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Bringing Social Security into the 21st Century: A Preface By the Co-Chairs

Social Security is one of the most important and most popular domestic programs of the United States government. For millions of retirees, it serves either as the sole or the primary source of income, the mainstay of their dignity and independence. Millions of others look to it to sustain or supplement the retirement they hope to begin within the next several years. Since its inception in the midst of the Great Depression, it has made a vital difference in the lives of generations of hardworking Americans and their families.

The road, however, hasn't always been smooth. Social Security has been beset by periodic fiscal crises, and recently by public skepticism that could reasonably be termed a crisis of confidence. In establishing a Commission to Strengthen Social Security, President Bush had both concerns in mind.

The crisis of confidence is real. Many working adults do not believe that they will ever collect retirement benefits from Social Security. Such a failure has never once happened in a program that dates well back into the last century. But Americans tend to be skeptical of government, and this is no bad thing. It would, however, be a terrible thing if the skeptics should turn out to be right this time. Part of the Commission's mandate is to prove them wrong.

Among the program's fiscal crises, the most dangerous occurred in the early 1980s, when the pay-as-you-go system was approaching the point where promised outlay would exceed expected revenues. A bipartisan National Commission on Social Security Reform was created to work out a solution in 1982. For all its good intentions, the commission could reach no agreement for a year. It wasn't until the prospect of default – that is, the need to obtain general revenue to maintain benefit payments – that minds became sufficiently concentrated. In early 1983, in the course of eleven days, a number of commission members together with White House officials reached a comprehensive agreement that literally saved Social Security for the decades that followed.

Before long, the system was not only stabilized but running a substantial surplus. This will continue for another 15 years, when the very same crisis will recur, compounded by the mounting pressure of demographics. In brief, the problem is this: more and more of us are living healthier and longer lives. At the same time, we're having smaller families. Birth rates are now just over half what they were during the peak of the baby boom.

The relentless truth of ascending life expectancies and declining birth rates will put an intolerable squeeze on the system that now exists. Consider the facts. In 1940, when benefits were first paid, there were 42 workers per retiree. In 1960, there were five workers for every retiree. Now there are slightly more than three. Before long there will be just two. This downward trend in the ratio of workers to retirees, under the existing system, would require either painful tax increases, significant benefit cuts, or astronomical levels of borrowing.

It could be worse. There are European countries for which the United Nations projects a population decline of more than 40 percent by mid-century. By contrast, our population will experience a measure of growth, thanks not least to immigration. But the ratio of workers to retirees will never again be anything like that of the age in which Social Security was founded.

As powerful as the impact of demographics is, there are other factors at work that require the overhaul of a system conceived in the first half of the last century. The stock market and personal investing are no longer solely the prerogative of the rich and privileged. Due to a major extension of the opportunities for higher education, the gradual dismantling of the legal and social barriers to the economic advancement of minorities and women, and an explosion of new businesses and start-up enterprises, traditional job roles and life-long occupational patterns have been altered or swept away.

For our forebears, Social Security was a transforming novelty. For us, it's a system utterly devoid of options for building a net worth that reflects the dynamism of the American economy or which facilitates investments to the benefit of our children or heirs. Nowhere is this dearth of possibilities more glaring than among the growing number of single-parent families, most of whom rely on Social Security as their only tool of preparation for retirement.

At present, under the Supreme Court ruling in *Flemming v. Nestor*, workers and retirees have no legal ownership over their Social Security benefits. Instead, what they have is a political promise that can be changed at any time, by any amount, for any reason. In any retirement system a lack of legal ownership is a source of insecurity. In one that is under-financed by over 25 percent, it is a problem on its way to becoming a crisis.

Though the Social Security system has itself reached retirement age, almost no one proposes that it be dismantled or eviscerated. The Commission came to work clear about its mission. Our job is to bring the system into the 21st century, to make it more responsive to the extraordinary social and economic changes that continue to remake every facet of our lives, and to ensure its fiscal strength and fiduciary soundness.

The charge that President Bush gave us is nonpartisan and nonpolitical: *The promise of Social Security to current and future generations of Americans must and will be kept.*

We believe the diversity of views, opinions and political beliefs represented on this Commission is critical to our ability to make an objective analysis. Equally, we believe that all of the members are determined to do their very best to help "promote the general welfare" of the American people and not to serve political ends. With these intentions and principles in place, the Commission has reached several conclusions that are presented on the following pages. Here we emphasize three:

If we are to maintain a sound system of support for tomorrow's retirees, this present generation of Americans must be encouraged to save and invest more than it currently does;

The Social Security program, as it now stands, does nothing to promote individual savings or investment. Workers have little sense of proprietorship or a sense of what they are entitled to. Many have lost confidence in ever receiving anything back;

The system is broken. Unless we move boldly and quickly, the promise of Social Security to future retirees cannot be met without eventual resort to benefit cuts, tax increases, or massive borrowing. The time to act is now.

This report presents the facts and reasons behind our conclusions. It is not meant to please any one constituency or to provide a rationale for preconceived notions of what should be done. Its purpose is twofold; to identify what has to be fixed in order to modernize a program conceived and designed for a different era and a different economy; and to preserve the spirit of intelligent innovation and concern for the common good that created Social Security in the first place.

If the problems spelled out in this interim report become a topic of national debate and receive the public's focus and scrutiny, that in itself will be a positive step forward. The greatest threat is in taking the course of least resistance, ignoring the challenge and doing nothing.

We believe that the opportunity now exists to do more than analyze and debate. The moment has arrived for a fundamental restructuring of the nation's Social Security system that doesn't merely postpone the day of reckoning but guarantees adequate funding for future retirees. If we do it right – and we have every confidence that a bipartisan coalition can – Social Security may be funded by clearly earmarked money that cannot be diverted to other purposes through the political process.

For the first time, the program can become an active rather than a passive instrument of personal financial security. Rather than ending with the life of the beneficiary, it can be a means of wealth accumulation and long-range investment, giving families resources they never had before, and widening the circle of Americans fortunate enough to pass on the accumulated results of their investments and hard work.

If we have the will, we have the means to reestablish equity, maintain benefits for current retirees, and enable workers to acquire a measure of wealth in the course of their working lives.

In our final report, the Commission will make specific suggestions for concrete steps toward the reform and revitalization of Social Security. For now, we wish to reiterate our enthusiastic belief that we have an historic opportunity to make Social Security more relevant, more equitable and more effective than ever before. The ultimate beneficiary of our commitment to act promptly, impartially and decisively to resolve what is both a fiscal crisis and a crisis of confidence will be the American people.

Daniel Patrick Moynihan

Richard D. Parsons

Summary

Our Opportunity is Equal to Our Challenge

- If we have the will, we have the means to reestablish equity, maintain benefits for current retirees, and enable workers to acquire a measure of wealth in the course of their working lives.

General Findings of the Commission

- To support tomorrow's retirees, we must save and invest more.
- The existing Social Security program does not save or invest for the future.
- Arguments against reform are equivalent to express advocacy of increasing taxes, cutting benefits, reducing other government spending, or borrowing on an unprecedented scale.

The Current System is Not Designed to Cope with Demographic Changes

- The ratio of workers to retirees will drop to close to 2-to-1 within a generation.

Social Security's Cash Deficits Are Projected to Begin in 2016

- In 2016, the program's benefit obligations will exceed its annual tax revenue.

Faster Economic Growth Will Not Save the Existing System

- Under the Trustees' faster-growth estimates, permanent cash deficits would only be delayed by one year, to 2017. Even if every economic and demographic variable were changed to reduce costs, permanent deficits would begin in 2020.

Building up a Social Security Trust Fund Will Not Change Tough Choices

- The report cites several sources, including the Social Security Public Trustees, the Congressional Budget Office, the General Accounting Office, the Congressional Research Service, and the Clinton Administration FY2000 Budget, each to the effect that the Trust Fund is not an asset of the government.

How Would Households Be Affected if Shortfalls Were Met By Raising Taxes?

- If tomorrow's shortfalls were faced today, the following additional taxes would be required from a two-earner couple with \$50,000 in income:

Shortfall in 2020:	\$860 in today's earnings
Shortfall in 2030:	\$2,100 in today's earnings

How Would Beneficiaries be Affected if Shortfalls Were Met By Cutting Benefits?

- If tomorrow's shortfalls were faced today, benefits would be reduced by the following amounts for an average retiree and spouse:

Shortfall in 2020:	\$2,227 in today's annual benefits
Shortfall in 2030:	\$4,605 in today's annual benefits

What if Shortfalls Were Met By Cutting Other Spending?

- By 2020, required cuts would equal the combined size of Head Start, WIC, the Departments of Education, Interior and Commerce, and the EPA. By 2025, the combined cuts would equal all of the above plus NASA and the Department of Veterans Affairs.

What if Shortfalls Were Met by Adding to Public Debt?

- The total borrowing required to finance Social Security's cash shortfalls would equal \$7 trillion by 2040, \$14 trillion by 2050, and \$47 trillion by 2075 (in 2001 dollars).

Our Opportunity to Improve Social Security for Women

- Women are more likely than men to suffer poverty in old age.
- Poverty rates are highest for widowed, divorced and never-married women.
- Women receive a higher percentage of their retirement income from Social Security than do men, and thus are particularly threatened by the benefit reductions that would occur in the absence of reform (a 27 percent reduction in 2038).
- Social Security contains many inequities that hurt women who work. A low-income two-earner couple experiences a lower rate of return than a high-income one-earner couple.

Our Opportunity to Improve Social Security for Vulnerable Americans

- Despite popular perceptions, recent studies show that Social Security provides little, if any, systematic redistribution from rich to poor.
- Recent academic research finds that, as a result of mortality differences, African Americans receive nearly \$21,000 less on a lifetime basis from Social Security's retirement program than whites with similar income and marital status.
- Because they are younger than the general population, disproportionate numbers of Hispanic Americans will enter retirement having received below market rates of return from the Social Security program.

Our Opportunity to Improve Social Security for Younger Americans

- Under the existing system, Social Security will provide a bad deal for today's young workers, as seen in the charts on the following page. These charts show rates of return plummeting for individuals entering the workforce, who would have to live well past their expected lifetimes to receive back the value of their contributions.

Our Opportunity to Become A Nation of Owners and Savers

- The median U.S. household owned only \$17,400 worth of financial assets in 1998, including retirement accounts. For African American and Hispanic households, the numbers were only \$3,060 and \$1,200 respectively.
- Tax payments to Social Security represent the largest contribution to retirement preparation for most Americans. If savings and investment opportunities are not created within Social Security, these Americans will lose their best opportunity to acquire financial assets.

What age must you reach to get back what you've paid in?			
Year of retirement	Age an average earner gets back taxes paid into the retirement portion of Social Security	Total Life Expectancy for Individual Reaching Age 65	
		Male	Female
1940	65.2	77.7	79.7
1960	66.1	78.2	82.4
1980	67.8	79.7	83.8
2001	81.8	81.3	84.6
2010	85.2	81.9	85.0
2020	89.7	82.5	85.6
2030	91.9	83.0	86.1

Source: Congressional Research Service, "Social Security: The Relationship of Taxes and Benefits for Past, Present, and Future Retirees," June 22, 2001; updated via telephone conversation with author.

Under the intermediate assumptions of the 2001 Trustees Report and taking into account benefit increases and continued accrual of interest after retirement but not the taxation of benefits. The retiree is assumed to begin work at age 22 and attain age 65 and retire in January of the designated year. Assume contributions earn interest equal to the long-term government bond rate.

Real Rates of Return Falling Under Social Security				
Birth Year	Single Male (Medium wages)	Single Female (Medium wages)	Single Earner Couple (Medium Wages)	Two-Earner Couple (Medium/Low wages)
1970	1.13	1.59	3.42	2.24
1980	0.91	1.36	3.31	2.08
1990	0.88	1.29	3.14	1.97
2000	0.86	1.25	3.02	1.88

Source: May 27, 2001 memorandum from Social Security Office of the Actuary.

1) Maintaining Our Commitment to Social Security

Social Security affects the life of nearly every American through its provision of retirement, survivors and disability benefits. Today Social Security faces serious challenges but must always honor its founding purpose of protecting the elderly from want and bringing dignity to retirement.

Social Security was created in a world different from our own. It was a world of large families and short life spans, a world in which markets were perceived to have failed and faith in the individual had ebbed. Social Security effectively responded to the needs of that world.

The world is different today. Americans enjoy the blessing of long life: by the year 2050 more than one-fifth of the population will be over age 65. Americans have chosen to have smaller families: birth rates today are just over half what they were during the peak of the Baby Boom. These two facts put a severe strain on our system of retirement security. In 1960, there were over five workers for every retiree. Today there are three and a half workers per retiree, and by 2030 there will be just over two. Under the existing system, this downward trend in the ratio of workers to retirees will require the government to raise taxes, cut benefits, cut other government spending, or borrow the necessary funds. Under such circumstances, rates of return for workers – already low – will fall further, and most retirees would have to live well past the average life expectancy simply to get back what they had paid into the system.

The creators of Social Security were not content to do nothing in the face of an unacceptable status quo. We who inherit their achievement must live up to their example.

Though the demographic changes since 1935 will soon strain our retirement system, other changes offer opportunities to improve it. We better understand the power of markets than Americans did during the shock of the Great Depression. We feel more urgently the importance of extending the benefits of personal asset ownership. And we are more strongly committed to equitable treatment of all our nation's people, regardless of race, income or gender.

These advances have sparked a new need for a retirement system that includes saving and ownership. Social Security must adapt to today's population of young people, the self-employed, minorities and women. And it must serve this new society as well as the existing system served a past society in which men were often the sole earners in the family.

Social Security today offers every worker a promise that will vary in value depending on the length of that worker's life and the policies of Congresses decades in the future. Simple arithmetic dictates that these promises can be honored in full only by imposing substantially higher costs on future generations of workers.

The way to alleviate this burden is to provide opportunities for individuals to save more for their retirement. The more wealth individuals can accumulate, the less they will have to rely on taxes imposed on tomorrow's workers. Just as important, higher saving rates increase the capital stock and enhance worker productivity. A more productive economy can more easily support larger populations of retirees without overburdening

workers or their families. Outlining a strategy to boost personal and national saving is one of the most important tasks of this Commission.

President Bush directed this Commission to review Social Security and recommend reforms to strengthen and sustain it. Thus far, we have reached the following conclusions:

If we are to support tomorrow's retirees without overburdening tomorrow's workers, this generation of Americans must save and invest more.

The existing Social Security program does not save or invest for the future. It was not designed to facilitate saving, and the political process cannot be relied upon to save on behalf of American families.

Under the existing system, Americans will soon face inescapable choices: cut Social Security benefits, raise taxes, cut other government spending, or borrow on an unprecedented scale.

Arguments for doing nothing are equivalent to direct advocacy of one or more of these options.

This report presents the evidence on which these conclusions rest – and the case for acting now, while there is adequate time to prepare, rather than waiting for the inevitable crisis. We must understand the nature and dimension of the challenge that we face. One aspect of that challenge is clear: *Inaction is not a solution.*

2) The Demographic Challenge

**Income Transfer system:
Each generation supports the generation that came before it.**

**Funded system:
Each generation saves and invests for its own retirement.**

Many people believe that Social Security is a national pension fund in which workers make “contributions” to an investment account called the “Trust Fund.” When a worker retires, dies or becomes disabled, his contributions, plus interest, are taken out of the fund to pay benefits.

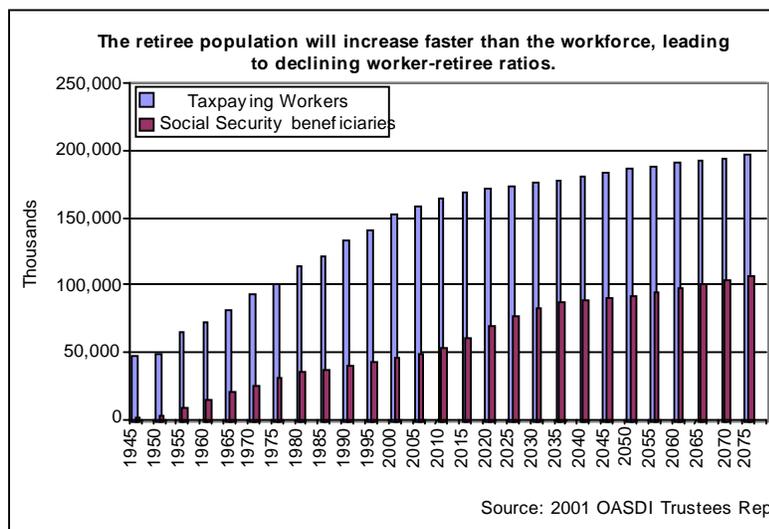
The reality is different. Our Social Security system is managed as an income transfer program. This means that every penny of benefits paid each year comes from taxes collected or money borrowed from the public in that year. Under such a system, higher taxes today do not reduce tax burdens in the future.

The present value of Social Security’s currently accrued obligations exceeds \$12 trillion. This means that if Social Security were a funded pension plan, it would need to hold over \$12 trillion worth of real assets to pay future benefits.¹

Today’s beneficiaries are not living off financial assets accumulated in the past. Today’s workers are not accumulating financial assets for the future. Workers “invest” their payroll taxes not in financial assets but in the willingness of future politicians to tax future workers to pay future benefits.

The Importance of the Worker-to-retiree Ratio

As an income transfer system, Social Security works best with a high ratio of workers to beneficiaries. When the United States had a rapidly growing workforce supporting a small elderly population, Social Security seemed sustainable. But when fewer new workers are paying into Social Security and more new retirees are collecting from it, the burden placed on individual workers must inevitably rise.

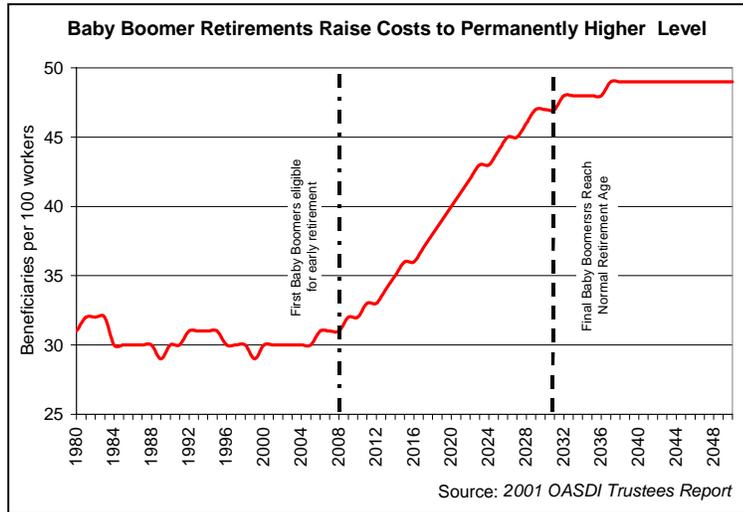


That’s exactly what has been happening. In 1960 there were more than five workers paying into Social Security for every individual collecting benefits. Today, demographic

¹ This assumes that assets would be invested at the long-term government bond rate.

changes have reduced the worker-to-retiree ratio to 3.4-to-1. By 2050 it will be just 2-to-1. In other words, a future worker will bear a relative Social Security burden two-and-a-half times as large as a worker in 1960.

Problems Continue After the Baby Boomers Retire



Beginning in 2008 the first Baby Boomers will be eligible to take early retirement. The following two decades will see a rapid increase in the cost of delivering Social Security benefits, from 10.9 percent of taxable earnings in 2008 to 17.4 percent of earnings in 2031, when the final Boomers reach Normal Retirement Age.

Baby Boomer retirements mark the beginning of Social Security's financing problems. But Social Security's problems will continue – and grow worse –

even after the Boomers are gone. In 2025, for instance, when the youngest Baby Boomer will be 60, the worker-to-retiree ratio will be 2.3-to-1. By 2050, when the youngest Boomer will be 85 and most of them will have passed on, the worker-to-retiree ratio will have further declined to just two workers per retiree.

Temporary stop-gap measures to keep Social Security solvent would not be effective because there is no relief from the demographic pressures bearing on the program. Baby Boomer retirements raise Social Security costs to a new and higher plateau from which there is no long-term relief under the current system.

Lagging Birthrates Mean Fewer New Workers

The “Baby Boom” generation born from the end of World War II to 1964 was originally a blessing to Social Security's finances. Returning veterans started new families by the millions, raising the total U.S. fertility rate from 2.2 children per woman in 1940 to 3.2 in 1947 and on to a high of 3.7 in 1957. For Social Security this meant millions of new workers paying taxes into the system.

But the Baby Boom didn't last. Following the Boom, birth rates fell *below* their pre-Boom level. By the mid-1970s, for instance, fertility averaged just 1.8 children per woman, half the level of the late 1950s. And while fertility rates have risen somewhat in recent years – they now stand at around two children per woman – Social Security's Trustees expect these historically low rates to continue indefinitely into the future.

The result is that over the next 75 years the U.S. working-age population is projected to grow at a rate just one-third as fast as during the 1970s. And this slowly growing work force will be expected to support a much more rapidly growing population of retirees.

Some Basic Social Security Math

For all its complexity, Social Security's underlying problems are governed by some basic math.

$$\frac{\text{Average benefits as percent of average taxable wage}}{\text{Worker-to-beneficiary ratio}} = \text{program cost as percent of average wage}$$

Example: Today's average Social Security benefit is equal to around 36 percent of the average worker's wage. Since there are currently 3.4 workers per retiree, the cost to each worker to support today's retirees is around 10.5 percent of his earnings. ($36/3.4 = 10.5$) Since today's payroll tax rate is set at 12.4 percent, Social Security currently runs a surplus.

What happens if the ratio of workers to retirees falls?

If the worker-to-retiree ratio falls, then each worker bears the burden of more retirees.

Example: If instead of 3.4 workers per retiree there are just 2, then the cost to each worker rises from 10.5 percent to around 18 percent of earnings. ($36/2 = 18$)

What level of benefits is affordable?

The same equation, recast to isolate the level of benefits, tells us what level of benefits a given payroll tax rate can support:

$$\text{Payroll tax rate} \times \text{Worker-to-retiree ratio} = \text{Affordable benefits as percent of average wage}$$

Example: With a 3.4-to-1 worker-to-retiree ratio, a 10.5 percent payroll tax rate can pay benefits equal to around 36 percent of the average wage ($3.4 \times 10.5 = 36$). But when the worker-to-retiree ratio falls to 2-to-1, the same 10.5 percent tax rate can provide benefits equal to just 21 percent of average earnings.

What is "wage indexing" and what is its relationship to current projections?

Initial Social Security benefit levels are currently indexed to the growth in national wage levels. Consequently, even if there were no demographic problem, Social Security costs would grow almost as fast as the economy as a whole. Faster growth means more tax contributions in the short term, and higher benefit obligations in the long term. Though this faster growth helps, it does far less than many people believe. Mostly it creates the illusion of improvement because short-term revenue gains postpone the projected date of Trust Fund depletion, whereas increased costs would occur mostly after the projected depletion date.

Increased Life Expectancies Mean More Beneficiaries

Americans of all ages, races and incomes are living longer than ever. This is good news for them. It is not such good news for Social Security. Increased life expectancies mean more workers will survive to collect benefits and will collect for more years than in the past.

More Americans survive to age 65 and live longer in retirement

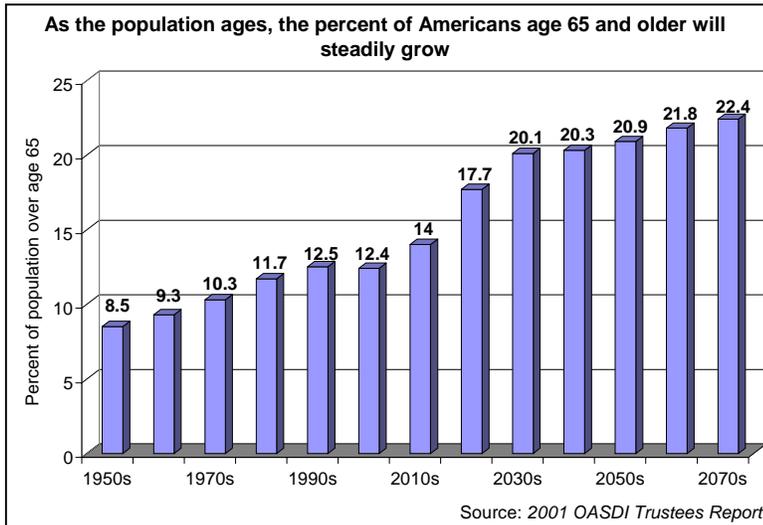
- Of the generation reaching age 65 in 1940, only 40 percent of males survived to age 65 and those who did lived for an average of 12.7 additional years.
- Of the generation reaching age 65 in 2000 (born in 1935), 69 percent of males lived to age 65 and those who did are expected to survive an average of 16.2 years.
- Of the generation reaching age 65 in 2050, 84 percent of males are expected to live to age 65 and those who do are expected to survive an average of 19.1 years.

In 1940, life expectancy for newborns was just 69 for men and 76 for women. Life expectancy for those at age 65 was 13 additional years for men and 15 for women.

By 2050, life expectancy for newborns is expected to rise to 83 for men and 88 for women, while life expectancy at 65 will rise to 19 years for men and 22 for women.

Moreover, the “oldest old” age 85 and over will more than double as a share of the total population, from 1.5 percent today to 3.7 percent of the total population in 2050. The oldest old are already the fastest growing elderly age group, increasing by 274 percent between 1960 and 1994, compared to 100 percent for the elderly population in general and 45 percent for the U.S. population as a whole. By

2050 more than 14 million Americans will be over the age of 85.



Over time, increased life expectancies and lower birthrates contribute to a gradual “aging” of the population. While in the 1940s just 7 percent of the population was age 65 or older, by the 2050s that proportion will rise to more than 20 percent. Moreover, Americans will spend more years in retirement than ever before.

3) The Consequences of Inaction

The Executive Order establishing the President's Commission to Strengthen Social Security requires that an interim report be submitted to the President describing "the challenges facing the Social Security system."

The fundamental challenge facing Social Security can be described succinctly: Inaction will result in significant tax increases, benefit reductions, cuts in other government programs, or increases in the national debt.

Social Security Cash Deficits Are Projected to Begin in 2016

Social Security's primary source of revenue is a 12.4 percent payroll tax applied to the covered earnings of wage earners. Social Security also receives money from the taxation of Social Security benefits.

In 2016, under current projections, Social Security will collect less in tax revenues than it has committed to pay out in benefits.

When that happens, the Social Security Trust Fund will still show a positive balance. But the Trust Fund holds not accumulated reserves of wealth but only promises that future taxpayers will be asked to redeem. Whether the balance in the Trust Fund is \$5 trillion or zero, to keep the system in balance the nation faces identical choices: raise taxes, reduce benefits, decrease other government spending, or increase borrowing from the public.²

When Social Security deficits begin in 2016, cash shortfalls will be relatively small and could possibly be financed through surpluses in the rest of the government's budget. But these deficits will eventually grow very large: \$194 billion in 2025, \$271 billion in 2030, and \$318 billion in 2035 (in 2001 dollars).³ The cost of paying benefits will rise from about 10 percent of taxable earnings today to almost 18 percent in 2035. The effects of these pressures on beneficiaries and taxpayers will be shown on subsequent pages.

The year 2016 may seem a long way off, but it is not. For a person who is 50 years old today, Social Security will begin experiencing financial difficulties just when he or she reaches retirement age.

² Adding to the public debt means that the public debt would be greater than if there were no Social Security cash shortfall. If the government maintained a deficit, this would mean that deficits and debt would be increased. During a time of surplus, this would mean that surpluses would be reduced. It is difficult to predict future government budget policy and thus not possible to say which situation would exist when Social Security faces cash deficits.

³ In current dollars, Social Security's cash flow deficits will be \$419 billion in 2025, \$687 billion in 2030 and \$948 billion in 2035.

Will Faster Economic Growth Avert the Problem?

No. This report relies on the Social Security Trustees' Intermediate Assumptions for economic and demographic factors affecting the current system. Some argue that the Trustees' economic forecasts are pessimistic and that faster economic growth would restore Social Security to financial health. But retirees' initial Social Security benefits are indexed to the growth of wages. Hence, while faster economic growth will raise wages and payroll tax receipts, it will also increase the benefits that Social Security promises to pay.

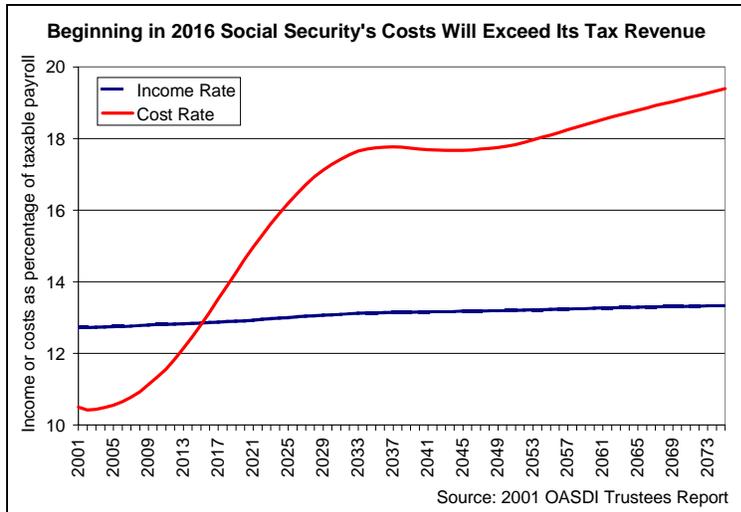
The principal boost to Social Security's finances from faster economic growth comes from the delay between higher taxes being received and higher benefits being promised. Even if wages grow at more than double the rate projected, Social Security will still become insolvent. Faster economic growth is desirable both for workers and for retirees because it enables a higher standard of living for all. But it will not solve Social Security's financial problems.

In addition to wage growth, the Trustees estimate how variations in fertility, mortality, immigration, inflation, interest rates, and incidence of disability would affect Social Security's finances. Substituting the Trustees' Low-Cost Assumption for any single variable will not change the date of cash flow deficits by more than one year.

Even if every single economic and demographic variable were simultaneously adjusted to reduce projected costs – that is, if the economy grows faster, wage growth rises, unemployment falls, interest rates increase, life expectancies fall, fertility rates increase, more immigrants pay taxes into the system, and fewer workers become disabled – Social Security would experience its last cash flow surplus in 2019, just four years later than currently projected.

Why the Social Security Trust Fund Doesn't Alleviate the Problem

Social Security will begin running annual cash deficits in 2016. Technically, however, the program could redeem government bonds in its Trust Fund to pay full benefits until 2038.⁴ Does this mean there is nothing to worry about until 2038? Not at all. Revenue must be raised from taxpayers to redeem these bonds.



Social Security has run payroll tax surpluses since the mid-1980s and will continue to do so until 2016. But these past surpluses were “loaned” to the Treasury to cover deficits in the rest of the federal budget. These “loans” to the Treasury were not considered part of the debt held by the public, although

they were in truth a public obligation.

Bonds were credited to the Trust Fund over time, resulting in a Fund balance now exceeding \$1 trillion. The problem is that when Social Security begins running cash deficits in 2016 and must begin redeeming the Fund's bonds, the nation will face the same difficult choices as if there had been no Trust Fund at all.

This situation arose because past payroll taxes were not truly saved. As a result, future repayment of Trust Fund bonds will not be any less difficult. The Clinton administration's fiscal year 2000 budget made the point succinctly:

These [Trust Fund] balances are available to finance future benefit payments and other Trust Fund expenditures – but only in a bookkeeping sense. ... They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large Trust Fund balances, therefore, does not, by itself, have any impact on the Government's ability to pay benefits. (FY2000 Budget, Analytic Perspectives, p. 337.)

The government could keep Social Security technically “solvent” forever simply by issuing new bonds to the fund. Alternatively, Social Security could be made technically “solvent” by requiring that a higher rate of interest be paid by the Treasury to the Trust Fund. Regardless, the need to raise taxes, cut spending or borrow would remain exactly the same. While there is an obligation to honor the bonds in the Social Security Trust

⁴ There are two Trust Funds – one for Old Age and Survivors Insurance and a second for Disability Insurance. In practice, however, they are treated essentially as a single entity.

Fund, what is important economically is not the amount of bonds in the Fund but the real resources backing those bonds.

With or without a Trust Fund, the current Social Security system will need extra resources after 2016. And with or without a Trust Fund, the steps required to obtain that money remain the same: raise taxes, cut benefits or other government spending, or add to the national debt. The Trust Fund can neither delay the need for new resources by a day nor reduce the need by a dollar.

Non-Partisan Experts Agree: Social Security Trust Fund Not an Asset

Social Security Public Trustees: “Rather than providing net revenue to the Treasury, after 2016 the combined trust funds will require rapidly growing infusions of revenues from the Treasury to pay benefits projected under current law. It is at this point--and not at the later dates when trust fund assets (i.e., the securities being redeemed) are technically exhausted--that Social Security and Medicare will begin to be in direct competition with other Federal programs for the resources of the Treasury...” (Thomas R. Saving of Texas A&M University and John L. Palmer of Syracuse University, Public Trustees to the Social Security and Medicare programs.)

Congressional Budget Office: “Although there is no money in the Treasury to pay for future obligations, the obligations to people eligible for Social Security benefits are real. And most important, those obligations are a direct result of federal law, not a consequence of whatever may or may not be credited to the Trust Funds. In particular, the size of the balances in the Social Security Trust Funds – be it \$2 trillion, \$10 trillion, or zero – does not affect the obligations that the federal government has to the program’s beneficiaries. Nor does it affect the government’s ability to pay those benefits.” (CBO Director Dan L. Crippen and Deputy Director Barry B. Anderson, testimony before the House Ways and Means Committee, Feb. 23, 1999)

General Accounting Office (GAO): Social Security’s “Trust Funds are not like private Trust Funds. They are simply budget accounts used to record receipts and expenditures earmarked for specific purposes. A private Trust Fund can set aside money for the future by increasing its assets. However, under current law, when the Trust Funds’ receipts exceed costs, they are invested in Treasury securities and used to meet current cash needs of the government. These securities are an asset to the Trust Fund, but they are a claim on the Treasury. Any increase in assets to the Trust Funds is an equal increase in claims on the Treasury.” (David M. Walker, Comptroller General of the United States, “Social Security And Surpluses: GAO’s Perspective on the President’s Proposals,” Feb. 23, 1999)

Congressional Research Service: “What often confuses people [about the Trust Fund] is that they see these securities as assets for the government. When an individual buys a government bond, he or she has established a financial claim against the government. When the government issues a security to one of its own accounts, it hasn’t purchased anything or established a claim against some other person or entity. It is simply creating an IOU from one of its accounts to another. Hence, the building up of federal securities in federal Trust Funds – like those of Social Security – is not a means in and of itself for the government to accumulate assets. It certainly establishes claims against the government for the Social Security system, but the Social Security system is part of the government. Those claims are not resources that the government has at its disposal to pay future Social Security benefits... The key point is that the Trust Funds themselves do not hold financial resources to pay benefits – rather, they provide authority for the Treasury Department to use whatever money it has on hand to pay them.” (David Stuart Koitz, “Social Security Taxes: Where Do Surplus Taxes Go and How Are They Used?” Congressional Research Service, April 29, 1998)

The Inescapable Choices Under the Status Quo

Under the current Social Security system, individuals do not withdraw benefits from savings accounts held in their names. Benefits are paid from only one ultimate source: tax dollars. If the current system's financing is left in place, future workers and retirees will experience one or more of the following: 1) large tax increases, 2) significant benefit cuts, 3) widespread reductions in other government programs, or 4) unprecedented accumulations of public debt. The only uncertainty is which steps will happen and which groups will be hit the hardest.

But these steps, however undesirable, cannot solve the current system's problems permanently. Cash deficits in one year will be followed by larger shortfalls the next year, and larger again in every year thereafter. Social Security needs structural improvement if it is to cope with the realities of an aging society. The four choices:

1) Raise Taxes

One option facing the nation is to maintain full benefit promises by raising taxes. While it is impossible to predict what taxes a future Congress might choose to raise, the chart to the right shows the effect of tax increases needed in future years if applied proportionately to wages currently subject to the Social Security payroll tax.

<i>How much would taxes increase?</i>		
If the percentage shortfall in the following year existed today:	A couple's taxes could increase by:	Tax increase (in percent of payroll taxes)
2020	\$860	14%
2030	\$2,100	34%
2040	\$2,275	37%
2050	\$2,295	37%
Explanation: this table applies the percentage tax increases in future years to a couple earning \$50,000 today. Because future incomes will increase, tax increases in real dollars would be substantially larger than shown here.		

2) Cut Benefits

Another option is to cut benefits to the level that could be supported out of currently legislated Social Security tax revenues. In the long run, this would produce benefits more than one-quarter below the levels currently promised by Social Security's benefit formula. We illustrate with a medium-wage earner and spouse who retired this year at 65 receiving, under current benefit rules, a total annual benefit of \$18,945. If benefit cuts required to balance the system in the future were applied proportionately to this couple today, they would receive thousands of dollars less annually from Social Security.

<i>How much would benefits be cut?</i>		
If the percentage shortfall in the following year existed today:	A couple's annual benefits could be reduced by:	Benefit reduction in percent
2020	\$2,227	12%
2030	\$4,605	24%
2040	\$4,867	26%
2050	\$4,888	26%
Explanation: this table applies the percentage benefit reductions in future years to a retired couple receiving \$18,945 annually in benefits today. Because future benefit levels will be higher, reductions in real dollar terms would be substantially larger than shown here.		

3) Cut Other Government Spending

A third option to address Social Security's cash flow problems would be to cut other government spending. By freeing up enough on-budget revenues we could redeem Social Security Trust Fund debt without raising taxes, cutting benefits or borrowing. But how much would other spending have to be cut?

In 2016, the first year in which Social Security is projected to run cash deficits, the program faces a shortfall of \$17.4 billion (in today's dollars). Assuming that federal spending maintained its present size relative to the rest of the economy, making up Social Security's 2016 deficit by cutting other spending would require eliminating programs the combined size of Head Start and the Special Supplemental Nutrition Program for Women, Infants and Children (WIC).

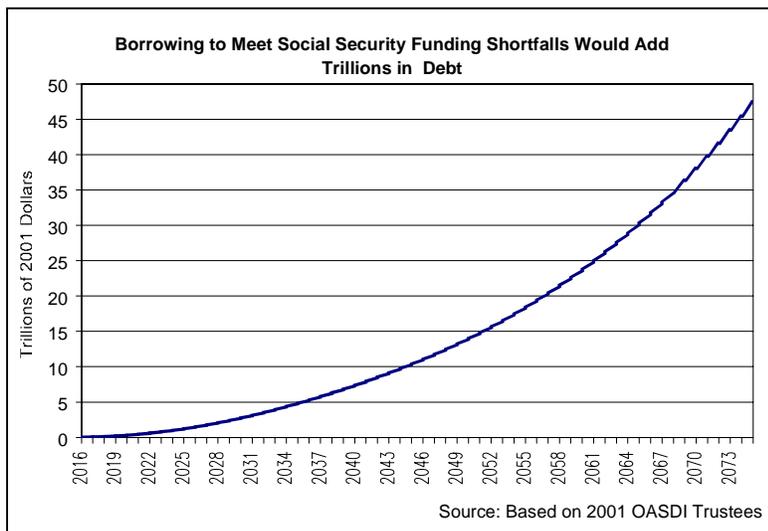
Annual Social Security cash shortfalls, in 2001 dollars	
2016	\$17.4 billion
2020	\$99.3 billion
2025	\$194.3 billion
2030	\$270.8 billion
2035	\$317.6 billion

By 2020 Social Security deficits will have grown to \$99.3 billion, requiring cuts – in addition to those already listed – equivalent to eliminating the Departments of Education, Interior and Commerce, as well as the Environmental Protection Agency.

By 2025, Social Security deficits will reach \$194.3 billion in today's dollars, requiring cuts equal to all the programs mentioned above plus NASA and the Department of Veterans Affairs. The \$270.8 billion shortfall in 2030 would require eliminating the Departments of Energy and Housing and Urban Development (HUD) as well. By 2035, when Social Security faces a \$317.6 billion annual shortfall, the Department of Justice and the National Science Foundation would also have to be eliminated.

4) Increase Public Debt

The final option available to the country in 2016 is to issue additional public debt to meet Social Security shortfalls without raising taxes, cutting benefits or reducing other federal spending.



The accompanying chart shows the additional debt required to finance cash shortfalls that Social Security will begin to experience in 2016. This debt would accumulate to more than \$7 trillion (in 2001 dollars) by 2040, \$14 trillion by 2050, and over \$47 trillion by 2075. This additional public debt would be

larger than the national debt at the end of World War II, relative to the economy. Further, the additional public debt would continue to rise indefinitely.

***Social Security and Medicare Will Absorb
A Growing Share of the Nation's Resources***

One way to understand the consequences of inaction on Social Security reform is simply to assume that tax revenues are raised as necessary to fulfill currently legislated benefit promises.

Social Security currently consumes 4.2 percent of the nation's gross domestic product – almost \$2,600 for every working-age American. If additional revenues were provided to Social Security as needed, by 2075 system costs will rise to 6.7 percent of GDP – a 60 percent increase.

Medicare will also command an increasing share of the nation's resources, leaving less room in the budget to absorb Social Security's rising costs. While Medicare costs 2.3 percent of GDP today, these costs are projected to escalate to 8.5 percent of GDP by 2075. Combined, Social Security and Medicare will absorb more than 15 percent of the nation's gross domestic product unless these programs are made sustainable. For comparison, all personal income taxes paid to the federal government today total approximately 9 percent of GDP.

This will be a direct consequence of a failure to improve the basic structure of these programs. Only through meaningful, structural improvements can Social Security and Medicare be placed on a sustainable path.

4) An Opportunity to Improve Social Security for Vulnerable Americans

Social Security redistributes income among households based on differences in such factors as marital status, income, length of life and year of birth. For previous generations of retirees, who were on the receiving end of income transfers, the program effectively lifted many seniors out of poverty simply because most participants received substantially more than they put in. Today, when this is true for only some of those entering retirement, Social Security's haphazard distribution of benefits is becoming more apparent. When Social Security begins to experience cash deficits, the effects will not necessarily be equally shared by all segments of American society. Some examples:

Low-Income Americans

Social Security's benefit formula is intended, in part, to reduce the risk of old-age poverty among low-income workers. But accumulating evidence suggests that Social Security is not nearly as redistributive as many people believe. Also, low-income households own few assets outside of Social Security and thus are disproportionately affected by the benefit cuts that will occur under current law. Absent reforms, current law will reduce benefits by over one-quarter after the trust fund becomes insolvent in 2038, pushing many low-income households into poverty.

Three factors offset much of the intended redistribution within the current Social Security system. First, lower-income individuals tend to have shorter life expectancies. As a result, low-income workers spend a greater portion of their lives contributing to Social Security and a smaller portion collecting from it.

Second, Social Security's spousal benefit redistributes money from single individuals and two-earner couples to one-earner couples. For instance, under the current system a 30-year-old single low-income male would receive a 2.22 percent real return on his contributions to the retirement program (2.63 percent for a single low-income female). By contrast, a high-income one-earner married couple would receive a 2.75 percent return.⁵ Social Security is structured, in this and many other instances, to redistribute income from single earners and working couples with less to couples in which one spouse can afford not to work. Because low-wage earners are more likely to be single or divorced, they are less likely to receive a spousal benefit. The highest risk of poverty in old age is faced by divorced, separated or never-married women.

Third, many people never become eligible for Social Security benefits because they do not have enough years of contributions to earn their own benefits. Current Social Security rules require a worker to pay into the system for roughly 10 years before gaining eligibility for retirement benefits.

Social Security's lifetime redistribution from high to low earners is haphazard at best. Numerous academic studies show little if any systematic redistribution by income

⁵ Source: May 27, 2001 memorandum from Social Security Office of the Actuary.

under the present Social Security retirement system due to the complex interactions between tax collections, benefit formulas, spousal protections and life expectancy.⁶ Even without the benefit reductions that will occur under current law, Social Security may not remain an effective barrier against poverty.

Women

The current system contains spousal and survivors protections used disproportionately by women. Nevertheless, poverty rates for women age 65 and over remain more than 70 percent higher than for elderly men (11.8 percent vs. 6.9 percent.) Widowed, divorced or never-married women also face particularly high poverty rates in old age: 16.8 percent for widows over age 65, and 24.7 percent for divorced, separated or never-married women over 65.⁷

Social Security plays a particularly important role in the lives of women. Despite changes in the workplace, women on average still receive less wage income, have less non-Social Security pension coverage and are more likely to miss time from the workforce. A working spouse may receive a spousal benefit no higher than if she had not worked, reducing her incentive to enter the workforce.

Women also live an average of 5.5 years longer than men. Consequently, women are disproportionately dependent on Social Security for retirement income. Non-married women over 65 rely on Social Security for an average of 50 percent of their retirement income. Thirty-eight percent of unmarried women rely on Social Security for 90 percent or more of their retirement income.⁸

If no action is taken by 2025, current benefit promises will exceed the program's annual income by approximately 25 percent. What this means is that failure to restructure Social Security poses a disproportionate threat to the overall retirement security of women, due to the comparatively larger impact upon them of the benefit reductions inherent in current law.

⁶ Alan L. Gustman, Thomas L. Steinmeier, "How Effective is Redistribution Under the Social Security Benefit Formula?" NBER, March 2000; Julia Lynn Coronado, Don Fullerton, Thomas Glass, "The Progressivity of Social Security," NBER, February 2000; Jeffrey Liebman, "Redistribution in the Current U. S. Social Security System," Harvard University, July 2001.

⁷ U.S. House of Representatives, Committee on Ways and Means, *2000 Green Book* (Washington: Government Printing Office, 2000), p. 999.

⁸ Susan Grad, "Income of the Population 55 or Older, 1998," SSA no. 13-11871, 1998, p. 104.

Quirks In Benefit Structure Pose Problems For Certain Women

Spousal Benefits: Under Social Security's spousal benefit rules, the spouse with lower lifetime earnings (usually the wife) effectively receives a either benefit based on her own earnings or an amount equal to half her spouse's worker benefits, but not both. While fine for an era in which few women worked outside of the home, today Social Security's spousal benefit rules create inequities between traditional single-earner couples and dual-earner couples in which both spouses work.

Example: The Smiths and Joneses both have \$3,000 total monthly earnings. Mr. Smith earns \$3,000 while Mrs. Smith does not work outside the home. Mr. Jones earns \$2,000 while Mrs. Jones earns \$1,000. At retirement in 2001, Mr. Smith would be eligible for a monthly benefit of \$1,292 and Mrs. Smith a spousal benefit of \$646, for a total of \$1,938. By contrast, Mr. Jones would be eligible for a monthly benefit of \$984 based on his earnings and Mrs. Jones a benefit of \$641 based on her own earnings, for a total of \$1,625. While the two couples have identical total earnings, the single-earner couple receives benefits 19 percent higher than the dual-earner couple.

Divorce: A divorced woman must have been married for 10 years to be entitled to benefits based on her former husband's earnings. The National Center for Health Statistics reports that marriages ending in divorce have a median length of just 7 years, and fully one-third of all marriages end prior to the 10 years needed for benefit eligibility. In addition, the number of divorced elderly women is projected to increase, causing the current system's outdated divorce rules to affect more women.

Example: Mrs. Smith becomes divorced one day short of 10 years while Mrs. Jones's divorce occurs just one day past 10 years. That is the sole difference between eligibility for benefits equal to 50 percent of the former husband's benefit and no eligibility at all. Nor is remarriage a guarantee of spousal benefits. One-third of second marriages are disrupted through separation or divorce before 10 years. For women under age 25 at remarriage, 47 percent of second marriages are disrupted before 10 years. For African Americans, these percentages are higher.

Widows Benefits: A widow is eligible for the greater of her husband's worker benefit or her own, but not both. As a result, her household income may be cut by up to one-half upon his death. Since the cost of living for one person is almost as much as for two the standard of living of the surviving spouse is likely to fall. The poverty line for a single individual age 65 and over, for instance, is only about 20 percent less than that for couples.

Like the spousal benefit, the survivor benefit formula favors single-earner households over dual-earner households. Since a widow is eligible for either her own benefit or her husband's but not both, women from households with identical total incomes could find themselves with different benefits once widowed. Specifically, women who worked would receive lower widows benefits than women who did not work outside the home.

Example: Mrs. Smith, who never worked outside the home, becomes widowed and is eligible for survivors benefits based on Mr. Smith's \$3,000 monthly income. By contrast, Mrs. Jones paid Social Security taxes over her lifetime. When she becomes widowed she can receive benefits based on Mr. Jones's \$2,000 monthly income or her own \$1,000 income, but not both. The result is that Mrs. Smith, who neither worked nor paid into the system, receives benefits more than 30 percent higher than Mrs. Jones, who is from a household with identical earnings and who worked and contributed her entire career.

Women from all incomes are affected by these aspects of Social Security's benefit formula, but low-income women, with little or no non-Social Security pension resources, suffer the most.

African Americans

Social Security pays retirement benefits as an annuity that begins at retirement and ends at death, so those with shorter life expectancies can expect to receive less in retirement benefits. African Americans have shorter life expectancies than other groups, as shown in the accompanying table. As a result, an African American earning the same lifetime earnings and paying the same lifetime Social Security payroll taxes as someone in the general workforce is likely to receive a lower rate of return and lower lifetime benefits from the retirement system. Moreover, African Americans as a group also receive less in Social Security spousal benefits. Forty seven percent of African American marriages are disrupted before the first 10 years, and African American women are substantially less likely both to remarry after divorce and to have a second marriage last for the 10 years needed for spousal benefit eligibility.

Age	White Male	Black Male	White Female	Black Female
Birth	74.6	67.8	79.9	74.7
10	65.3	59.2	70.5	66.0
20	58.2	49.6	60.6	56.2
30	48.6	40.7	50.9	46.6
40	36.9	31.9	41.3	37.4
50	28.0	24.0	31.9	28.7
60	19.8	17.2	23.2	20.9
65	16.1	14.3	19.2	17.3
70	12.9	11.6	15.5	14.0
80	7.5	7.2	9.0	8.6

Source: National Center for Health Statistics, "Deaths: Preliminary Data for 1999," National Vital Statistics Reports 49, no. 3, June 26, 2001

Recent academic research finds that, as a result of mortality differences, African Americans receive nearly \$21,000 less on a lifetime basis from Social Security's retirement program than whites with similar income and marital status.⁹

African Americans are more likely to receive benefits from Social Security's disability program than are other groups. Moreover, because African Americans have higher death rates, their children are more likely to receive benefits as child survivors. In 1999, 2.8 percent of African American children under 20 were receiving a child survivor benefit, compared to 1.5 percent of white children and 1.8 percent of all children. Young African Americans are also more likely to receive disabled child benefits as survivors. This partially mitigates the fact that African Americans receive lower lifetime retirement benefits. But Social Security's survivors, disability and retirement programs have distinct purposes. If the retirement program can be improved for African Americans without offsetting reductions in the survivors and disability programs, Social Security as a whole would better serve African Americans.

It is likely that the opportunity for an inheritance would benefit African Americans relative to the general population. This is because African Americans on average have less non-Social Security retirement savings than the average worker. As a result, African Americans are disproportionately threatened by the financing shortfalls facing the current system. They are more likely, on average, to die before receiving benefits.

⁹ Jeffrey Liebman, "Redistribution in the Current U. S. Social Security System," Harvard University, July 2001.

Hispanic Americans

By some measures, Hispanic Americans fare better than the population as a whole under the current Social Security system. This is the result of lower average lifetime earnings combined with higher life expectancies. Yet this makes Hispanics somewhat more vulnerable than average to inevitable changes in the current Social Security structure.

Though the program's progressive benefit may appear to help Hispanics as a group, its financing structure hits Hispanic Americans particularly hard. Hispanics tend to be younger than the American population as a whole and would consequently bear a disproportionate share of the rising cost of sustaining an income transfer system. Rates of return from Social Security are declining for younger workers, of which Hispanics are one of the fastest growing ethnic groups

Below-average private pension coverage for Hispanic workers is correlated with their below-average wage levels and job tenure rates. Moreover, fewer than half of Hispanic households were net savers in 1998. The poverty rate for Hispanics age 65 and over in 1998 was 22.5 percent, compared to 10 percent for non-Hispanics.¹⁰ This greater reliance on Social Security creates greater vulnerability to the benefit reductions that will occur under current law.

Hispanics represented 3 percent of the elderly population in 1990, but have grown to 5.4 percent today and are projected to rise to 17.5 percent of the 65-and-older population in 2050. Comparatively few Hispanics entered retirement having received the above-market rates of return that the Social Security system provided in its early years. In 1998, Hispanics as a group paid \$33 billion in OASDI payroll taxes but received only \$18 billion in benefits. By the time today's Hispanic taxpayers are eligible for retirement benefits, the current Social Security system would be paying substantially lower returns than it did to earlier generations.

Younger Generations

Younger generations have more at stake than other age groups and hence should be more interested in Social Security reform. Under current rules Social Security system is able to pay benefits to current retirees until 2016, and there is a broad political consensus that current retirees should not be affected by changes to the Social Security program.

Young generations will bear the brunt of continuing exclusively with the current income transfer system. As the ratio of workers to retirees drops over time, the tax burden placed by Social Security on workers will increase. This means it is less and less likely that even average wage future workers will live long enough to recover taxes paid into the Social Security retirement system. Workers paying the maximum tax into Social Security and retiring in 2030 would have to live past age 110 simply to get back what they had paid in.

¹⁰ Grad, Susan, op cit, p. 126.

What age must you reach to get back what you've paid in?			
Year of retirement	Age an average earner gets back taxes paid into the retirement portion of Social Security	Total Life Expectancy for Individual Reaching Age 65	
		Male	Female
1940	65.2	77.7	79.7
1960	66.1	78.2	82.4
1980	67.8	79.7	83.8
2001	81.8	81.3	84.6
2010	85.2	81.9	85.0
2020	89.7	82.5	85.6
2030	91.9	83.0	86.1

Source: Congressional Research Service, "Social Security: The Relationship of Taxes and Benefits for Past, Present, and Future Retirees," June 22, 2001; updated via telephone conversation with author.

Under the intermediate assumptions of the 2001 Trustees Report and taking into account benefit increases and continued accrual of interest after retirement but not the taxation of benefits. The retiree is assumed to begin work at age 22 and attain age 65 and retire in January of the designated year. Assume contributions earn interest equal to the long-term government bond rate.

As a result, rates of return for younger workers will be substantially lower than for workers in the past. Most young workers will receive returns even lower than the accompanying chart depicts, because these figures neglect the cost of meeting Social Security's cash deficits from 2016 through 2038. For example, those born in 1990 will spend most of their working careers after 2016, when Social Security will require additional tax revenues beyond those tabulated here.

Though rates of return are not the only important measure of system fairness, they nonetheless illustrate the problems inherent in continuing exclusively with an income transfer system. Under such a system, entire generations will receive rates of return below those of risk-free government bonds. In practice, they will be forced to lose money through Social Security.

Action to strengthen Social Security is more than an opportunity to restore fiscal soundness to the nation's public pension program. It is an opportunity to improve the program for all Americans, particularly those Americans who need it most.

Real Rates of Return Falling for All Retirees (Assumes No Change in Law, Retirement at Age 65)				
Birth Year	Single Male (Medium wages)	Single Female (Medium wages)	Single Earner Couple (Medium Wages)	Two-Earner Couple (Medium/Low wages)
1970	1.13	1.59	3.42	2.24
1980	0.91	1.36	3.31	2.08
1990	0.88	1.29	3.14	1.97
2000	0.86	1.25	3.02	1.88

Source: May 27, 2001 memorandum from Social Security Office of the Actuary

5) An Opportunity to Become A Nation of Owners and Savers

Increasing national saving is the only sure way to improve retirement security for current workers while also lessening the burden on future generations. Increased saving leads to capital formation and higher labor productivity, which will help a relatively smaller labor force maintain the standard of living of a relatively larger group of retirees. It will expand the size of the economic pie available for everyone – both young and old – to consume. But America is not saving enough.

At a time when additional saving is needed to provide for future retirees, our national retirement program does not facilitate saving, either nationally or on behalf of individuals. In order to provide for a better retirement future, America must more truly become a nation of owners and savers.

The median African American household held only \$3,060 in cash, certificates of deposit, retirement accounts, or stocks and bonds in 1998; the median Hispanic household, only \$1,200.

Few Americans own much in the way of liquid assets. In 1998, the median U.S. household owned only \$17,400 worth of financial assets, including sums in retirement accounts. Four out of every nine households in the United States

saved nothing at all in 1998. Six out of 10 African American and Hispanic households saved nothing that year.

For these non-saving families, Social Security contributions may represent their only hope to build assets and wealth. In effect, those in the bottom half of the American population – and a larger population of the African American and Hispanic population – lack a pool of private savings to support them in old age. Meanwhile, 12.4 percent of low-income Americans' earnings are collected to support a system that offers them only uncertain promises and below-market rates of return.

Exclusion from financial markets is a serious problem for lower-income Americans. Under Social Security, their retirement income depends not on assets they

Even modest amounts invested in real assets could produce substantial wealth. A contribution of as little as \$500 per year for 40 years at only a 4 percent return would yield \$50,000.

possess but on the hope that politicians elected 20 and 30 years from now will raise taxes on tomorrow's workers. In fact, the Supreme Court has ruled in *Flemming vs. Nestor* (1960) that workers and retirees have no legal ownership over their benefits, even after a lifetime of paying taxes into the system.

Moreover, the Social Security system may discourage individuals from saving on their own.

A Congressional Budget Office study concluded "the Social Security system most likely has had a negative impact on private saving."¹¹

¹¹ Congressional Budget Office, "Social Security And Private Saving: A Review Of The Empirical Evidence," July 1998.

The failure of Americans to save raises troubling economic questions – and profound moral concerns. The strong growth of the value of financial assets over the past century means that many Americans can look forward to a comfortable old age largely sustained by their own resources. But many others will have to depend almost entirely on payments from the government. In other words, without reform, future retirees will be divided not merely between the haves and have-nots but between those who think of themselves as independent and those regarded as dependents.

Tax payments to the Social Security program represent the largest contribution toward retirement for most Americans. The ability of those Americans to save and accumulate assets will be determined largely by whether such opportunities are created within Social Security.

6) Analytical Criteria

The President's Executive Order establishing the Commission requires the interim report to set forth "criteria by which the Commission will evaluate reform proposals."

First and foremost, our criteria must be consistent with the President's principles for strengthening Social Security, as outlined in the Executive Order.

The President's Principles For Strengthening Social Security

(1) Modernization must not change Social Security benefits for retirees or near-retirees.

(2) The entire Social Security surplus must be dedicated to Social Security only.

(3) Social Security payroll taxes must not be increased.

(4) Government must not invest Social Security funds in the stock market.

(5) Modernization must preserve Social Security's disability and survivors components.

(6) Modernization must include individually controlled, voluntary personal retirement accounts, which will augment the Social Security safety net.

Within those principles, the Commission has been provided with flexibility to recommend measures to improve the fiscal soundness of Social Security as well as to propose the size, structure and financing of personal accounts. To develop a bipartisan consensus on these points, understanding of the Commission's criteria and standards is essential. Our eight criteria of analysis are presented on the following page.

Criteria for Analysis

The Commission has established eight criteria by which to evaluate proposals for strengthening the Social Security system:

1. Encouragement of workers' and families' efforts to build personal retirement wealth, giving citizens a legal rather than merely a political right to a portion of their benefits.
2. Equity of lifetime Social Security taxes and benefits, both between and within generations.
3. Adequacy of protection against income fluctuations, such as those caused by retirement, disability, death of an earner, or unexpected longevity.
4. Encouragement of increased personal and national saving.
5. Rewarding individuals for actively participating in the workforce.
6. Movement of the Social Security system toward a fiscally sustainable course that can withstand unforeseen economic and demographic changes.
7. Practicality and suitability to successful implementation at reasonable cost.
8. Transparency: Analysis of reform plans should measure all necessary sources of tax revenue, and all benefits provided, including those from the traditional system as well as from personal accounts.