FIFTH IN A SERIES OF SUBCOMMITTEE HEARINGS ON PROTECTING AND STRENGTHENING SOCIAL SECURITY

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

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U.S. HOUSE OF REPRESENTATIVES

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FIFTH IN A SERIES OF SUBCOMMITTEE HEARINGS ON PROTECTING AND STRENGTHENING SOCIAL SECURITY

TUESDAY, JUNE 14, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:06 p.m., in room B-318, Rayburn House Office Building, Hon. Jim McCrery (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE
June 07, 2005
No. SS–5

CONTACT: (202) 225–9263

McCrery Announces Fifth in a Series of Subcommittee Hearings on Protecting and Strengthening Social Security

Congressman Jim McCrery (R–LA), Chairman on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold the fifth in a series of Subcommittee hearings on protecting and strengthening Social Security. The hearing will examine the impact of the American population's increasing longevity on Social Security's finances and explore ways to encourage work at older ages. **The hearing will take place on Tuesday, June 15, 2005, in room B–318 Rayburn House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Seventy-eight million Baby Boomers are heading toward retirement and eligibility for Social Security benefits. Those Baby Boomers and the generations that follow are living longer in retirement. Life expectancy at age 65 has increased from about 14 years in 1940, to 18 years today, and will increase to 22 years over subsequent decades. In addition, American families are having fewer children, so the number of workers paying Social Security taxes to support the program isgrowing much more slowly than the number of beneficiaries.

These demographic trends have put Social Security's finances on an unsustainable path, because Social Security operates on a pay-as-you-go-basis; Social Security taxes paid by today's workers fund the benefits of today's retirees. As the population ages, the number of workers supporting each beneficiary is falling—from 16 to 1 in 1950, to about 3 to 1 today, and it will reach 2 to 1 by 2040. As a result, Social Security's Trustees estimate that in 2017, Social Security will pay out more in benefits than it collects from payroll taxes, and that by the time today's 26-year-olds are eligible to retire in 2041, Social Security's trust funds will be exhausted. Then, unless changes are made, revenues would cover 74 percent of promised benefits. As costs continue to rise faster than income, 68 percent of scheduled benefits are expected to be payable by 2079.

Bipartisan councils and commissions, as well as many individual experts and policymakers, have laid out options for modifying Social Security to mitigate the effect of these demographic changes and to encourage older Americans who want to continue working to do so.

In announcing the hearing, Chairman McCrery stated, "Our aging society creates both challenges and opportunities for our Nation. As we explore how to improve retirement security and protect and strengthen Social Security, we need to understand the impact of upcoming changes in our population."

FOCUS OF THE HEARING:

The hearing will focus on the impact of America's aging population on Social Security's finances, as well as options to strengthen Social Security, improve overall retirement security, and encourage individuals who want to work at older ages.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Tuesday, June 28, 2005. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman MCCRERY. The hearing will come to order. Good afternoon, everyone. Welcome to the fifth in the Subcommittee hearing series on protecting and strengthening Social Security. Today we will learn more about how our society is growing older, and how this trend will impact Social Security's finances. Each new cohort of seniors is living longer and living healthier. As everyone

in this room either is, or expects to be a senior, that is very good news for all of us.

However, our increased life expectancy has implications for many aspects of society, including Social Security. The Social Security actuaries predict that the number of workers will grow more slowly than the number of beneficiaries. While 3.3 workers support each Social Security beneficiary today, only two workers are expected to support each beneficiary by 2040. This is an important statistic because Social Security is a pay-as-you-go system. The Social Security contributions of current workers pay for the benefits of current retirees. Along with Social Security, our aging problem has implications for our labor force. We all know that older workers can make valuable contributions to our economy and society. One question we will address today is how Social Security can be modernized to help, not hinder people who choose to work in their senior years. Eyewitnesses will share their insights into America's future. As responsible policymakers we need to look ahead, as the policy choices we make today will have a major role in shaping that future. I welcome our distinguished panel. Thank you for coming today. I look forward to hearing your views. I would ask the Ranking Member, Mr. Levin, if he would like to make an opening statement?

Mr. LEVIN. Thank you very much, and I join in welcoming all of you. A few of you have been at this table or another, but for others it is your first visit, so a special welcome. Today's hearing is to discuss a piece of very good news, that Americans are living longer now and are expected to live even longer in the future, and to discuss its impact on Social Security, which provides retirees with guaranteed benefits no matter how long they live. Some of my colleagues may suggest that the main answer to this challenge is to raise the normal retirement age, the age at which one can retire and collect full Social Security benefits. Currently that age is rising, as we know, to 67. Workers are allowed to retire as early as 62, but if they retire before normal retirement age, their benefits are reduced.

As our population ages, it is important to ensure that older adults are protected from discrimination, and allowed to work as long as they choose, both to reduce pressure on our retirement systems, and to ensure that we fully benefit from their experience and talent. Many people, however, do not have the luxury of choosing their retirement age. Their decisions are dictated by their health, their employers, and other factors outside of their control. As a result—at least one result—the experience to date has been that increasing the Social Security retirement age, rather than making it possible for people to work longer, forces them to take reduced benefits when they retire. Accordingly, the burden of proof is on those who would further raise their retirement ago to show that it would have the desired impact.

This is particularly true, in our judgment, for those who support President Bush's proposal to privatize Social Security by diverting trillions of dollars to private accounts. Those accounts alone would make Social Security's shortfall worse, potentially forcing much more draconian benefit cuts, whether via retirement age increases or other changes. The massive borrowing proposed by the President, nearly $5 trillion in the first 20 years of accounts alone, will

also make it more difficult for us to prepare Medicare and Medicaid to provide the health care and long-term care we know future retirees will need.

Our longer lives do pose a challenge for Social Security, but they also make preserving Social Security's current structure all the more important. Its guaranteed defined benefit, which rises with inflation and cannot be outlived, ensures that long-lived retirees do not end up in poverty. Private pensions, retirement savings, and investment accounts do not have these protections. Social Security's benefits account for a larger and larger share of retirement income as people age.

The President has proposed that we privatize Social Security, over time replacing its guaranteed benefits with risky private accounts. This change is particularly risky as we live longer, since the income from the accounts is not guaranteed and the private annuities the President's plan requires people to buy from insurance companies would likely not be fully protected against inflation, leaving people to grow poorer and poorer as they age. They also could not offer the same level of protections for spouses and survivors, who are also living longer, as Social Security does today. The American people have spoken very clearly about the privatization proposals. The more they hear about them, the less they like them. I do believe we should discuss ways to ensure that workers have long and productive careers, both to support our retirement systems and to support our economy. Unfortunately, the President's insistence on private accounts remains a roadblock in the way of our ability to craft bipartisan legislation to address the shortfall in 2041 or 2052. Thank you, Mr. Chairman.

Chairman MCCRERY. Thank you, Mr. Levin. We are pleased to have a very distinguished panel to share their views with us today. Steven A. Nyce, Senior Research Associate from Watson Wyatt Worldwide; Thomas L. Steinmeier, Department of Economics and Geography at Texas Tech University in Lubbock, Texas; Gene Steuerle, Senior Fellow at the Urban Institute; Ron Gebhardtsbauer, Senior Pension Fellow, American Academy of Actuaries. Did I get that right? Okay. Valerie Long, who is here today in her own right as the President of the Service Employees International Union, Local 82, and the International Vice President of the International Executive Board. She is also here on behalf of Gerald Hudson. Mr. Hudson could not make it today. He is the Executive Vice President of Service Employees International Union. So, Ms. Long, thank you for making the effort to be here to replace Mr. Hudson. And Maya MacGuineas, Senior Fellow at the New American Foundation. Welcome to all of you. We look forward to your testimony. You have submitted written testimony which will be inserted in the record in its entirety. We would ask you to try to summarize that testimony in about five minutes. Dr. Nyce, we are going to let you start it off. You may proceed.

STATEMENT OF STEVEN A. NYCE, PH.D., SENIOR RESEARCH ASSOCIATE, WATSON WYATT WORLDWIDE

Mr. NYCE. Mr. Chairman and distinguished Committee Members, thank you for the opportunity to be here before you today to discuss the challenges of our aging population. My name is Steve

Nyce, and I am a senior Research Associate at the Research and Information Center at Watson Wyatt Worldwide. As a firm we have long been engaged in research concerning the aging of the U.S. work force and its implications for our retirement system. As we think about how our aging population will affect the financing of our pay-as-you-go retirement plan, it is generally considered in terms of the payroll tax rate required to sustain it. The tax rate required to support the system is the product of two very important ratios, the ratio of beneficiaries relative to workers, or the dependency ratio, and the ratio of average benefits to average covered earnings, or the replacement rate. The future financial problems with the system are almost entirely tied to the dependency ratio which is expected to increase significantly in the coming decades. Today there are roughly 3 beneficiaries for every 10 workers. By 2040, that ratio will rise to one beneficiary for every two workers. While this may not seem like a significant increase, it is because of these demographic changes that the Social Security actuaries are projecting program costs to increase by over 50 percent over the coming decades.

Much of the discussion around the challenges we face due to our aging society has revolved around retirement policy. The debate has centered on figuring out ways within the framework of our current budgets to honor those promises we made decades ago. However, the issues related to population aging and its economic impact go beyond simply keeping the elderly out of poverty. Instead, the issue is of stagnant or falling standards of living that could affect all segments of our society. In very simple terms, the amount of output an economy can create is determined by the number of workers and the efficiency with which output is produced. In more formal terms, the rate at which Gross Domestic Product (GDP) grows essentially equals the sum of labor force growth plus worker productivity growth.

The United States has historically enjoyed steady economic growth and improvements in standards of living. By many accounts, the steady improvement in the standards of living over the last half century has created an appetite for continued upward mobility. In this context, the challenge with our aging population is that the future simply will not see the labor force growth of the past 30 years or so. Over the coming decade the labor force growth will be only about 75 percent of that seen during the nineties, and the growth rate projected for the 2010s will be only about one-third that experienced over the past decade. So, if we want to continue to enjoy standards of living growth similar to those we have become accustomed to, and the demographics indicate slower rates of labor force growth, we are going to need a significant uptake in productivity growth to make that happen.

So, herein lies the crux of the aging problem. If we find that we are unable to fix our problems by boosting labor supply growth or achieving higher rates of worker efficiency, the future portends slower rates of improvements in standards of living. Retirement programs will simply become a primary mechanism used to allocate our disappointing outcome across various segments of our society. The critical question we face today is how do we share this burden

across our society? More importantly, how do we share this burden between generations?

The fiscal challenges we face in the future are not all fixable through our Social Security system. However, there are a number of measures that can be taken. Encouraging greater work force participation at older ages is one of the most important avenues we should consider. Some of the most valuable human capital assets in our economy are the seasoned and educated workers in their fifties and sixties. Some avenues we may consider are raising the early and normal retirement ages, eliminating the earnings test, increasing the back-loading of benefits, and improving public awareness about the embedded incentives in these programs. Each of these measures has the potential to realign our system, and thus our expectations about retirement ages and benefit levels, to the pace of improvements and life expectancy. These measures have the potential to reduce the number of retirees, thus lessening the burden of retiree dependency. The increased number of workers would also increase total output, giving policymakers more flexibility in redesigning retirement programs. So, workers could realize the fruits of their improved productivity without having to drive the retiree population into poverty. As noted earlier, it is more than just about increasing work at older ages. It is about finding ways to boost work force participation among all individuals, and about adopting policies to enhance worker efficiency. Only by doing so will we be able to satisfy the wants and needs of our population for generations to come. Thank you, Mr. Chairman.

[The prepared statement of Dr. Nyce follows:]

Statement of Steven A. Nyce, Ph.D., Senior Research Associate, Watson Wyatt Worldwide

Mr. Chairman and members of the Subcommittee on Social Security of the Ways and Means Committee of the U.S. House of Representatives, thank you very much for the opportunity to testify to you today about the challenges of our aging population. My name is Steve Nyce, and I am a senior research associate at the Research and Information Center of Watson Wyatt Worldwide. As a firm, we have long been engaged in research concerning the aging of the U.S. workforce and its implications for our retirement system. Recently, my co-author, Syl Schieber, and I have published an extensive analysis of the economic challenges that all developed societies will encounter due to their aging populations entitled, "The Economic Implications of Aging Societies: The Costs of Living Happily Ever After". I am very pleased to be here today, and all the views expressed here are my own, and should not be attributed to Watson Wyatt Worldwide.

Aging in the Context of Social Security [1]

Since the mid-1950's, Social Security has been primarily operated on a pay-go basis. In the most basic sense, this means that contributions paid into the system are immediately paid out as benefits. However, most of these programs are not run as a pure pay-go basis. In practice, policy makers generally utilize a small contingency trust fund as a leveling device to sustain operations over variations in benefits and revenues across economic cycles.

The "cost" of a pay-go retirement plan is generally considered in terms of the payroll tax rate required to sustain it. The tax rate required to support the system is the product of the number of beneficiaries relative to workers multiplied by the ratio of average benefits to average covered earnings. The ratio of beneficiaries to workers is called the dependency ratio—the number of retirees dependent on benefits relative to the number of workers supporting them. The ratio of benefits to wages in a retirement plan is called the replacement rate—how much of an average worker's

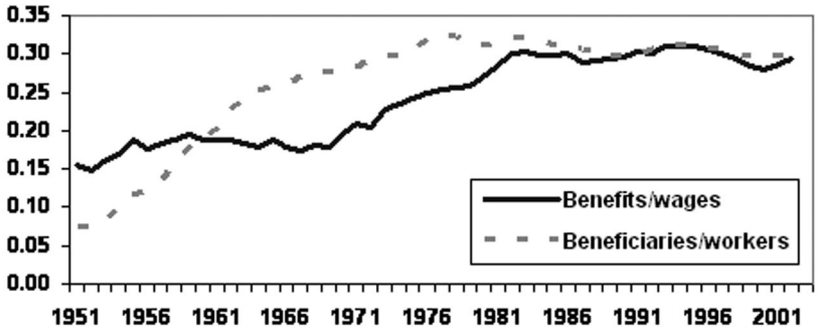
[1] For further discussion see Sylvester Schieber's, "Social Security Reform," *Watson Wyatt Insider*: Special Edition, March 2005, pp. 42–51.

earnings are replaced by the retirement benefit. The reason why population aging sets off alarms is clear from the dependency ratio measure in the costing of the program. As the ratio of pension beneficiaries to contributors rises under these plans, the cost of a given replacement rate rises proportionately.

By now, most Americans are aware that our population is aging. As such, expectations are for a significant increase in old age dependency ratios in the coming decades. But the way demographics will affect costs in the future will be very different than it was over the last half century. Figure 1 maps the dependency ratio and the replacement rate under the system. First, the dotted line shows the dependency ratio. Between 1951 and 1977 the ratio of beneficiaries to covered workers rose from roughly 7 percent to over 32 percent, respectively. Certainly changing demographics, notably advancements in life expectancy, played a part. But most of the change was attributable to the way we phased in the program. In the program's early years, very few people over age 65 received benefits because they had not paid payroll taxes during their working careers. Initially, payroll taxes were levied on all wage and salary workers in the private sector—roughly 60 percent of the workforce in the 1930s. Over the years, coverage was gradually expanded to include farmers and the self-employed, professionals and domestic workers, and state and local government workers on a voluntary basis. The final sizeable expansion of coverage was the addition of newly hired federal civilian workers. It was not until the mid-1970s that the program actually matured. It was at that point that the percentage of people over 65 who were receiving benefits equaled the percentage of the active workforce contributing to the program. Since that point, the dependency ratio has remained relatively stable reflecting the maturing of the system.

Figure 1

Historical Retiree to Worker Dependency Ratios and Average Benefit to Average Wage Ratios in the U.S. Social Security Program



Source: Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin,* various years; and Office of the Actuary, Social Security Administration.

The solid line in the graph represents the ratio of average benefits to average wages. Over much of the 1950s and 1960s, the replacement rate under the Social Security program was relatively constant at about 18 percent. However, in the late 1960s the concern about poverty led Congress to expand the program. This expansion continued through much of the 1970s until the 1977 and 1983 amendments were implemented to stabilize the program. In fact, the rapid rise in the replacement rate in the 1970s created a string of deficits that had people talking for the first time about the system literally running out of money.[2] When all was said and done, average benefits to average wages rose by nearly two-thirds over this period. Since its peak, program costs have been relatively flat and have remained that way for most of the last two decades. Expectations are for costs to remain stable for the

[2] Schieber, Sylvester J., John B. Shoven, *The Real Deal*, (New Haven: Yale University Press, 1999), pp. 185.

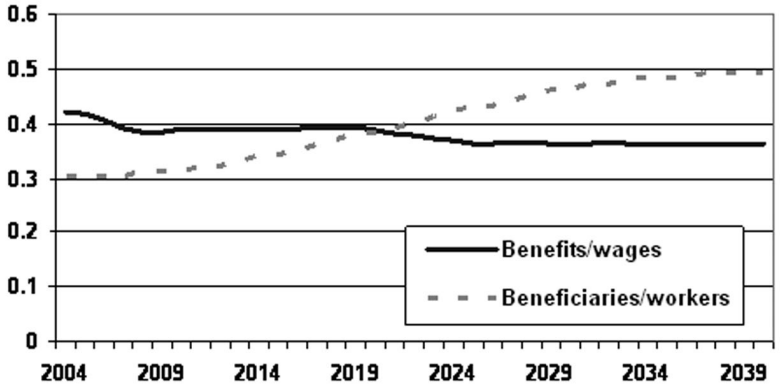
next few years until the Baby Boomers begin to retire at the end of the current decade.

Looking to the future, we see in Figure 2 that the coming challenge in a mature system will be the rising rate of beneficiaries. This picture extends the series in Figure 1 using projections by the Social Security actuaries for the dependency ratio and the replacement rate. It is important to note that the ratio of benefits to wages in this picture is for the medium-earning worker who retires at age 65. This is different from the previous picture which showed the ratio of benefits to wages for all beneficiaries, including dependents and survivors who receive somewhat smaller benefits.

Over the next forty years or so the ratio of benefits to wages will remain relatively flat. The subtle decline in the average-worker's replacement reflects the rising age of normal retirement and the reduced benefits for an individual retiring at age 65. The dependency ratio, however, is much more important in terms of its long-term implications. As the leading edge of the baby boom begins to exit the workforce starting in 2008, the dependency rate will begin a long sustained rise projected to last the next thirty years. Today, there are roughly three beneficiaries for every ten workers. By 2040, that ratio will fall to one beneficiary per every two workers. While this may not seem like a significant increase, Social Security actuaries are projecting the cost rate of the program to climb from 11% to about 18% over this period.

Figure 2

Projected Retiree to Worker Dependency Ratios and Benefit to Wage Ratios for Hypothetical Medium Wage Workerrs Retiring at Age 65 in the U.S. Social Security Program



Source: Office of the Actuary, Social Security Administration.

A comparison between the two figures clearly shows that the financial dilemma facing Social Security today is of very different makeup from the earlier one. The financial dilemma we faced in the 1970s was almost entirely the result of economic factors and problems with the benefits formula. Over the 1970s, the ratio of average benefits to wages increased nearly 40 percent compared to a 13 percent increase in the dependency ratio. As such, the earlier crisis was about the replacement rate. Once those problems were addressed and the program reached maturity in the 1980s, costs have remained relatively flat. The future financial problems are almost entirely tied to the dependency ratio. It is because of these demographic changes for the coming quarter century or so that the Social Security actuaries are projecting program costs to increase by over 50 percent over the coming decades.

Aging Considerations in a Larger Economic Context

Much of the discussion around the challenges we face due to our aging society has revolved around retirement policy. The debate has centered on figuring out ways within the framework of our current budgets to honor those promises we made decades ago. However, the issues related to population aging and its economic impact

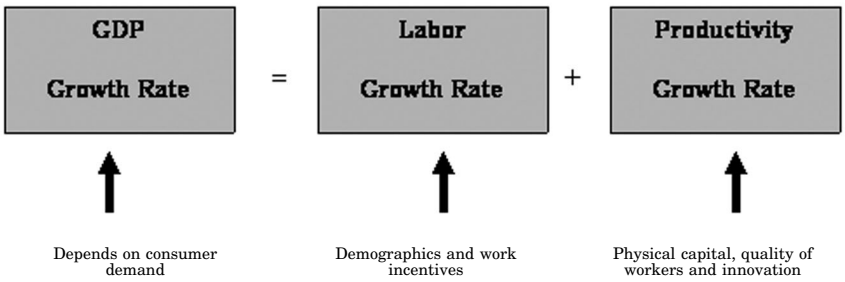
goes beyond simply keeping the elderly out of poverty. Instead, the issue is of stagnant or falling standards of living that could affect all segments of our society. If economic growth is brought to a halt by the changing demographic composition, pension policy is naturally one of the primary mechanisms for allocating the disappointing outcome across various segments of our society. It is within this context that much of the angst over pension policy in the developed world is framed today.

The challenges before Congress are much broader than that of Social Security reform. They are fundamentally about figuring out how to satisfy the wants and desires of our population. With the first of the Baby Boomers less than a decade from reaching the normal retirement age under Social Security, we are now faced with the prospect of not being able to do that. To better understand the effect of aging in a broader economic context, it's useful to revisit the underlying factors that determine growth within an economy.

A fundamental dynamic in every economy is the interplay between consumer demand for goods and services and society's ability to meet that demand. From the earliest systematic study of economic behavior, economists have sought to explain the production of output in terms of its inputs. While there is no universal agreement on the mathematical formulation of the model, it is well understood that the basic building blocks of economic prosperity are determined by the number of workers and the efficiency with which output is produced. Although economists often employ complex terminology in their descriptions, at a fundamental level, economies operate in a very simple fashion. The rate at which gross domestic product (GDP) grows essentially equals the sum of labor force growth plus worker productivity growth (See Figure 3).

Figure 3

Operations of the Macro Eonomy and Why Demographics Matter



The United States has historically enjoyed steady economic growth and improvements in living standards. One measure of growing consumer demand is the GDP per capita, a reasonably good measure of the standard of living over time. By this measure, the United States has historically shown continued improvement—that is, the demand for goods and services has steadily outpaced population growth (see Table 1). People have generally been willing to drastically change their lifestyles in order to improve their standard of living. Faltering economic progress has usually also meant political pressure for our elected leaders to restart the growth process to settle a restive citizenry. This remarkable economic success story has been helped along by improved health and education systems, new and better physical infrastructure, technology, and the relatively strong cross-national cooperation that our governments have been able to establish and maintain. One cannot ignore, however, the role that growing labor forces have played in this prosperity.

By many accounts, the steady improvement in the standards of living over the last half century has created an appetite for continued upward mobility. Expectations of future levels of U.S. output herald continuing improvement in standards of living over the next two decades. Based on Congressional Budget Office (CBO) estimates, annual real per capita GDP growth is projected to be roughly 2.0 percent over the remainder of this decade, which is consistent with historical patterns. From 2010 to 2020, the growth in GDP per person is anticipated to slow to roughly 1.66 percent per year, which again is roughly in line with the past.

Table 1: Population and Output Measures in the United States for Selected Periods and Expectations for the Future

	Annualized GDP growth rate from prior date (percent)	GDP per capita in 2000 dollars	Annualized growth rate in per capita GDP from prior date (percent)
1950		$11,669.73	
1960	3.48	13,845.05	1.72
1970	4.19	18,390.54	2.88
1980	3.19	22,658.91	2.11
1990	3.26	28,507.01	2.32
2000	3.28	35,659.28	2.26
2010	2.87	43,449.48	2.00
2020	2.48	51,237.00	1.66

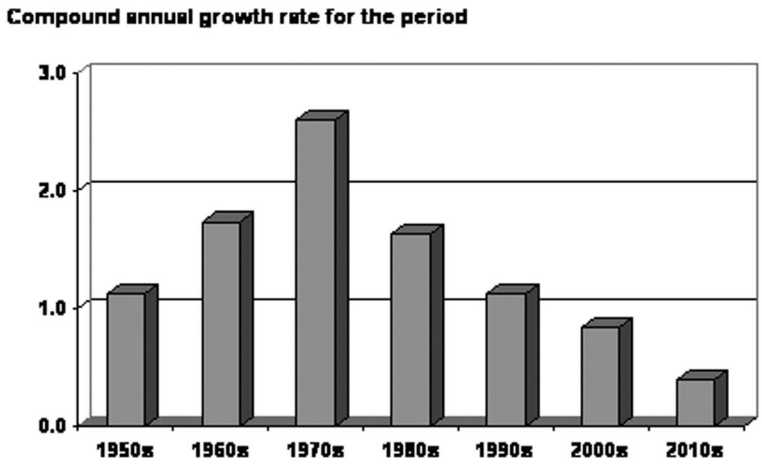
Sources: Congressional Budget Office; Census Bureau; and U.S. Department of Commerce, Bureau of Economic Analysis.

How are we going to meet those expectations? The corollary to rising dependency rates shown in Figure 2 is that the future simply will not see the labor force growth of the past 30 or so years. Over the coming decade labor force growth will be only about 75 percent of that seen during the 1990s, and the growth rate projected for the 2010s will be only about one-third that experienced over the past decade (see Figure 4). This is not idle conjecture—most of the people who will make up our workforce over the next 20 years are already alive. We know a lot about working patterns, when people usually retire, and how long they are likely to live. While some of these patterns may change slightly over time, they are not likely to change drastically over the near future.

So if we want to continue to enjoy standards of living growth similar to those in the past and given our expectations are as much and demographics indicate slower rates of labor force growth, the critical question is whether we will have enough productivity growth to make this work? Looking again to our most recent history, productivity grew by 2.66 percent per year during the 1950s and 1960s and then slowed. In fact, the average annual growth in productivity over the last three decades was a modest 1.5 percent. However, recent years have witnessed a resurgence in productivity growth, averaging roughly 2.1 percent per year during the last half of the 1990s and over 2.3 percent in 2002 and 2003.

Figure 4

U.S. Civilian Labor Force Growth Rates for Selected Decades



Sources: Lofgren, Eric P., Steven A. Nyce and Sylvester J. Schieber. (2003). "Designing Total Reward Programs for Tight Labor Markets." *Benefits for the Workplace of the Future*, eds. Olivia S. Mitchell, David S. Blitzstein, Michael Gordon and Judith F. Mazo, Pension Research Council of The WhartonSchool, University of Pennsylvania, Philadelphia, March.

Using the CBO's estimates of GDP growth over the coming decade with our estimates of labor supply growth, it is relatively straight forward to solve for productivity growth rates needed to meet our expectations over the coming decade. The bottom line is that for us to continue to experience rising standards of living like those we've become accustomed to, we are going to need a significant rise in productivity growth. In fact, we will need to maintain productivity growth of near 2.5 percent for this entire decade to achieve the growth we desire. This is a significant divergence from that of the last three decades, which averaged roughly 1.5 percent. If we extend our projection period to the end of the second decade, the required rate of productivity growth needed to meet our desired rates of economic growth is 2.2 percent. The lower rate reflects the CBO's anticipated slowdown in economic growth over the 2010s—in part reflecting the demographic challenges ahead. While we have seen rising rates of productivity growth in our near term here in the US, the question is whether these are sustainable.

So here in lies the crux of the aging problem. If we find that we are unable to fix our problems by boosting labor supply growth or achieving higher rates of worker efficiency, the future portends slower rates of improvements in standards of living. Retirement programs will simply become a mechanism we use to allocate our economic disappointment. The critical question we face today is how do we share this burden across our society? More importantly, how do we share this burden between generations?

In the most basic sense, there are two possible options to achieve solvency under a pay-go financed system—raise taxes or reduce benefits. The worry that our current retirement systems will demand taxes that are too high articulates a concern that workers' disposable income levels will fall or not keep appreciably abreast of improving worker productivity. If that happens, then workers will be producing more but receiving less, in that their productivity will not purchase the same increase in standards of living enjoyed by their parents. The worry that pension benefits will have to be reduced articulates the concern that retirees' disposable income levels will fall, potentially leaving future generations of our elderly more vulnerable to income insecurity.

Whatever course we choose, we must understand that the problems with a pay-go financed Social Security system are not just financial. If we limit our solutions

of the financing dilemma to tax increases of the active workers or the reduction of retiree benefits to achieve solvency, we may very well create a host of inefficiencies in our labor and capital markets that ultimately impede economic growth. Changes in the fundamentals of the system have been shown to have adverse effects on key demographic factors, private savings and long-term growth rates. Notably, recent research has shown that increases in payroll taxes are associated with declines in net marriage rates and total fertility rates.[3]

But the adverse effects of high payroll tax burdens on labor markets are not limited to workers. Payroll taxes are shared between both employers and employees. As the burden rate rises, employers may react to these higher costs creating its own set of economic problems. For example, in a number of EU countries with expensive social programs, the persistently high rates of unemployment largely result from the high fixed costs of hiring workers. Also higher employer taxes on labor may depress real wage growth, thus passing the rising costs of social insurance programs onto workers, which has occurred in several developed economies over the last few decades. While our demographic and economic outlook is much more favorable than many other developed societies, it is important that we do not become complacent with our own situation. If we do, there is concern we could fall into the same trap that countries like Germany and Japan are in today.

The Challenges Ahead

The basic structure and the myriad of rules that make up our retirement system here in the U.S. has entrenched into our culture expectations about the age we can retire, how much income we should receive and about the basic lifestyle we can expect to lead during the remaining years of our lives. Our most fundamental challenge is figuring out how to adjust these expectations to encourage greater workforce participation, longer working careers and greater labor market efficiency. The fact is our current system has not adapted rapidly enough to our changing demographic realties where surplus labor is a thing of the past.

The fiscal challenges we face today are not all fixable through our Social Security system. However, there are a number of measures that can be taken. Since the focus of our discussion today is about ways to encourage greater workforce participation at older ages I will limit my comments to those measures. Some of the most valuable human capital assets in our economy are the seasoned and educated workers in their 50s and 60s. Keeping workers in the labor market longer would reduce the number of retirees, thus ameliorating the effect of retiree dependency. The increased number of workers would also increase total output, giving policymakers more flexibility in redesigning retirement programs, so workers could realize the fruits of their improved productivity without having to drive the retiree population into poverty.

Raise the early and normal retirement ages

When Ida May Fuller first received her check in January of 1940, her life expectancy at that point was 14.7 years. Today, an individual retiring at 65 is expected to live on average another 19.6 years. But when Ida May Fuller retired, the typical worker did so at age 65 or later; today, workers claim Social Security benefits at age 62 more than any other age. The fact that people are living longer is essentially a very good thing. But the fact is our system has not adjusted retirement ages and benefit levels to keep pace with improvements in life expectancy. The result has been increasingly longer retirement periods with greater lifetime benefits. The modernization of production techniques in manufacturing and the shift toward service-oriented work have reduced the strenuous nature of work for most people. If work is becoming less strenuous and people's ability to do it is improving, does it makes sense to continue to subsidize longer retirement periods when many individuals are still able to be productive?

For all practical purposes, raising the retirement age is a benefit cut. But compared to other proposals that reduce benefits, the lifetime benefit for those that delay retirement would be higher due to the additional revenues from working longer. A concern of allowing individuals to take benefits at a reduced rate at the early retirement age is that it may result in greater numbers of individuals with inadequate income to meet their needs throughout retirement. Moreover, the system would benefit from the additional revenues as well as a reduction in the number of beneficiaries.

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[3] Ehrlich, Isaac and Jinyoung Kim, "Social Security, Demographic Trends, and Economic Growth: Theory and Evidence from the International Experience," *National Bureau of Economic Research* Working Paper No. 11121, February 2005.

The concern is that this approach does not account for those individuals with shorter expected lifespans. To account for these groups who typically have lower lifetime income through separate provisions makes more sense than continuing to subsidize ever-longer retirement periods.

Eliminate all earnings tests

Under the original earnings test, Social Security benefits for those with earnings above a certain threshold would lose part or all of their benefits in the year of their earnings. This essentially imposed an additional tax on earnings for beneficiaries creating a disincentive to work. However, the Senior Citizens Freedom to Work Act of 2000 eliminated the earnings test for Social Security beneficiaries who have reached the full retirement age. Given the number of years since its repeal, it is now possible to study its effect on labor force participation of those 65 to 69. A recent analysis provided by the Social Security Administration indicates that it has had favorable effects at encouraging higher earnings for some workers and at increasing workforce participation, albeit slightly.[4] Prior to its repeal, earnings for individuals 65 to 69 clustered around the earnings test threshold. Eliminating the test shifted the percentage of workers in this age group above the earnings threshold, indicating an increased use of earnings to supplement Social Security benefits at older ages.

The repeal of the earnings test for those between early and full retirement would likely have a similar effect on the decision of individuals to delay entry into full retirement. This would occur despite the benefit increases being actuarially fair. In fact, recent research that simulated the potential effect of the this repeal and shows a four percentage point per year reduction in the percentage retired from full time work.[5]

Moreover, eliminating the earnings test for those between early and full retirement may also lead to an even greater effect on workforce participation among those above the full retirement age. To the extent that the earnings test creates disincentives to work for those between 62 and full retirement, the workforce effects of the existing earnings test repeal does not account for the difficulty in increasing work intensity once an individual has scaled back or even outright left the labor market.

Increase the back loading of benefits

It is very common in the private pension system for employers to design their pension programs to provide low levels of benefits for short tenured younger workers and to pay a much more generous benefit for those with longer tenure. This sort of accrual structure of a defined benefit plan can create significant incentives for workers to stay with their existing employer throughout their careers. The fact that claims on the current Social Security system cluster around the early and normal retirement ages indicates a low response by individuals to the delayed retirement credits. Tilting the accrual structure so that older workers receive increasingly higher benefit payouts would create much greater incentives for individuals to delay claims and remain in the workplace. This adjustment can very sensibly be accomplished without increasing the cost burden on the system.

Disability Program

Discussion of the disability program has often escaped the same level of scrutiny that the retirement program has received—in part because the DI program is much smaller than OASI. But over the last two decades the liberalization of the DI system has lead to over a 4.5 percent annual increase in covered beneficiaries. Part of the problem is that the definition of "disability" may appear to be a reasonably objective determination, but in practice it is very difficult to determine whether or not an individual is capable of "substantial gainful activity". As work in this country becomes increasingly less physically demanding in our "knowledge economy", it might be useful to rethink not only how disability is defined but also how this definition is implemented. While many individuals currently receiving DI benefits are rightful candidates for who the program was designed to insure, there are a number of others within the system that maintain the skills and capabilities to be a productive resource in our economy.

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[4] Manchester, Joyce and Jae Song, "New Evidence on Earnings and Benefit Claims Following the Removal of the Retirement Earnings Test in 2000," Presentation at the Tax Economists Forum, Wednesday, June 8, 2005.

[5] Gustman, Alan L. and Thomas L. Steinmeier, "The Social Security Retirement Earnings Test, Retirement and Benefit Claiming," *National Bureau of Economic Research* Working Paper, No. 10905, November, 2004.

Campaign for improved public awareness

One of the greatest challenges that is often overlooked in our retirement system today is the lack of understanding among workers about their retirement benefits. Studies repeatedly find that workers fail to understand the value of the benefits they will receive, age at which they can receive benefits and the risks associated with their retirement decision. This problem is not isolated to our Social Security system; it is widespread throughout the private sector as well. Recent research by Watson Wyatt shows that one out of three workers does not even recognize that their employer offers a defined benefit plan. If workers do not understand the provisions of their retirement program, it is highly unlikely they will respond to the financial incentives imbedded in the plan. If we hope to fundamentally change workforce behavior of older individuals through a myriad of adjustments in the current program, it is critical that we engage people in the process and take measured steps to increasing individual's understanding. A generous communication campaign around these reforms is an effective way to better equip individuals to make informed decisions.

CONCLUDING REMARKS

In many regards, the financial challenges we face in the future with our Social Security program are minor relative to those in other developed nations. This is largely the result of favorable fertility rates and a high propensity of both men and women to work at all ages. However, by no means does this portend an easy road ahead. When the baby boomers begin to retire as early as 2008, the demographic forces will become highly unfavorable for a pay-go financed system making the need for imminent reforms essential.

The challenge of our aging population is much bigger than the narrow scope of the current debate. The challenge is about figuring out ways to meet the expectations of our population. We now face the prospects of slowing or stagnant standards of living. Adopting measures that create incentives for postponing retirement could go a long way to meeting the promises made under the current system. But it is more than just about increasing work at older ages. It is about finding ways to boost workforce participation among all individuals and about adopting policies to enhance worker productivity. If we are unable to do this, retirement policy will be one of the mechanisms for distributing the disappointing outcome across various segments of our population.

Whatever path we choose to take, acting sooner rather than later is critical. The fact of the matter is that most people do not use the sorts of sophisticate models economists typically use to plan for retirement. Most people use a somewhat simpler model—what we might call a "looking-around" model. Many people look at their parents, older siblings and fellow workers go through life. Over time, they develop certain expectations and aspirations about how their own life will play out. This works well in a stable environment. But the looking-around model is prone to breaking down in an unstable environment like the one we face with a rapidly aging population. My fear is that the longer we delay adjusting our system, the larger the cuts that are likely to be required. The longer we delay getting people into other savings vehicles, the smaller their cash reserves will be when the real financing crunch hits. In short, the longer we delay taking action, the steeper the fall will be from the pension aspirations most people acquired from watching their parents' generation in retirement.

Thank you Mr. Chairman. I would be pleased to answer any questions you may have.

Chairman MCCRERY. Thank you, Dr. Nyce. Dr. Steinmeier?

STATEMENT OF THOMAS L. STEINMEIER, PH.D., PROFESSOR OF ECONOMICS, DEPARTMENT OF ECONOMICS AND GEOGRAPHY, TEXAS TECH UNIVERSITY, LUBBOCK, TEXAS

Mr. STEINMEIER. Chairman McCrery, Ranking Member Levin, and Members of the Subcommittee, thank you very much for the opportunity to speak here. My name is Thomas Steinmeier, and I am a Professor of Economics at Texas Tech University. For the past decade, my colleague, Alan Gustman, and I have used data in the Health and Retirement Study to examine how potential

changes in Social Security and pensions may affect savings and retirement decisions. A distinguishing feature of our research is the use of a model which allows individuals to have differing degrees of impatience regarding current versus future consumption. Today I would like to summarize four of our findings which may be of interest to the Subcommittee.

First, changes in the early retirement age are likely to have significantly more impact on retirement than would changes in the normal retirement age. I should note that in these comments, I will use the term "retirement" to mean a substantial or complete withdrawal from the labor force. Currently about 15 to 20 percent of each cohort of individuals retires during their 62nd year, which under current rules is the early retirement age. Some individuals simply have not saved enough to retire before Social Security eligibility. Others highly value the benefits which would be lost by working, and tend to ignore that foregoing current benefits would increase future benefits. In short, they view the lost benefits more as a tax, which discourages work. Our model indicates that of those who currently retire at 62, roughly two-fifths would delay retirement to age 64 if the early retirement age were increased to that age. There may be some increase in disability awards, but an analysis of the pattern of new disability awards suggests it is unlikely to have a substantial impact on the labor force participation effects of increasing the early retirement age.

Second, eliminating the current earnings test, which applies between age 62 and the normal retirement age, would also increase work effort, though by a smaller amount than increasing the early retirement age. Presently, the earnings test reduces current benefits by $1 for every $2 of earnings over a threshold amount, though later benefits are increased in a roughly actuarially fair manner. In our simulations of eliminating the earnings test, much of the impact is that fewer individuals would be working part time and more would be working full time. However, without the earnings test, more individuals would be eligible to collect benefits at ages 62 through 64, and many would do so, which would be a drain on the finances of the system. This would also reduce the eventual level of benefits that these individuals could collect during their retirement, since they would be collecting benefits earlier, and hence, would be subject to a larger early retirement reduction.

Third, increases in the early retirement reduction rate would also have significant effects. Model Three of the Presidential Commission's report proposed that individuals retiring 3 years before the normal retirement age would get 75 percent of full benefits rather than the current 80 percent. Our model suggests that changing the reduction rate to the level specified in the Commission's report would increase the percentage of 62- to 64-year-olds working full time by around 3 percentage points, which is a little less than eliminating the earnings test, but nonetheless substantial. Proposals to increase the delayed retirement credit, which increases benefits to individuals who delay collecting benefits beyond the normal retirement age, would have much less of an effect on retirement, primarily because the earnings test does not apply to individuals above the normal retirement age.

Fourth and finally, lump sum distributions, such as might be available with personal accounts, can have a significant effect on retirement. If lump sums are tied to retirement, individuals may retire earlier in order to gain access to the lump sums, especially if the lump sums are made available at age 62. If the lump sums are not tied to retirement, we can expect a non-trivial fraction of the population to withdraw and spend the lump sums, leaving less income and fewer assets available to support retirement later on. To make matters worse, these are likely to be individuals who have accumulated few other assets for retirement. I hope these remarks have been helpful, and I thank you for your patience in listening to them. I will be glad to answer any questions you may have later in this hearing. Thank you.

[The prepared statement of Dr. Steinmeier follows:]

Statement of Thomas Steinmeier, Ph.D., Professor of Economics, Texas Tech University, Lubbock, Texas

Chairman McCrery, ranking member Levin, and members of the subcommittee, thank you very much for the opportunity to speak here. My name is Thomas Steinmeier, and I am a Professor of Economics at Texas Tech University. However, I should be clear that the views expressed here do not represent the views of the university.

For the past decade my colleague Alan Gustman and I have used the data in the Health and Retirement Study to examine how potential changes in Social Security and pensions may affect retirement and saving patterns. A distinguishing feature of our research is the use of a model which allows individuals to have differing degrees of impatience regarding current vs. future consumption. Today I would like to summarize four of our findings which may be of interest to the subcommittee.

First, changes in the early retirement age are likely to have significantly more impact on retirement than would changes in the normal retirement age. I should note that in these comments, I will use the term retirement to mean a substantial or complete withdrawal from the labor force. Currently about 15 to 20 percent of each cohort of individuals retires during their 62nd year, which under current rules is the early retirement age. Some individuals simply have not saved enough to retire before Social Security eligibility. Others value highly the benefits which would be lost by working and tend to ignore that foregoing current benefits would increase future benefits, even though those increases are roughly actuarially fair. In short, they view the lost benefits more as a tax, which discourages work. Our model indicates that of those who currently retire at age 62, roughly two-fifths would delay retirement to age 64 if the early retirement age were increased to that age.

If the early retirement age were increased, it is possible that more individuals would apply for disability. However, the number of SSDI male recipients who enter the program at any age is relatively small; the numbers from the 2003 Statistical Bulletin are:

Age	Entrants
55	21,000
56	16,000
57	16,500
58	17,900
59	19,500
60	19,300
61	18,100
62	15,900
63	9,600
64	7,100

If, as a result of increasing the early retirement age to 64, the number of entrants at ages 62 and 63 increased to 19,000, which is close to the average of the previous five years, the increase would only amount to around 11,500 individuals. This is about 0.6 percent of the approximately 1,800,000 62 and 63 year old males who are either disability insured or had been disability insured at the time of their retire-

ment. This is too small a number to change the labor force participation results appreciably.

Second, eliminating the current earnings test, which applies between age 62 and the normal retirement age, would also increase work effort, though by a smaller amount than increasing the early retirement age. Presently the earnings test reduces current benefits by $1 for every $2 of earnings over the threshold limit of $12,000 per year, though later benefits are increased in a roughly actuarially fair manner. In our simulations of eliminating the earnings test, much of the impact is that fewer individuals would be working part time and more would be working full time. However, without the earnings test, more individuals would be eligible to collect benefits at ages 62 through 64, and many would do so, which would be a drain on the finances of the system. This would also reduce the eventual level of annual benefits that these individuals could collect during their retirement, since they would be collecting benefits earlier and hence would be subject to a larger early retirement reduction.

Third, increases in the early retirement reduction rate would also have significant effects. The Presidential Commission's report, in its Model 3, proposed increasing the reduction for retiring three years before the normal retirement age from the current level of 20% to 25%. Our model suggests that changing the reduction rate to the level specified in the Commission's report would increase the percentage of 62–64 year olds working full-time by around three percentage points, which is a little less than eliminating the earnings test but nonetheless substantial. Proposals to increase the delayed retirement credit, which increases benefits to individuals who delay collecting benefits beyond the normal retirement age, would have much less of an effect on retirement, primarily because the earnings test does not apply to individuals above the normal retirement age.

Fourth, lump sum distributions, such as might be available with personal accounts, can have a large effect on retirement. If lump sums are tied to retirement, individuals may retire earlier in order to gain access to the lump sums, especially if the lump sums are made available at age 62. If the lump sums are not tied to retirement, we can expect a nontrivial fraction of the population to withdraw and spend the lump sums, leaving less income and fewer assets available to support retirement later on. To make matters worse, these are likely to be individuals who have accumulated few other assets for retirement.

Our related work has generated other punch lines relevant to the design of Social Security policies. Four I will mention here. (1) Price indexing or longevity indexing has the potential to increase full-time work effort. In simulations of the proposed indexing schemes of the President's Commission report, price indexing increased the percent of 62 year-old men working full-time in 2075 by 7 percentage points, relative to simulations with current formula benefits. The increase is 4 percentage points for longevity indexing. Relative to simulations with feasible benefits, which are benefits payable from current taxes in 2075, the numbers are smaller: a 2.5 increase in full-time work for price indexing and a very slight decrease for longevity indexing. (2) Despite the progressive appearance of the benefit formula, there is little redistribution among families with different earnings levels. This occurs primarily because of the greater longevity of higher-income families and because spouse and survivor benefits flow disproportionately to higher-income families. (3) High-wage immigrant families with short tenures in the U.S. get exceptionally high returns from Social Security. The source of this result is that many years of zeros get included in the average monthly earnings calculation for these individuals, and the resulting low average earnings causes the benefit formula to treat them in the same generous way that it normally treats low income workers. This anomaly could easily be fixed by using a relatively simple pro-rated method for computing benefits. (4) Regarding the proposals of the President's Commission, the "offset" method the Commission chose to calculate benefits implies if there are further changes in the way traditional benefits are computed, those changes will have the same impact whether or not a person had selected a personal account. To the degree that returns in the personal accounts exceed the interest rate in the offset accounts, individuals with personal accounts would be in a better position to withstand cuts in traditional benefits.

I hope that these remarks have been helpful, and I thank you for your patience in listening to them. I would like to thank the Social Security Administration and NIA for financial support over the years, and the Michigan Retirement Research Center, the National Bureau of Economic Research, and the Health and Retirement Study, and Texas Tech University for research support. I would be glad to answer any questions you may have about this work later in the hearing.

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All work is joint with Alan Gustman. National Bureau of Economic Research Working Papers are available at www.nber.org/papers/. All opinions and conclusions are those of the authors and not those of the Social Security Administration, the NIA, the Michigan Retirement Research Center, the National Bureau of Economic Research, Texas Tech University, or Dartmouth College.

Chairman MCCRERY. Thank you, Dr. Steinmeier. Dr. Steuerle?

STATEMENT OF C. EUGENE STEUERLE, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE

Mr. STEUERLE. Mr. Chairman, Mr. Levin, Members of the Subcommittee, I appreciate this opportunity to testify before you on achieving sustainable balance in Social Security. When it comes to life expectancy in Social Security, which is the subject of this hearing, I believe reform requires answering publicly and directly two basic questions. Do we really want a Social Security system that is a middle-aged retirement system? Second, do we want to maintain as the number one budget priority in the Nation's budget, to increase the value of Social Security and health benefits for the average income retiring couple from more than $700,000 today toward $1 million and beyond in the near future? I believe that if we would honestly and publicly answer those two questions, we would be a long way on the road toward reform.

Begin by defining "lifetime benefits" as the value at age 65, of Social Security and Medicare benefits as if they were in a 401(k) account. In today's dollars, lifetime benefits for an average income couple are about $400,000 in Social Security and about $700,000 in Social Security and Medicare. One way to think about the benefit side of reform is simply to place a limit on the growth rate in that lifetime package of benefits.

Let me try another lens. Close to one-third of the adult population is scheduled to be on Social Security within about 25 years, and people are already retired for about one-third of their adult lives. If people retired today for the same number of years as when Social Security was young, that is in 1940, they would actually be retiring at about age 74 today. In another 60 years, they would be retiring at about age 78 if they were to retire for the same number of years of life expectancy as when the system was younger. By constantly increasing the benefits that go to these middle-aged re-

tirees, at least as defined by life expectancy, smaller and smaller shares of Social Security benefits are being devoted to people who are elderly.

Believe it or not, I think there is tremendous opportunity in all of this. People in their fifties, sixties, and seventies are going to represent to the labor force for the first half of the 21st century what women did for the last half of the 20th century: they can be a major source of labor supply if we can break down the barriers to them providing it. Restoring Social Security to an old-aged, not a middle-aged, retirement system can be done partly by increasing the retirement ages, including both the early and the normal retirement age. A related move would be to back-load benefits more to help those who are older. One can also provide a better actuarial adjustment for working longer since we currently subsidize people who retire early. Such changes would progressively move benefits to later ages when they are needed more, and they put the labor force incentives in the right place, up front, when people are more likely to be able to increase their labor supply.

Now, admittedly, some groups have shorter than average life expectancies, but attempting to address their needs by giving you and me a 20th, 21st, and 22nd year of retirement support is a very bad form of trickle down policy. Therefore, I favor meeting their needs by providing a good minimum benefit, one that contains substance, not just symbol, and that increases the income of the low-income elderly.

One question that often arises when discussion centers on work limitations is whether Social Security needs to provide an increasing share of benefits every year to those further from the date of expected death, or whether people can work longer. In my testimony I provide three pieces of evidence. First, Americans age 55 and older, have been reporting improved health for some time now. Second, the physical demands of jobs have been declining over time. Finally, until recently, the labor force participation of those with similar life expectancies to those now retired was much, much higher. In my testimony I also suggest that absent other types of reforms, we think about adopting some rule for default growth in the system so that the system would not continually grow when there are projected long-term deficits.

In summary, our current Social Security system increasingly favors middle-aged retirement and reduces both the share of Social Security resources for the truly elderly, and the share of total revenues of government for children and working families. A reformed system could easily reduce poverty rates while providing the truly old a lifetime benefit as good or better than most generations have received in the past. I provide a lot of data in my testimony trying to back up the statements I have made before you, and I would be glad to talk to you further about them. Thank you.

[The prepared statement of Dr. Steuerle follows:]

Statement of C. Eugene Steuerle, Ph.D., Senior Fellow, The Urban Institute, and Co-director, Tax Polyc Center, and Columnist, Tax Notes Magazine

Mr. Chairman and Members of the Subcommittee:

Thank you again for the opportunity to testify on ways to try to build a viable system of Social Security for the 21st century. As you have requested, much of my testimony will deal with our increasing inability to protect the young, the truly old,

and the vulnerable when Social Security morphs into a middle-age retirement system.

As I have noted before the full committee a month ago, the legacy we are about to leave our children is a government whose almost sole purpose is to finance our own consumption in retirement. The impact on the budget is being felt already. Medicare and Medicaid long-term care are primary sources of this problem since they combine the old age problems of Social Security with the excessive cost growth that derives from an open-ended health care budget. But Social Security is the *flagship* around which the rest of the fleet hovers, whether it is old age health care insurance or private labor compensation schemes that the follow Social Security in encouraging people to retire in middle age.

Define "lifetime benefits" as the value, at age 65, of Social Security and Medicare benefits as if they were sitting in a 401(k) account that would earn interest but be drawn upon over retirement. In today's dollars, lifetime benefits for an average-income couple have risen from about $195,000 in 1960 to $710,000 today ($439,000 in Social Security and $271,000 in Medicare) to over $1 million for a couple retiring in about 25 years (over $½ million in both Social Security and Medicare—see figure 1). These numbers quickly reveal what is happening to the budget as a whole. We cannot provide a very large portion of American couples $½ to $1 million of benefits and simultaneously encourage them to drop out of the workforce for the last third of their adult lives without affecting dramatically the services that can be provided through the budget to our children and to working families.

These benefit are provided so early in life that many people are "tricked" into believing they will be well off in retirement when such is not the case. Income may appear adequate to a person at age 62 or 65 when in fair to excellent health and there is more likely to be a spouse around to help with minor impairments. However, twenty years or more later—and most couples get benefits for more than 20 years—the income is not enough. Social Security income falls relative to wages and living standards, private pension income often falls even in real terms (often because it is not wage indexed), earning power decreases, and there often is no longer a spouse around for mutual assistance.

A middle-age retirement system SERVING THE VULNERABLE LESS EACH YEAR

Social Security's current dilemma centers almost entirely on the drop in scheduled workers per retiree. It is and remains a labor force issue. Although more saving would be nice, whether in trust funds or retirement accounts, we are not going to save our way out of this problem. Consider some of the consequences of the current system.

Social Security has morphed into a middle-age retirement system.

- Close to one-third of the adult population is scheduled to be on Social Security within about 25 years. Including adults on other transfer programs, we are approaching the day when the majority of the adult population will depend upon transfers from others for a significant share of its support.
- People already retire on average for close to one-third of their adult lives.
- The average Social Security annuity for a man retiring at 62 lasts 17 years, for a woman 20 years, and for the longer living of a couple at least 25 years. The life numbers are even higher for those with above-average lifetime earnings because they have above-average life expectancies.
- When Social Security was young—for instance, in 1940 and 1950—the average worker retired at about age 68. To retire for an equivalent number of years on Social Security, a person would retire at age 74 today and age 78 in another 60 years (figure 2).

Almost every year a smaller share of Social Security benefits goes to the most vulnerable.

- By constantly increasing benefits to middle-age retirees, at least as defined by life expectancy, smaller and smaller shares of Social Security benefits are being devoted to the elderly (figure 3). If progressivity is defined by how well the vulnerable are served, the system is becoming less progressive every year.

The economy gets hit several ways, not just in terms of costs.

- Among the most important, but ignored, sides of the Social Security budget equation is the decline in growth of the labor force (figure 4, with its additional effect on slower growth in national income and revenues).
- When a person retires from the labor force at late middle age, national income declines. But the decline is borne mainly by other workers, not by the retiree. For instance, when a $50,000-a-year worker retires a year earlier, national in-

come declines by approximately $50,000, but most of those costs are shifted onto other workers as the retiree starts receiving about $23,500 in Social Security and Medicare benefits (much more in the future) and pays about $18,300 less in taxes (figure 5).

- Saving declines because people retire in what used to be their peak saving years. For instance, when a person retires for 20 years versus 15, he both saves for 5 years less and spends down his or society's saving for 5 years more.

THE OPPORTUNITY: INCREASING WORK SPANS WHILE PROTECTING THE VULNERABLE

Believe it or not, there is tremendous opportunity in all of this. People in their late 50s, 60s, and 70s have now become the largest underutilized pool of human resources in the economy. They represent to the labor force for the first half of the 21st century what women did for the last half of the 20th century. The labor demand, I believe, will be powerful, and it is mainly our institutions, public and private, that are blocking us from making full use of these valuable and talented people.

Keep in mind that this labor force story differs dramatically from that of the past 60 years. Two factors made the remarkable decline in labor force participation among older men possible: the entry of the baby boom population into the labor force and the increased labor force participation of women. The net effect over the post-World War II period was an adult employment rate that actually *increased* over almost all non-recession years (figure 6). What this tells me is that there is a demand for labor that very possibly would be met by this extraordinary pool of talented older workers if institutions adjusted to encourage it and let it happen.

We don't really know yet how all of this will play out. But if we remove the disincentives to work, increased labor force participation could make all sorts of budget decisions easier over the long run. Again, it is because increased labor will add both to national income and to revenues—thus lessening how drastically programs for the young AND the old have to be cut.

RE-ORIENTING BENEFITS TOWARD the OLD

Restoring Social Security to an old-age, not a middle-age, retirement program can be done partly by increasing the retirement ages (including the early retirement age—else it is just an across-the-board benefit cut). A related move would be to backload benefits more to help those who are older. Whatever the level of lifetime benefit settled upon in a final reform package, actuarial adjustments can provide more benefits later and fewer earlier. These adjustments can take various forms: adjust benefits upward when Social Security predicts that average life expectancy has fallen below, say, 12 years (about age 74 in 2005 and indexed for life expectancy in later years) and downward in earlier ages; or provide a lower up-front benefit in exchange for post-retirement wage indexing.

A related adjustment would be to provide a better actuarial adjustment for working longer. Currently we subsidize people to retire early. While lifetime benefits are about the same for a worker retiring at, say, age 62 or 65 or 68, the worker who stays in the workforce contributes much more in the way of tax. A greater differential between earlier and later retirement would be appropriate both from a fairness and an efficiency standpoint. Note that there are two separate adjustments that have to be dealt with here—first, the adjustment simply for delaying the receipt of benefits, and, second, some adjustment for additional contributions made by those who work more. Among the problems with the current system in the latter category is the silly way that it counts only so many years of work—thus giving the worker who works 45 years at $35,000 (wage indexed) substantially fewer benefits than the worker who works 35 years at $45,000.

These changes in retirement ages and in the lifecycle distribution of benefits have many positive effects. They progressively move benefits to later ages when people have less ability to work, lower income, and less help from a spouse to deal with impairments. Support in old age *was* the original purpose of the program. They put labor force incentives where they are most effective—in late middle age, including the 60s, when most people report being in fair, good, or excellent health. When cuts in benefit growth rates are required, they cause less hardship than almost any across-the-board benefit cut for two reasons: first, they are more likely to increase revenues, thus making it possible to afford a better benefit package, and second, they don't affect the benefits of the truly old as long as they adjust their work lives in line with the changes in the retirement ages.

I recognize that some people are concerned about groups with shorter-than-average life expectancies. But attempting to address their needs by granting many of us who are healthy a 20th and 21st and 22nd year of transfer support and tens,

if not hundreds, of thousands of dollars in extra benefits for retiring early is a very bad form of trickle-down policy.

An increase in the retirement age can be combined with other provisions that help, rather than hurt, groups with shorter life expectancies. One way to do this is to provide a minimum benefit aimed at lower-income households and at reducing poverty rates (using a poverty standard adjusted for living standards or wage-indexed) among the elderly. With such a minimum benefit in place, any of the age-of-retirement adjustments can actually increase, rather than decrease, the relative share of benefits for groups with lower life expectancies, since their life expectancies are correlated with lower lifetime earnings. In fact, with a good minimum benefit, we can increase the income of low-income people and reduce poverty rates, even relative to current law.

One warning is in order here, however. Some minimum benefit packages end up more symbol than substance. For instance, they may not be indexed for wages, so don't cost much in the long run. Or they have so many years of work requirement that they don't help some groups of low-income people, especially women. We need Social Security and other agencies to provide estimates of the effectiveness of different alternatives if we want to provide a base of protection.

EVIDENCE ON ABILITY TO WORK

One question that often arises is whether Social Security needs to provide an increasing share of benefits every year to those further and further from date of expected death. Three pieces of evidence are provided here: (1) health trends among old and near-old; (2) physical demands of jobs; and (3) the ability of people to work at similar ages in the years before early retirement options and other benefits were made available.

First, older Americans over age 55 seem to be reporting that their health has improved. Figure 7 reports the share of older adults reporting fair or poor health in two groups: those age 65—74 and those age 55—64 between 1982 and 2002. Even among those age 65—74, the fraction reporting fair or poor health is less than one-quarter. The fraction actually reporting poor health is much smaller still. The rest report being in good or excellent health.

Similarly, among those age 55—59, the share with work limitations has declined from 27.1 percent in 1971 to 19.5 percent in 2002 (figure 8). Note that a work limitation does not mean inability to work but, rather, a limitation to do certain types of jobs. In any case, the trend moves in the same direction: as years pass, fewer people of a given age have been reporting work limitations.

Survey results such as those just reported, of course, involve qualitative data. We need to check alternative evidence. A second approach is to try to find trends in physical limitations of jobs using a similar measure over the years. One source, shown in figure 9, indicates that the share of U.S. workers in physically demanding jobs has declined from over 20 percent in 1950 to about 8 percent in 1996.

Finally, let us compare the labor force participation of males with a similar life expectancy from 1940, when Social Security first paid benefits, until 2001. In figure 10, we see that about 86 percent of men with about 16 years of life expectancy participated in the labor force in 1940. That figure remained high until the late 1960s, a few years after men with a similar life expectancy became eligible for early retirement benefit and after Medicare benefits were enacted into law. After those enactments, labor force participation began a very rapid descent to less than 35 percent. That decline has leveled out and may be beginning to rise slowly—one more piece of evidence that demand for labor is shifting to older workers.

It is hard to believe that as the physical demands of jobs have declined, people have become that much less capable of working. It is more likely that the higher levels of benefits in Social Security and Medicare, increasingly available for more and more years before expected death, have been the major factors driving the drop in labor force participation.

CHANGING THE DEFAULT

Under current policy, federal government spending grows automatically, by default, faster than tax revenues as the population ages and health costs soar. These defaults threaten the economy with large, unsustainable deficits. More important, they deny to each generation the opportunity to orient government toward meeting current needs and its own preferences for services. Only by changing the budget's auto-pilot programming can we gain the flexibility needed to continually improve government policies and services.

Rudolph L. Penner (also a senior fellow at the Urban Institute and a former director of the Congressional Budget Office) and I have come to believe that there is no way to get the budget in order without addressing the issue of these defaults. Budg-

et-irresponsible defaults apply to many programs of government, but the largest are linked to Social Security and Medicare. As currently structured, these programs are designed to rise forever in cost faster than national income and revenues—an impossible scenario. In Social Security, the problem is caused by the combination of more years of retirement support over time and wage indexing for annual benefits.

Regardless of what Social Security reform is undertaken, some rule should be adopted that would put the program back into balance over the long term when, for instance, the trustees report for three consecutive years that the program is likely to be in long-run deficit. This trigger should force the system's automatic features to move responsibly back toward budgetary balance.

With the trigger pulled, three of many options at that point strike me as particularly simple and easy to implement. First, the early and normal retirement ages could be automatically increased two months faster per year than under current law for everyone younger than, say, 57 in the year the trigger is pulled. (See also note below on removing the confusing language on "early" and "normal" retirement ages.) Second, in those years, the benefit formula could be indexed to the lower of price or wage growth in a way that allows average real benefits to increase but more slowly than wages.[1] This approach could be supplemented by a new special minimum benefit indexed to wage growth. Other approaches to this option can also be devised to reduce the growth rate of benefits more for high earners than for low earners.[2] A third option is to cap the growth in benefits for households who, on average, are expected to receive more than, say $400,000 in Social Security benefits, or more than $750,000 in Social Security and Medicare benefits.

I generally prefer any method that tends to increase the retirement ages since that allows more revenues for the system and, consequently, higher lifetime benefits for the same tax rate. Other benefit reductions, as noted, hit the oldest beneficiaries with their greater needs as well as everyone else. For similar reasons, among the "progressive price indexing" options, I prefer creating a wage-indexed minimum benefit since that is more likely to protect the more vulnerable, including survivors, than is a form of progressive price indexing that continues to spend larger shares of revenue on increasing benefits for succeeding generations of those with well-above-median lifetime earnings. If restrictions are placed on lifetime benefits, then retirement age and benefit growth might be adjusted at the same time. But, regardless, the system must be redesigned so that, when on automatic pilot, the default option leads to a responsible and sustainable budget.

There is, of course, no reason to believe that such automatic changes will alone lead to a socially optimum Social Security system. For instance, they do not deal with the discrimination in current law against single heads of households. The point of changing the defaults is, rather, to migrate from a system in which the Congress has little choice but to enact painful benefit cuts to one in which Congress has the opportunity to provide more generous benefits from time to time—that is, to play Santa Claus rather than Scrooge sometimes, as politics requires.

By creating a system in which the budget automatically becomes ever more responsive and responsible to future taxpayers and beneficiaries, the door is also open to spending more now on programs for people who aren't elderly—especially children—and on public investments. Or Congress might use the freed-up resources to make Social Security benefits more generous to those with low average lifetime earnings or to provide more cash to lower-income elderly to help pay for medical payments. And, of course, Congress can always choose to raise taxes to provide a higher benefit growth rate in each year, though remaining responsible means making each year's decision to increase benefit levels independent of the next year's.

A WORD ON THE PROCESS

One of the issues facing reformers is that the goals they seek are specified too tightly, denying to estimators the ability to provide options that achieve those goals better or to improve efficiency and equity at the same time. This may appear to be a technical matter, but, in fact, it is a MAJOR process issue is trying to achieve a benefit package that, at any given tax rate, does the most to protect the truly old and vulnerable. Below I list some of the dilemmas and ways that they might be resolved.

Delemma 1: Making the System More Transparent: Changing the retirement age is explicit—it is not a hidden tax increase or benefit reduction. Hence, at times, it tends to draw more attention than do other reforms that, in truth, are much more

[1] Technically, there are different ways that price indexing can be approached.

[2] The term "progressive price indexing" has sometimes been applied to this effort, but there are many ways to change the growth rate differentially for workers with different levels of lifetime earnings.

threatening to a good life in retirement, but are less transparent. This political reality discourages admitting to and addressing the consequences of the middle-age retirement system we now have in place. As I continually note, increasing work lives is among the least painful benefit adjustments because it puts more benefits in old age when needs are greater, and it increases national output and revenues.

Dilemma 2: Addressing the Early Retirement Age. Addressing the Early Retirement Age. Increasing the normal retirement age is nothing more than an across-the-board benefit cut. It also does nothing to change Social Security's misleading signal that old age somehow starts as early as 62. Those aged 62 are not "old," if defined by life expectancy. Failure to adjust the early retirement age also gives reform much less potential to achieve in employment and revenue.

A variety of reformers, liberal and conservative, tell me that they would privately favor adjusting the early retirement age but they think it is politically difficult to address publicly. But consider the following two alternatives in terms of language:

- Congress raises normal retirement age to 70 (indexed for life expectancy), or
- Congress increases earliest retirement age to 65 (indexed for life expectancy), the age it was when Social Security was first enacted in 1935.

These two could easily be equivalent in terms of the total lifetime benefits provided by Social Security, depending upon design. But the latter looks a lot less radical than the former, even if the two are equivalent.

I suggest also that Congress drop altogether the distinction between early and normal retirement ages. Declare an earliest retirement age and then make adjustments of one type or the other after that point. Again, to concentrate benefits at older ages, I would provide a bump up in benefits at older ages.

Dilemma 3: Increase in Work by Older Workers. Increase in Work by Older Workers. I believe there is considerable and growing demand for older workers. But some of this will take time and is subject to uncertainty. Private behavior by both employers and employees will need to adjust to the labor market of the new century. Estimators, however, generally will not assume very large changes in behavior without more empirical evidence is gathered over time. One reason is that they do not know whether the rest of the fleet, including private pension systems, will follow the Social Security flagship if it moves back toward providing for old age, rather than middle age, retirement. However, if one adopts a system that encourages greater work at older ages, and at the same time, slows down the growth rate in benefits when there are projected imbalances, then any yet-uncounted gains from additional work effort would effectively allow benefits to grow more than might be shown in current projections.

Dilemma 4: Choosing the Right Target. As I have noted, lifetime benefits provide a better first target for Social Security than do annual benefits, which do not take into account the number of years that benefits are received. As people have retired for more and more years, they have effectively reduced the annual benefit and replacement rate they could receive for the same lifetime benefit package. Congress, therefore, might consider the advantages for public presentation if limits were placed on lifetime benefit packages, rather than particular parameters of that package (e.g., annual benefit). Would the public really object if Congress said that the growth rate in lifetime benefits in Social Security and Medicare were to be limited for those couples who were projected to receive more than $750,000, at least during periods when the two systems were projected to be out of balance? Or limited for those couples scheduled to receive, say, more than $400,000 in lifetime benefits? The President could then be tasked with giving Congress alternative options from year to year on how this might be achieved, although a default option is again required if no action is taken.

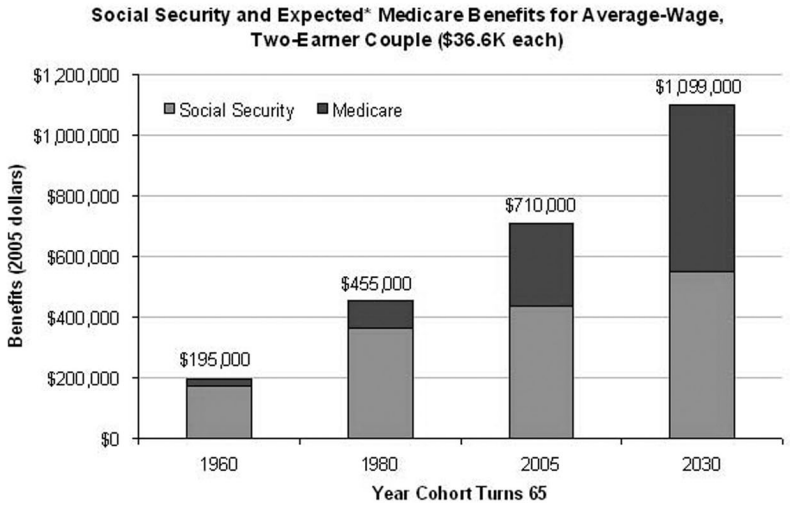
CONCLUSION

We can and should fix a Social Security system that favors middle-age retirement and that continually reduces both the shares of Social Security resources for the truly elderly and the share of total revenues remaining for programs for children and working families. A reformed system can easily reduce poverty rates (adjusted for standard of living), while providing many others among the truly old a lifetime benefit as good, or better, than most generations have received in the past. It can also deal with other inequities and inefficiencies on which I provided more detail in my previous testimony, including the extraordinary discrimination against single heads of household and the ways that new revenues are weakly allocated to reduce elderly poverty further. I attach a list of suggestions, which expands somewhat on those I provided in my testimony to the full committee last month.

Summary of Recommendations

- **Increase the early and normal retirement ages** so that at any given tax rate, the system provides fewer subsidies for middle-age retirement and increased revenues, higher annual benefits in retirement, higher lifetime benefits, and a greater portion of resources to those who are truly old.
- **Drop all language pertaining to early and normal retirement ages, and simply enact an earliest retirement age,** with actuarial and other adjustments (e.g., a backloading of benefits to old age) to be made from there.
- **Backload benefits more** to older ages, such as the last 12 years of life expectancy, so as to progressively increase benefits in later ages when they are needed more and to increase labor force incentives for individuals still in late-middle age, as defined by life expectancy.
- **Provide a well-designed minimum benefit** to help low-income households and groups with less education and lower life expectancies, while simultaneously reducing poverty rates (relative to living standards or wages) among the elderly.
- **Determine family benefits for middle—and upper-income individuals in an actuarially neutral manner** by applying private pension standards, making sure that benefits are shared equitably, and reducing or removing significant discrimination against single heads of household, many abandoned spouses, two-earner couples, many divorced persons, those who marry others close to their own age, some who pay significant marriage penalties for remarrying, and those who bear children earlier in life.
- **Provide a minimum benefit that extends to spouses and divorced persons as well as workers** to provide additional protections for groups that are particularly vulnerable, and as an alternative to free and poorly targeted transfers to higher-income households.
- **Count all years of work history,** providing an additional work incentive and removing the discrimination against those who work longer.
- **Ensure responsible budgetary policy by changing the default rules** to guarantee the system automatically moves toward balance—say, through adjustments in the retirement ages or the rate of growth of annual or lifetime benefits for higher-income households—whenever the Social Security trustees repeatedly report a likely long-run deficit.
- **Design reform around lifetime benefits by, say, paring the growth rate of benefits for those above some amount,** e.g., those scheduled to receive over $400,000 in Social Security benefits or more than $750,000 in Social Security and Medicare benefits.
- **Reduce the tax gaming** used with retirement plans when taxpayers simultaneously report interest deductions while deferring or excluding interest and other retirement plan income from taxation.
- **Provide additional incentive for plans that do a better job at providing a portable benefit for all workers,** such as using the FICA tax exclusion to finance increased deposits to retirement accounts and guaranteeing all workers in a qualified plan a minimum level of portable benefits.
- **Make clearer in the law that employers can use opt-out, not just opt-in, methods of encouraging retirement plan participation—**without threat of lawsuit.
- **Focus retirement plan incentives more on lower-wage workers,** for instance, through an increase in a modified savers credit, which should be adjusted so that it is available for employer, as well as employee, contributions and so that the credit is deposited in retirement accounts.
- **Provide safe harbors from lawsuits** for designated types of retirement and other benefit plans offered by employers who hire or retain older workers.
- **Restore the earnings base for Social Security** by increasing the portion of cash wages subject to Social Security tax, capping the tax-free levels of health insurance that can be provided, and dealing with tax preferences for other employee benefits.

Figure 1



*Expected rather than realized benefits. Notes: The "high" and "average" wage profiles are those hypothetical profiles routinely employed by the Social Security Administration in its analyses. Lifetime amounts, rounded to the nearest thousand, are discounted to present value at age 65 using a 2 percent real interest rate and adjusted for mortality. Projections based on intermediate assumptions of the 2005 OASDI and HI/SMI Trustees Reports. Includes Medicare Part D. Source: Adam Carasso and C. Eugene Steuerle, The Urban Institute, 2005.

Figure 2

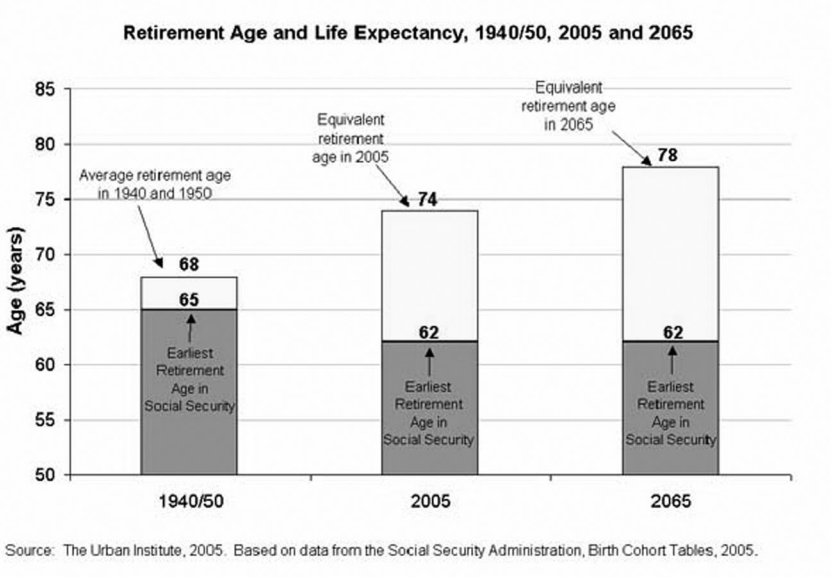
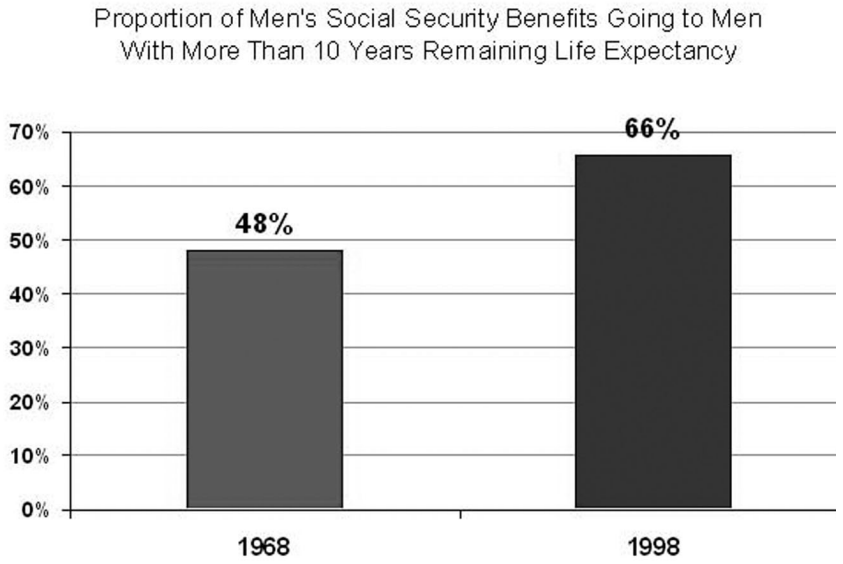


Figure 3



Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2002. Based on data from the Social Security Administration's 2001 Annual Statistical Supplement, Table 5A.1.

Figure 4

Labor Force Projections

Annual Growth Rate (% over Period)		
2000-10	2010-20	2020-30
1.08	0.38	0.38

Note: Projections assume no change in patterns of retirement by age and sex.

Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2002. Based on data from the US Bureaus of Census and Labor Statistics.

Figure 5

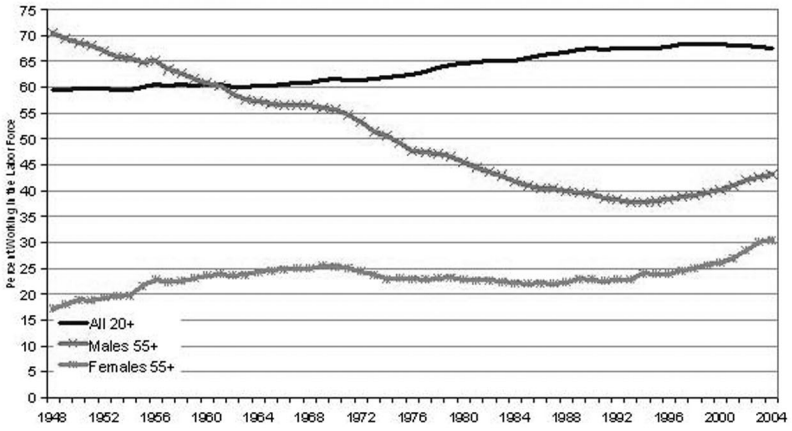
For a worker who earns $50,000...

Increases in Resources Transferred from Others	
Social Security Benefits	$18,500
Medicare Benefits	$5,000
Total 1	$23,500
Decrease in Resources Transferred to Others	
Social Security Taxes	-$7,700
Federal Income Taxes	-$6,600
Other Taxes (Including State and Local)	-$4,000
Total 2	-$18,300
Net Change in Transfers Received (Total 1 - Total 2)	**$41,800**
Addendum: Additional decline in retiree's after-tax earnings otherwise available to meet current and future needs	$31,700

Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2002.

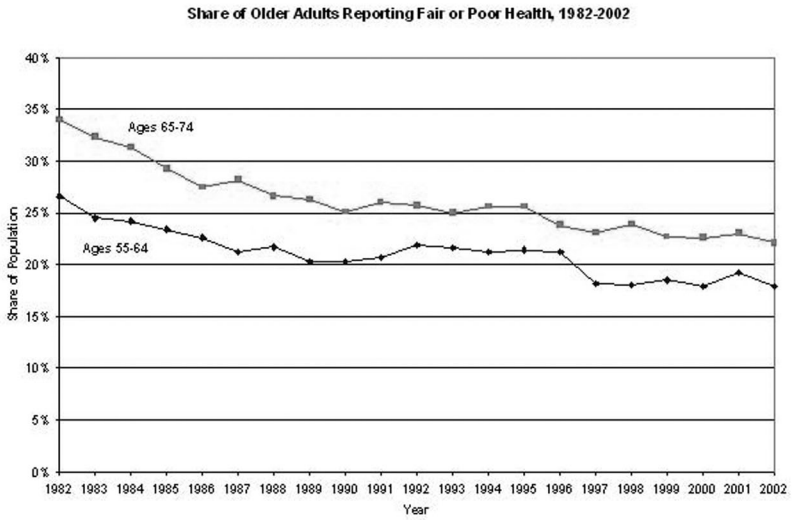
Figure 6

Labor Force Participation Rates: Males and Females Aged 55+ vs. the Adult Population, 1948-2004



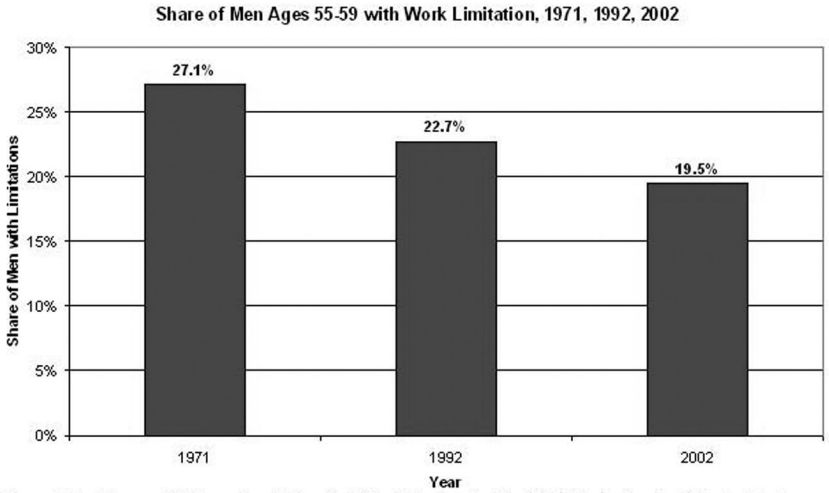
Source: U.S. Bureau of Labor Statistics, 2005.

Figure 7



Source: National Center for Health Statistics (2004).

Figure 8



Source: Richard Johnson and C. Eugene Steuerle, "Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population." Pension Research Council Working Paper 2003-26. Available online at http://www.urban.org/UploadedPDF/410932_promoting_work.pdf. Estimates from the National Longitudinal Survey of Older Men and the Health and Retirement Study.

Figure 9

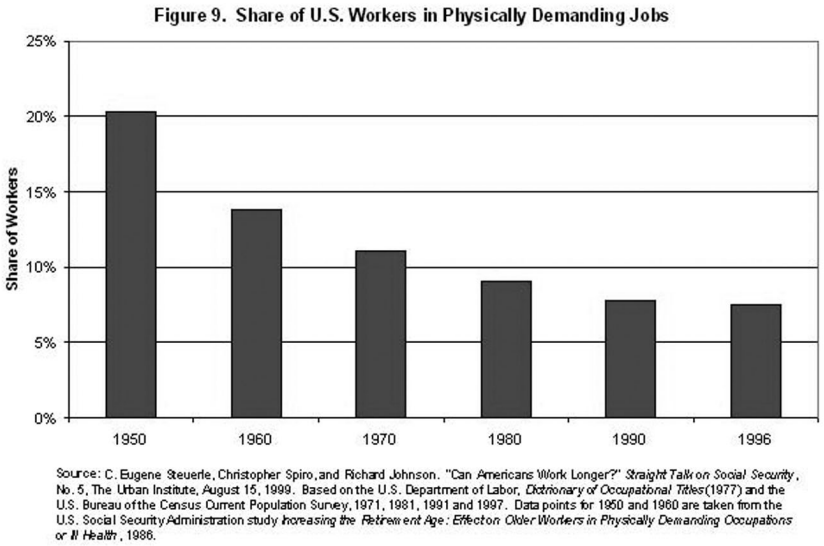
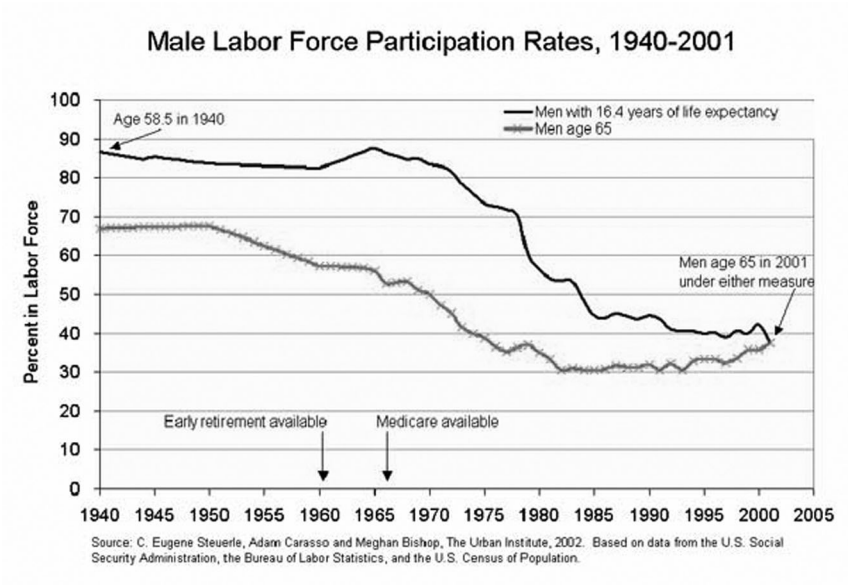


Figure 10



Chairman MCCRERY. Thank you, Dr. Steuerle. Mr. Gebhardtsbauer.

STATEMENT OF RON GEBHARDTSBAUER, SENIOR PENSION FELLOW, AMERICAN ACADEMY OF ACTUARIES

Mr. GEBHARDTSBAUER. Thank you. Chairman McCrery, Congressman Levin, and distinguished Committee Members, for the opportunity to testify. My name is Ron Gebhardtsbauer, and I am the Senior Pension Fellow at the American Academy of Actuaries. We are the non-partisan professional organization representing all actuaries in the U.S. In the interest of time I will quickly mention the major points in my written testimony, so please ask for clarification if you would like.

Social Security's normal retirement age recently increased from 65 to 66. Gradually raising it further by 1 month every 2 years would reduce Social Security's shortfall by about a third. While that reduces the increase in the annual benefit, it doesn't have to reduce the increase in the total lifetime benefits because each generation is living longer, and therefore receiving more years of benefits. The 1983 amendments reduced the impact of raising the normal retirement age on workers by phasing it in gradually so that there would be little noticeable effect, and it only affected people under age 45 at enactment, thus, it had no impact for 17 years.

In addition, we are not only living longer, we are healthier at older ages, and fewer jobs are physically demanding. People are also interested in staying active both mentally and physically, and jobs help promote that. Now, I will compare it with price indexation. Price indexation can reduce benefits four times faster than raising the normal retirement age on just an indexation basis. Also, price indexation reduces disability benefits, whereas indexing the normal retirement age doesn't. Both ideas affect early retirees. Workers could still retire at age 62 and receive Social Security benefits, but the benefits would be smaller.

The early retirement issue is important for workers in physically demanding jobs. If Social Security continues to pay benefits at age 62, the benefits will be small. To avoid these inadequate early retirement benefits, some proposals also will gradually increase the earliest eligibility age from 62 to 65. While this only reduces Social Security's shortfall by an additional 10 percent, it can have a big impact on when people retire since a person's retirement date is very much a financial decision. This points out the importance of having an employer-sponsored pension system to provide supplemental benefits until Social Security is available. Proposals on tax reform, lifetime savings accounts, or annuity taxation substantially change employer incentives to offer pension plans, so care should be taken not to kill them. Pension plans help us to not rely on Social Security for all of our retirement needs.

Now I want to talk about ways to keep Social Security solvent and sustainable. Unlike the 1983 fix, indexing retirement ages and price indexing can be ongoing so that Social Security does not go out of balance so easily due to our continually increasing lifespans. However, in order for this to work, Social Security will need to be more stable. Price indexation actually makes the initial benefit less stable, that is, price indexation of the initial benefit makes Social Security less stable because price inflation can exceed wage growth as it did in the seventies. Wage indexation, as we do it now, is actually more stable, because when wages and thus taxes go up more

or less than expected, the same thing will happen for benefits. That is not to say that price indexation should never be used. It could be used to gradually curtail benefits, but it only makes sense to use it until benefits are at the desired level. If price indexation is not turned off, benefits eventually become inconsequential in comparison to wages.

Similarly, progressive price indexation could be used if you want to move to a Social Security system that provides more level benefits. Under a current proposal for progressive price indexation, benefits would essentially be the same for almost everyone in 65 to 75 years. A longevity indexation provision could also help prevent Social Security from getting out of actuarial balance in the future. There is much disagreement on whether our lifespans will increase faster or slower than the intermediate projections in the trustees reports. A response to unexpected changes in lifespans might be to automatically adjust the indexation, as Eugene was mentioning.

What should be indexed: benefits, taxes, or retirement ages? In order to analyze this, it helps to look at extremes. If we look in the distant future when people are living to, say age 150, will it make sense to have retirement age still at 67 and our pensions tiny, or will it make sense to have later retirement ages and to not have to continually cut benefits or raise taxes? In summary, the demographic challenges for Social Security brought about by our longer lifespans can be solved through continual indexation. Automatic changes to the indexation could reduce Social Security's vulnerability to future changes that we can't predict. Then Social Security would be less likely to go out of balance, assuring American workers that they would get their benefits from Social Security. I will be happy to answer your questions later.

[The prepared statement of Mr. Gebhardtsbauer follows:]

Statement of Ron Gebhardtsbauer, Senior Pension Fellow, American Academy of Actuaries

The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is non-partisan and assists the public policy process through the presentation of clear, objective analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.

Protecting and Strengthening Social Security

Chairman McCrery, Congressman Levin, and distinguished committee members: thank you for the opportunity to testify on the impact of longevity on Social Security's finances and ways to encourage work at older ages. My name is Ron Gebhardtsbauer, and I am the Senior Pension Fellow at the American Academy of Actuaries. We are the non-partisan professional organization representing all actuaries in the U.S. and do not endorse or propose legislation. Instead, we analyze the potential effects of legislation and evaluate its advantages and disadvantages relative to current law.

The Demographic Challenges for Social Security: As you noted in your announcement for this hearing, there are major demographic challenges for Social Security: the retirement of the baby boomer generation and longer life spans. Chart I, at the end of this testimony, graphs Social Security's annual income and outgo. It shows that outgo increases rapidly for 20 or so years starting in 2008, when the baby boomers are first eligible for (old-age) retirement benefits. Outgo, as a percentage of covered payroll continues to increase thereafter, even though the baby boomers are retired, due to projected increases in our longevity. The problems do

not get easier. The difference between Social Security's outgo and income will continue to widen, unless we reduce benefits, increase taxes, and/or raise the normal retirement age (NRA).

Raising Social Security's Retirement Ages: You have asked us to discuss the options for raising Social Security's retirement ages. Retirement age is at the heart of the issue of balancing the Social Security system by defining the appropriate cultural expectations between the period of work and retirement life. More extensive information on the effects of increasing retirement ages on workers, employers, and Social Security can be found on the Academy's website (*http://www.actuary.org/socsec/background.htm*). At this hearing, you expressed a particular interest in how raising the retirement age would affect Social Security benefits and retirement ages.

Current Rules Increasing the Normal Retirement Age (NRA): Between 2000 and 2005, Social Security's normal retirement age (the age at which there is no reduction for early retirement) increased from age 65 to age 66. Although this change has already affected the benefits of people born after 1937 who retired early, there has been little negative feedback. That may be because:

1. Congress made this change in 1983, many years before it affected anyone's retirement benefit.
2. Congress only applied the change to people under age 45 at enactment, thus giving workers many years to prepare for it. The change did not affect people who were closer to retirement, who would have had less ability to change their retirement plans.
3. Congress phased the increase in NRA to age 66 gradually over the six years from 2000 to 2005 so there would be no reduction in initial benefits compared to people who retired the year before. For example, raising the normal retirement age from 65 to age 65 and two months in the year 2000, reduced benefits for people retiring at age 62 by about 1 percent. As wages probably increased by more than 1 percent over their last year of work, a retiree's benefit is likely to be larger than the initial benefit of a similarly situated person who retired in the prior year.
4. We are not only living longer, we are healthier at older ages, as shown by lower levels of impairment.[1]
5. Fewer jobs are physically demanding, now.
6. More people are interested in staying active both mentally and physically, and jobs help to promote that.
7. Many recent retirees may not even have realized it happened.

The 1983 Social Security reform also increased the normal retirement age from age 66 to age 67, but it won't start affecting people's benefits until 2017. It affects people born after 1954, and will be fully phased in at age 67 for people born after 1959. Thus, all these gradual changes in the NRA (from age 65 to age 67) affect people born after 1959, so their benefits will have been reduced by about 13 percent. However, because each generation is living longer, we really only decreased the value of lifetime benefits by around 5 percent.[2] In other words, if we don't increase the NRA, then we are de facto increasing Social Security lifetime benefits, because future generations will receive benefits for more years. If we do gradually raise the NRA, we can keep total lifetime benefits about the same (or the same relative to payroll taxes paid).

Proposals to Increase NRA: One possible reform option would eliminate the hiatus in the increase in the NRA to age 67. Instead of waiting until 2017 to start increasing the NRA again, it could start next year. The Social Security actuaries have determined this change would eliminate only about 7 percent of Social Security's 75-year shortfall, because it only affects people born between 1944 and 1959 and only by a small amount.

Another option found in the 1996 Social Security Advisory Council Report would, in addition to the last suggestion, very gradually increase the NRA by one month every two years so that the NRA would reach age 68 in 2035 for workers born in 1973. Age 70 would be reached in 2083, but that would only affect people not yet born (i.e., for people born in 2021). This proposal increases the NRA only one-fourth

[1] See Chronic disability trends in elderly US populations: 1982–1994 by Manton, Corder, & Stallard. In 1982, 14.1 percent of elderly between 65 and 74 were IADL (Instrumental Activities of Daily Living) or ADL-impaired or institutionalized. In 1994 this decreased to 11.5 percent. For ages 75 to 84, it dropped from 31.9 percent to 26.9 percent.

[2] Based on Table V.A.4, males age 65 in 2022 will live 8.4 percent longer than males age 65 in 2000, so the 13.3 reduction in benefits is offset by an 8.4 percent increase in years receiving the benefit.

as fast as the recent increases in NRA, and it eliminates about 36 percent of Social Security's shortfall.

Raising the NRA could eliminate the shortfall if it were done fast enough. The current increases in the NRA of two months per year create benefit cuts that are very similar to those created by price indexing the basic benefit formula, which would eliminate the shortfall. Thus, continuing the increases in the NRA by two months per year to an NRA higher than 67 would substantially reduce Social Security's shortfall.

Disability Retirees Not Affected:[3] Raising the NRA is different from a straight-forward benefit cut in one aspect. It does not affect disability benefit amounts, whereas decreases in the benefit formula do affect the disabled because the same formula is used to determine both old age and disability benefits. Because disability benefits are not cut when the NRA is increased, more people in their 60s may apply for and receive disability benefits, and the Social Security actuaries have reflected that in their pricing of the proposals that affect retirement ages.

Early Retirees Are Affected: The above proposals do not change the earliest eligibility age (EEA) for retirement benefits under Social Security. Workers could still retire at age 62 and receive Social Security benefits. However, if the earliest retirement age stays at age 62, then those benefits become much smaller. For example, if we raise the NRA to age 70, then the age 62 retiree will have retired 8 years earlier than the NRA, which means their benefits will be only 55 percent of the benefits they would have received at the NRA. This issue of inadequate benefits is also important for surviving spouses, because a couple's total benefit can drop by one-third on the death of a spouse. One way to discourage these early retirements might be to require the spouse to sign off on early retirement decisions (acknowledging the reduction in benefits due to early commencement), but that would complicate administration (e.g., if separated spouses cannot be found or if they disagree on the appropriate retirement age).

This issue is important for workers in physically demanding jobs. Should Social Security continue to pay these benefits at an early age (even though they would be smaller), even though it can encourage people to retire too early, or should we increase the earliest eligibility age for Social Security benefits? This issue also affects employers who provide these jobs. If they need to retire workers in physically demanding jobs early, then they will find that they need to provide adequate pensions at those ages, which emphasizes the importance of a strong voluntary defined benefits retirement system to provide supplemental benefits until Social Security benefits are available.

Proposals to Increase the Earliest Eligibility Age: To avoid inadequate early retirement benefits, some proposals also gradually increase the earliest eligibility age for retirement benefits from age 62 to age 65. Social Security's actuaries noted that this would eliminate an additional 10 percent of the Social Security shortfall.[4] This change in EEA doesn't help Social Security much over the long run, because the system is designed so that a person's total lifetime benefits have approximately the same value regardless of the age that one elects to commence benefits. The effect on Social Security is that a small amount of cash outlays would be delayed, which would help the unified budget a small amount, but the following year their benefits would be paid and their benefits would be slightly larger than they would have been had people been able to retire earlier. In addition, raising the EEA might encourage more unhealthy workers (especially those in physically demanding jobs) to apply for disability benefits, which are larger than early retirement benefits.

Encouraging Work at Older Ages: While raising the EEA only reduces Social Security's shortfall by 10 percent, it can have a large effect on when people retire, since a person's retirement date is very much a financial decision.[5] Raising the EEA can encourage people to work longer, and not retire until they can get their Social Security pension. Chart II, at the end of this testimony, shows that retirement ages quickly shifted to age 62 after Social Security allowed benefits at that age for men in 1961 (enacted in 1956 for women). However, in the past 20 years, workers have started retiring later due to:

1. Government policy encouraging work (e.g., mandated employer-based pension accruals after age 65, higher Social Security earnings limit before NRA, no

[3] Certain other survivors are not affected by an increase in NRA, as noted in my earlier testimony on the subject of Increasing the Retirement Age, at *http://www.actuary.org/pdf/socialsecurity/ss_future.pdf* (page 2).

[4] Per the 1994–1996 Social Security Advisory Council Report Appendix III, items D1c and D2a.

[5] In addition, people retire due to a desire for leisure, or due to the inability to work or find work, or due to the desire to retire after a spouse retires.

earnings limit after NRA, increased NRA, increased credits from Social Security for working beyond NRA, training programs under Older Americans Act, etc.);

2. Employers converting their defined benefit plans to 401(k) arrangements, which will provide smaller incomes for most people and require employees to retain investment and longevity risks;
3. Employers cutting back on their post-retirement medical plans so that many more employees wait until they can receive Medicare at age 65; and
4. Employers compensating workers more to retain them in certain industries due to labor shortages, particularly now that baby boomers are starting to retire and the numbers of new workers may not be enough to replace the retiring workers.

Increasing both the Normal and Earliest Eligibility Ages: Increasing Social Security's earliest eligibility age to 65 in tandem with the increase in the NRA to age 70 by 2083 (described earlier) would eliminate about 46 percent of the shortfall.

Solvency and Sustainability of Social Security: So far we have only discussed raising retirement ages. Another option would be to increase contributions. Increasing contributions by 1.92 percent of covered earnings would eliminate 100 percent of the shortfall and make the system *solvent* over the next 75-year period. However, if this is the only change, we might be back here in 20 years with a large deficit again, due in part to our continually increasing life spans. The same is true if we immediately cut all benefits by 13 percent to achieve 100 percent solvency. In fact, this is one reason why the 1983 fix did not last. It made the system solvent for the 75-year period ending in 2058 (1983 + 75).[6] Now the 75-year period includes many more *deficit* years, in which outgo is more than income due to our longer life spans. Thus, as long as we continue to live longer, we will need very slow and gradual increases in retirement ages (or small and continual increases in taxes or reductions in benefits). If we don't want Social Security to continually go out of balance, then we need to not only make it solvent, but also make it sustainable. The accepted test for sustainability is that trust fund ratios in the final years of the 75-year period be level or increasing.

Predictability: There is another reason that could bring us back to the table in future years, even if we have a solution that is estimated to be sustainable under intermediate projections. We may live longer than assumed under the intermediate projections, have fewer children, have higher inflation, or be less productive. In fact, these last two concerns become more relevant now that we are discussing price indexation (or progressive price indexation) of the initial benefit at retirement.

Indexation of Initial Retirement Benefits: Under price indexation, if real wages increase less than projected under the intermediate assumptions, Social Security will receive less payroll taxes. Benefit outgo could increase more than wage income if real wages were negative like they were in the 1970s. Thus, under price indexation, the pessimistic projection of trust fund assets could still go to zero just when the economy is in bad shape, and benefits would have to be cut and/or taxes raised again. On the other hand, if real wages increase more than expected under the intermediate assumptions, payroll taxes would be more than expected, but benefits (only increasing with price inflation) would fall further and further behind wages. This would make the optimistic projection of the trust fund assets increase much faster than expected. If it actually happened, we would find we had cut benefits more than needed and/or increased taxes more than needed. In summary, price indexation would increase the spread between the optimistic and pessimistic forecasts. Social Security's finances would be more volatile. Wage indexation reduces that problem, because when wages go up more than expected, benefits do too (although with a lag).

Automatic Adjustments: Because it is impossible to predict the economy or the future demographics of the system, Congress might want to consider slightly modifying Social Security so that it automatically handles unexpected changes in the economy or the demographics of the nation. For example, indexing the initial retirement benefits to *wages* would make the system less volatile to unexpected changes in wages.

That's not to say that we should not use *price indexation*. We could use it (or something similar, such as increasing initial retirement benefits by wage growth less 1 percent) if we wanted to gradually decrease benefits, but it only makes sense to use it until benefits are at the desired level. If price indexation is not turned off, benefits eventually fall below contributions, at which point, Social Security would

[6] Another reason is that some assumptions did not fare as well, such as real wage growth and mortality, and this will be discussed later.

have surpluses thereafter. Some note that this gives us the option to reduce payroll taxes at that point in time. We could also decide now whether to return to wage indexation or reduce taxes at that date (although it should be noted that if we do not ever return to wage indexation, then benefits eventually become inconsequential in comparison to wages). Similarly, we could try *progressive price indexation*, if we wanted to move to a Social Security system that provides level benefits (i.e., the same benefit for everyone as in the United Kingdom's tier I benefit) instead of the individually equitable benefits under today's system. Under a current proposal for progressive price indexation, benefits would become the same amount for middle and upper income workers in 75 years assuming real wages grow by 1.1 percent per year (or 65 years assuming real wages grow at 1.3 percent per year).

We could also automatically respond to unexpected changes in life spans. That would decrease the large spread between the optimistic and pessimistic projections.

Life Spans: There is much disagreement on whether life spans will increase faster or slower than the intermediate projections in the trustees' reports.[7] Past improvement in life spans suggest that we could fully index the system to keep it in balance by increasing the normal retirement age very gradually (by one month every two years, which reduces the increase in benefits by only ¼ percent per year). This would be less than one-fourth of the reductions in benefits under price indexation. If life spans increase more, then we would eventually have to cut benefits more or raise taxes more. If life spans increase less than expected, then benefits will have been cut too much (or taxes raised too much). A solution would be to index benefits, payroll taxes, or the NRA to life spans. Some call this longevity indexation. If life spans increase faster or slower than expected, Congress could create rules that automatically make an adjustment (within parameters set by Congress on how fast the changes could occur and how soon they could be applied).[8] These adjustments would be based on historical improvements in life spans and not depend on the person doing the calculations. If the Social Security system is indexed by longevity, then the optimistic and pessimistic projections would not be so far apart.

Which of those three choices (indexing benefits, taxes, or NRA) would make the most sense? In order to analyze this, it helps to look at the extremes. In the distant future, when people are living to age 150 (for example), will it make sense to still have the retirement age at 67 so that we are retired for 80 years (twice as long as our working lifetimes) and our pensions are tiny, or our contributions huge (to maintain the same level of benefits)? Or will it make more sense to have a later retirement age and not have to continually cut benefits and/or raise taxes so much? While raising the normal retirement age appears to be a more logical solution, we would still have to address the issue of unhealthy people who are not quite eligible for Social Security disability benefits and workers in physically demanding jobs. Gradually relaxing Social Security's disability tests as is done currently at older ages[9] already addresses this concern to some extent. A flexible employer-sponsored defined benefit system, which can provide pension benefits tailored to the individual aspects of each company's workforce also can be of great help.

These longevity indexation provisions could help prevent Social Security from getting out of actuarial balance in the future, relieving Congress from having to address Social Security issues every 20 years. While it might not put Social Security on autopilot forever, it would be an improvement on current rules. In addition, if Congress ever felt uncomfortable with benefits being cut too much (or taxes going up too fast) by the automatic rules, they could revise them. In fact, they could give themselves an automatic standing order to vote on changes, with preferential rules requiring a vote.

Additional Issues to Address

In addition to the issues discussed above, you asked that we discus ways to encourage people to work at older ages.

Consistent Laws: If Congress wants to encourage work at later ages, you may want to consider having consistent rules so that workers think of age 67 as the "*normal*" retirement age. For example, Medicare still uses age 65, and employer pension

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[7] Olshansky, S.J., Passaro, D., Hershow, R., Layden, J., Carnes, BA., Brody, J., Hayflick, L., Butler, RN., Allison, DB., Ludwig, DS. 2005. A Possible Decline in Life Expectancy in the United States in the 21st Century. New England Journal of Medicine 352:1103–1110

[8] For example, we might not want benefits, taxes, or retirement ages to be constantly changed up and down, so some smoothing mechanism could be employed. In addition, Congress might not want to change benefits or retirement ages for people close to retirement.

[9] Per Social Security regulation Sec. 404.1563

plans are not allowed[10] to use a normal retirement age later than age 65. During these economically difficult times for employers, it might be valuable for Congress to consider allowing, and possibly encouraging, employers to have a normal retirement age in their pension plans that was consistent with Social Security. For example, Congress could provide employers flexibility in meeting the administratively complex accrual rules, if the plan sponsor increases the NRA gradually for employees who were accruing benefits. The new benefit accruals would ensure that employees' benefits were not being reduced, without having to test them each month.

This would not mean that employees had to work until age 67 to get their employer pension. Just as with Social Security, most employers allow employees to retire and commence pensions earlier. In fact, most employers allow early retirement at age 55. It would just allow employers to keep their NRA consistent with Social Security's NRA, and thus keep their pension plan costs from spiraling up as we live longer.

Conversions to Cash Balance Plans and Elimination of Early Retirement Subsidies: A new kind of defined benefit pension plan, called a cash balance plan, also encourages workers to retire later. Some history may be needed to explain it. Many employer pension plans added subsidized early retirement benefits in the 1970s and 1980s when the labor supply was high. It helped workers retire at younger ages when the baby boomers (and many women) were looking for work. However, now the tide has turned and labor is not as plentiful, so employers may not want to encourage early retirement; they may need to retain their employees. Employers can eliminate their early retirement subsidies or they can convert their traditional pension plan to a cash balance plan. Cash balance plans promise workers an account with a guaranteed rate of return. They are easier for employees to understand and provide better benefits for young and mobile workers, but they can also decrease the growth in future accruals for older, long-service employees. After 20 years of their existence, the law is still not clear for these plans, and court cases have further complicated their prospects. Employers need Congress to clarify the law so that they can design their pension plans in an acceptable way that won't subject them to expensive litigation.

Phased Retirement: Employers are developing other ways to retain their employees, such as phased retirement programs; however, such programs face legal obstacles because an IRS regulation[11] requires that retirement plans be exclusively for (full) retirement. The Internal Revenue Service is to be commended for proposing a rule allowing employers to pay partial pensions when employees are phasing gradually into retirement. However, there is concern about the incredible complexity in the proposed rule as discussed in our letter to the IRS on this subject. Congress might consider clarifying the law, so employers can have phased retirement programs without having to constantly monitor an employee's hours and adjust their pension amount for ups and downs in hours worked.

Other Dangers to Employer Sponsorship of Retirement Plans: There are suggestions to reform the federal tax system to a consumption based tax, or provide equivalent tax advantages to all savings through such vehicles as Lifetime Savings Accounts (LSAs), or provide tax advantages to annuities purchased with non-pension funds. If there are no incentives for employers to surmount the enormous complexity and cost of providing pension plans to their workforces, they will surely face no alternative but to terminate their pension plans. This would be unfortunate not only for the retirement security of the nation's workers, but also for employers who use these plans to help with workforce management issues, and for the country, which benefits from the large pool of pension savings that are efficiently invested in the economy. In addition, employer-sponsored pension plans help reduce our reliance on Social Security and help provide diversification of retirement risks over the three legs of the retirement stool (government retirement systems, employer-sponsored pension plans, and individual savings). If any of these proposals are acted upon, it is important to examine and debate how they would affect national retirement security, and consider ways to encourage employers to provide pensions for their employees.

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[10] See Internal Revenue Code Sec. 411(a)(8), which defines the maximum NRA as age 65 and 5 years of service, Sec. 401(a)(9) which defines a maximum distribution starting age of 70½ for owners, and Sec. 401(a)(14) which sets the latest commencement date rules (age 65 and 10 years of service).

[11] IRS regulation Sec. 1.401–1(b)(1)(i)

Summary: The demographic challenges for Social Security brought about by the baby boomers' upcoming retirements and our longer life spans can be solved through various gradual indexation methods. These include indexation of contributions, benefits, or the NRA to life spans and anti-volatility mechanisms to automatically adjust them if longevity improves faster or slower in the past. This indexation could reduce Social Security's vulnerability to future changes that we can't predict. Then Social Security would be less likely to go out of balance and Congress would be less likely to be called on to address these difficult issues. It would also help workers feel more assured that they would get their benefits from Social Security.

In addition, preserving and providing flexibility to the employer-based pension system could help us encourage more work at older ages. It also could help us avoid having to pay the larger Social Security benefits prevalent in other countries. Hopefully, Congress will continue to encourage employers to provide these pension plans, and not discourage them, as might happen with some recent proposals.

The Academy appreciates the opportunity to testify before this committee.

Chart I

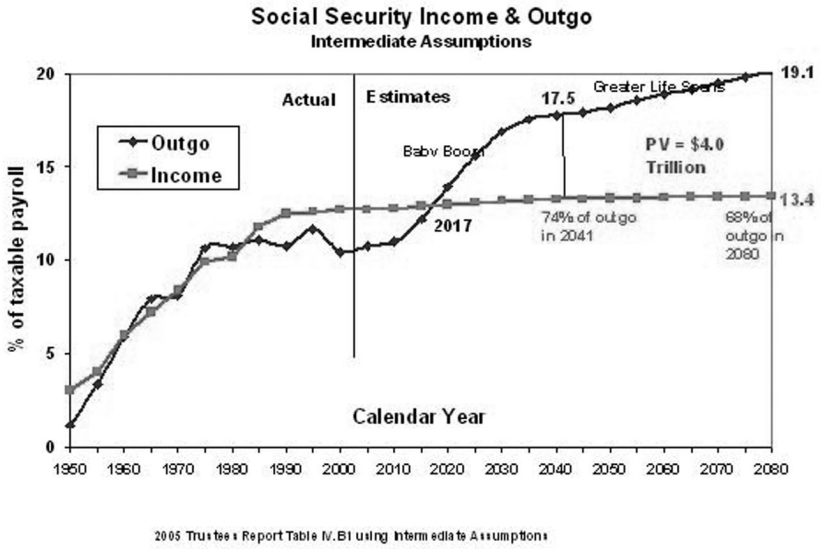


Chart II

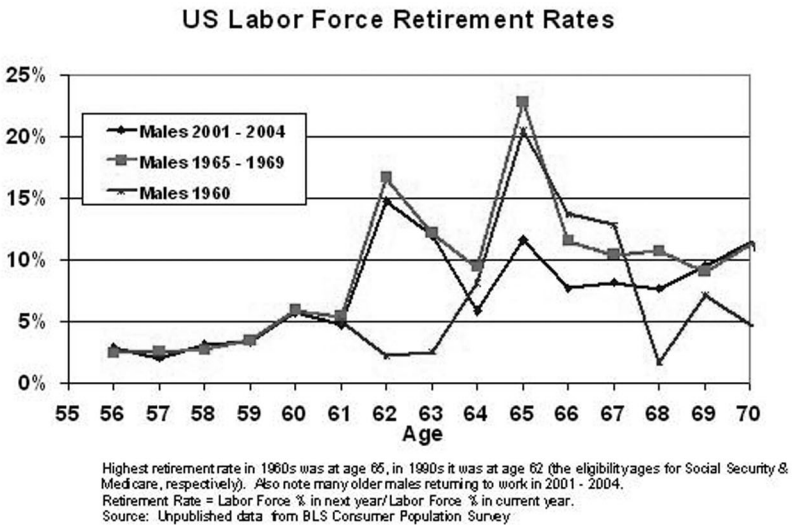
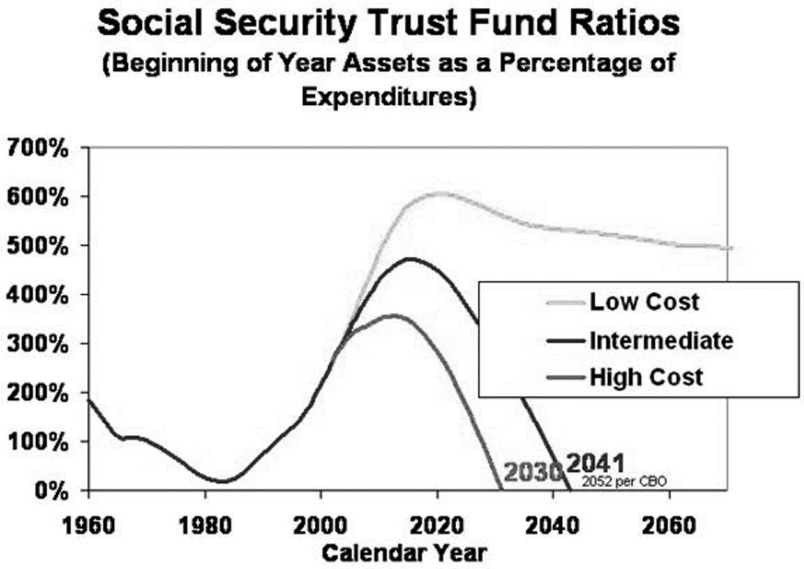


Chart III



Chairman MCCRERY. Thank you. Ms. Long?

STATEMENT OF VALERIE LONG, PRESIDENT, SERVICE EMPLOYEES INTERNATIONAL UNION, LOCAL 82, AND INTERNATIONAL VICE PRESIDENT, INTERNATIONAL EXECUTIVE BOARD, ON BEHALF OF GERALD HUDSON, EXECUTIVE VICE PRESIDENT, SERVICE EMPLOYEES INTERNATIONAL UNION

Ms. LONG. Thank you, Chairman McCrery and Ranking Member Levin, and Members of the Subcommittee. First I would like to extend apologies for Executive Committee Member Gerald Hudson, who wasn't able to make it today, and I really appreciate the opportunity to speak on behalf of 1.8 million members of the Service Employees International Union (SEIU) that we represent. More importantly, I would like to talk on behalf of the 8,000 property services workers of which I am privileged to represent here in Washington, D.C. I represent janitors, other building service workers, and ground keepers right here in the Nation's capital. Our overall State council represents 25,000 workers, about 8,000 of them are long-term care workers that work in nursing homes, as well as public services.

The majority of those people work really hard at physically demanding jobs. The kind of work that leaves you dead tired at the end of the day. They do it week after week, month after month, year after year, and at the end of decades they want to retire and get some rest. When we consider the proposals to provide secure retirement for ordinary working folks like those, the deliberations that you are involved in are important to those members that we are privileged to represent.

A janitor's working day, the members that I represent, is filled with stooping, bending, heavy lifting, having what the industry calls backpack bags on your back that are loud and heavy. People are pulling trash, pulling are stooping a lot, and many of them are part-time workers, who leave those jobs and go to other jobs like day labor jobs, food service jobs, and are doing the same demanding work, and sometimes even more demanding. It is the same in other industries where we represent workers. I have worked with a lot of our members in long-term care that work in nursing homes, and what they tell me is their work is extremely physical. You are on your feet all day, you are responding to the needs of people who are unable to feed, clothe, or bathe themselves because of age or poor health. Daily you are lifting people in and out of beds and into wheelchairs, turning them around in their beds, helping them take their baths. At any time, one slip or fall can cause permanent injury, and there are thousands of these workers who have back injuries. Nursing home work is some of the most dangerous work in America. While most people believe that nursing homes are safe facilities, they are actually more dangerous for workers than a coal mine, a steel mill, a warehouse, or a papermill. Nearly one in five nursing home workers will be injured or become ill on the job each year, more than twice the rate of other workers.

So, it is no wonder that by the time nurse's aides and janitors get to be 50 or 55, often with more than 30 years on the job, they start to pay close attention to what they can expect from Social Security. It won't be much. Even unionized workers in these indus-

tries sometimes don't have any retirement benefits or pensions, and those kind of cleaning companies aren't known for high pay either, but it can be enough to keep them out of poverty when they can't work any more. That is the point. There comes a time sooner or later when workers really can't physically work any more, and because they aren't a lot of other jobs out there for 50—and 60-something building cleaners or nursing home workers, these folks are going to need Social Security benefits sooner rather than later. That is true for a lot of SEIU members like road workers, nurses, and home health care aides and many others.

It is also true for millions of hard-working Americans with jobs in manufacturing, transportation, construction, and other physically demanding jobs. It is true too for people working in jobs where the stress is less physical but no less demanding, like social workers and prison guards. The time comes when people simply can't keep working. If that time comes before the normal retirement age, they stand to collect benefits that are about 25 percent lower than their peers who can hold out longer. Raising the normal retirement age won't magically make everyone able to work longer, it will only move the finish line so they must wait longer for their full Social Security retirement benefit, or more likely, take a bigger benefit cut.

When the Social Security Act (P.L. 74–273) was amended in 1956 and 1961 to allow early retirement, the age was set at 62, and a worker starting to collect benefits at that age faced a 20-percent reduction. Then the 1983 amendments increased the full retirement. Once full retirement age reaches 67 in 2022, the early retirement reduction will be 30 percent rather than 20 percent. A lot of working people can expect benefit cuts if the retirement age goes up. Most workers already retire before reaching full retirement age. About 71 percent of the people retiring in 2002 elected to receive early retirement benefits, and more than half of all retirees receiving benefits today began to draw their benefits at age 62. Only 4 percent waited until 66 or later to receive benefits. Probably some of these early retirees were people who did well enough in their jobs or their investments that they could afford to stop working when they felt like it. I know that many of the people who elected to start collecting their Social Security checks at 62 or 63 did it because they had no choice: their aging bodies could no longer stand up to the wear and tear of their jobs, and Social Security was the only way to keep the wolf from the door. Changing the Social Security retirement age would do a great injustice to millions of people who have worked the hardest to earn a decent rest at the end of their working lives. Thank you.

[The prepared statement of Ms. Long follows:]

Statement of Valerie Long, President, International Vice President, Service Employees International Union, International Executive Board, on behalf of Gerald Hudson, Executive Vice President, Service Employees International Union

Chairman McCrery and Ranking Member Levin:

Thank you for the opportunity to join in this discussion of preserving and strengthening Social Security. I appear today on behalf of the 1.8 million members of the Service Employees International Union, the nation's largest and fastest-growing labor union. SEIU members work in health care, public services, and property

services. Our members have elected me to serve them and take responsibility for our long-term care division, which represents nearly 500,000 nursing home and home care workers nationwide.

The majority of SEIU members do hard physical work, the kind of work that leaves you tired at the end of the shift, worn out at the end of the week—and ready to retire at the end of decades on the job. I got a good sense of that work in the 1970s, when I was a direct care worker at the Hebrew Home for the Aged in Riverdale, NY.

Back then I had no idea that one day I would find myself testifying before Congress about work and retirement. But today when I consider proposals to provide a secure retirement for ordinary working folks, I think back to the people I worked with at the Hebrew Home, and how hard-working people like them will be affected by the decisions made here in the Congress of the United States.

Things haven't changed much in the last thirty years for nursing home workers and home care workers. The work of long-term care is extremely physical: you're on your feet all day long, responding to all the needs of people who are unable to feed, clothe or bathe themselves because of age or poor health. Daily you lift people into wheelchairs, turn them in their beds, help them into a bath. At any time, one slip could cause a painful and possibly disabling back injury.

In fact, nursing home workers have some of the most dangerous jobs in America. While most people believe that nursing homes are safe, clean health care facilities, a nursing home is actually more dangerous for workers than a coal mine, a steel mill, a warehouse, or a paper mill. Nearly one in five nursing home workers will be injured or become ill on the job each year—more than twice the rate of other workers.

I could tell you about Charlie Benninger, a nurse aide in Pennsylvania who suffered a herniated disk in his spine after six years of lifting nursing home residents. Or Ann Davis, whose ongoing back pain resulted from breaking the fall of a resident in the Ohio nursing home where she worked. Or Olgarene Oliver, still working in pain at age 61 after 22 years of lifting, turning and supporting residents.

So it's no wonder that by the time nursing home workers get to be 50 or 55—often with more than 30 years on the job—they start to pay close attention to what they can expect from Social Security. It won't be much—even union nursing homes aren't known for their high pay or benefits—but it can be enough to keep them out of poverty when they can't work any more.

And that's the point—there comes a time, sooner or later, when workers ***can't*** work any more. And because there aren't a lot of other jobs out there for fifty—and sixty-something nurse aides, these folks are going to need their Social Security benefits sooner, rather than later.

That's true for a lot of SEIU members like janitors and road workers, nurses and home health aides, and many others. It's also true for millions of hard-working Americans with jobs in manufacturing, transportation, construction, and other physically demanding jobs. It's true, too, for people working in jobs where the stress is less physical but no less demanding, like social workers and prison guards. The time comes when they simply cannot keep working.

If that time comes before the "normal" retirement age, they stand to collect benefits that are about 25 percent lower than their peers who can hold out longer. Raising the "normal" retirement age won't magically make anyone able to work longer; it will only move the finish line so they must wait longer for their full Social Security retirement benefit, or, more likely, take a bigger benefit cut.

When the Social Security Act was amended in 1956 and 1961 to allow early retirement, the age was set at 62, and a worker starting to collect benefits at that age faced a 20 percent reduction. When the 1983 amendments increased the full retirement age, no change was made in the age for early retirement. Once full-retirement age reaches 67, in 2022, the early retirement reduction will be 30 percent, rather than 20 percent.

A lot of working people can expect benefit cuts if the retirement age goes up. Most workers already retire before reaching full-retirement age. Seventy-one percent of the people retiring in 2002 elected to receive early retirement benefits. And more than half of all retirees receiving benefits today began to draw their benefits at age 62. Only 4 percent waited until age 66 or later to begin receiving benefits.

Probably some of those early retirees were people who did well enough in their jobs or their investments that they could afford to stop working when they felt like it. But I know that many of the people who elected to start collecting their Social Security checks at 62 or 63 did it because they had no choice: their aging bodies could no longer stand up to the wear and tear of their jobs, and Social Security was the only way to keep the wolf from the door. Changing the Social Security retire-

ment age would do a great injustice to millions of Americans who have worked the hardest to earn a decent rest at the end of their working lives.

Chairman MCCRERY. Thank you, Ms. Long. Ms. MacGuineas.

STATEMENT OF MAYA C. MACGUINEAS, PRESIDENT, COMMITTEE FOR A RESPONSIBLE FEDERALBUDGET, AND DIRECTOR, FISCAL POLICY PROGRAM, NEW AMERICA FOUNDATION

Ms. MACGUINEAS. Thank you. Mr. Chairman, Members of the Subcommittee, for having me testify. It is a privilege to appear before you. Since Social Security began, life expectancies have grown while birth rates have declined, leading to a work force that will grow more slowly than the retired population, and an ongoing decline in the worker to beneficiary ratio. Thus, the underlying premise of an inter-generational pay-as-you-go transfer system has actually been turned upside down. In many ways, Social Security reform is a numbers game. We have to decide what revenues to increase and what benefits to reduce. We have to decide on the timing of these changes, and we have to decide who will be affected and who will be protected. The more people we protect, the more others will have to be affected. When it comes to dealing with the demographic and labor force challenges, there are some sensible policies that could have dynamic positive effects beyond just their effect on Social Security solvency.

A sensible place to start is building adjustments into the Social Security system that reflect demographic changes. Longevity indexing is one such adjustment. Under longevity indexing, benefit levels would be adjusted based on projected increases in life expectancy. As life expectancies continue to grow, the amount of the annual benefits would be lowered to balance out that benefits would be collected over a longer period of time. So, benefits would still increase from one cohort to another due to wage indexing. Whereas now, each subsequent cohort gets a raise from wage indexing and longer life expectancies, that double bump up would be reduced. This change would offer more flexibility than increasing the retirement age, and it comes with less political baggage. Importantly, the changes would be made automatically, freeing Congress from having to continually make the tough choices of when to adjust benefits.

Another option is something I would call progressive longevity indexing, and this option would use more detailed life expectancy projections, broken apart by economic group, reflecting that high-income individuals are living increasingly longer than those with lower incomes. Progressive longevity indexing would undo some of the disproportionate gains that are going to the better off. Like longevity indexing, the change would do nothing to make cohorts worse off on a lifetime basis than those that came before them. An additional approach to adjusting benefits is to find ways to encourage workers to remain in the workforce longer, thereby increasing the revenues they pay into the Social Security system and decreasing the time period over which they collect them.

The effects of the higher economic contributions and keeping people engaged in productive work for longer would be significant. One option would be to tie full retirement benefits to a set number of years of work rather than a set retirement age. For instance, workers could be entitled to full benefits after 40 years of contributions, which would allow somebody who began working at age 20 and worked straight through, to retire at 60, while somebody who may have spent more time in school or out of the work force would receive full benefits at a later age. People would still be able to retire earlier, but their benefits would be reduced accordingly, reflecting their fewer years of contributions.

Another option would be a late retirement bonus. It is well established that people prefer lump sum payments to annuities, even when the value of the annuity would be higher. By allowing workers to choose to take some of the larger benefit they would have accrued from their additional years of work in the form of an up front payment, we could encourage people to work for a bit longer. Perhaps the most important change we can make is developing more flexible workforce options for workers who want to remain in the work force beyond the retirement age. With good reason, the idea of gradual retirement and productive aging is becoming more popular. Finding new ways to allow for, and encourage, flexible work environments will be key in both helping the solvency of the Social Security system and addressing the wider problems of labor market shortages.

Reducing the many biases that exist against part-time work, both in terms of compensation and perception, will be key. For instance, allowing workers to begin collecting from their private pensions while participating in phased retirements would be one option. The solution probably does not lie in using mandates to force businesses to change or using the over utilized tool of tax credits to encourage them to do so, but instead, the combination of the mass exodus we are about to experience from the labor pool, and the many benefits of keeping talented workers active provides a win-win option for businesses and individuals.

Interestingly, I think there is a tremendous opportunity here for the AARP and work-family communities to work together in helping make transparent what kind of more flexible work conditions really help people choose to stay in the workforce for longer. I am encouraged by the choice of the topic of today's hearing. Both longevity indexing and more flexible work conditions offer fair and sensible options to help the Social Security system. None of the choices we confront as the result of an aging society are simple, and the changes I have mentioned today alone will not be sufficient to fix Social Security, but they are a good place to start in implementing long overdue reforms in that they would both help the Social Security system, and would also help the economy at large. Thank you.

[The prepared statement of Ms. MacGuineas follows:]

Statement of Maya C. MacGuineas, President, Committee for a Responsible Federal Budget and Director, Fiscal Policy Program, New America Foundation

Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for the opportunity to testify. It is a privilege to appear before the Subcommittee. When

Social Security started in 1935, it was assumed that each generation would be larger than the previous one, leading to manageable costs on individual workers. Nobel Laureate Paul Samuelson wrote, "The beauty about social insurance is that it is actuarially unsound. Everyone who reaches retirement age is given benefit privileges that far exceed anything he has paid in . . ." However, demographics have changed from what we expected when the program was designed. Life expectancies have increased while birth rates have declined, leading to a workforce that will grow more slowly than the retired population, and a continuation in the decline of the worker to beneficiary ratio.

The first of the seventy-eight million Baby Boomers will retire in 2008. Many of them will spend as much as a third of their adult life in retirement. Over the next half century, the number of Social Security beneficiaries will more than double, while the number of covered workers will increase by only 22 percent.[1] Thus, the basic underlying premise of the intergenerational, pay-as-you-go, transfer system has been turned upside down.

Table 1

	At Birth		At Age 65	
	Male	**Female**	**Male**	**Female**
Actual				
1940	61.4	65.7	11.9	13.4
1950	65.6	71.1	12.8	15.1
1960	66.7	73.2	12.9	15.9
1970	67.2	74.9	13.1	17.1
1980	69.9	77.5	14.0	18.4
1990	71.8	78.9	15.1	19.1
2000	74.0	79.4	15.9	19.0
Projected				
2010	75.4	80.0	16.6	19.2
2025	77.0	81.2	17.5	20.0
2050	79.4	83.2	18.9	21.4
2075	81.3	84.9	20.2	22.7

Source: Social Security Administration

In many ways Social Security reform is a numbers game—we have to decide what revenues to increase and what benefits to reduce. We have to decide the timing of these changes. And we have to decide who will be affected and who will be protected—the more some are protected, the more others will have to be affected.

But when it comes to dealing with the demographic and labor force challenges, there are some sensible policies that have dynamic, positive effects beyond just their effect on Social Security solvency. Let me be clear, I am not advocating that there are any free lunches out there—there are not. Social Security reform will require tough choices and they should be made sooner rather than later. But smart choices will help ease the transitions.

When Social Security began, workers on average were not expected to live to the retirement age of 65 while now they are expected to live decades beyond that. Though the retirement age is moving (at glacial speed) towards age 67, this change alone will not be close to enough to return the ratio of retired years to working

[1] According to the Social Security Administration, between 2005 and 2055, beneficiaries will grow from 47 million to 98 million, while covered workers will grow from 158 million to 194 million.

years to what it once was. Supporting retirees for roughly a third of their adult life in retirement would require far greater levels of Social Security taxes than we have been willing to contribute.

Changes to Social Security

A sensible place to start is building adjustment into the Social Security system that reflect these demographic changes. Longevity indexing is one such adjustment. Under longevity indexing, benefit levels would be adjusted based on projected increases in life expectancy. As life expectancies continued to grow, the amount of the annual benefits would be lowered to balance out that benefits would be collected over a longer period of time. If life expectancy increases slowed down, the adjustments would slow correspondingly. Benefits would still increase from one cohort to the next due to the wage indexing of benefits. But whereas now each subsequent cohort gets a "raise" from wage indexing *and* longer life expectancies, that double-bump up would be reduced. A number of reform proposals have included longevity indexing in one form or another as one of their components. This reform is not untried; versions of it have been used in Italy and Sweden.

Longevity indexing can be done in a number of ways. One option is to reduce the initial benefit based on life expectancy. Another is to modify the 90, 32, and 15 PIA formula factors to reflect life expectancy expectations or by some pre-set amount. Generally, proposals would rely on the Social Security Administration's projections for life expectancy and adjustments would be made on a regular basis. Most proposals would exempt disability and some other auxiliary benefits from the adjustments.

This change is similar to increasing the retirement age, but has the advantage that it would allow more choice about when participants retire, which offers a desirable level of flexibility. Furthermore, while increasing the retirement age (both early and normal) is a sensible policy, many politicians strongly oppose it. Thus, longevity indexing offers a policy with similar benefits but less political baggage. A second advantage is that the changes would be made automatically, thereby removing the need for Congress to continually make the tough choice of when to adjust benefits. Congress could always alter the adjustments, but automatic indexation would do much of the heavy lifting.

Another option is something I would call "Progressive Longevity Indexing". Generally, longevity indexing is based on a single, unisex, life expectancy projection. However, one could use more detailed life expectancy projections, broken apart by economic group. This approach is easily justified by the fact that high-income individuals are living increasingly longer than those with lower incomes. Thus, the effects of growing income inequality are exacerbated by the growing inequalities in life spans. Progressive longevity indexing, which would allow benefits to be adjusted by life expectancy expectations for specific income groups, would undo some of the disproportionate gains going to the better-off. Like longevity indexing, the changes would do nothing to make cohorts worse off than those that came before them on a lifetime basis.

Labor Force Alternatives

An alternative or additional approach to adjusting benefits to reflect longer life expectancies is to find ways to encourage workers to remain in the workforce for longer, thereby increasing the revenues they pay into the Social Security system and decreasing the time period over which they collect benefits. The positive benefits of such policies clearly go beyond their effects on the Social Security system. The labor force is projected to grow far more slowly in the future than it has in the past. This is true even accounting for higher levels of immigration. The higher economic contributions from keeping people engaged in productive work for longer would be significant.

One option would be to tie full retirement benefits to a set number of years of work rather than a set retirement age. For instance, workers could be entitled to full benefits after 40 years of contributions, which would allow somebody who began working full-time at the age of 20 and worked straight through, to retire at 60, while those who may have spent more time in school or out of the workforce, would receive full benefits at a later age. People would still be able to retire earlier, but their benefits would be reduced accordingly, reflecting their fewer years of contributions. This policy would undo some of the bias against workers who are in the workforce for years beyond those where they get full credit for their contributions.

Another option would be a late retirement bonus. It is reasonably well established that people prefer lump-sum payments to annuities even when the value of the an-

nuity is higher.[2] Thus, there is an opportunity to incentivize people to stay in the workforce by offering a lump-sum payment as a reward. For instance, workers who remained in the workforce until the age of 70, or for 45 years or more, could be offered a small immediate payout upon retirement on top of their traditional benefit. By allowing workers to choose to take some of the larger benefit they would have accrued from their additional years of work in the form of an up-front payment, many would be motivated to work a bit longer. You could construct this lump-sum payment so that it would actually save money for the Social Security system but still serve to encourage workers to work longer.

Perhaps the most important change we can make on this front is developing more flexible workforce options for workers who want to remain in the workforce beyond the retirement age, but may not want the commitment or responsibility of a traditional, full-time job.

With good reason, the idea of gradual retirement and productive aging is becoming more popular. Many workers do not want to shift abruptly from a full-time work environment to full-time leisure. At the same time, they do want to scale back their time commitments and increase the flexibility of their jobs, to allow more leisure time, time with the family, flexibility to deal with health issues, etc. Similarly, many employers are realizing they are beginning to lose a significant segment of their talent pool. This loss of institutional knowledge will only grow as the Baby Boomers start to leave the workforce.

Finding new ways to allow for and encourage flexible work environments will be a key in both helping the solvency of the Social Security system and addressing the wider problem of labor market shortages. Currently, part-time and nonstandard workers receive, on average, lower hourly wages than do their full-time counterparts.[3] Furthermore, only 14% of nonstandard workers receive healthcare benefits compared to 69% of traditional workers in the same jobs.[4] The discrepancies between part and full-time coverage for pensions is similar to that of healthcare.

Reducing the many biases that exist against part time work—both in terms of compensation and perception—will help to encourage workers to remain in the workforce well beyond when they might otherwise retire. For instance, allowing workers to begin collecting from their private pensions while participating in phased retirement would be one option to induce workers to remain in the workforce. There is a tremendous opportunity for advocates of flexible work from the AARP and the work-family community to work together on this issue. The solution does not lie in using mandates to force businesses to change, or using the over-utilized tool of tax credits to encourage them to so. Instead, the combination of the mass exodus we are about to experience from the labor pool and the many benefits of keeping talented workers active, provides a win-win option for businesses and individuals.

I would like to conclude by saying that I am encouraged by the choice of topic for today's hearing. Both longevity indexing and more flexible work conditions offer fair and sensible options to help the Social Security system. None of the choices we confront as the result of an aging society are simple. And the changes I have mentioned today will alone not be sufficient to fix Social Security. But they are an excellent place to start on implementing long-overdue reforms to help Social Security in that they offer one of the few silver linings in the Social Security debate since they would help both the Social Security system and the economy at large.

Chairman MCCRERY. Dr. Steuerle, I want to start with you. Ms. Long brought up the primary objection that I hear to increasing the rate of retirement, either early retirement or full retirement, and that is, a lot of people work in jobs which are difficult physically and they are just simply not able to work as long as the rest of the elderly society. How do you respond to that? Is there a way we can accommodate that concern and yet increase the age of retirement?

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[2] Warner, John T. and Saul Pleeter, "The Personal Discount Rate: Evidence from Military Downsizing Programs." *American Economic Review*, vol. 91, no. 1, March 2001, p. 33–53. Atkins, Allen B. and Edward A. Dyl, "The Lotto Jackpot: The Lump Sum Versus the Annuity." Finan*cial Practice & Education* 1995. vol. 5, issue 2. p. 107–111.

[3] New America Foundation's Work and Family Program: "Working Families' Catch-22: Inflexibility or Part-Time Penalty." April 2004.

[4] Ibid.

Mr. STEUERLE. I think there is, but I do not want to indicate that anything we do here is pure. If you think about the system and the way it is indexed, jobs have increasingly become less physically demanding over time, and we have correspondingly provided more and more years of retirement support. If we were to be concerned with the physical demands of jobs, we probably should have had many more years of retirement support back when jobs were more physically demanding and then accommodated fewer physical demands with fewer benefits over time. Also, if we look at the data on the health reported by people even as old as 65 to 74, the vast majority of whom are out of the work force altogether, I believe less than 10 percent reported being in poor health and less than a quarter reported being in poor or fair health.

So, there is a very substantial number of people who are not, as I say, elderly. They are late middle-aged, and report being capable of working longer in the work force. The cost to the system of not having them in the work force stretches beyond the question of Social Security solvency. I would work on reforming Social Security lifetime benefits or on the age of retirement even if the system was totally solvent, because if we could get more people in the workforce, what we get are three big gains: one, we get a higher annual benefit, an especially important item for some of those low-income people who retire at 62 and find out by the time they are 80 or older they do not have enough income. It is not quite the same having that same income at 80 as it was at 62. Second, we get more revenues for the system, and not just for Social Security. Revenues increase throughout all of government. It helps relieve all of the other pressures on the budget—on children's programs and working family programs. Three, because we get more revenues in Social Security for the same tax rate—assuming you agree to a final tax rate as a compromise, with more people working you get more revenues—we actually can increase the lifetime benefit across the board for everyone.

This leaves the problem of how we adequately take care of that small minority who actually have very severe physical problems. There we have to ask questions, and they are tough questions, such as how to structure our Disability Insurance program, whose problems we have not really been tackling well. As many of you know, we have done a horrible job in that program in getting people back to work once we get them on the rolls. So, there are a lot of questions we have to address there. I think there are also some compromises you can make if you are going to increase the normal and the early retirement age. By the way, I suggest just dropping that terminology altogether and just having an earliest retirement age, and making your actuarial adjustments from there. I think there are other things we could do with looking at the disability payments. I suggest that even if you are not willing to deal with the retirement age, you could cap or provide a lower benefit up front, say at age 62 or 65. That would actually take care of most low-income people because that adjustment may not affect what they are eligible to receive in the first place. Then back-load benefits more so that most middle, or at least upper-income people, cannot get so much cash up front. They could wait a little bit longer to get the higher benefit, say until they have 12 or 15 years of life expectancy

instead of for all years of retirement. It is a tough question you raise, and I do not want to indicate that I have completely solved it. It is just very, very expensive to try to solve a problem for what may be 5, 10, or 20 percent of the population, by taking 100 percent of a population and encouraging them to duck out of the work force.

Chairman MCCRERY. Thank you. Dr. Nyce, you said that if we limit our solutions for strengthening Social Security to tax increases and benefit cuts, it could create inefficiencies in our labor and capital markets that would ultimately impede economic growth. Could you expound upon that a little bit? What negative effects could result, especially if we have high payroll tax burdens?

Mr. NYCE. In terms of the payroll tax, it essentially affects both sides. It affects employees as well as employers. It affects employees in the sense that employees see the payroll tax as exactly that, a tax, not as a contribution into the system. There has been a disconnect between the contribution into the Social Security system and the payout eventually that they will receive. On the employer side, the concern is that employers, if we look around the globe and see the case of France and Germany, the high social insurance costs in those systems has been an impediment to capital moving to those countries. Actually, we have seen capital moving quite rapidly out of those countries because of the higher social costs. If the option on the table is to increase tax rates in the future, we may eventually fall into the same traps as those countries.

Chairman MCCRERY. Just to give us a little more, what has been the experience in those countries that have high tax burdens to support high social costs? You mentioned capital flowing out instead of in.

Mr. NYCE. Standards of living have been lower.

Chairman MCCRERY. Standards of living have been lower.

Mr. NYCE. That is eventually what it would lead to.

Chairman MCCRERY. What about general employment?

Mr. NYCE. Unemployment has been much higher as well, and there has also been some recent research that higher payroll taxes have been linked to lower rates of fertility.

Chairman MCCRERY. I would like to see that research.

[Laughter.]

Mr. NYCE. It is in my testimony. The paper is there for you to read.

Chairman MCCRERY. Good.

Mr. NYCE. I am not sure how much I believe it, but——

Chairman MCCRERY. Thank you. Thank you very much. Mr. Levin?

Mr. LEVIN. I don't think I will follow up that question.

[Laughter.]

Just a couple of points. Dr. Nyce, I don't think it is correct, from my experience, anyway, that workers do not feel that their payroll tax is paid for Social Security. I don't think that is true. The people I have talked to feel they earned their Social Security, and that is part of the resistance to change. Also, I think we face this problem. Right now the defined benefit plans are becoming less and less reliable, and the guaranteed portion, the guaranteed character of Social Security, therefore, is becoming more and more important. I

just warn everybody, as you talk about changing the benefit as people grow older. When there is less of a foundation for them in their belief, and also in reality for lots of them, there is a real problem. As people grow older, they are more reliant on Social Security, not less.

Let me just focus in, and I will start with you, Dr. Steuerle. We admire your dedication, your innovations, but I think all of us here on this panel, and everybody else in the Congress and the White House, had better try to get into the shoes of our constituents and ask ourselves: What is it? You say it is a middle-aged benefit. I don't think that is the perspective of the recipient. They like to think of themselves when they are 65, 67, 68 as middle-aged. I can attest to that. I just don't think that that really works. So, let me suggest—I will take a few minutes, maybe some of my colleagues will follow up. I was reading these materials, and it says, "Only 4 percent waited until age 66 or later to begin receiving benefits." People have been telling us something by the huge proportions who retire early. It has been a rather persistent pattern. That statistic, only 4 percent waited—this is in 2002—until 66 or later to begin receiving benefits, that at least is a warning flag to us. Whatever we think here, think about what the feelings and reactions and conduct are of people.

You used the words "putting them off work." You used "put off." I think I heard you correctly. People who retire early, we did not put them out of their jobs in most cases. Most of these retirements either are because of certain conditions or because of their attitude toward their years of retirement. It is complicated. So, I just urge you as you do your work to not just dismiss what people are doing with their feet. They are walking into retirement at age 62 often because they have no choice because of various attributes, but in many cases because that is what their family wants. Do you understand? What are the American people telling us when they retire before 65 if it is voluntary? What are they telling us?

Mr. STEUERLE. Mr. Levin, when I go out and make public appearances on these issues and related matters, I present the issue as a matter of choices. For instance, if I relate that the child poverty rate is much above the elderly poverty rate, and I ask people if they really think that having, for instance, a 20th year in retirement or a 19th year or an 18th year in retirement is the national priority in our budget, they almost always say "no." What you are referring to is why we choose to retire. Our choice to retire is partly related to the fact that we judge when we are old, by past history. We look at when our parents and our grandparents were old, and so we don't always look at how much data have changed, although even that perception, I think, is changing somewhat. You are also referring to something that economists often call option value. If we are given the option of taking something now, we often will take it, even sometimes when it is a bad deal—like in some employer-provided plans, when employees get tricked into taking bad deals because they get the money up front. If you give people a choice to have money now or money later, they will often just take the money now. That is what often happens when people take the money. At about age 66, by the way, whether they retire or not,

they are eligible to take the money. They will take it, in part, because it is available.

I don't have to run for office. I don't have to figure out how to turn what I consider to be a 50-year political trend around. A trend where we spent larger and larger shares of our National wealth on giving us more and more leisure in retirement. I do try to address the broader public issue of what do we really need to do as a society, where are our greatest need?. Are our programs really providing us too much in the way of some benefits, when we look at lifetime benefits at retirement? Are programs dealing with terrorism, are they dealing with our kids in the street, are they dealing with our educational system, which I think is a failure. I think one reason we fail to deal with this last problem is because we put so much money in elderly years. I think the public does respond when the broader issue is presented as a matter of choice. It is not just as if I am coming to the—or, in particular, you as an elected official are coming to them and just asking them to give up something. You and I are offering them something in its stead.

Mr. LEVIN. My time is up, but I think we have to be very careful not to sell people short and consider them irrational or they take something just because they are not wise enough to wait 2 or 3 more years. People are more rational than that, and they are saying something to us by their choices as to retirement. We also have to figure that out and not simply dismiss it. It is not political. What motivates here, I don't know how many of us—I won't say that—need the votes. That is not what is motivating us. It is what is true in the real lives of people and the choices they make and the choices they want to make. Thank you. Thank you, Mr. Chairman.

Chairman MCCRERY. Yes, sir. Mr. Shaw?

Mr. SHAW. Thank you, Mr. Chairman. Ms. Long, you mentioned the problem of many walks of life and having to retire early because of physical disability, such as, I know, nurses in nursing homes turning patients or nurses in hospitals turning patients. It is a burnout job, and there are a lot of problems working until you are 62, 66, or 67, or whatever the retirement age is. How much of that, though, shows up in disability payments under Supplemental Security Income (SSI)?

Ms. LONG. I don't know the statistic on that, but the discussion reminds me that the work force, working America, is getting older, and that industry, the long-term care industry, whether it is in nursing homes, assisted living, is going to explode in the next few years. That work force is going to continually be getting older as we are taking care of older people. It just seems to me that part of this debate has to bear that fact in mind, for there are people who want to retire in dignity and retire before their bodies fall apart. I am sure there are some that get disability insurance, just like my members, some of them collect workers' comp because, you know, they cannot carry the backpack anymore. That is a horrible quality of life if you are being forced to wait until age 67 or longer before you can retire.

Mr. SHAW. Well, the present law takes us up to 66, and then there is a hiatus there of some 10 years, and then it ratchets up to 67. Did any of you all do any research as to what would be the effect if you did away with that 10 year hiatus period and went

straight into just ratcheting it up to 67? Has anyone taken a look at that as to what effect that would have on the revenue?

Mr. GEBHARDTSBAUER. They call that the hiatus period, you bring it up to 67 much quicker?

Mr. SHAW. Yes, sir.

Mr. GEBHARDTSBAUER. It just eliminates about 7 percent of Social Security's shortfall. So, it is not a huge effect, and the reason is because it only affects people born between 1944 and 1959, and it only changes their benefits by a little amount. So, it is not huge. This gives me a chance to mention one other thing. You were talking about ways of addressing the concern of people in physically demanding jobs and still be able to raise the retirement age. You mentioned SSI, and there are also a couple other ways to address it, too. One is, Social Security actually has a disability definition that is relaxed as you get older. In your twenties, in order to qualify for disability benefits, you must not be able to do your job, but any job. As one gets older, it gets to the point where it is more you cannot do your own job because of education or physical abilities, so it is a little bit easier to get a disability benefit. So, that is one way of addressing having the retirement age go up, but still strategically address the issues of people in physically demanding jobs.

Now, it depends on how far you want to go in this direction of tailoring Social Security to each different group, and they did that in South America, and eventually they had so many different Social Security systems for different groups that it got too unwieldy, too complex, and that is one reason why they went to individual accounts. So, you do not want to go overboard in that area, but that is one way of addressing people that are not able to do their physically demanding jobs.

Now, how about partially disabled people? Maybe they do not satisfy the disability rule. Another way to deal with that is with pension plans. In the private sector a lot of employers that have very physically demanding jobs provide pension plans that are bigger and you can commence benefits at younger ages. So, for industries where there are physically demanding jobs, you can get it at an earlier age. That has always been very valuable in the past. Of course, as Congressman Levin mentioned, there are fewer and fewer companies that are providing these Defined Benefit (DB) plans, so one of my responses then would be to encourage companies to still provide them. Right now our rules are going in the opposite direction of discouraging employers from having these DB, or even any pension plan. Some of the ideas could discourage even defined contribution plans. We want to encourage them because they can address different industries in a flexible way and provide more pensions in those areas.

Mr. SHAW. Mr. Chairman, I agree with Mr. Levin as far as I view Social Security certainly as an earned benefit. The worker is taxed. There is no question of any discretion as to whether to pay that. The courts have said that it is not an asset that the Congress can't change. I think the Congress certainly views it as a responsibility, and I would certainly say here that I feel that it is our responsibility to save Social Security for all time. I compliment you for having this hearing. Life expectancy now is about 10 years more than it was back when Social Security first came online. As

Mr. Nyce just said, increasing the payroll tax also decreases fertility, and I would suggest that maybe you would want to have a whole hearing on that. I think we would have complete attendance at such a hearing.

[Laughter.]

That has got to be a very complex story. I think that we should try to work together and get this thing saved. That is our responsibility as Members of Congress, to save Social Security for all time, and I think it should be retained as a guaranteed benefit plan. Thank you. I yield back.

Chairman MCCRERY. Thank you, Mr. Shaw. Mr. Neal?

Mr. NEAL. Thank you very much, Mr. Chairman. I think that most of us here in the House can draw the distinction between Members of Congress who routinely serve into their seventies, their eighties, their nineties, and I believe in one case an individual who was 100 years old. That is far different than an iron worker in the Second District of Massachusetts. I don't know many iron workers who work into their sixties, their seventies, their eighties, their nineties, and I think that is a very important distinction for all of us to draw. Let me, Ms. Long, since you raised that very point, direct this question to you. Doesn't rising life expectancy make Social Security's guaranteed benefits that cannot be outlived and full inflation protection and survivor benefits more important than ever?

Ms. LONG. I am sorry. I did not understand the question. I am sorry.

Mr. NEAL. The idea that you cannot outlive Social Security, doesn't that make it more important than ever?

Ms. LONG. Oh, absolutely.

Mr. NEAL. For your members.

Ms. LONG. Absolutely true, and I can't remember which distinguished panelist said there were issues with education that might outweigh issues of Social Security. I don't think in our society it should be an either/or. There are workers in this country who deserve to have their kids be able to go to good schools, and there are people who deserve to retire in dignity. There are more and more folks in the workplace. If you look around D.C., buildings are getting built. There are going to be workers that clean them. That work is not going away, and it is not getting easier. It is not like you have robots cleaning these buildings. It is very difficult, demanding work, and folks are going to be doing it for years to come. People deserve to be able to retire in dignity. I certainly support this man's suggestion that maybe you should have a hearing on forcing employers to have pension plans. You know, the labor movement would love that. So many employers do not, and that is just the crux of it. I think that these are hugely difficult decisions that you all are making, and I support Congressman Shaw saying that it has to continue being something that people earn and can have.

Mr. NEAL. Dr. Steuerle, your point, I understand as you have offered it, is well taken about how we distribute dollars here in Washington. Isn't there some evidence that at least during the last four or 5 years that balance that you spoke of in the ideal world really has not been practiced? Because, overwhelmingly, benefits here in the last few years have gone to the very wealthy. We argue

about redistributing wealth. We certainly have redistributed it in Washington. It has gone to the people in the top income groups. Your question about spending more on the needs of children is legitimate, but I think one could argue just based upon basic charts and graphs that the money here clearly has been directed toward the wealthiest Americans.

Mr. STEUERLE. My dilemma is that if we free up money, we free up resources. The question is what is done with it, and to be quite honest, I think the fear among those who are progressives is that, well, the money would just go for tax cuts and not go to meet other needs. The fear perhaps, among conservatives, is that the money is freed up and just goes for wasteful government expenditures. So, we still have to face this dilemma through the political process. I think it is a basic fact that the budget process has a bias in favor of programs that have built in automatic growth, and in the U.S. system—actually in a lot of industrial countries' systems—that growth is basically in health and retirement. We have these systems that grow automatically, faster than the economy. They constantly squeeze everything else, and then we face the dilemma of what to do. Both parties say, well, I am not sure I want to free up the resources because I am not sure I trust everybody else to deal with those resources well.

I cannot tell you how to make that compromise to make an appropriate tradeoff, but there is no doubt that there is a bias in the political process—in the budget process—-in favor of systems that have automatic growth. By the way, that includes some tax expenditures, too. Those systems that have automatic growth absorb most of the resources. They get their additional money automatically when every other program does not. One of two suggestions in my testimony that has immediate implications is to change the defaults in the system. Maybe we should have no default system that can grow faster than the economy, whether it is a tax cut or tax expenditure or Social Security system or Medicare system. That frees up the resources and puts back to the electorate to decide year after year how to use those additional revenues that come with economic growth. That is a wider political question. I cannot get around the dilemma: you just cannot maintain these systems that have such large automatic growth in them. It is not a viable budget in the long run.

Mr. NEAL. Would you say that the wealthy have done okay for the last few years, sir, in America?

Mr. STEUERLE. Yes.

Mr. NEAL. Pardon?

Mr. STEUERLE. Yes.

Mr. NEAL. Ms. Long, could I go back to you for a second because of your members. One of the things we have all had the experience of doing here in Washington is—I will get right to this, Mr. Chairman, because I know my time has expired—attending many functions with iron workers and tin knockers, and electricians, and others. One of the things you notice very quickly are the calloused hands, and you will hear them say, particularly the iron workers and the tin knockers, that they cannot climb the heights anymore. They do not take early retirement because they want to give up what is a decent wage base. They take early retirement because

they cannot climb the iron anymore. That is the fear part of their lives. I think in the case of electricians and the tin knockers as well, that is a problem that they confront. If you just want to quickly respond to that, that would be fine.

Ms. LONG. I think you are right. You know, I have most knowledge about nursing home workers and cleaners, but if you talk to building trades workers, laborers, electricians—I talked to a guy that works at Amtrak, actually fixes MARC trains and the Acela, the brakes, he helped fix those brakes. He talked about several of his coworkers who have had to leave work because they have to climb up on the trains, and they cannot do it anymore. You know, people that are in those physically demanding jobs are not talked about a whole lot. There are more and more of them in our society who do not know what they are going to do based on the choices that we are deliberating on today.

Mr. NEAL. Thank you. Thank you, Mr. Chairman.

Chairman MCCRERY. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman. Dr. Steinmeier—and put that mike over there close to you—I wonder if you could discuss the issue you raise in your testimony about high-wage legal immigrants and that they get disproportionately higher rates of return from Social Security. I presume you are talking about H1-B visas and that sort of thing.

Mr. STEINMEIER. Well, the question is how the formula works. It is a progressive formula with 90 percent of the first dollars of earnings and then 32 percent and 15 percent. The average earnings is taken by adding up the highest 35 years. If you don't have 35 years of earnings, zeros are added in the average. So, if you have somebody who has been in for 10 years, he may have been earning $60,000 a year, but his average earnings over the 35 years with all the zeros looks more like $17,000 to $18,000, and the benefit formula is arranged to treat somebody like that very well relative to the tax they have paid.

Mr. JOHNSON. That is right, but most of those guys are high income, too, higher than what you are talking about.

Mr. STEINMEIER. They are high income. The problem is that the system is treating those workers as low-income workers, when, in fact, they are high-income workers.

Mr. JOHNSON. You also, all of you, are talking about lump sums, for goodness sake, as if that is a bad deal. You know, I agree with you. I would take the lump sum, too, if I had the opportunity. Most of the plans that I have seen call for an annuity to forestall at least part of that. Would you all like to comment on that?

Mr. STEINMEIER. The work we have done assumes that you will be forced to annuitize up to some minimum poverty level, and what we are really talking about are lump sums beyond that. There is a wide variety of individuals in the country. Some of them are very farsighted, and some of them are not very farsighted. What our model is showing is that a lot of people who are not so very farsighted, if lump sums are available, will probably take them and run.

Mr. JOHNSON. Then live in poverty.

Mr. STEINMEIER. Or retire, and then they will be——

Mr. JOHNSON. Yes, and not have the same amount.

Mr. STEINMEIER. Yes.

Mr. JOHNSON. Mr. Gebhardtsbauer, you discussed making pension law and Social Security law consistent. Social Security full benefits are going up at age 67. Medicare eligibility is 65. Many employer pensions offer full benefits at 62 or earlier. You suggest allowing the employers to keep their retirement age consistent with Social Security. You also raise the issue of phased retirement that permits people to collect retirement benefits and a paycheck. I wonder if you would discuss those two issues a little bit.

Mr. GEBHARDTSBAUER. Okay. If Congress is interested in encouraging more work at older ages, one way to do it is something you have already done on the Social Security side—in fact, way back in 1983—to say 67 is now normal or it will eventually be normal. For company pension plans, the law still says you cannot use an age higher than 65 in a company pension plan. So, there are mixed signals here.

Mr. JOHNSON. Do you think we should make that consistent with Social Security?

Mr. GEBHARDTSBAUER. Right. You could allow in pension law for company pension plans to also use age 67 so that employees realize that, okay, age 67 now is the normal retirement age. I think it would change what is in our minds. It may not affect retirement dates as much as raising the early retirement age, but I think it still would encourage people to think of 67 as normal instead of 65. Employers cannot do that now. So, it would be good to allow that, but I should note that it would be difficult for employers to raise it to 67, too. That would be one way to allow them to do it and also give flexibility in how they do it.

On the phased retirement issue, some companies are doing it, and there is an Internal Revenue Service (IRS) regulation out now that won't allow employers to both pay a paycheck and a pension at the same time. Now, the IRS is coming out with a proposed regulation that says, okay, if you reduce your working period down to half-time, then you can get half your pension and half a paycheck. It is very complex, and it would be great if it could be simplified a little bit so that employers could do that without having to watch whether an employee is changing their hours, because as soon as you change your hours, then you have to give them more wages and less pension, or if they reduce their hours, you have to reduce their paycheck and increase their pension.

So, some of those ideas could really work. I think employers are very interested in doing that because the the growth in the work force is getting smaller, so I think a lot of employers are going to want to retain their older employees, and one way to do it is say we will keep you on but maybe not full-time, maybe part-time, and they may like doing that, and getting a partial pension. So, ways in which Congress can encourage phased retirement would be good.

Mr. JOHNSON. I think we should look at that. Thank you, Mr. Chairman.

Chairman MCCRERY. Mr. Johnson, there is another Committee, authorizing Committee, that has a Subcommittee with an excellent Chairman that I think could take care of that.

[Laughter.]

Mr. JOHNSON. Like I say, we are working on it.

Chairman MCCRERY. Okay. Mr. Pomeroy?

Mr. POMEROY. Thank you, Mr. Chairman, and thank you for scheduling another very interesting hearing. I really do think these questions of longevity get to the heart of what we need to keep in our minds as we look at Social Security solvency issues or, for that matter, privatizing Social Security. Personally, I am terribly concerned about the kind of lifestyle people are going to have in their nineties with the increased life expectancy they will be enjoying, but, on the other hand, the toll that that takes on retirement savings. Dr. Steuerle, I am very interested in your comments on lifecycle distribution of benefits. Do you want to explain that concept a little bit? I noted it in your testimony, but it gets to something I am quite interested in.

Mr. STEUERLE. Well, as I say, my concern about retirement age is in many ways independent of the actuarial imbalance in Social Security.

Mr. POMEROY. Yes.

Mr. STEUERLE. It is partly a question that goes all the way back to Public Finance 101 courses, if you want, to designing programs to progressively address needs of society. It seems to me that Social Security is primarily—skipping over the disability part, and focusing on the old age part of the system—designed to provide benefits in old age. Going back in the history of this country, all the way back to the Civil War pensions, there was a sense that, well, at some age, a substantial portion of the population would be impaired enough that they probably would not be able to work. So, that is the point at which we would not use a disability measurement system. We would just say, well, you are old enough now, we will provide benefits for old-age itself.

Over time, we have increased the number of years that people can receive benefits. If we wanted to provide a stock of benefits for people in the last 10 years of life, but then we let the system go to 12,13, or 15 or more years and keep increasing the number of years that benefits are provided, then within that pile of benefits we give, smaller and smaller shares are going to the people in those last years of life. There is a graph I have in my testimony that shows that it used to be that the majority of benefits among men went to people with less than 10 years of life expectancy. Now, the vast majority of those benefits go to people currently with more than 10 years of life expectancy. So, we are taking smaller and smaller shares for the people who are really old, which used to be one of our measures of need. We are giving larger and larger shares to those people who I would define as being closer to, or actually in, middle age. There are repercussions not only for the progressivity of the system but on the extent to which people work. By the way, Mr. Johnson, also on the extent to which people save——

Mr. POMEROY. You can talk about Johnson on Johnson's time. [Laughter.]

Mr. STEUERLE. They retire in their prime saving years. I am saying that people now they retire in what used to be their prime saving years.

Mr. POMEROY. I see it in very simple ways. You have a pot of dough. You stretch it out longer, smaller incremental payments. To have it shorter, more meaningful payments. So, as I look at two-

thirds of the people accessing their Social Security before full retirement age, they are accepting a discounted payment. Certainly some absolutely need to access that benefit. They are played out. Chairman Thomas spoke of his father, a plumber. He said he was used up when he got to that retirement age. Two-thirds are not. Some are making a decision. They want early access to benefits. I think we need to do a better job of explaining the system, that that involves some serious tradeoffs. You have a discount for that early access to benefits. As the years go up from 66 and 67 that discount is going to be even steeper. You get a smaller payment. Well, that smaller payment, it may look okay in your sixties, you are going to work a little here, and you have some savings accumulated there, what about when you are in your eighties and early nineties when you are not going to be working and the savings are gone? You have got yourself on a real tight little payment. Or, for that matter, in the sixties, we do allow unlimited earnings in addition to Social Security if you are full retirement age. If you are accessing it early, you do not have that unlimited earnings opportunity.

So, you are taking some serious tradeoffs, and with two-thirds exercising that option, I do not believe everyone fully understands that tradeoff. I do worry about that. With my time rapidly running here, Mr. Gebhardtsbauer, as we try to deal with longer life expectancies, it seems to me that the notion of a longevity risk pool reflected in Social Security is critically important. A massive pool of Americans, some live longer, some live shorter. There is a cross-subsidy within that pool. That is the way we are able to absolutely guarantee benefits for as long as you live. Now, it seems to me if we would privatize Social Security and carve into this pool of these private accounts, you would significantly diminish your ability to ensure longevity risk for the people of this country. Do you have a comment on that? And I see my time has elapsed.

Mr. GEBHARDTSBAUER. I guess it depends on how you set up the individual accounts. Some of the proposals do require annuities. So, to the extent that it requires annuities, then you do spread that pool better. To the extent that you don't require annuities, then the people who are going to live a long time are more likely to get annuities. The people that are not going to live very long won't buy annuities. So, annuities become more expensive. So, it is not only more efficient, but you use that pooling better if you require everybody to buy an annuity.

Mr. POMEROY. Thank you.

Chairman MCCRERY. Mr. Ryan?

Mr. RYAN. Thank you, Mr. Chairman. I came in a little late, and, Mr. Steinmeier, you were in the middle of your testimony talking about the earnings limit for 62 to 65. I think that was your testimony. Am I correct?

Mr. STEINMEIER. Yes.

Mr. RYAN. I wanted to ask you, Is it your analysis—and anybody else feel free to chime in—that if we removed the earnings limit for 62 to 65, that you would, in fact, have more people—I am trying to catch this. Did you say more people would retire early or less?

Mr. STEINMEIER. People would retire later, but start collecting earlier.

Mr. RYAN. Earlier benefits. So, you are saying people would try and get both benefits. They would get their payments, and then they would also be able to work without getting the penalties. So, you think that that is adverse toward reaching solvency, essentially. Is that what your point is?

Mr. STEINMEIER. I don't do a lot of work on solvency, but they will start collecting the benefits earlier.

Mr. RYAN. That is what your research has found?

Mr. STEINMEIER. Yes.

Mr. GEBHARDTSBAUER. That would happen, yes. If more and more people started collecting benefits at 62, it would be more expensive for Social Security because when people work beyond their 35th year, as Gene was talking about, your benefit does not go up as much. You are putting in a full contribution, but your benefit is not going up as much. So, we would lose some of that.

Mr. RYAN. Ms. MacGuineas, I wanted to ask you a question. You mentioned progressive longevity indexing, kind of a melding of the two concepts that have been talked about lately. How would that work in your description? Are you talking about picking a certain percentile like the progressive indexing, 30th percentile, and then longevity indexing on top of that while freezing the current calculation in place? I guess what we are all trying to get here is an accurate measurement for those who truly, as you mentioned earlier, those who truly cannot work anymore, whose bodies cannot get them into extra years of work. How do you find the most accurate measurement of doing that? Raising disability eligibility may be one way of doing it. I don't know if that is something that workers would prefer, going on disability as a part of the retirement planning. Would you describe how you would meld the two, progressive indexing along with longevity indexing, to try and accomplish that end goal?

Ms. MACGUINEAS. Right. I think a lot of the questions here have been focused on that there are a number of tensions between different goals that we have. Clearly, we want to find a way to resolve the underfunded problems of the system. One of the ways that makes sense is to adjust the system in a way that reflects the changes in demographics. That said, you want to continue to allow for enough flexibility so anybody who cannot work would never be required to work. How you create a system that allows for both is the real challenge here.

Mr. RYAN. Right.

Ms. MACGUINEAS. So, one of the interesting sort of innovations, I think, that there could be is we know that life expectancy is growing, but we also know that it is growing differently for different income quintiles. So, I guess quintile would be the way I would think about it. You could do it in different ways if you wanted. It happens that many of these workers who we are worried about who cannot work for longer also have lower-paying jobs and also have lower life expectancies. So, it seems rather punitive to say we are going to raise the retirement age or do a flat rate longevity indexing even knowing that this low-income manual laborer is, one, going to have a harder time working longer and, two, more likely not to collect benefits for a longer period of time. So, if we got a little bit more specific and said, based on these different eco-

nomic quintiles, this is your life expectancy, and we are going to adjust benefits accordingly, it is a little bit more tailor-made for some of the built-in unfortunate inequities that we have because higher-income people tend to live longer.

Mr. RYAN. Let me ask the actuary in the room. Mr. Gebhardtsbauer, do you agree with that analysis that on a quintile basis—I know that is a little rough, but on a quintile-by-quintile basis it does track, as Ms. MacGuineas just mentioned? Are life expectancies longer for higher quintiles than lower quintiles?

Mr. GEBHARDTSBAUER. Oh yes, right.

Mr. RYAN. So, the question here is, actuarially does this line up? Ms. Long, what is your impression of that idea?

Ms. LONG. Obviously we focused—I focused in my testimony on, you know, hard-working people who physically cannot do the work, and to that extent I would have to agree that you should not think there is a monolithic work force that we have in society. People who are rich tend to live longer and enjoy life better than folks that are digging ditches. I also said in my testimony that there are high stressors and other types of work. There is social work that is high stress, people who work in the criminal justice system. So, I don't know—I have never heard the word "quintiles" before. I like that word. I don't know that they would fit, do you know what I mean? I think that there is a way in which we need to look at how many different subsections there would be to make sure it is fair for folks who put in 30 years of life and want to retire with dignity, even if their hands are not calloused or even if their backs are not broken.

Mr. RYAN. I will just close here. I cannot see the clock, but I assume it is going out. Under a personal account, not only under most personal account plans, you get to choose when you want to retire, so you can tailor-make your retirement benefit for your particular situation based upon your ability or willingness to continue working or not, but also through a personal account you have an incentive to keep working because under the current system it is the high 3 for your 35 years. Under a personal account, every year you keep working you are adding to your personal account. You are growing your benefit that you will get in retirement. If you want to annuitize the whole thing at the end, you will be able to do that under most of these plans. There is some level of minimum annuitization that occurs, but under a personal account situation it gives the worker the ability to custom-make their retirement benefit per their particular situation and an incentive to keep working if they want to because they keep growing their retirement benefit because they are putting more money into the retirement system through their personal retirement account. So, I think that is one thing that is just not mentioned here. I assume my clock is red. I cannot see it from here. It is something that I think we all need to think about as one of the solutions to fixing this very important problem.

Chairman MCCRERY. Thank you, Mr. Ryan. I also want to point out, I am not averse to looking at some kind of progressive longevity index, although, to tell you the truth, I have not thought about it much before today. I think we should all remember that Social Security benefits are already quite progressive. They replace

a much higher percentage of a lower-wage worker's income than a higher-wage worker's income, and that is by design. That is to make it progressive. So, any index that you apply is going to be applied against an already very progressive benefit structure. Yes, Ms. MacGuineas?

Ms. MACGUINEAS. A quick response, because I think that is right, and it is certainly up to the people who designed the system how progressive the system should be. My thinking was if we do raise the retirement age further, that will actually make the system slightly less progressive. This is a way to return it even just to the current levels of progressivity if you chose.

Chairman MCCRERY. Yes, I understand that, but if you take the longevity index in isolation, do not raise the age of retirement, just take that in isolation, then I am not sure you want to further make that index progressive. Dr. Steuerle?

Mr. STEUERLE. Mr. Chairman, I suggest in my testimony, a way to get around to this dilemma. My proposal involves meeting multiple objectives. To examine the current system, I did a study with a member of the SSA using both records and some projections. It turns out that Social Security does have a progressive benefit formula. Its progressivity is offset for people with shorter life expectancies, which would also largely be the people who have trouble working longer, by the fact that forced annuitization means they get fewer years of benefits. So, actually the system isn't all that progressive on net: forced annuitization is roughly matched or offset by the fact we have the progressive benefit formula.

What I suggest we do is focus on some level of lifetime benefit we would have in the future. We could make sure these lifetime benefit packages are of a certain level for people with certain lifetime earnings patterns. So, for instance, I suggest we bump up a minimum benefit; that helps the people in the bottom quintile. Now, I don't think we can define that quintile well, quite honestly, in part because there is a big difference between women and men. A lot of women fall in the low earnings quintile, although they are very healthy. A lot of men fall in the lower earnings quintile who are full-time workers. There are all sorts of differences here. You could make use of lifetime earnings. You could develop a system that solved your progressivity problem by looking at lifetime benefits, and still adjusted for retirement age. There are ways to get around that problem. The mistake is thinking we have to change one parameter at a time. We could change three or four things at the same time to try to maintain whatever progressivity we want in a balanced system.

Chairman MCCRERY. Thank you. Mr. Becerra?

Mr. BECERRA. Thank you, Mr. Chairman. Again, like Mr. Pomeroy, I would like to thank you for another very good hearing on the issues of Social Security. Let me see if I can address squarely one question that I think you have to talk about in any discussion about retirement age and longevity, and that is that increasing the retirement age hurts, by its very, nature those who rely on it most. Those are lower-paid, higher-risk workers. So, any discussion about tinkering in any way with retirement age means that you are going to hit folks who have had the least amount of time and the lowest

amount of income to try to prepare for their retirement. Would anyone dispute that? Mr. Steuerle?

Mr. STEUERLE. Again, the problem comes in looking at one parameter at a time. Most of the people who have shorter than normal life expectancies also have disabilities, they often lose out because they don't even make it to 65. You know, the difference——

Mr. BECERRA. If they are not going to make it to age 65, chances are they are not going to put enough away in a nest egg, whether in a private account or otherwise, to have much in retirement anyhow.

Mr. STEUERLE. If we do something like only increase the retirement age, it would proportionally cut benefits slightly more for those people who are in the lower earnings group, that is correct, slightly more.

Mr. BECERRA. Okay. So, now——

Mr. STEUERLE. But if we provide a minimum benefit, we can more than compensate for it, that is——

Mr. BECERRA. Now you are talking about making some adjustments. From the get-go, if you start talking about tinkering with retirement age, those who you have to worry about most are going to be those who are lower-income and in the higher-risk jobs. You might find ways to try to accommodate that, but the reality is that any discussion about tinkering with the retirement age is going to hit modest-income workers most who happen to also, as Ms. Long has said, work very long, very tough hours, and, therefore, are in most need of something that is stable like Social Security.

Mr. STEUERLE. I am also worried about the old versus the young, and by giving more years of benefits we are hurting the old.

Mr. BECERRA. I do not disagree with you, but I am just saying if you are going to talk about this issue, you have to address squarely the audience that is probably going to be most concerned about the discussion, because whether we make adjustments, as you indicate, Dr. Steuerle, or not, they are the ones that are going to be most affected by any change that occurs. If you are higher-income, you do not have to rely on Social Security as much. If you are in a less risky job, you also don't have to worry so much about dying before you are able to take advantage of those benefits for quite some time. Let me move to a second question. Does anyone here on this panel believe that in any reform of Social Security we should cut disability benefits?

[No response.]

Okay. I will take that silence to mean no.

Ms. MACGUINEAS. I better speak up. I think—and, actually, I am going to address your first question, too.

Mr. BECERRA. No, no, no, because my time is focused, please just try to address this second question, if you can.

Ms. MACGUINEAS. I think it is impossible to analyze any one change to Social Security in isolation, because the one thing we know is that the current system is unsustainable. Some changes will have to be made. So, I think in order to evaluate the fairness of any change, you need to know what the alternative is. It is not the current system. It is other reforms. So, I would want to know what other reforms you are planning to do.

Mr. BECERRA. That is a fair answer. I think that is an answer that anyone in the panel could have given or anyone sitting up here would give, that you have got to consider everything. The reason I asked that is because if you are going to tinker with the retirement age or reduce benefits somehow because of age, then what you are probably doing is making some people calculate, have I reached the point in my life when I am working, where I am actually physically so incapable of continuing my work that I can claim disability benefits versus wait till that new higher retirement age? Or, do I continue working in a job when I am less able physically, and risk that I will find myself truly permanently disabled?

My concern with, again, tinkering with the retirement age, is that you probably start making a lot of folks start to think, maybe I had better start claiming those disability benefits under Social Security. If that is the case and you are shifting people's application for disability versus retirement benefits under Social Security, then have we really saved ourselves much money in causing people to make that shift toward disability payments under Social Security versus retirement age? Another question. Unemployment benefits. If we require people to work longer in their life, to age 70, 72, and we know how difficult sometimes it is for a worker in his or her older age who may become unemployed or is laid off, to be able to secure relatively similar employment with similar pay, and we know the issues of age discrimination that occur throughout the country. I know, Mr. Chairman, my time has expired, so I will end with this one question. What could the effect be on an increased retirement ago on States' obligations under unemployment benefits to help cover now workers who have to work longer before they can retire, but are finding it very, very difficult to find a job to replace the one that they had before?

Ms. MACGUINEAS. I think you raise really important points in saying that anything we do to the retirement age will also probably affect increased costs for disability and unemployment. I think those are both very valid points. The only other important factor is that the labor market is going to be significantly different in a decade and two decades from now because the labor force will be growing at such a slower pace, there will actually be some demand-side solutions in that employers are going to want to find ways to keep people employed for longer because they are going to need more laborers than they currently have as more people move toward retirement.

Mr. BECERRA. Although you have seen, in some cases, industries where they replace older workers with younger workers because the cost of sustaining a younger worker is far less than an older worker.

Ms. MACGUINEAS. Right. Those are some of the kinds of policies that we should look at when we are thinking about how to encourage people to stay in the workforce in a more flexible way for longer.

Mr. BECERRA. Excellent point, thank you. I know my time has expired, Mr. Chairman. If Gebhardtsbauer wants to respond——

Chairman MCCRERY. Sure.

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. GEBHARDTSBAUER. Just really quick. When you ask the actuaries at Social Security to price something that raises the retirement age, they do price in the fact that more people will take disability, and so they reflect that in their costs.

Chairman MCCRERY. Mr. Brady.

Mr. BRADY. Thank you, Mr. Chairman. Ms. MacGuineas had a great point there. In 20 years, maybe 25, we will be holding hearings in Congress trying to figure out ways to find enough workers for the jobs that are needed in America. We have got a different challenge there. I just wanted to follow up on the issue that Paul Ryan raised at the very end about the practice today where people don't really relate their years of work and wages to their Social Security benefit. They don't see the need to work an extra few years because they don't see really any payoff in their retirement in Social Security, or at least they don't make that connection.

Several of you have suggested—I like the idea of being able to tailor-make your own retirement, to make it higher or lower depending on what is right for you and your family. Several of you have suggested modifying the benefit structure to provide greater rewards at older ages, for example, reducing benefits even more for early retirement, and as we know, 55 percent of our folks choose the early Social Security retirement, and providing greater benefit enhancements for delayed retirement. In other words, the ability to really create a stronger and larger retirement by working those extra years of your choice. Any of the panelists, could you describe in more detail various options for accomplishing this, for back-loading the benefits for those who choose to work longer?

Mr. STEUERLE. Mr. Brady, I had a few comments in my testimony, and I don't want to take too much of your time, so I will just refer you mainly to those. It is not just increasing the retirement age. One could even do a neutral exchange. For instance, if you have a choice between $100 today and $100 10 years from now, dodging discounting, I could give you $50 today and $150 10 years from now. It would be the same lifetime benefit package but you would have a substantial incentive by having that lower amount up front—to think about whether you wanted to work longer. We discussed this a little earlier. A lot of people make the choice. They look at age 62, at the amount of cash income they have, they look at the wage they have, they look at what their taxes are going to be—and they say, you know, I am pretty well off—and Mr. Pomeroy raised this issue—they say, I am going to retire. Then what happens is they retire when most of them have substantial human capital and work capability. They retire when they are more likely to have a spouse who can help them through some minor impairment so they don't need a nurse or somebody else to help out. Yet their retirement wages relative to the economy are probably going to fall 20 or 30 percent 20 or 30 years from now. The price of a practical nurse, for instance, is something that is going up in that time. So, they think they are okay retiring at 62. By the time they hit 85 or 90 they are often in deep trouble, and the government sometimes has to come back and help them with nursing home and other care.

We could think of a variety of ways of back-loading benefits. Some we could do actuarially. That is, just make actuarial adjust-

ments for working longer. Some of them we could just do by putting more benefits on the tail end and less on the front end. If you are really worried about the low-income worker, you do that less for them. You keep some minimum base. As I say, I think we want to think long and hard about how we protect the low-income person when we do that reform. I think there are a variety of ways that you can think about——

Mr. BRADY. As an alternative to raising the age, you really can provide some incentives, you know, for people to voluntarily choose.

Mr. STEUERLE. The one warning I will give you, because I have worked a lot with the CBO and the actuaries, is that for 50 years we have been in this system where a person could retire earlier and earlier and younger and younger, I think literally that we are in the midst of a multi-decade process of turning in the opposite direction. The estimators are going to sit there and give you the estimate, you know, when Chairman McCrery is sitting there with Mr. Levin and they are actually trying to add up the numbers to get Social Security balanced. The estimators are reluctant to give you huge labor supply effects even though, as Maya has suggested, and I think a number of us agree, there is a substantial potential for labor demand there. You may not get it right up front when you actually do the first step. It is almost like we are saying: free up the system, make it much easier for people to work longer. We think if the flagship, Social Security, starts turning in that direction, then the private pension systems, the employers and others, will start turning in that direction too. I have to confess, you know, we don't fully know.

Mr. BRADY. Ms. MacGuineas, you have a——

Ms. MACGUINEAS. Yes. One of the challenges here is that if you think about how you would ideally structure some of these changes, you might say, okay, we are going to give you a little bit larger of a bump up in your Social Security benefits if you choose to retire later, but you will still have the flexibility. However, if you do that, you end up having a situation where you helped the labor market incentives, because people are going to stay in the labor market longer, but actually you could potentially hurt Social Security solvency because people will then collect larger benefits. You also run the risk of some adverse selection, where low income people won't take it as much, knowing that they are not going to live as long, and high income people will. So, you may have even opened up the problem a little bit more.

The challenge I was trying to meet when I was writing about kind of a lump sum bonus, where instead of doing an actuarially fair increase, you would do one that is unfair, that gives people less than they would have deserved for their additional contributions, but you would give it in the form of a lump sum, which as long as there is the underlying Social Security annuity, as long as people's basic benefit is still there and indexed for inflation and lifetime, you might, instead of giving them an additional annuity, give them a little bit in a lump sum which will prove enticing enough to that they will stay in the labor force for a little bit longer, but won't drain the Social Security system of additional revenues beyond what would be fair.

Mr. BRADY. The year-end bonus versus the small amount in each paycheck over the years. Mr. Chairman, on a personal note, I have an interest in this discussion because, as you know, I have a 3 year old, and I figured out to pay to get them through college I have to work 'till I am 100.

[Laughter.]

So, that is why I have a real interest in incentives on the back end of Social Security. Thank you, Mr. Chairman.

Chairman MCCRERY. Good question, Mr. Brady. Ms. Tubbs Jones.

Ms. TUBBS JONES. Thank you, Mr. Chairman. Good afternoon, ladies and gentlemen. Thank you for appearing before our panel. I don't know where I want to begin. It has in fact been government and private industry that has encouraged people to retire early by offering buyout programs because they wanted the older worker to get out to bring the younger worker in. Is that true?

Mr. GEBHARDTSBAUER. That was true in the seventies particularly because there were a lot of new workers.

Ms. TUBBS JONES. It is not happening in the eighties, and the nineties, and 2000?

Mr. GEBHARDTSBAUER. I don't know that it is happening quite to the same extent, but it is still happening.

Ms. TUBBS JONES. So now you are offering——

Mr. STEUERLE. It will happen less in the future because there will be fewer and fewer people coming in, but huge numbers of retirees going out.

Ms. TUBBS JONES. I don't know what is going to happen in the future. Who knows what is going to happen? Perhaps we will lower the tax, you know, we will repeal the tax that gave the top 1 percent all the money we needed to operate Social Security and Medicare benefits, and we will be better off than we are today. Be that as it may. Was it you, Dr. Steuerle, who said that there are less people working in hard labor jobs now than previously? Was that you, Dr. Steuerle?

Mr. STEUERLE. Yes. We tried to figure out what is a consistent data source—this is just a question of how can you find a consistent measure over time——

Ms. TUBBS JONES. Hold on. I know you can give me a great——

Mr. STEUERLE. In my testimony, physical demands in jobs have gone down.

Ms. TUBBS JONES. Have gone down. So, let us talk about a service worker's job. Those physical demand jobs are still very serious, right? A janitor's job is still a very serious demand, hard work?

Mr. STEUERLE. There are a lot of jobs that have severe physical demands and——

Ms. TUBBS JONES. If they have gone down, what percentage of the jobs are still jobs that have high physical demand? Just roughly, you don't have to give it——

Mr. STEUERLE. There is a chart in my testimony.

Ms. TUBBS JONES. Roughly tell me what the chart says.

Mr. STEUERLE. I don't remember off the top of my head. I am sorry. Let's see, the share of U.S. workers in physically demanding jobs in 1950 was a little over 20 percent. By 1996 it dropped down

to about 7 percent. This is defined by the amount of weight they have to lift on the job.

Ms. TUBBS JONES. Truly—there are no doctors at the table—but we understand that people who are not lifting weights do demanding jobs. A golfer even has a demanding job with swinging that club and then a lot of them end up with back trouble as a result of that.

Mr. STEUERLE. Yes, of course.

Ms. TUBBS JONES. So, that is not really a true reflection of what a demanding job is, just solely lifting weight.

Mr. STEUERLE. It is a reflection that the physical demands of jobs have gone down. It doesn't mean there are not physical demands on jobs.

Ms. TUBBS JONES. What I am saying to you is—your statement was that lifting weight was the way in which you determined whether a job was a physically demanding job. That is what you just said, is it not?

Mr. STEUERLE. That is correct, but——

Ms. TUBBS JONES. I am saying to you that there are other physically demanding jobs where you don't have to lift weight and it is not a true reflection of physically demanding jobs that are in our government or in our country today. Well, anyway, you don't want to answer the question, so I am going to move on. You understand what I am saying to you, sir, and I am sure everybody listening——

Mr. STEUERLE. There are many jobs with physical demands, yes.

Ms. TUBBS JONES. Yes. That would require workers or would put workers in a position that they need to retire early. For example, my father carried bags for United Airlines for 40 years. Fortunately, he was able to retire at 62 and is till living at 85, but he is an unusual person in the midst of people who work in that type of job and have the opportunity to live that long that are African-American males. You would agree with that, wouldn't you, sir?

Mr. STEUERLE. Yes.

Ms. TUBBS JONES. Okay, thank you. I can't remember who mentioned this, but about having a family that is capable of having a spouse that can take care of them while they are having minor illnesses, and then that may even lower the cost of health care for older—was that you also, Dr. Steuerle?

Mr. STEUERLE. I was pointing out that if we want a system to progressively meet people when their needs are greater, their needs are often greater when they are single than when they are married because the cost of taking care of their impairments often rises.

Ms. TUBBS JONES. Are you aware of the fact that the cost of the health care of a caretaker is aggravated as a result of being required to take care of a spouse? In other words, the caretaker's health diminishes as great as the person that they are taking care of when they are at that other end of the age spectrum.

Mr. STEUERLE. Sure, of course.

Ms. TUBBS JONES. So, we need to factor that in when we begin to talk about whether that is a good ideal for deciding what happens with workers or adjusting their income.

Mr. STEUERLE. Ms. Tubbs Jones, I think we are on the same page—I am trying to figure out how we can design a system so it is progressive, and, for every dollar we spend that dollar goes where needs are greatest. I think we are aiming at the same target.

Ms. TUBBS JONES. I want to be progressive also, but I am just trying to point out to you some of the things that you are thinking of as progressive are truly not progressive because people, older people trying to take care of other older people diminished their health even if it enhances the health of the person they are taking care of. I am out of time. Thank you, Mr. Chairman.

Chairman MCCRERY. Thank you, Ms. Tubbs Jones. Mr. Rangel, would you like to inquire?

Mr. RANGEL. Thank you, Mr. Chairman.

Chairman MCCRERY. My pleasure.

Mr. RANGEL. I really want to thank the witnesses because you can see we are going to need a lot of help if we are going to resolve this very complicated problem. This is especially so if we recognize that you either have to raise taxes, which is off of the table; we have to either extend the retirement age or cut the benefits. Of course, our job is basically to try to get solvency in terms of the long term so that we don't have to revisit that. To me this screams out for Republicans and Democrats to be working together because it is nothing on this but pain, pain, pain. The only way any party can do it, if our constituents believe that we did the best that we could by them. The difficulty we have is that—do any of you believe that it is necessary to have private accounts on the table and to be a part of the solution in order to resolve what is basically our mandate, and that is the solvency problem, and that would be the person, if any, that I would want the talk with.

[Laughter.]

Ms. MACGUINEAS. I guess I will take a quick stab at this. I feel like I am answering all the unpopular questions, and I am a little worried about opening up this topic in this hearing.

Mr. RANGEL. Please let me make it clear that you guys should not have the burden of the political aspects of it. You are experts in what you do. This is not going anywhere, and I guess all of us want to be able to walk away from this saying that we made the contribution because we were looking for a solution. So, if you agree it has to be bipartisan, then you have to be able to say that you believe we cannot resolve this unless we do have private accounts.

Ms. MACGUINEAS. That is not exactly why I am making the point. Here is what I would say.

Mr. RANGEL. That is exactly the question I am asking. Can we resolve this, in your opinion, without having private accounts on the table? Not whether you think we should have it. I think we should have taxes on the table. The President said strike that out. I don't think increases in taxes is on the table, so I don't bother with it. I am asking you, as a professional, do you think we can reach the goal of long-term solvency if we sacrificed putting private accounts on the table?

Ms. MACGUINEAS. I heard a couple of questions. So, yes, I think you can achieve long-term solvency without putting private accounts on the table.

Mr. RANGEL. That was my only question.

Ms. MACGUINEAS. Well, but I don't—well, I guess I heard a couple different questions. I think in order for a bipartisan solution to happen, which I agree with you completely is what needs to be there because there has to be a lot of cover because there are a lot of difficult choices. Probably the best place is to start with everything on the table. That includes private accounts and that includes tax increases. Second, I think the role of private accounts can be—is required if you want two things, solvency and prefunding or building up savings in order to have the money there for Social Security. So, changes that we would make now instead of postponing them all to the future. If you think private accounts are a replacement for trust funds as a way to prefund the system, then they play a critical role.

The key that I would put there is that it is not a replacement for finding ways to pay for those private accounts. I do believe that you also have to put taxes and spending reductions on the table in order to create the private accounts which would prefund the system. So, I am not sure if that answered your question, but I think it is best to start with everything on the table and the understanding it must be bipartisan, but the realistic understanding, most importantly, that none of these choices are easy. They come down—the tough policy choices on the revenue side, on the spending side and figuring out the fairest distribution of those choices and the timing so that we can spread the costs over generations and hopefully do it in a way that helps the economy.

Mr. RANGEL. I appreciate that answer. Does anyone else, on the question of private accounts, because I support private accounts as an incentive for savings. I just don't support it in connection with Social Security. I support having thrift accounts like we in the Congress, but we in the Congress don't have—that doesn't have anything to do with our pension or our Social Security. So, it is not that I am against private accounts and incentives for savings. I want to see whether we can do something with Social Security, and if there is anyone who believes that unless we put private accounts on the table that we can't do it, then I just would want to hear from them, and I respect your answer.

Ms. LONG. I guess I would say for the workers that we represent, low-wage workers, have nothing to depend on except for Social Security. There are not annuities. There are not pensions for the vast majority of low-income workers. A lot of folks don't have savings. So, to the extent that personal accounts would replace Social Security, I don't think that is fair to folks who put a lifetime into retirement—for retirement.

Mr. STEUERLE. Mr. Rangel, I would guess—this is going to be very short—that if you ask every member of this panel, we would think of some ways of combining some private pension reforms that might have aspects of personal accounts in them as part of a longer term solution to the problems we are addressing. But, no, you don't need to have the private accounts just to reach solvency in Social Security if that is all you are aiming for.

Mr. RANGEL. Thank you, Mr. Chairman.

Chairman MCCRERY. Thank you, Mr. Rangel. I think Ms. MacGuineas answered your question very well. That is just about the way I would have answered it. The fact is, technically we can fix the solvency problem of Social Security without personal accounts or private accounts, and according to the Social Security actuaries, we can fix the Social Security solvency problem totally with personal accounts or private accounts, with no cuts in benefits, no change in the benefit structure, no increase in the retirement age. So, yes, it can be fixed with or without personal accounts. Whether they should be on the table is a political question that only we can ultimately answer, and my hope has been all along that we would bring everything to the table, as Ms. MacGuineas suggested, and so far that hasn't been the case.

More to the theme of this Subcommittee hearing—and Mr. Ryan raised this briefly at the end of his questioning, but I would like to give the panel a chance to respond more thoroughly—and that is, can having a personal account contribute to a person staying in the work force longer? In other words, right now Social Security is only on your 35 years of highest earnings, so, if you have already been in for 35 years you have got those earnings clocked, there is not much incentive, if you can get that benefit right now, to stay in the workforce. Your benefits are not going to get appreciably higher unless you expect to make a whole lot more money in the next few years than you have over your working life. If you have a personal account to which you are adding and watching it grow, and you know it is going to grow every year that you stay in the work force and add to it, wouldn't that be an incentive to staying in the workforce?

Mr. LEVIN. No guarantee that it would grow.

Chairman MCCRERY. Ms. MacGuineas? Let me get the panelists to respond.

Ms. MACGUINEAS. Generally I would answer the question certainly as yes. My personal belief is that in order to fix Social Security we are going to have to do something on both the revenue side and the benefit side. I also believe that individual accounts, if paid for, will prove to be far superior to the existing trust fund as a way of prefunding the system. In order to pay for them I think one of the policies to look at is to increase revenues. The reason I think you look at that specifically is that a revenue increase that goes to traditional Social Security system will have the effects more similar to a tax, where it will have more—it will create more inefficiencies in the labor force and for employers, on the employer side, whereas if those contributions go directly into people's accounts it is less likely to have the negative economic effects. I generally think that will lead people to staying in the labor force longer.

There is one risk, which is when you see your account and you see that full of savings, you will actually feel richer and you will therefore retire more quickly. So, I think that one thing that is very important is to make sure we show people the value of their accounts in terms of annuities. Whether you require annuitization or not is another choice, but to say the value of this $150,000 account will get you X dollars a month, so that people don't make the mistake I was talking about before, which is choosing that lump

sum and overvaluing it. So, as long as we make the real value transparent, I think it will serve as a way to keep people in the work force for longer.

Chairman MCCRERY. Any other panelists want to comment on this? Yes, Dr. Steinmeier.

Mr. STEINMEIER. The Social Security already increases benefits if you delay retirement, and that is possible. You don't have to collect them the minute you retire. You can leave them in there and opt to collect them later. Almost nobody does, so that suggests that there is not much effect to be had there. As I said in my earlier testimony, when you start to permit any kind of lump sums, then you are going to have a certain segment of the population that is going to take that money, and if it is tied into retirement, they may well retire earlier to do it.

Mr. STEUERLE. There is some empirical evidence—and again, this can be interpreted two different ways—that when people have defined contribution plans, that is, Individual Retirement Accounts (IRAs), personal accounts, 401(k)s or whatever, that if they look at the value of a 401(k) account versus the value of a defined benefit pension system that has an annuity, they are more likely to work longer in the first case. That is, on average people with defined contribution plans work about 2 years longer than people with defined benefit plans of the same value.

Now, you can consider that two different ways. You might worry about the risk that is associated with the defined contribution account if you haven't annuitized it, so there could be a increased level of risk. Yes, there does seem to be some evidence, that in comparing one plan versus the other people work longer when they are absorbing a little more of the risk. They are recognizing a little more what they have to do in retirement, again, given two equal cost systems.

Mr. GEBHARDTSBAUER. We have had some experience over the last 10 years in this area on assets and defined contribution plans, and when the defined contribution plans did really well and the assets went up a lot, then more people did retire at an earlier age. In fact, I am on the Board of the United Methodist Church's pension plan. Some people's assets did so well, they could get more than their salary, so they definitely retired earlier. Now that assets are not doing well, more people are remaining in the work force. You can see the labor force participation rates have actually gone up at ages 65 because their accounts aren't doing as well. So, it can affect you in different directions depending on how the markets go, and also depending on whether employers are willing to hire or not willing to hire more people.

Chairman MCCRERY. Thank you. Mr. Becerra, did you have a comment?

Mr. BECERRA. Mr. Chairman, I just wanted to make sure we were clear in terms of Social Security. If I understand Social Security correctly, there still is an incentive to work beyond the 35 years because since Social Security averages your highest 35 years, your initial years of work when you are young are probably paid at a lower rate than your final years when you are getting close to retiring, so the more years you put in, the better the chance is that you are going to knock out the years when you were younger

working and earning less and averaging out only the best 35 years of whatever amount of years you worked so that you end up with a higher benefit after you retire. I just wanted to clarify that. There is an engaging discussion on just the whole issue.W

Chairman MCCRERY. I think intuitively, you know, one might conclude that, but the evidence suggests otherwise.

Mr. LEVIN. Let me just quickly comment.

Chairman MCCRERY. Sure.

Mr. LEVIN. If you want to make the benefit more and more risky, people will work longer if the risk turns out to be heavy, very true. If people—I think a lot of people who are losing their pensions today are going to work longer, for sure. My guess is that people who work for United who are suffering these cuts will work longer than if the defined benefit had really been there. So, changing from a defined benefit to defined contribution may have people work longer because they are poorer. One of the strengths of Social Security is that there isn't that risk, and I would hope that our main effort to get people to work longer would not be to increase the risk of their retirement program.

Chairman MCCRERY. Well, if personal accounts were on the table, we could discuss ways of perhaps combining guaranteed benefits with the prefunding that would take place in personal accounts and solve your concern.

Mr. LEVIN. Well, we will—I guess they called the vote, so we would not continue this, so we had better——

Chairman MCCRERY. Yes. Ms. Tubbs Jones.

Ms. TUBBS JONES. Just very quickly. I met yesterday with several leaders of banking institutions in my community, and two of them actually have cash benefit plans that they offer to their retirees, and they asked me to come back to the Congress and remind Congress that we are still looking, they are still looking for us to help them know specifically what the regulations are going to be with regard to cash benefit plans so they can understand what they are supposed to do under those regulations. So, I just want to put that on the record so I can tell my constituents I did what they asked me to do.

[Laughter.]

Thank you, Mr. Chairman.

Chairman MCCRERY. Thank you, Ms. Tubbs Jones. Thank all of the Members for coming today and participating. I want to thank our panelists particularly for your testimony. It was very good, and appreciate your patience in answering our questions. Thank you. The hearing is adjourned.

[Whereupon, at 4:06 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Dr. Marilyn Bean Barrett, Nantucket, Massachusetts

Thank you for the opportunity to share my experience as you consider this important topic. I am 58 years old. I grew up in New York State and have taught in Washington, DC and Massachusetts for 36 years. My Social Security history is this:

In 1964, I got my first small high school summer secretarial job and began contributing small amounts each year to Social Security. During college from 1965–69, I had a job at a public library and at my father's company, Crouse-Hinds, Co. in Syracuse, NY as a summer secretary. (SS–3/4) (SS=Social Security; PS=Public School)

In 1969, I began my teaching career in Marshfield, MA. After two years in public school teaching, I went to Vermont to get a Masters degree. At this point I had accumulated two years of social security plus a few other quarters part-time. (SS–1, PS–2)

I did my student teaching in Mexico, learned Spanish and got my first job in 1972 in Washington, DC at a private language academy. I then taught at 2 private universities and one private secondary school in Massachusetts until 1977. (SS–6, PS–2) When my daughter was born, my husband and I began to job share one job. My husband eventually went to a full time job, but I stayed half time until my daughter and then son, born in 1980, entered school full time in 1986. (SS–10.5, PS–2) Throughout this period at Northfield Mt. Hermon School in Northfield, MA, I taught summer school every year. As I tried to regain full time employment, the 1987 recession hit, and part-time school employees were laid off.

My husband still had a full-time job at the school, and we had housing, so I decided to go to the University of Massachusetts, Amherst to get a doctorate in education. After starting, I applied for and was hired to be part of a special initiative called the Futures grant, in Lawrence, MA working with Latino youth in the public schools so I worked 4 days a week, traveling back and forth to the university and completing my first year of study. The job in Lawrence, although it worked with public schools, was a private foundation so it was a social security position. (SS 12, PS–2)

I then got a part-time job in the Greenfield, MA public schools that allowed me to study and apply my learning to my teaching. After completing my doctorate in 1994, the school system continued to have me work at part-time (.6–.85) percentages and hire full time younger teachers to assist me. The law stated that the years (1989–2000) would count as complete years of experience until such time as I got a full time job and then the percentages would revert to fractions of a year. So by 2000, I had 2 years from 1969–71 and then 11 years all in the public sector. Through all these years, I continued teaching summers at Northfield Mt. Hermon, accumulating a few months a year toward social security. (SS 16, PS 13)

In 2000, I began searching for full time work as my children were entering college. I got a research position at the School for International Training, in Brattleboro, VT at a cut in salary but full time. It is a private school. (SS 17, PS 13)

Then in 2001 I got a full-time job creating a new department for the Nantucket Public Schools, Nantucket, MA. My goal was to get a good job which required my doctorate and to try to stay at least three years at a decent full time salary so that when I retired, I would get a fraction of a better wage than what I had earned to date. Since September of 2001, I have been a teacher/administrator here and plan to continue. When I got this full time job, all my part-time years in Greenfield reverted to fractions so 11 years experience fell to 7. So at this time I have 2 years 1969–71, 7 years 1989–2000, and 4 years 2001–2005 for a total of 13 years. If I maintain my health and teach until 65 years of age, I will have a total of 20 years in public institutions. Massachusetts retirement would provide me with a pension of 40% of the average of the last three years of my salary. If I were to retire at 60 after 15 years, I would only get about 25% of my final salary as a teacher's pension or less than $20,000/year.

My private school earnings for social security have accumulated at low wage private school positions from 1972–1989 and again 2000–2001 for a total of 18 years. The social security benefit from these wages is small but under the double dipping law, I cannot receive even that amount even though both amounts are minimal compared to a reasonable living wage in my retired years because of low private school pay.

At 65, I will have taught continuously, at least part time, my entire adult life but could conceivably receive about $30,000 a year or less. Teachers who stay in public schools their entire lives normally earn a pension of 80% of their final salary. Private school teachers may have TIAA–CREF or small annuities but there is no pension income or even real estate to sell because of living in school housing much of one's life. I started teaching earning $5500. From 1974–1988, my salary went from $6,000 to $18,000. In the public school part time, my salary from 1989–2000 went from $24,000 to $40,000. I also worked part time as an adjunct faculty member at a community college from 1993–6, in the public sector but did not have enough hours to accrue benefits.

From what I understand, the "double-dipping" law was created to prevent early retirees from public pension jobs like the military or the post office from going into private business for 20–30 years and earning a large amount of social security in addition to a full pension. But I believe that this law inadvertently (I hope!) discriminates against low paid or middle income working public employees who have

spent time in private or religious schools, or have worked in small businesses intermittently throughout their public career. It does not allow us to receive the proportional amount of money earned toward putting into social security over a lifetime in addition to working in an institution that has a pension plan.

The Government Pension Offset (GPO) and Windfall Elimination Provision (WEP) affects only California, ***Massachusetts,*** Ohio, Texas, Maine, Alaska—a total of 15 states. That distinction alone makes it inequitable.

I hope you will vote to eliminate this law. I believe women who elected to stay home and/or work part time during their child-raising years as well as public servants—the firemen, police and teachers—are the main recipients of this legal discrimination. Thank you very much.

Statement of Ruth Ann Cone, Montgomery, Alabama

I very much appreciate the opportunity to submit this written testimony on the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP) Social Security provisions, and their adverse and unfair impact on me—a Federal retiree. Thank you for taking the time to listen to me, and many other retirees, who are in a similar situation as I am.

My husband served honorably in the United States Air Force for over twenty years. When we first married, our assignment was overseas in England. My husband, at the time, was a Staff Sergeant. For over three years, I tried to get a job in the Civil Service, but back in the 1960's, unless you had three years of career status Civil Service, they would not even talk to you, much less hire you. It was difficult trying to raise a family on a staff sergeant's pay, so I had to work.

We were transferred in 1970 to San Angelo, TX. I still did not have my three years career status with the Civil Service, so I still could not work for the government—so I entered the civilian world of working. I did have my government paperwork showing my typing and shorthand skills; but without working three consecutive years in the Civil Service, I was always unacceptable. Unfortunately most of the tours for servicemen back in those years were three years—so we never stayed in one place long enough for me to earn my career status.

Finally, in 1973, we were sent to Italy and I was hired to work in the Civil Service as a GS–05 in 1975. However, we did not stay long enough, so I was considered a temporary GS employee. After returning to the states, we were assigned to Maxwell Air Force Base in Alabama.

I had to go to Huntsville, AL to retest and get another rating. It was over a year before I heard anything. Finally, I received a call from the Army Corps of Engineers for a temporary GS position—which I took. I then was hired at Air Command and Staff College (ACSC) and stayed at ACSC until I had my three years status—although my husband had received orders to report to Germany. I made the decision to remain behind with my two children so I could get my three years and then I joined him several months later. I was immediately hired by the Army in Germany, and remained in the Civil Service for the rest of my working career.

We moved back to Montgomery, AL, but our retirement dreams were short lived as my husband passed away at the age of only 56. I retired with 29 years and 8 months. Yes, I am drawing a Civil Service Retirement System (CSRS) retirement check; however, I was forced to return to work in the civilian world, so that I can continue to pay my mortgage, utility bills, health care, etc. Although my husband is no longer with me, the bills are, and must be paid.

I am simply an ordinary working woman trying to better my life in retirement age, and really need the Social Security spousal benefit to which I am entitled. My husband started working when he was 13, and continued paying into the Social Security system for 43 years. Yet, none of his contributions are being given to his family. Had I known about this, I would ***never*** have worked for the Civil Service.

When I called the Social Security Administration office in Montgomery, Alabama, I was informed that I would have been entitled to my husband's social security in the amount of over $1,100 a month, due to being a widow. I turned 60 back on March 13, 2004—which amounted to $13,200 for the year. But due to the fact I was a federal employee, receiving CSRS, I was not entitled to one penny—this is not right. We were married almost 35 years and we were not only married, but he was my best friend. He wanted to make sure I and my children would be taken care of should something happen to either of us—and I felt the same way.

Life is precious and you must live it on a daily basis—you never know what the next day will bring. My husband and I lived by the motto "Cherish Yesterday,

Dream Tomorrow, Live Today" and I truly believe this. This is something we worked for all our lives, our social security benefits, and now, I am being penalized because I worked for the Federal Government.

I know several years back, if a retired military officer went back to work for the Federal Government, he had to give up half of his retirement pay—well, they changed that law a year or two ago—now these generals, colonels, etc. are coming back to the exact job they had while in the service, receiving a full federal retirement check, a current federal retirement check and when they are eligible, they will receive some social security check—so what is the difference between me and others like me and the retired military officers????

In addition, I am further adversely impacted by the WEP which drastically cuts my own earned Social Security benefits because I also am covered by the CSRS. This is simply not fair.

I love America and all it stands for. I highly respect all that our military does for us, and am proud that I was able to serve. However, these laws penalize federal workers, and are simply wrong. Please repeal them.

Statement of J. Douglas Fay, Bronston, Kentucky

Please keep in mind that strengthening SS will require adding funds to the program. That is a given! However, you must realize that you must also pay back to the program money that has been taken from those who have made contributions over the years and have been bilked out of their entitlement. I am referring to those affected by GPO and WEP.

To deny budgeting to replace those funds as too expensive is unfair to all of those civil servants who have given so much. When this administration has spent billions to fight the proverbial windmills of unnecessary war, it is unconscionable to say that "making the pot" right is too expensive.

Please plan for replacing the 40% that the Government Pension Offset and the Windfall Elimination Provision cut from current and future retirees, and then support H.R. 147 and S. 619.

Teachers, Firemen, and Police Officers throughout the country are depending on you to do the right thing.

Statement of Charles Loveless, American Federation of State County and Municipal Employees (AFSCME)

The American Federation of State, County and Municipal Employees (AFSCME) is a labor organization that represents 1.4 million employees who work for federal, state, and local governments, health care institutions and non-profit agencies. We submit the following statement for the record of the House Ways and Means Committee hearing on Protecting and Strengthening Social Security and Examining the Impact of the American Populations Increasing Longevity on Social Security's Finances.

The Subcommittee's statement announcing this hearing noted that recent demographic trends, the increase in life expectancy and a lower birth rate leading to fewer workers paying Social Security taxes, has "put Social Security's finances on an unsustainable path." Similarly, *The New York Times* reported on June 12, 2005 that "policy experts have told Congress in recent weeks that any effort to improve Social Security's long-term finances should somehow deal with this jump in life expectancy by adjusting benefits, raising the retirement age, increasing taxes or creating new incentives to work longer." Many proponents of radically altering the Social Security program to include private investment accounts have described these demographic trends as the major and newly discovered cause of the shortfall that Social Security is expected to experience sometime between 2041 (Social Security Trustees 2005 Report) and 2052 (Congressional Budget Office).

In actuality, however, the current debate over whether the retirement age for Social Security should be raised because Americans are living longer and having fewer children is déjà vu all over again. The 1983 bipartisan Greenspan Commission was fully cognizant of these same demographic statistics and structured their recommendations, including raising the retirement age to 67 by 2026 and raising the payroll tax rate, based on their implications. The Greenspan Commission's recommendations went on to form the basis of the modifications that Congress made

on a largely bipartisan basis to the Social Security program and that then-President Ronald Reagan signed into law.

There has been only a very minor change in the assumed rate of decline in the mortality rate for Social Security beneficiaries since 1983, and as such, it should play a very small part in determining Social Security's financing gap. If the 1983 assumption was adjusted, less than 5 percent of the total actuarial shortfall would be eliminated. In fact, when all of the demographic factors affecting Social Security's current financial outlook are accounted for—fertility rates, mortality rates and immigration—demographic factors have actually improved the actuarial balance of the Social Security system since 1983. The small declines in mortality rates and stable fertility rates relative to what was predicted in 1983 have been trumped by the larger than anticipated immigration flows.

Therefore, if everyone thought that the problem had been fixed in 1983, why has another actuarial deficit materialized? If the implications of increasing longevity and declining births were accounted for in the 1983 changes, what has happened that the Greenspan Commission did not foresee? According to a recent report by the Economic Policy Institute (EPI), 60 percent of the reemergence of Social Security's long term deficit can be accounted for by two major economic trends that the Greenspan commission did not anticipate; the growth of average wages earned by U.S. workers slowed considerably and income inequality rose significantly. The unexpected growth in inequality also meant that Social Security lost revenue and interest on that revenue as the percentage of wages subject to the Social Security cap declined from the historic 90 percent level to the current 85 percent level. This loss in revenue, and the interest it would have earned, coupled with the two unexpected economic changes, combine to account for about 75 percent of Social Security's reemerged long-term deficit.

If lawmakers wish to address the causes of Social Security's long term projected shortfall, they should focus on remedying the underlying economic causes—slow real wage growth and inequality—that are creating the bulk of the problem and not compel American workers to take another hit. Despite the continuing improvements in longevity, large segments of the American workforce simply cannot physically work more years. AFSCME's members work at jobs that represent a cross-section of how America works. Our members work in hospitals, schools, and prisons. They climb trees and utility poles, drive buses and ambulances, repair roads and parklands, and lift sick patients and heavy machinery. These are jobs that require strength of mind and body.

Some workers may want to continue working until they reach full retirement age, which is mandated to climb to 67, and some may want to work even longer, but many just do not have the option. Often a worker's health has deteriorated to the point that he or she is not physically able to continue. This is especially true for low-income and blue-collar workers, women, African-Americans and Latinos. Social Security was designed as a social insurance program. Raising the retirement age would hurt exactly those workers for whom Social Security was created in the first place and who continue to depend on Social Security for the major portion of their post retirement income.

AFSCME urges the Committee, the Congress and President Bush to preserve Social Security as a life long social insurance program that workers have earned by their many years on the job. American workers don't deserve to have their benefits cut—and raising the retirement age would be a benefit cut.

Statement of Mary Ellen Marvin, Punta Gorda, Florida

I very much appreciate the opportunity to submit this written testimony on the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP) Social Security provisions, and their adverse and unfair impact on me—a federal retiree. First I want to thank Chairman Jim McCrery and the other legislators serving on this Subcommittee for conducting this important hearing. As a federal worker being adversely impacted by these provisions, I urge all Subcommittee members, and lawmakers, to repeal them as soon as possible and allow me to receive my full social security benefits.

I took an early Civil Service Retirement in 1989, and then worked for private employers from 1991 to 2004. My Social Security earnings statement led me to believe that I would get about $400 per month in Social Security benefits.

However, when I actually retired in 2004, I only received $171 per month of my earned Social Security benefits because I was also covered under the CSRS retire-

ment system. If I had worked in the private sector for my whole career, then I would be receiving all my earned Social Security benefits with no penalties.

I had purchased a retirement home with the assumption that I would have $400 each month from Social Security. Now that I am receiving only $175 per month (with the 2005 COLA increase), I am having trouble making ends meet and am considering selling my retirement home. Receiving that extra few hundred dollars each month would enable me to keep my home.

Please fix this inequitable problem. Don't punish Americans for working for the federal government.