Three out of four Americans pay more in Social Security tax than they pay in Federal income tax, so it is a huge marginal tax on labor, therefore affecting productivity.

All of these problems stem from the basic nature of Social Security, which is a pay-as-you-go system. In a pay-as-you-go system, your Social Security taxes are not saved for you or invested in any way. Instead, the money comes in and it immediately goes out the door to pay benefits for people who are retired today. When you retire, you have to hope there is another generation behind you that will pay taxes to support you.

The problem is demographics. In 1950, there were 16 people paying those taxes for every person who was retired. Today, there are three. By 2025, there will be just two people paying taxes for every person who is retired and collecting benefits.

The only way to preserve a retirement system and retirement dignity for future generations without huge increases in taxes is to change from a pay-as-you-go system to a system based on savings and investment, where your Social Security taxes are safe for you and are invested in real assets, stocks, bonds, annuities, and so forth. By moving to that type of fully funded, fully invested, wealth-creating system, we can preserve a Social Security system that will ensure that young people will be able to retire with the same dignity as their parents.

Let me just close by pointing out, the Social Security system that we know was created in the 19th century in Prussia, when people rode around on horses to get around. Today, we are on the edge of the Internet age, going into the 21st century. Should we not have a 21st century Social Security system, not a 19th century one?

Thank you very much, Senator.

Testimony of

Michael Tanner

Director of Health and Welfare Studies

Cato Institute

before the

Senate Special Committee on Aging

June 30, 1998

Not long ago, President Clinton went to Georgetown University to launch his campaign for Social Security reform. At that appearance the president called for Americans to be "open to new ideas, not to be hidebound and believe that we can see the future through the prism of the past." If the president is serious about fixing Social Security's many problems, he should follow his own call for "bold experimentation" and offer Americans a new Social Security system based on individual ownership and private investment.

Social Security's problems begin with a looming financing crisis. The date most often cited in public debate is 2029, the year in which the Social Security trust fund will be exhausted. But focusing exclusively on that date is misleading. The implication is that Social Security's financing is fine until 2029, at which point benefits will suddenly stop. The reality is much more complex.

Currently, Social Security taxes bring in more revenue than the system pays out in benefits. The surplus theoretically accumulates in the Social Security trust fund. Beginning as early as 2012, the situation will reverse. Social Security will begin paying out more in benefits than it collects in revenues. To continue meeting its obligations, it will have to begin drawing on the surplus in the trust fund. However, at that point we will discover that the Social Security trust fund is really little more than a polite fiction. For years the federal government has used the trust fund to disguise the actual size of the federal budget deficit--borrowing money from the trust fund to pay current operating expenses and replacing the money with government bonds.

Beginning in 2012, the Social Security Administration will have to start turning in those bonds to the federal government to obtain the cash needed to finance benefits. But the federal government has no cash or other assets with which to pay off the bonds. It can obtain the cash only by borrowing and running a bigger deficit, increasing taxes or cutting other government spending. All those options pose obvious problems.

Even if Congress can find a way to redeem the bonds, the trust fund surplus will be completely exhausted by 2029. At that point, Social Security will have to rely solely on revenue from the payroll tax. But that revenue will not be sufficient to pay all promised benefits. Either payroll taxes will have to be increased to at least 18 percent, a 50 percent increase over today's 12.4 percent tax rate, or benefits will have to be slashed.

Social Security's financing problems are a result of its fundamentally flawed design, which is comparable to the type of pyramid scheme that is illegal in all 50 states. Today's benefits to the old are paid by today's taxes from the young. Tomorrow's benefits to today's young are to be paid by tomorrow's taxes from tomorrow's young.

Because the average recipient today takes out more from the system than he or she paid in, Social Security works only as long as there is an ever-larger pool of workers paying into the system compared to beneficiaries taking out of the system. However, exactly the opposite is happening.

Life expectancy is increasing, while birth rates are declining. As recently as 1950, there were 16 workers for every Social Security beneficiary. Today there are only 3.3. By 2030 there will be fewer than 2. The Social Security pyramid is unsustainable.

Those financial troubles are reason enough to reform social Security. But focusing on the program's financing is to miss an even bigger problem. Even if Social Security's financial difficulties can be fixed, the system remains a bad deal for most Americans, a situation that is growing worse for today's young workers. Payroll taxes are already so high that even if today's young workers receive the promised benefits, those benefits will amount to a low, below-market return on payroll taxes. Studies show that many young workers' benefits would amount to a real return of one percent or less on the required taxes. For some, the real return would be zero or even negative. Those workers can now get far higher returns and benefits through private savings, investment and insurance.

Raising taxes or reducing benefits to keep the system solvent will only make the rate of return worse.

There is a better alternative. Social Security should be "privatized," allowing people the freedom to invest their Social Security taxes in financial assets such as stocks and bonds.

A privatized Social Security system would essentially be a mandatory savings program. Money would still be deducted from a worker's pay and matched by the employer, the same as it is today. But instead of sending that money off to Washington to disappear into the black hole of Social Security, those workers who wish to do so could redirect their money into a personal retirement account (PRAs) of their choice.

PRAs would operate much like current individual retirement accounts (IRAs)or 401(k) retirement plans. Individuals could not withdraw funds from their PRAs prior to retirement, determined either by age or by PRA balance requirements. PRA funds would be the property of the individual, and upon death, any remaining funds would become part of the individual's estate.

PRAs would be managed by the private investment industry, and workers would be free to choose the fund manager that best met their individual needs and could change managers whenever they wished. The government would establish regulations on portfolio risk to prevent speculation and protect consumers. Reinsurance mechanisms would be required to guarantee fund solvency.

The government would continue to provide a safety net in the form of a guaranteed minimum pension benefit. If upon retirement the balance in an individual's PRA were insufficient to provide an actuarially determined retirement annuity equal to the minimum wage, the government would provide a supplement sufficient to bring the individual's monthly income up to that level.

Of course, some people might worry that allowing people to invest privately is too risky. But that seriously misstates the risks of both privatization and of remaining with the current Social Security system.

Are stocks really risky? In any given year, stocks can go up, but they can also go down. For the last several years the stock market has been riding a wave of expansion. Undoubtedly, there will eventually be a correction.

But the year-to-year fluctuations of the market are actually irrelevant. What really counts is the long-term trend of the market over a person's entire working lifetime, in most cases 45 years. Given that long-term perspective, there is no time in which the average investor would have lost money by investing in the U.S. stock market. In fact, taking just 20 years of stock market returns, the worst period in U.S. history, including even the Great Depression and the 1929 crash, produced a positive real return of more than 3 percent. The average 20 year real rate of return has been 10.5 percent.

As Sen. Robert Kerrey (D-Neb.) explains, "History shows conclusively that long-term investment in the stock market is safe and profitable."

By comparison, relying on the current Social Security system is extremely risky. Because Social Security is at its core a political system, future benefits are dependent on political decisions. Indeed, the Supreme Court has ruled, in <u>Nestor v. Fleming</u> that individuals have no right to Social Security benefits based on the taxes they've paid. Congress and the president can change or reduce Social Security benefits any time they choose. A young worker entering the Social Security system is gambling on what benefits a Congress and president <u>45 years from now</u> will decide to bestow. Given the already low rate-of-return to young workers and the system's coming financial shortfall, the political risk of staying in Social Security far exceeds the market risk of private investment.

The most difficult issue associated with any proposed privatization of Social Security is the transition. Put quite simply, regardless of what system we choose for the future, we have a moral obligation to continue benefits to today's recipients. But if current workers divert their payroll taxes to a private system, those taxes will no longer be available to pay benefits. The government will have to find a new source of funds. The Congressional Research Service estimates that cost at nearly $7 trillion over the next 35 years.

While that sounds like an intimidating figure, it should be understood that this is not a new cost. It is really just making explicit an already existing unfunded obligation. The federal government already cannot fund as much as $9 trillion of Social Security's promised benefits. Privatizing Social Security, therefore, will actually reduce the amount of debt we owe.

Of course there will be a temporary cash flow problem while we make the transition. We will have to find the revenues to pay benefits to current retirees. While any financing mechanism will be political, involving some combination of debt, transfers from general revenues, asset sales and the like, the expected budget surplus offers a good place to start. President Clinton has called for using the surplus to save Social Security. If both parties are willing to forgo new spending programs and junk tax cuts, we can begin the transition to a new, improved Social Security system.

Social Security privatization may be an idea whose time has come. For our children's sake, it can't come too soon.

Senator SANTORUM. Thank you, Michael.

Marshall.

STATEMENT OF MARSHALL BLUME, WHARTON SCHOOL OF BUSINESS, UNIVERSITY OF PENNSYLVANIA, PHILADELPHIA, PA

Mr. BLUME. Thank you very much for asking me to testify before this committee. Besides being a professor at the Wharton School, I am also a member of the Financial Economists Roundtable. It is a group of senior financial economists from a wide range of schools who meet periodically to discuss issues of current policy.

At its annual meeting in July 1997, we discussed Social Security reform and we issued a statement. The statement was signed by 31 financial economists representing schools from the West Coast to the East Coast, Stanford to the University of Pennsylvania, MIT, and so on. We reached definitive conclusions on four points. It is unusual for economists to reach conclusions on anything, but we did on four. I would like to read those four.

The first was that investing part of the Social Security trust fund in common stocks does not solve the basic problems facing the current pay-as-you-go Social Security system, contrary to what some people think. There is a euphoria about common stocks, but they are highly risk.

Second, a reformed Social Security system should be partly funded through individual retirement accounts, but it should preserve a safety net, that is, a minimum benefit for all participants financed on a pay-as-you-go basis.

Third, individual retirement accounts should be invested in well-diversified portfolios of securities, including common stocks. But the calculations that we have seen on the value of investing in common stocks greatly exaggerate the value of that type of investment.

Fourth, individual retirement accounts should be fully owned by the workers, just as workers own IRAs and 401(k) plans. Prudent and low-cost management is absolutely essential. We also believe that competition between the private and public management of these funds would be healthy.

Now I would like to summarize in some detail, where I can, the rationale for some of these conclusions.

I was very much impressed with the first panel. They understand exactly what Social Security is. You tax the current workers and pay it out to the current retired people. I dare say that that is not the general understanding of Social Security. Most people think, and they use the word, and one person actually used this word, they "contributed" to Social Security. There is no contribution. It is a tax.

People have properly recognized that the Social Security trust fund is really non-consequential. It will grow to around the year 2022, something like that, where it will represent about 3 years of payments for Social Security. Basically, there is not a trust fund. What is in the trust fund is really IOUs from the taxpayers to pay it.

People have recognized, quite correctly, that demographics and longevity of people is causing this issue. There are less people for each retired person as time goes on. That means that each worker has to pay more for each retired person to fund the retirement program.

The solution is very clear. Either benefits have to go down or taxes have to go up in some way.

We thought that it was appropriate for the system to move to a partially funded system—it is not a black or a white choice. It is sort of a combination—where you have individual retirement accounts. The basic problem is the transition financing of these individual retirement accounts. If benefits are to remain the same, somehow, we have to raise new revenues to fund these individual retirement accounts. There is no way of doing it otherwise.

We found no clear reason for an increase in the payroll taxes to fund these individual retirement accounts. Rather, we thought that it might be more desirable from an economic point of view to fund these with general revenues. We already have some lip service with that with using the surplus to fund the Social Security transition, and that might be a good way of doing it.

We spent some time looking at the type of individual retirement accounts. We were very much concerned that many people do not understand the risks of investing in common stocks and we thought that people should be given a limited choice of well-diversified portfolios of stocks and bonds. The costs have to be low. They cannot be high. We thought of a tiered system, whereby up to a certain threshold, the money would be invested in government-controlled index funds, but thereafter, people would have the option to invest money in private and public-managed funds.

We were very much concerned about firewalls if the government invests the money on behalf of the beneficiaries. It is easy for politicians to spend money when they have it in their own pocket.

We also were concerned that most of the proposals for the reformed Social Security system missed the macroeconomic effects. Basically, if you allow the Social Security system to invest, or if you allow individual retirement accounts to invest in common stocks, the government will have to borrow more money from the public to fund government expenditures and there is really a one-for-one type of substitution there. So we were concerned about that.

We also thought that a lot of the calculations of the benefits of investing in common stocks were just using mirrors to discuss or to indicate how desirable it would be. The statement itself gets into the technical issues of why that is true. Thank you.

[The prepared statement of Mr. Blume follows:]

Statement of Marshall E. Blume

United States Senate Committee on Aging
Field Hearings on Social Security Reform

June 30, 1998

Thank you very much for asking me to testify before the Committee on Aging. My name is Marshall E. Blume , and I am currently the Howard Butcher III Professor of Finance at the Wharton School, University of Pennsylvania. I am to report on a statement of the Financial Economists Roundtable. The Financial Economists Roundtable is a group of senior financial economists who have made significant contributions to finance literature and seek to apply their knowledge to current policy debates. It meets annually to discuss an issue of current import. At its annual meeting in July 1997, it discussed Social Security reform and issued a statement summarizing that meeting on March 31, 1998. It is my pleasure to submit this statement to the Committee.

Financial Economists Roundtable

Statement on Social Security

March 31, 1998

(The following statement on Social Security was discussed at FER's annual meeting in July 1997 and released on March 31, 1998.)

The Financial Economists' Roundtable met in July 1997 to consider long-run problems facing the Social Security system. The goal was not necessarily to endorse any particular proposal for Social Security reform, but to explore how the principles of modern finance can clarify the current debate.

The Roundtable reached definite conclusions on the following points:

- Investing part of the Social Security Trust Fund in common stocks does not help solve the basic problems facing the current, pay-as-you-go Social Security system.
- A reformed Social Security system should be partly funded through individual retirement accounts. But it should preserve a safety net, that is, a minimum benefit for all participants, financed on a pay-as-you-go basis.
- Individual retirement accounts should be invested in well-diversified portfolios of securities, including common stocks. But the money's worth ratios reported in the Report of the Advisory Council on Social Security exaggerate the value of investing in common stocks.
- Individual retirement accounts should be fully owned by workers, just as they own IRAs and 401K plans. Prudent and low-cost management is essential. Competition between private and public management could be healthy.

Introduction

Unlike private pension plans, Social Security is not funded; it is a pay-as-you-go system. The payroll taxes paid by each generation of workers are not invested to cover that generation's retirement. Instead the taxes are used to pay benefits to workers who have already retired. The young pay the old, and when the young become old, they in turn are paid by the next generation.

Payroll taxes will exceed benefit payments for the next few years. These surpluses will flow to the OASDI (Old Age, Survivors and Disability Insurance) Trust Fund. The Trust Fund is not intended to fund future Social Security liabilities. At its projected peak in about 2020, the Trust Fund will cover less than three years of benefit payments.

The Social Security system faces two serious problems. First, pay-as-you-go will not work in the long run at current tax rates and benefit levels. Projected annual benefits will exceed taxes before 2015, and the Trust Fund will be exhausted by about 2030. Projected annual and cumulative deficits become steadily worse through at least 2075.

The projected deficits are created by several economic and demographic trends. For example, the ratio of young workers entering the workforce to older workers retiring from it will decrease, and once retired, workers will live longer and therefore collect more Social Security benefits.

Second, pay-as-you-go systems do not encourage saving. Young workers invest payroll taxes in exchange for a promise of Social Security payments at retirement, but no net aggregate saving takes place, because the taxes flow to current retirees.

The Advisory Council on Social Security has put forth three proposals for reform:

- **Maintenance of Benefits** (MB) would shave benefits, eventually increase payroll tax rates and (seriously consider) investing 40 percent of the OASDI Trust Fund in common stocks instead of Treasury bonds. The assumed higher return on stocks in the Trust Fund is used to reduce or delay planned increases in taxes or future reductions in benefits.

- **Individual Accounts** (IA) would shave benefits and also create mandatory investment accounts for all participants, financed with an additional 1.6% payroll tax. The accounts would be invested in government-managed stock and bond index funds. As annuities from the accounts become available for retirement, there would be offsetting reductions in pay-as-you-go benefits.

- **Personal Security Accounts** (PSA) would divert 5% of the payroll tax to accounts placed with private investment companies. The rest of the payroll tax would finance a flat monthly benefit of $410 in 1998 dollars. The transition to the new system would be spread over 72 years, financed with an additional 1.52% payroll tax and by Federal borrowing.

The Roundtable concentrated on these three proposals, not to endorse or refute any one of them, nor to rule out other proposals, but to focus discussion on the financial issues in Social Security reform.

Individual accounts invested in common stocks

If Social Security participants acquire individual accounts, as in the IA and PSA plans, the accounts should be invested in well-diversified portfolios. Most portfolios would include common stocks as well as fixed-income securities. The additional risks of investing in common stocks -- compared, say, to investment just in Treasury bonds -- are offset by higher expected rates of return.

But it is wrong to project the higher expected returns without accounting for the additional risk. The Advisory Council Report makes this mistake.

The Report says that the IA and PSA plans give participants greater money's worth ratios than the MB plan, that is, more valuable benefits relative to payroll taxes paid. In fact, these misstated ratios make the IA and PSA plans look much better than they really are, relative to the MB plan.

The money's worth ratios calculated for the IA and PSA plans look good mainly because the Report projects relatively high rates of return from investments in the stock market and then discounts projected future benefits at a lower Treasury bond rate. The resulting money's-worth ratios are therefore overstated.

Future benefits that depend on the performance of the stock market should not be discounted at a Treasury bond rate. Finance theory and practice require that discount rates include risk premiums sufficient to compensate for investment risks incurred. Replacing a safe investment with common stocks increases expected return, but does not increase present value once risk is accounted for.

In short, the money's-worth ratios in the Advisory Council Report are incorrect and unreliable. They overstate the value of investing in common stocks.

Investing the OASDI Trust Fund in common stocks

Although the MB plan has no individual accounts, its proponents contemplate investing 40% of the OASDI Trust Fund in common stocks. This allows more favorable actuarial assumptions and delays the need for a future payroll tax increase or a further cut in benefits. But this is a cosmetic improvement only.

What are the actual effects of investing part of the Trust Fund in common stocks, other things constant? The Trust Fund is now invested in Treasury bonds. If the Trust Fund buys $1 billion of common stocks from private investors, the Treasury will have to issue an additional $1 billion of bonds to private investors. The Federal government would be borrowing to buy equities, that is, swapping bonds for stocks. There would be no change in the funds received or paid out by the Federal government, and aggregate saving would not be increased.

The secondary effects of Trust Fund investment in equities are difficult to forecast. Purchases of stocks by the Trust Fund, and sale of additional bonds by the Treasury, may push stock prices up a little relative to bond prices. Therefore expected rates of return on equities may fall slightly, relative to long-term interest rates, making risk capital relatively less expensive. However, the Roundtable believes that any such changes will be small and probably imperceptible.

Trust Fund investment in equities may also shift risks between current and future generations. Suppose, for example, that the stock market does much worse than projected. (Given the market's volatility, this outcome can not be ruled out, even in the long run.) If the benefits formula is not changed, the shortfall in projected return has to be made up by future workers (as taxpayers in a pay-as-you-go system). But of course benefits might also be reduced. On the other hand, if the stock market does exceptionally well, future payroll taxes could be lower. But in this case, the political will to hold the line on benefits will weaken. Thus risk would probably be shared by future workers (as taxpayers) and current workers when they retire.

An improved Social Security system

An improved Social Security system should:

- Move to a partially funded system, gradually eliminating part of the unfunded deficit of the current pay-as-you-go system. Funding should be accomplished through mandatory individual retirement accounts.

- Promote saving and assure that individual accounts are invested prudently and managed efficiently.

- Preserve a safety net, that is, a minimum retirement benefit for all participants, financed on a pay-as-you-go basis.

Moving to a partially funded system requires transition financing to maintain benefits for retired or nearly retired workers. Otherwise the shift of payroll taxes to individual accounts will create a dollar-for-dollar shortfall in the Federal budget, and aggregate saving will not increase. It is not clear that the transition costs should be covered by increased payroll taxes; this forces younger workers to pay for current retirees' benefits and also for their own future retirement. A broader-based tax should be considered.

The PSA plan is generally consistent with the goals just stated. The Roundtable does not endorse PSA specifically, but it is better than the IA or MB plans as a framework or prototype for change. The PSA plan moves towards partial funding through individual accounts, preserves a guaranteed monthly payment for all participants, and provides transition financing (although the financing comes from an additional payroll tax, not a broader-based tax).

The IA plan also creates individual accounts funded by an additional 1.6% payroll tax. Annuities supported by the IA account balances would gradually replace part of the benefits from the existing pay-as-you-go system. The IA plan moves toward a partially funded system, but much more slowly and cautiously than the PSA plan. Also, it is not clear whether participants would truly own their accounts. For example, the IA proposal does not say what happens to a participant's account if he or she dies before normal retirement. Does the balance revert to the government?

The MB plan contemplates minor changes to the present system and is not a significant improvement.

Management of individual accounts

Partial funding of Social Security requires a savings program designed to accumulate assets to cover part of retirement benefits. Saving would be mandatory for all workers covered by the system, and many participants would have few other financial assets. Therefore, excessively risky investment strategies would be unacceptable. Securities would be held in index funds or other widely diversified portfolios. Portfolios would be balanced, with investment in fixed-income securities as well as stocks. Participants would be allowed to move to safer portfolios, for example by investing less in stocks and more in fixed-income securities, as they approach retirement.

The PSA plan calls for private management of individual retirement accounts, with few restrictions on investment. Some participants would choose excessively risky portfolios and/or end up paying high investment management fees. The IA plan calls for the government to pool the accounts and invest in index funds, perhaps subcontracting management to a small number of investment companies. In this case diversification would be assured and costs would be very low.

The Roundtable believes that mandatory individual retirement accounts should be restricted to widely diversified portfolios. Excessive costs or fees for investment management should be avoided. Given these constraints, the differences between government and private management of workers' retirement accounts would not be marked. Each would require oversight by an independent agency or regulatory authority to assure that workers' investments go to widely diversified and efficiently managed portfolios. The Roundtable reached no specific conclusions about how this oversight should be implemented.

A government-managed system would not necessarily be more or less simpler or less cost-effective. Keeping track of collections, transfers and cumulative balances might be more complex in a privately managed system, partly because workers would have greater choice. On the other hand, a government-managed system would require firewalls to prevent political interference in investment management.

The Roundtable did not evaluate any detailed proposals for the administration and management of individual retirement accounts. However, it believes that a combination of private and public management could be healthy. For example, a worker's initial contributions might be directed to publicly supervised index funds invested in bonds and stocks; this would minimize investment management expenses on small accounts. But the worker could be given the option to switch to a privately managed portfolio once a minimum account balance is reached.

Whatever the arrangements for administration and investment management, workers should own their investment accounts. The account balances should be available to a deceased worker's heirs. Upon retirement there should be a choice of payout options, including inflation-indexed annuities.

FER Members Signing Statement

(Affiliations shown for identification purposes only)

- Rashad Abdel-Khalik, University of Florida
- Edward I. Altman, New York University
- George J. Benston, Emory University
- Gerald O. Bierwag, Florida International University
- Marshall E. Blume, University of Pennsylvania
- Richard Brealey, London Business School (U.K.)
- Willard T. Carleton, University of Arizona
- Andrew Chen, Southern Methodist University
- Franklin R. Edwards, Columbia University
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- James Van Horne, Stanford University
- Ingo Walter, New York University
- Roman L. Weil, University of Chicago
- Richard West, New York University
- J. Fred Weston, University of California at Los Angeles

Senator SANTORUM. Thank you very much.
David.

STATEMENT OF DAVID LANGER, DAVID LANGER COMPANY, INC., NEW YORK, NY

Mr. LANGER. Thank you for inviting me here, Senator. It is a pleasure to be here.

I am a consulting actuary in employee benefits in New York. I have been in the field about 40 years and I have been concerned about retirement in all those years. When proposals came forward with regard to Social Security, I had been so used to Social Security, I was brought up on it, I saw all the good that it did, and when I heard that there was an alternative, including individual separate accounts, I naturally became quite interested in it and I have been studying the privatization issues for about 3 years now. Being an actuary, naturally, I want to emphasize the actuarial side of it.

There are five problems with regard to privatization. I call them Achilles heels, and I will take them one at a time.

Everybody is now thoroughly indoctrinated with the idea that there is a financing problem in Social Security. I got hold of the last 20 annual reports of the trustees of the Social Security fund I put a lot of the data into my computer, and then I began to form a lot of charts, and lo and behold, I found, in my humble opinion, that there is no financial problem.

Let me show you one of my key charts. This is the actual past experience of the assumption with regard to the economy, the gross domestic product. You will notice it is around 3.5 percent in 1979 and each point is the average from each point in time down to the year over here. There has been a fairly narrow range from about 2.9 to about 3.5 percent, with an average of 3.3.

Now, each year, the actuaries at Social Security project into the future 75 years. I took the average of all those 75 factors for each of the 20 years, and notice the trend: down, down, down, down, down, despite the fact that the actual GDP has not shown that pattern.

We started out at an assumed 3 percent GDP in 1978, which is half a percent below what actually was back then, and it goes down to 1.5 percent in 1998. So the assumed GDP for the purpose of the calculation was cut in half, which is not indicated as justifiable by the fact that the actual GDP averages have not shown this. In fact, if you go back to pre-depression, in the 1920's, you go back 75 years, the average has been pretty much what you see over here, 3.1 to 3.3.

Therefore, you have to raise the question, why are the Social Security actuaries using such a very, very low rate of 1.5 percent at the present time? I mean, you get the picture by looking over here at the actual GDP, up, up, up, up, and they are assuming down, down, down. They stabilize a little bit here. This figure here of 1.5 is less than one-half what the actual average has been.

Now, actuaries have some leeway. You really cannot predict the future all that well, but there are guidelines that they have to follow which are published by the American Academy of Actuaries, and I think if you are an actuary or even if you are not an actuary but you want to make predictions, would you not want to look at past experience and give that a lot of credibility as opposed to the future?

Now, if you are an economist, you can project out all kinds of scenarios for the future. However, if you take ten economists, they are going to have ten different points of view of the future.

Now, the danger in what the Social Security actuaries did is that once you get past 1 year or 2 years, you are in blind country and you do not really know what you are going to have. Therefore, all the more need to rely on the past.

The danger that exists is that biases begin to creep into your future projections. This would be true of anybody, if you are conservative, or if you are a liberal. Now, if you had some liberal actuaries in Social Security, they might predict, a strong economy. We would then be sitting here and Senator Santorum would be talking with us about raising benefits 20 percent to 30 percent instead of cutting them and setting up an entirely new system.

Therefore, it is essential that actuaries not project themselves too much into the future, and this is what I believe, after 40 years in the field. You really have to rely on hard, objective evidence. Otherwise, you lose credibility with the public because they can see you are wrong each point in time.

So my first point is that we do not have a financial problem. The problem is strictly an actuarially structured one and one could just as easily structure a blessing in terms of higher benefits.

My second point is, I call it, an Achilles heel of the privatization proposals——

Senator SANTORUM. Mr. Langer, I just would note that you are on your second point and your 5 minutes are already up, so you have got——

Mr. LANGER. What would you like me to do?

Senator SANTORUM. You can summarize. How is that?

Mr. LANGER. OK. Sure. Thank you.

Senator SANTORUM. If you have any highlights or the other points.

Mr. LANGER. Second, they are comparing apples and oranges. A bleak future from Social Security's point of view, from the private side's point of view, a great, great economy in the future.

Third, all the criticism you have been hearing at this table about Social Security going bankrupt and you do not get your money's worth, et cetera, et cetera, I say in my written remarks, they are not true. I think they were designed to frighten the public, with all due respect to the fellow speakers over here, and they have succeeded admirably. They have done a very good job of doing that to the public.

Chile, as an example of a great privatization program. I feel very sorry for Chileans today. They do not know whether they are going to have any money left in the fund. Their fund is going down, down, and they are fully privatized, which is what the privatizers would like for us over here.

Finally, there are some ironies, which I will not go into, in terms of Social Security.

But my basic point was, I do not think we have a problem in Social Security.

Senator SANTORUM. If you guys would like to react, since Mr. Langer had the benefit of hearing your testimony first, now I will give you the opportunity to respond, since I saw some shaking of heads over there between——

Mr. TANNER. If I could just jump in on this GDP point, it is not the GDP that is dispositive when you are dealing with Social Security because that is across the entire economy, whereas Social Security is a wage-based tax. So what counts there is the real growth of wages plus the real growth in the working population, both of which—while the real growth in wages has actually been stagnant, productivity has actually declined over the last 20 years and the Social Security Administration is actually projecting a higher, in their actuarial assumptions, a higher increase in productivity than we have seen over the last 20 years. They are actually returning to 1950-era increases in productivity and I do not know that we are going to see that.

Real wages have been stagnant. The working population is declining, and, in fact, if it were not for immigration, we would actually have a declining overall working population today.

So I think that we should be very careful in assuming away Social Security's problems simply because we are going to have increased economic growth in the future.

Mr. BLUME. Well, let me comment a little bit on this. I think one of the key variables, and I agree with David, it is very hard to project what is going to happen 35 years from now. However, I think there are some facts which we really do know.

Right now, there is a general agreement that there are about 3.2 people supporting each retired person. There is a general agreement by about the year 2030 or so, there will be 2.0 people supporting each retired person. That suggests a problem.

Now, what are the assumptions there that could go wrong? Well, there is the proportion of dual working households. You have to make an assumption. It is probably not going to increase very much there. We have immigration. You could get more people in. We could be wrong there. People could die earlier. Mortality schedules could be wrong. I doubt that that is the situation. I think that, really, the ratio of workers to retired highlights the problem.

Senator SANTORUM. OK. A question to the panelists on some of the alternative solutions. Actually, three of you mentioned the possibility for personal savings accounts, although Dr. Blume suggested that that is not going to help save the system. First, I would like to explore that. You suggest that investing in common stock does not solve the problem, but then you say you should go ahead and do it, so economists are again befuddling us all. I would appreciate a comment on that.

Second, on the suggestion by some that we should take a portion of the Social Security trust fund and invest that in the stock market or other investments outside of Treasury bonds. So if you want to take the first question and then I will throw the second ones over.

Mr. BLUME. The question is, investing in Social Security or investing these individual retirement accounts in equities may not solve the Social Security problem, I think is correct. The problem is that we do not have a partially funded system or even a fully funded system. We have a system which is pay-as-you-go.

Taking some of the money, the revenues that people currently pay, and putting them into private savings accounts will reduce the amount of money available to pay existing benefits. What you need to do is somehow put more revenues into the Social Security system today. That is what will solve the problem, and we are suggesting that those additional revenues go into a private savings account. Now, those private savings accounts should be invested in equities. So, basically, what you need is an increase in revenues.

Another proposal has been to put part of the Social Security fund into equities, not into private savings accounts. What does this do? Well, right now, your money, when it goes into the trust fund, is used to buy government bonds. We now use that money to buy equities. That means the government is going to have to go to the public to borrow more money for the bonds. There is a one-to-one relationship between the Social Security fund buying equities and the need for the government to borrow more money. At least initially, they are going to offset each other and people will just rearrange their portfolio. So that is not going to change anything.

Now, the calculations that show that works are based upon a faulty actuarial calculation. They assume a higher rate of return on the Social Security funds. Then they discount that at the low safe interest rate. One of the things you learn in financial economics is if you are investing your money in higher-risk vehicles, you have to discount that back to the present at a higher interest rate and that is where the mistake is being made to show that it actually solves the problem and it really does not.

Mr. BEARD. I would like to comment. First, Senator, I want to point out that the younger panel all stayed within 5 minutes and none of the older panel came close. I do not know what that shows. [Laughter.]

The other thing I would like to point out is that in this discussion, as I have debated around the country, people who say, do not go to individual-funded accounts, the imbalance in Social Security is minor, they also have a major part of saving Social Security by having major investment in the private sector. So let us see what I have just said.

President Clinton had the Social Security advisory panel and it had 13 members, and Bob Ball, who is a great American and has been a devotee about saving Social Security, to try to get his numbers to work, basically said, you need to start with hundreds of billions of dollars and end up with the Federal Government investing about $5 trillion. Then with the extra rate of return with the Federal Government investing $5 trillion, then Social Security's imbalance is minor, and then he did some other things underneath it.

So what is interesting is the advocates of keeping Social Security just the way it is want the Federal Government to invest $5 trillion. Two-thirds of the members of the panel said if you are going to start investing hundreds of billions and build it up to $5 trillion, the money actually comes from us. So why do you not allow every working American out of taxes they are already paying to put $1,000 into an account that they own.

So I think it is just interesting, if someone says, well, this is a minor imbalance, please understand that there is no plan which does not assume large-scale extra investment in the private sector to get the extra rate of return, and your real choice is, do you trust the politicians, Senator, you as an exception, of course——[Laughter.]

Do you trust the politicians to want to invest $5 trillion or do you want to have it in individual accounts managed by professional money managers.

Mr. TANNER. Senator, if I could just make two quick points. One is, again, on this idea of the government investing, I think that raises two very serious issues. It would turn the Federal Government into the largest shareholder in every major American corporation, and I think that that offers enormous possibilities for mischief. Do we really want a government representative sitting on the boards of every American corporation voting government interests?

Now, I realize some people say this could be a passive investment. The government would not get involved. It would not vote their shares. I do not have that much faith in any government to resist the temptation. Imagine if the Federal Government owned 20 percent of General Motors and General Motors said, "We are going to close our plants and move them to Mexico." What President is going to shrug and say, "Well, there is nothing I can do about it even though we have all that stock. We could stop them, but we are just going to do nothing about it."

The second problem is, to what degree, or what type of stocks do you buy? Even if you have got an index and a passive, clearly passive system, should the Federal Government be buying tobacco stocks and propping up RJR? Should the Federal Government invest in the companies that do business in Cuba or Burma or Northern Ireland? Should the Federal Government invest in companies that donate to Planned Parenthood or that are environmentally suspect? I have always said, the day you invest in Walt Disney, some of your colleagues will go to the floor and the debate will go on until I retire. So I think you have to be very careful about that.

If I could make one other real quick point, that is on the cost of this transition. There is a problem in paying for the transition, but it should not be thought of as a new cost because Social Security currently owes $10 trillion that it has promised in benefits that it cannot pay. Those unfunded liabilities are not on the Federal Government's books, but they are just as real as if they were. So when you compare the cost of going to the new system, you have to take into account the cost of what it would cost to maintain that $10 trillion in benefits that you cannot pay right now.

In many ways, it is like refinancing your mortgage. If you go out and refinance your mortgage, you lower your total amount that you are going to have to pay because you get a better interest rate. You end up over your lifetime paying less. Now, in the short term, you bear certain prices. You have to have points. You might have to increase your payments in the short term.

That is the financing problem that is going to be so difficult, Senator, for you folks to do up there, and it may involve cutting government spending, it may involve a number of other things, but you are going to have to meet that obligation whether it is in the short term or a much bigger obligation when you try to pay that $10 trillion in the long term.

Mr. LANGER. I disagree with the costs that are being projected here. I think there is an attempt here to make them look like they are really very, very minimal, and they are not, you know, by comparing them to other large numbers.

Initially, the privatization program, would require both the worker and the employer to put in another 1.52 percent, they say until the year 2070, but I wonder about that.

Second, money will have to be borrowed in order to pay the current benefits because the 5 percent of pay which is now going to pay benefits largely will be going into individual accounts. So the government has to borrow money in order to do that and the privatizers themselves estimated that that will come to $10 trillion at a peak, and then it would dwindle down and the theory is that eventually this will become zero. But when you get to $10 trillion, let us say you have a 6-percent interest rate, that is going to add $600 billion of interest to the budget, and you can see what it is going to do to the deficit.

Third, there are a lot more expenses you are going to have to pay in terms of rearranging programs. You have to educate a lot of people, many of whom do not want to get involved in the market. They are going to have to get involved whether they like it or not. There is a tremendous amount of output in time and effort that is going to be required to privatize.

With regard to the $8 trillion or $10 trillion present value of benefits, that is a spurious number. I have not seen that justified and it does not really apply to the Social Security program.

Mr. BEARD. The only thing I would say, David, and I am glad that you are up here and have a different view—the man I was sitting next to said this panel looked stacked—so that we are having a good discussion. The numbers we use of up to $8 to $10 trillion in unfunded liability are never our numbers. It is all Social Security's numbers. So these are not made-up numbers. It is not that we have an opinion. Everybody in the debate goes to the Social Security trustees, and my best experience is the trustees are really smart and they are not political. They do as serious a job of figuring out what these are as possible. We use all their numbers.

Mr. LANGER. Can I reply?

Senator SANTORUM. Sure.

Mr. LANGER. The number that is being used of $10 trillion, was that you, Sam, who used that?

Mr. TANNER. That was me. It is a closed group model of all benefits promised minus all taxes paid plus obligations accrued to people within the 75 years.

Senator SANTORUM. And where did you get that number from?

Mr. TANNER. That is from the Social Security Administration.

Mr. LANGER. All right. Numbers are numbers. First, it does not apply to the Social Security system because it is not a private pension plan, nor is it an insurance program, where if the program terminates at any point in time, you would have to have a large number. I am not saying it is $10 trillion. It could be some lesser amount. So, therefore, it is not relevant to Social Security.

Additionally, your number depends on the assumptions that you use. I suspect they use a very low interest rate which drives up the value, so you might get a lower amount if you do that. They are using, in my opinion, in reviewing the assumptions, too low an interest rate, which tends to make this program look more expensive than it really is. So they are already moving in that direction of more and more conservatism, which I do not think they should do because it is misleading to people. They should not be liberal. They should not be conservative. They should be pretty much on target.

Senator SANTORUM. The economists——

Mr. BLUME. I would like to echo what Michael Tanner said. I think he is very right on. There is currently an unfunded liability. The question is, do we recognize it today and spread the cost of adjusting for that unfunded liability in smaller increments over a number of years or do we wait until the year 2030 and then increase taxes——

Senator SANTORUM. Can you explain maybe what you mean by an unfunded liability, because there seems to be a discussion as to what that means.

Mr. BLUME. Well, unfunded liability means that there is in some sense the current—in terms of Social Security—the current tax rate in the future will not pay for the benefits which people think they are going to get, and I go back to the basic numbers, which I do not think many people object to, because both of these people are already here. Right now, there are 3.2 workers per retired person. In 30 years, there are going to be about 2.0 persons per retired worker, and that means somehow taxes will have to go up to pay those benefits.

VOICE. What would the necessary employer——

Senator SANTORUM. If we could continue, we have a format that we hand in our questions, so let us stick to that.

There is a question here which is to me, actually, and I will answer it and then I will give you folks an opportunity to do so, and it says, Senator, tomorrow, July 1, you will have earned $68,000 of your salary. At that time, you will stop paying the Social Security fund. This means you have paid taxes on 50 percent of your wages. Workers who make $18,000 per year pay 100 percent. Would you be willing to vote to increase the base to over $68,000, and, in fact, there have been proposals put forward, Senator Moynihan was one of them, to increase the wage base, I think, to close to $100,000.

My response to that would be that if we are going to increase the wage base, then we have to increase the benefit structure to match the wage base. Otherwise, you lose all aspect of any kind of fairness to the system, that the reason you are only taxed an amount is then your benefits are tied to the amount that you are contributing.

If you increase the wage base and increase the benefit, then what are the real benefits of doing so? I am not too sure that that solves it. If you just simply increase the wage base and say, we are going to tax higher-income workers 12.4 percent of every dollar they earn and expect no benefit in return, then I would argue that we have now turned Social Security from a system which has some relevance in that you pay in so much and you get out some sort of benefit into, in fact, a welfare system, and I think if you do that, I think you jeopardize the popularity of Social Security and the long-term future of it.

But I would be happy to hear your comments. David, if you want to go first——

Mr. LANGER. Yes. I think the answer to what you are saying, Senator, is that the benefits are skewed. Your tax rate is flat, so if you go from $68,000 to $100,000, as we do under Medicare, it is a flat amount. However, the benefits are skewed so that the lower-paid people get a larger proportion of benefits than the higher. Therefore, the higher you go in your wage base, you are providing a lower level of benefit but you have the same rate of contribution, so you get a surplus which, by the way will be applied against the deficit.

Mr. BEARD. One thing I would like to do, Senator, is just, as I have gone around the country, the biggest objection to the funded accounts is people say, but it is risky and you cannot promise the stock market always goes up and things like that. So let me just talk a little bit about the risk and what that means.

What it means to everybody here in the audience is, first, assume out of taxes you are already paying, $1,000 now goes into an account that you would own. It is very important, as Dr. Blume talks about, to have all sorts of safeguards.

First, from a government viewpoint, this has to be for retirement only, so it is a mandated savings plan. No one could take the money. They could not borrow against it. Even if they reach age 65, the answer is, you cannot say, "Wow, I have $300,000 in this account, I am going to buy a boat or I am going to go around the world," because you cannot spend through it. So your option would be to buy an annuity or live off the income. Because if people spent through it, then you go back to the government for Social Security. So the money needs to be safeguarded.

Now, will the market go up and down? Yes. Dr. Blume has rightly pointed out, there is no assumption that all this money gets invested in equities or on the stock market. There are bonds. There are all sorts of other investment opportunities. Dr. Blume has talked about very large, diversified portfolios. That is where you need to go.

You are investing this money over a 45-year period. If you were to join the workforce at the beginning of the Great Depression and do what we are talking about, you would do substantially better than under the current system. So yes, there are ups and downs, but over a 45-year period, your investment is going to go up.

Then people say, "Do not do this because nobody knows anything about investing stocks." My answer is, give them no choice. You choose. You could either stay in Social Security the old way or you choose to go to a system where part of your money would be in funded accounts. You can then choose from a government list of approved, not rip-your-socks-off bunch of bad charlatans, but solid American companies who have professional money managers. You choose the money manager.

Then my version is, people know nothing about investment, so it is like going to a doctor. You choose the doctor but you do not tell the doctor how to do the operation, and I would give no choice. That makes me in a minority view. Most people talk about a safe range of investment options. Some people talk about everybody. We would pick up the phone and on Monday we design their personal portfolio.

Mr. TANNER. Just one real quick answer to the question of people cannot make investment decisions for themselves. Federal employees do today. Federal employees belong to a Federal Thrift Savings Program. So your mailman today is investing his retirement funds privately, and I believe that the average American can do what the mailman can do.

Mr. LANGER. I would like to point out an irony here in this discussion and the confidence in the stock market, which is easy to have now, because if you are in stocks, you are doing extremely well.

In 1929, the market crashed. Everybody knows about the depression. The stock market was hit hard and the market kept going down and down and it severely affected people's ability to go out and buy things, and lo and behold, 25, 30, 35 percent of the population was unemployed or making very, very little, and there was a good deal of panic going on.

The solution was a Social Security program in 1935 which was non-market-oriented because people felt the need for safety. Now we have gone full circle. The same kind of thinking is now back and financial people are saying, let us have a market-oriented Social Security system, but that is what caused the need for a non-market-oriented system that we have today.

Mr. TANNER. Mr. Langer—can I ask him a quick question? I know, Senator, you have a bunch of questions there that you want to get to us. I just want to ask, because he just brought up, in 1929, the market crashed, and I agree. If you had a 1929-style crash, a private individual account system would be in trouble. As you also mentioned, unemployment was 35 percent in 1932. How do you make a payroll-tax-based system work when you have 35 percent unemployment?

Mr. LANGER. I do not really get the relationship.

Mr. TANNER. In other words, if you had the great depression again with 35 percent unemployment, a system as we have now based on payroll taxes would not work, either.

Mr. LANGER. Well, you are getting into economics, which is——

Senator SANTORUM. You were getting into economics, sir. I mean, that is a legitimate question. Everyone talks about the stock market crash as being a big problem. If we have a depression with 35 percent unemployment, how are we going to pay the payroll taxes to afford the system? Either way, a crash hurts both systems. So to say the crash is something we should be afraid of really does miss the boat. A crash with high unemployment or a crash with a big devaluation of the stock market, both affect the funding stream for whichever proposal you go after.

I just want to make a point. Now, I am not speaking for Michael here because Michael is for a gradual phase-out of Social Security completely and into personal accounts, but most of the proposals that you have seen on Capitol Hill do not do that. What I have advocated does not do that.

When you say, well, we are investing all of that money in it, what Mr. Beard is suggesting does not do that. What Dr. Blume has suggested does not do that. What the proposals put forward on a bipartisan basis do not do that. What they do is they say, take a portion of the money that is now spent in Social Security and invest it into personal savings accounts.

If you look at the history of the stock market since 1926, prior to the great depression, up until 1993, prior to the big run-up in the stock market, the average rate of return was in excess of 7 percent. Now, that is including the great depression.

So I guess my question is, if the government is going to be there, as I think every plan will say, to provide some sort of minimum guaranteed benefit as a backstop, what is the problem with taking a portion of that money and allowing people to generate income and wealth in personal savings accounts?

Mr. LANGER. I do not think there is anybody stopping them now. Anybody in this room can walk in, take 2 percent of their pay, and put it in.

Senator SANTORUM. No, no, no. They are taking 2 percent of the money that now goes to Social Security, and there are a lot of people stopping them from doing that right now. You are not allowed to do that. You have to pay that 12.4 percent to the government. If you do not, you get in lots of trouble and we handle a lot of cases like that.

Mr. LANGER. Are you talking about 2 percent out of the current contribution?

Senator SANTORUM. That is correct.

Mr. BEARD. Mr. Langer, if your family income was $8,000 a year and you were paying $1,000 a year in Social Security tax, think about it, your family income is $8,000, you have just paid $1,000 to Social Security, how much extra are you going to reach into your pocket and put into your 401(k)?

Mr. LANGER. I do not——

VOICE. What is 6 percent of $8,000? Come on.

Mr. BEARD. Half by the employer, half by the employee. Six and six is 12.

VOICE. That is what the person is putting out of his——

Mr. TANNER. It actually comes out of his salary because the employer's portion is six.

Mr. BEARD. It is not on assumption, it is by law.

Senator SANTORUM. It is the law. The employer has to withhold 12.4 percent total.

Mr. LANGER. I would like to say that I am very sympathetic to that point of view. I do not like to see low-income people having to put anything at all into Social Security, but I think it was necessary to do that. Otherwise, you are getting into a welfare system and people begin to attack it and the money coming in has to be voted on by Congress. You get a conservative Congress and they say, that is a welfare program, we do not want to put the money in. I think the original thinking was in order to help preserve the system, you have to tax everybody.

I do not disagree with what you are saying, though. However, a partial solution would be to raise the taxable wage base where you get the surplus coming in on monies contributed over $68,000 and use that toward it and not go back to the lower-paid people for additional money. I do not like that idea, either.

Mr. BEARD. I got into Social Security not because I am expert. My whole background has been economic opportunity. I had worked with Senator Robert Kennedy and I have worked all my life financing things in slums; I did a lot of work here in Philadelphia and all over the country, in rural Mississippi, just around the country.

One-third of all income comes from wealth. Let us think what I just said. There are two sources of income, and this is the land of opportunity. I go get a job and I get paid. Everybody knows, if I have some money, money makes money. Now, in this country, the bottom half of the country only has 2 percent of the wealth. So it is a great goal to try to, through taxes people are already paying—this is not a welfare program, through taxes people are already paying, to create a nation of savers.

I look at that $8,000 worker, and I will play with semantics here. That $8,000 worker is a staggering saver. If I earned $8,000 and I was setting $1,000 a year for my retirement, that is massive. If I am a $20,000 worker, I am setting aside $2,500 a year for my retirement. That is massive.

I like what Michael was saying. These systems were invented in the 1800's and we are heading into the 21st century. Let us not go back to the Pony Express. Let us allow the three-quarters of America that does not have 401(k)s or IRAs and take a part of the taxes they are already paying through their hard work and let us cut them into the growth of the economy. That is what we are saying, and I think it is pretty simple.

Senator SANTORUM. We can move on to the next question, then. A couple of comments were made with respect to other countries, and we have a question here about England and a comment was made about Chile and the concerns that those systems have not worked. Can you give some feedback as to what has gone on in other countries and whether there are lessons learned?

Mr. TANNER. Let me jump in first to mention that this is not just a few other countries, but almost all the rest of the world is now facing the same problems of demographics that we are and is now moving away from pay-as-you-go systems to systems based on savings and investment.

It is not just England, it is Australia under a Labor government. In South America, it is not just Chile, but it is Argentina, Peru, Colombia, Uruguay, Bolivia, El Salvador, Mexico. Venezuela this week is voting to do it.

In Eastern Europe, Poland, Hungary, Latvia, Kazakhstan, even in Communist China. President Clinton is out there right now. He ought to look at their social security system, where you are allowed to take half of your social security tax and put it into a privately invested account in Communist China.

Now, to mention the Chilean system, the Chilean system was put in place in 1981. They actually had the first social security system in the Western Hemisphere, started in 1925, 10 years before ours, and it just went broke a little bit earlier. In 1981, they went to a system based on individually, fully invested accounts.

Since that time, the payroll tax has come down from what was then about 18 percent to 10 percent today. The average retirement benefit is approximately three times higher than what it was under the previous system. The average rate of return on a gross basis has been 12 percent average since the system was—real basis, but a gross basis for administrative costs—has been 12 percent a year, on average, since 1981. Their savings rate, national savings rate, has now increased to 28 percent. The result has been that the real GDP growth in their country has now averaged 7 percent a year for the last 12 years, so that the entire economy is booming.

I should just mention, the program is so popular that there have now been three governments, three elected governments since the time that the government was put in and not one government has ever proposed changing a single portion of the basic underlying bill. The only change that was made, or two changes to the commission structure to get rid of some of the churning that has been going on in the commission structure.

Mr. LANGER. I would like to point out that the Chileans are now sweating deeply over the social security system. If you have been reading the Wall Street Journal the last few days, they are in terrible trouble and there is a lot of misinformation being passed out, and let me just seize on the rate of return, the so-called 12 percent. It is not that high to begin with.

In the last 3 years, they had 3.5 percent, minus 2.5 percent, and 4.8 percent, and it is going down very sharply. Furthermore, the 12 percent is not correctly calculated. It is calculated after taking out all the expenses. If you go to mutual funds and there is a 1-percent expense, your yield is reduced by 1 percent. In Chile, there is an average expense, I guess it might be around at least 10 percent.

Mr. TANNER. No, 1.2 percent.

Mr. LANGER. Well, excuse me. The rate as a proportion of the annual contribution is between 15 and 20 percent, and if you factor that in, you have to take off many percentage points off the top. Therefore, there is a lot of misinformation being passed out about Chile. The program is not working well and they are sweating right now. Their economy is in serious trouble because they have been unable to sell to Southeast Asia, which was one of their biggest customers. The government is trying very, very hard to succeed in restoring confidence in the Chilean economy.

Mr. TANNER. If I could just comment on the administrative cost issue, measuring as a percent of contributions is a nonsensical way to measure. It is actually about 10 percent of contributions, if people actually want to know that. But that is comparing apples and oranges.

When you have a mutual fund, you do not measure as a percentage of contributions. You measure as a percent of assets managed, because most of the money in your fund does not come from the money you have paid into the fund, it comes from the return on the investment that you have earned, and that is what you should compare your administrative costs to.

They are about 1.2 percent in Chile compared to a little under 1 percent in the United States, which is still too high, but you have to also remember, Chile invented this system out of whole cloth. They had no mutual fund industry. They had no 401(k) programs. All the actuarial work, all the computerization had to be done essentially from scratch, which led to very high administrative costs initially. They have been declining steadily year to year and they are down to about 1.2 percent today.

Mr. BEARD. People who are against the idea of any sort of a funded system talk about administrative costs. You hear people say 18 percent administrative costs, 4 percent administrative costs, and they say there is a plot by Wall Street to rip off unsuspecting grandmothers, all that stuff.

So I took it very seriously because I tend to favor people owning their own money, and if you do things like you say, OK, let us go to the State of Pennsylvania and they have a huge pension fund with hundreds of millions, probably billions of dollars in it, and then they go to the private sector money managers and they negotiate the fee. The fee is, like, one-tenth of a percent of the assets. When you go to the Federal retirement fund, and here is this large pool of Federal employees, the fees for an indexed fund is one-one-hundredth of 1 percent. People talk about 18 percent, 4 percent, 5 percent. It is completely crazy. It is just not right.

Now, if I pick up the phone and I call a private sector mutual fund today, the average fee is 1 percent, and it ranges from half of a percent to 3 percent. The average fee is 1 percent. But when we talk about creating large pools of money under a Social Security system where you have the large pool, the much better model is what happens with other large pools. There is now $7 trillion in the pension fund, and those administrative fees are one-tenth of 1 percent, shrinking to one-one-hundredth of a percent.

Mr. BLUME. The Financial Economists Roundtable debated this issue quite a bit and we were very concerned about a totally free market in investing these personal savings accounts in the sense that people would spend money on marketing, fees would go up, and we came to the conclusion that there would have to be a government board of some sort that would approve a limited number of options, and then we talked about how often you could change your often. If you only have $200 or $400 initially in your plan, you cannot do it very often. Maybe every couple of years, you could do it. But we discussed this. These are details. Once you get the basic idea that you are doing it, then you have to do it in a cheap way.

Mr. BEARD. The only reason I raise it is the people that do not want it use it as a whipping post and it is a fake whipping post.

Senator SANTORUM. Can I just ask two more quick questions? One is, the question here was, with all this money now from personal savings that is going into the market, will we not just balloon the market? The market will be overvalued. There will be too much money in the market.

Mr. TANNER. That is a very good question. I think you will find some disagreements up here on that. I would suggest a couple of things to look into on this.

One is, it is not as much money when it is spread across the entire market as you might think. We have a huge capital market in the United States, and if you allow international investment, as well, it becomes—we are talking about investments equal to maybe 1 percent of the world's capital market. Even if you would direct it entirely into the U.S. market, and, in fact, if you directed it entirely to the New York Stock Exchange, it would be equal to 22 minutes a day worth of trading on the New York Stock Exchange because that is how large our capital markets are. So that is one thing to bear in mind.

The second is that stock prices are not solely a product of supply and demand. They are also a product of what people believe the future earnings of various corporations and such are going to be. So you are not going to see, just because you put more money in, a tremendous change in stock valuation. In fact, they find that when you, for example, change stock indexes and require that people who own certain index funds go out and buy a particular company, the effect on stock prices is very marginal. It lasts less than 7 days because the other factors overwhelm those costs. So I think you need to put both of those factors in.

Finally, it is not a case of where all this money is going to suddenly be withdrawn on a particular day, when everybody is going to hit 65 and then we are all going to completely cash in every penny in our accounts and all the money is going to come rushing out of the stock market. What you are talking about is a very gradual sell-off as people keep some of this money throughout their entire life, and in some cases want to pass these accounts on to their heirs. So some of the money will not be withdrawn even within their lifetime.

Mr. LANGER. Social Security was intended to be a base, not full income, but one of the three stools, the bottommost layer to provide security. On top of that, companies offer plans, 401(k) and other plans. On top of that, you could save money.

I am totally in agreement with what everybody says here at the table about the virtues of an individual going out and investing in the stock market, but I do not think the government should get involved in forcing people to do this. It should be voluntary, and if you can get this great deal, the market will sell itself. People will want to go into mutual funds and buy. I do not see the need for compulsion.

Mr. BLUME. I have looked at the survey of consumer finances, which is a list of assets held by individual households. A large number of individual households hold no significant financial assets. A few hold a very large proportion.

It reminds me of the debate about IRAs. Do IRAs increase savings rates? Well, for the rich, they probably do not. Basically, you take your $2,000 from one pocket and put it into another and your total saving rates remain the same. So from the point of view of the wealthy people, it is not going to have much impact.

The people, however, who are not saving at all will start to save a little bit, and that is probably good to increase the savings rates in this country, and to be sure, they are going to put it into equities and bonds. That will drive up the price of equities. Rate of returns will go down on equities, and, therefore, what will the rich people do? They will take some money out of equities and move it back into bonds. So I am not concerned about that issue.

Mr. TANNER. If I could just respond to Mr. Langer's comment about the three-legged stool, when you are a poor person and you are paying 12.4 percent of your income into Social Security, you have got only one leg. It is compulsion now. People are being forced to pay 12.4 percent of their income, and I point out, three out of four Americans pay more in that payroll tax than Federal income tax. They are forced now to put that into a system that is going to lose them money. If you are going to keep the system balanced, that tax has to go up to about 18 percent. Then they are going to be forced to put 18 percent of their money into a system that is going to lose them money. Is it not better to let them have the opportunity to get into a system that might make them money?

Mr. BEARD. One of the things that—this is what got me into this in the first place.

Senator SANTORUM. These are the concluding comments. I am going to put a burden on you, Sam, here, to really close it well.

Mr. BEARD. I will make the following concluding comment. Senator, thank you for having us here. [Laughter.]

Senator SANTORUM. Go ahead and finish your comment.

Mr. BEARD. The point I want to make is, I am no fancy pants. I was asked to write a book and I wrote the whole book about creating a nation of savers and I was not into Social Security, not at all. Then the point was, look at a family earning $50,000. By the time they pay their taxes, look after their kids, one or two car payments, now the 401(k) guy comes around and says, why do you not set aside $2,000 a year into this 401(k)? Look at compound interest. And they laugh. Seventy-five percent of Americans are living from paycheck to paycheck.

If you live in the city of Philadelphia and your family income is $50,000, you are not—you are putting nothing in this 401(k). At $50,000, you are putting $6,000 a year aside into Social Security and you have no choice. So what we are saying is, save Social Security but start to change parts of it from defined benefit over to defined contribution and let us cut people into owning something.

Then the only point I would say to you is, you can pick whatever number you want. Maybe you think $50,000 is a little too high. But if I am a $30,000 family paying $4,000 a year in Social Security, I do not have any extra money.

Mr. LANGER. I am not unsympathetic to what you are saying.

Senator SANTORUM. Let me first thank the panelists again for being here and thank all of you for being here.

I think what you have heard today is obviously an honest debate to go forward on Social Security and what the problem is and what the potential solutions are. I, for one, agree with the majority of the panelists that I think we need to look at a personal savings component, and Sam did not talk about this very much, but I think one of the most compelling things is the opportunity that we will give lower-income individuals. He mentioned at the end, giving lower-income individuals the opportunity to save.

To me, Social Security is not a system that is there to benefit the wealthy. I mean, most people who are wealthy—I get calls from people who are wealthy who are upset that their Social Security check comes. I had a call just a few weeks ago from a gentleman who remarried, had a child, but he is now over the age of 65. His child is a dependent, and so his child gets a Social Security check. And he said, "I am embarrassed. I do not need any money to take care of my child." We called Social Security and we tried to give the check back and they will not take it. We said, "We really do not want this benefit." They said, "Too bad."

So the fact of the matter is that for most wealthy people, Social Security does not mean much to them. But to millions of Americans, lower- and middle-income, it means a lot and it is going to mean less because the benefits, if we keep the old system, are either going to go down or the taxes are going to go up dramatically and the impact of that on the working poor is going to be even worse because you increase the cost of labor and make their possibility for employment even worse.

I am hopeful that we can continue to build a consensus, that we need to look outside of the box of just increasing taxes and cutting benefits to fix Social Security, and if we do that, and I think there is plenty of discussion as to how we structure it, how we pay for it, and do so in a way that can be bipartisan because this can only go forward with a bipartisan discussion.

Again, I want to thank St. Joseph's for sponsoring and giving us an opportunity to hold this hearing here on campus. I thank the Aging Committee and Senator Grassley for the opportunity to come and put this hearing together. Thank you all very much.

We are adjourned.

[Whereupon, at 11:35 a.m., the committee was adjourned.]

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